PROGRESS IN POLICY REFORM IN SOUTH EAST EUROPE

MONITORING INSTRUMENTS

Fourth Edition, April 2004

OECD

INVESTMENT COMPACT FOR SOUTH EAST EUROPE

STABILITY PACT FOR SOUTH EASTERN EUROPE

STABILITY PACT

SOUTH EAST EUROPE COMPACT FOR REFORM, INVESTMENT, INTEGRITY AND GROWTH

PROGRESS IN POLICY REFORM IN SOUTH EAST EUROPE

MONITORING INSTRUMENTS

PREPARED BY THE COUNTRY ECONOMIC TEAMS
OF ALBANIA, BOSNIA AND HERZEGOVINA, BULGARIA, CROATIA, FYR MACEDONIA, MOLDOVA, ROMANIA, and SERBIA AND MONTENEGRO

IN CO-OPERATION WITH

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD)

Fourth Edition, April 2004

The **Stability Pact for South Eastern Europe** is a political declaration and framework agreement adopted in June 1999 by over 40 partner countries and organisations, which undertook to strengthen the countries of South East Europe (SEE) "in their efforts to foster peace, democracy, respect for human rights and economic prosperity in order to achieve stability in the whole region". The Stability Pact is based on experiences and lessons from worldwide international crisis management. Progress in creating a secure environment, the promotion of democratic systems and economic and social wellbeing are essential for sustainable peace and democracy.

The **South East Europe Compact for Reform, Investment, Integrity and Growth ("The Investment Compact")** is a key component of the Stability Pact under Working Table II on Economic Reconstruction, Development and Cooperation. Private investment is essential to facilitate the transition to market economy structures and to underpin social and economic development in the region. The Investment Compact promotes and supports policy reforms that aim to improve the investment climate in South East Europe and thereby encourage investment and the development of a strong private sector. Co-chaired by Austria, the OECD and Romania (regional co-chair appointed in 2003) the Investment Compact Project Team, consisting of representatives of SEE countries, OECD Member countries, the Stability Pact office, European Commission, international organisations and financial institutions and the private sector, determines and oversees the strategy of the Investment Compact. The work of the Investment Compact has been actively supported and financed by 17 OECD Member countries: Austria, Belgium, Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Japan, Norway, Sweden, Switzerland, Turkey, United Kingdom and the United States of America (see www.investmentcompact.org)

The **Monitoring Instruments**, as presented in this fourth edition, provide a progress report on policy priorities identified by SEE countries for implementation. They have been prepared by the Country Economic Team Leaders of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the FYR Macedonia, Romania, Serbia and Montenegro and the analysis, incorporating feedback from the private sector, has been undertaken by OECD. The information in this edition shows the state of progress in the period April 2003 - January 2004. Where additional points of information have been provided up to the publication date, April 2004, these have been included.

Building on the core principle of the Investment Compact that "ownership" of reform rests within the region itself, the Monitoring Instruments record the commitments made by each SEE country and action taken to implement specific reform measures in accordance with an agreed timetable. The Monitoring Instruments are a key tool for measuring, in an open and transparent manner, the progress of SEE countries in meeting key policy reform goals, which they have set for themselves.

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1. THE INVESTMENT COMPACT STRATEGY

1.1. The Investment Compact Strategy - Working to Make Reform Happen

The objective of the Investment Compact, within the wider agenda of the Stability Pact, is to lay the structural policy foundations for sustained economic growth and development in South East Europe. The Investment Compact charter (the Investment Compact was formally adopted by Working Table II of the Stability Pact in Skopje on the 10-11 February 2000) records the range of commitments for policy reform made by countries of the region. Countries need to implement these in order to create a sustainable market economy and encourage local and foreign direct investment. The Investment Compact therefore pursues an agenda of promoting and supporting structural policy reform in the region that addresses these commitments under the following four main pillars of Investment Compact work:

- **The Monitoring Process** (i.e. agreeing specific targets for action within an agreed period and regularly monitoring progress on those targets).
- **Implementation of Reform** through selected 'Regional Flagship Initiatives' i.e. policy initiatives that share experience and expertise of all Stability Pact partners and seek to facilitate and promote implementation of reform measures.
- **Private Sector Partnership** and involvement in policy dialogue and reform.
- **Political Support** for Investment Compact Activity.

Substantial Investment Compact work in sharing OECD country experience, in conducting policy dialogue and most importantly in undertaking practical steps on policy implementation have been undertaken in SEE (www.investmentcompact.org). While some countries have better capacity (for example, Romania and Bulgaria) to drive reform there is a demand from all SEE countries for Stability Pact partners to provide continuing guidance and share experience of successful OECD country practice. The Investment Compact process emphasises at all times <u>the practical implementation steps needed to achieve effective reform</u>. Improving the business and investment environment requires committed action on a complex mosaic of policy reforms and a continuous process that focuses on measurable and effective implementation. The biggest challenge for most SEE countries is generally not in identifying issues, indeed most of these have been well documented over years but in establishing the process of change and maintaining the drive for implementation. OECD countries with long experience of tackling policy change and policy development have methodologies, tools and processes that can assist and help to guide that change agenda and the Investment Compact seeks to bring this experience and partnership to SEE. Private investment -- international and domestic (especially small business) -- is vital to the transition process in SEE. Effective implementation of reform can create the right environment for private business and new investment and this is the central aim, in co-ordination with other relevant players, of all Investment Compact activity.

1.2. Monitoring Process and Impact of Investment Compact Activity

The monitoring process is a mainstream activity of the Investment Compact. The enhancement of the monitoring process in 2003 involved (a) identifying the high priority policy targets for implementation within 6-12 months; (b) continuing Project Team and OECD monitoring missions with feedback reports to governments; and (c) regional and individual country reviews (for example, on specific themes such as national treatment standards for investors, investment laws and policies, regulatory reform, enterprise and small business policy, etc.). An important element of the overall monitoring and review process is the Investment Compact participation in the regular missions of the Business Advisory Council to the Stability Pact (BAC), which seek to identify obstacles to investment and provide feedback from business. The OECD is an associate member of the BAC. In addition the Investment Compact instigated and works closely with the Regional Network of Foreign Investors Councils (www.regionalfic.org) in the region as well as bilateral private sector chambers and this provides further valuable insights into crucial issues affecting business and investment.

This 4th edition of the ***Monitoring Instruments*** continues the process of reporting on policy priorities identified by SEE countries and has been prepared by the Country Economic Team Leaders of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Romania, and Serbia and Montenegro with OECD support and the main analysis, including views from the private sector, has been undertaken by the OECD.

The ***Monitoring Instruments*** are a central part of the strategy for 2003-2004 agreed by all Investment Compact Project Team members and endorsed at successive Project Team meetings. It is a key tool in setting out priorities and measuring progress in implementing reform. It should be noted that the ***Monitoring Instruments*** do not seek to record all policy reforms planned by SEE countries. Rather they concentrate on the 'top of the pyramid', namely the top three priorities in FDI Policy and Promotion, Enterprise and Small Business Development and Public and Private Governance (including Regulatory Reform and Competition Policy) and Anti-corruption and anti-bribery that are proposed for implementation within the coming 6-12 months. Clearly all SEE countries have a wide agenda of reforms that needs to be tackled. However the achievement or non-achievement of these priority targets is an indicator to investors and the international community alike of the level of fulfilment to the original commitments to reform as expressed in the Investment Compact charter by SEE countries. The ***Monitoring Instruments*** provide a references for private sector groups (Business Advisory Council to the Stability Pact, Foreign Investor Councils) to examine progress with key issues of concern to investors. Complementing the monitoring process and stimulating action to address targets identified in the Monitoring Instruments is a series of practical policy reform initiatives, designed to stimulate action on implementing reform.

1.3. The Investment Compact - Helping to Tackle Cultural Change and Implement Reform

Successful policy reform in transition economies involves deep rooted cultural change. While the benefits of a vibrant market economy are attractive to transition countries the mindset at all levels of society that accepts the reduction of state control and regular and unwarranted intrusion in private business takes time to evolve. Similarly, for example, the concept of independent regulatory bodies, the conduct of constructive dialogue with private investors (both domestic and international) on laws and policies before they are implemented and the need for continuity of effective policies to promote private sector development are crucial issues that need to be addressed in SEE. To achieve change and progress in reform in South East Europe it is not sufficient therefore to simply share developed country experience and 'best practice'. Although such experience can and does provide valuable guidance in steering the process of reform and change the countries often lack the capacity and receptive environment that allows change. Tackling the **process of change** leading to effective implementation of reform demands vision and leadership within SEE, constructive partnership at a regional and national level, regular review of performance and focused action to stimulate reform. The work of the Investment Compact seeks to encourage and promote that process region-wide and to undertake practical 'demonstration' projects (for example, in investment policy and promotion) that will deliver concrete results and underpin change.

1.4. Structure of Monitoring Instrument Report

Following the introductory section on the investment compact approach and description of the monitoring process: Section 2 provides a matrix of the Critical Time-bound Targets identified by SEE countries in approximately mid 2002 and a comparative picture of the progress achieved. This shows progress as reported by SEE countries. The information in this matrix shows the status as at end January 2004 and this is the position for the bulk of this report. Where further points of information were provided prior to publication these have been included but the general status is at January 2004. It is important to note that in many cases while progress is reported as 'Done', for example a law passed or new institution established, it will require substantial ongoing action to ensure full implementation and results from these reforms. Nonetheless the matrix gives an overview of performance on specific steps that had been set out by countries for action.

Section 3 provides an overall summary and commentary by OECD of progress with reform in South East Europe.

Section 4 provides the short country commentaries on each reform that was listed for implementation.

Section 5 presents the new Critical Time-bound Targets proposed for implementation in 2004. The Monitoring Instruments will continue to review progress on earlier targets established as well as the progress with these new targets.

Section 6 outlines individual country assessments by OECD.

Section 7 provides facts on FDI trends, an analysis of key issues and the outlook for investment in the future.

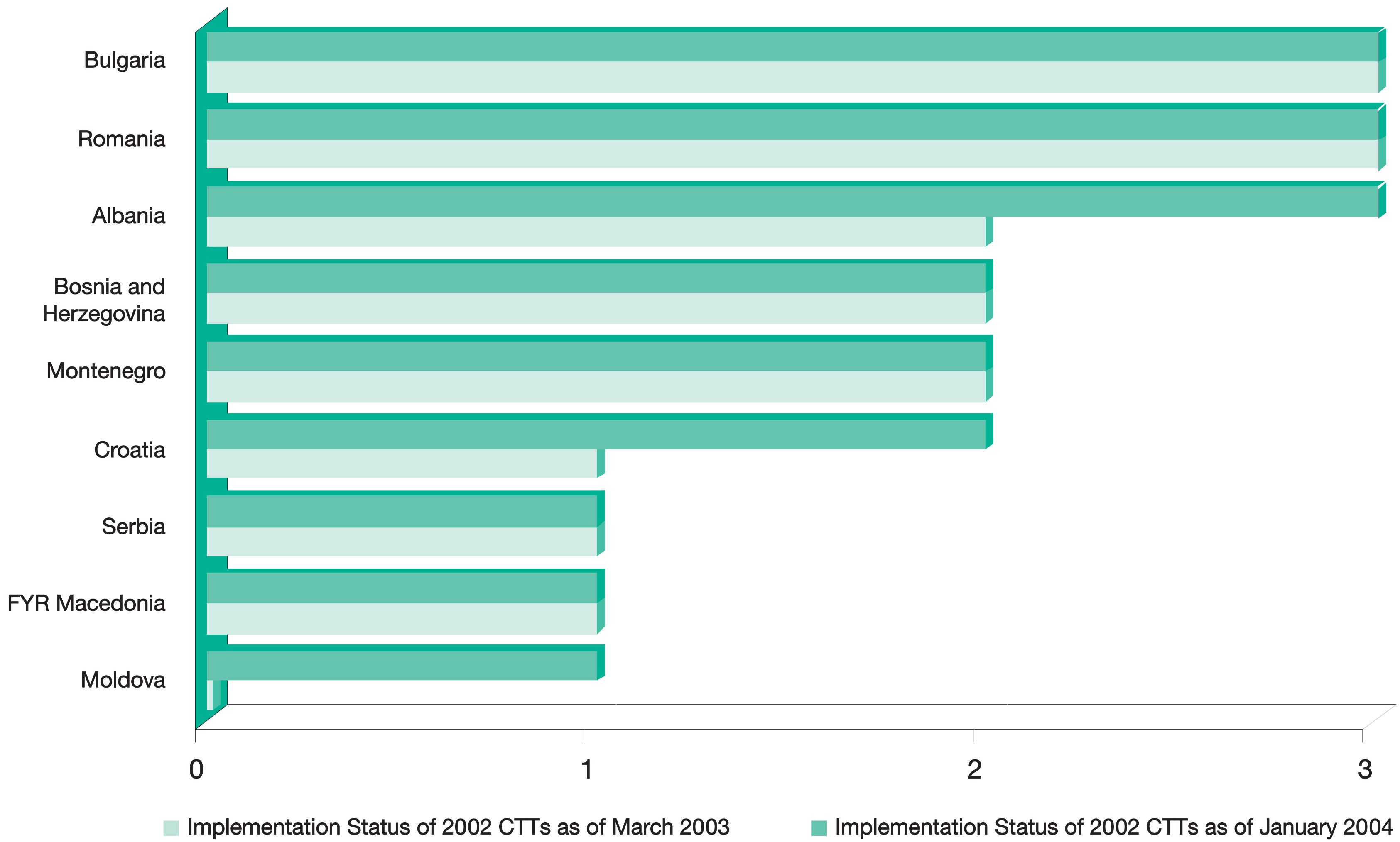
2. PROGRESS WITH CRITICAL TIME-BOUND TARGETS 2002 - 2003[1]

Table 1 - Summary of the Implementation Status of the Critical Time-bound Targets Selected in September 2002

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Romania	Serbia and Montenegro: *Serbia*	Serbia and Montenegro: *Montenegro*
1	Put into operation the Investment Promotion Agency	Harmonise customs tariffs at BiH (State) level	Adopt a uniform corporate tax rate of 23.5% and revoke the municipality tax as from 2003	Conclude drafting and enact amended Investment Promotion Law	Improve the institutional framework for FDI promotion	Submit to Parliament new FDI Law, inc orporating "national treatment" concept and revised investor incentives	Establish and put into operation the Romanian Agency for Foreign Investments (ARIS)	Simplify the acquisition of construction rights	Adopt a new strategy for FDI, following the approval of the Law on FDI, targeting in particular the tourism sector
	Done	**Done**	**Done**	**In Progress**	**In Progress**	**In Progress**	**Done**	**Done**	**In Progress**
2	Implement a mechanism for publishing all key legislative acts, regulations and executive documents issued by ministries and administrative bodies	Adopt the Law on Consumer Protection to introduce quality standards and curb counterfeit activity	Improve the performance of the judiciary system, particularly on civil code cases, by enacting amendments to several laws and procedures	Establish an Agency for Trade and Investment Promotion	Abolish the tax on financial transactions (0.5% per transaction)	Implement new Civil Code to provide a stable legal framework regulating commercial contracts and transactions	Ensure the full operation of the recently established National Credit Guarantee Fund for SMEs	Reform economic legislation by adopting the Concession Law, Secured Transaction Law, and International Arbitration Law	Establish local business centres and incubators, innovation centres and technology parks
	Done	**Done**	**Done**	**Done**	**Done**	**Done**	**Done**	**In Progress**	**Done**
3	Finalise the study on administrative barriers	Design and implement streamlined company registration process throughout State	Adopt the Law on Amendments and Supplements to the Commercial Law	Amend the Law on Protection of Market Competition to harmonise it with EU standards	Amend the Competition Law, lowering the threshold for prior notification of mergers and acquisitions to the Anti-Monopoly Authority	Put into operation the Competition Agency: appoint agency head, senior staff and allocate budget	Adopt implementation procedures for the new VAT Law	Simplify business incorporation and registration procedures	Ensure implementation of newly approved legislation affecting the business sector
	Done	**In Progress**	**Done**	**Done**	**In Progress**	**No Progress**	**Done**	**In Progress**	**Done**

1. The "Critical Time-bound Targets" represent the three top priority reforms selected by each SEE country in September 2002 for implementation within the following 6-12 month period. Targets rated as 'Done' or 'In Progress' reflect progress with specified steps on reform (see country reports) and does not mean that all reform in these areas is fully complete. In many cases further progress over time will be necessary (e.g. reform of judiciary or implementation of civil code) however the assessment here shows where progress has been made (or not made). The numbering of the Critical Time-bound Targets shown above does not denote an order of priority, it has been included for ease of reference. The status shown here represents progress reported as at January 2004.

Figure 1 - Implementation of Critical Time-bound Targets by Country



3. OVERALL SUMMARY OF PROGRESS ON POLICY REFORMS

This Section provides an overview of progress in the region - economic progress and progress with structural policy reform. In brief, the region continues to enjoy good economic growth and there has been measurable progress in both the business environment and with private investment. This progress is reflected in growth rates and in increased investment levels. The fundamental challenge for the region remains in the implementation and in maintaining forward momentum in that process. In addition to the challenges of transition, previously referred to, reform is hampered also by the lack of policy and institutional continuity following democratic change; for example, the short life and tenure of various institutions (and sometimes Ministries), which need a long term perspective but often do not get the time to mature and develop in handling challenging policy reform and instil a new culture. The work of the Investment Compact seeks to build regional cooperation and dialogue and to support links with OECD countries through sharing successful policy practices and practical demonstration steps, based on successful experience, on such issues.

Growth in South East Europe maintains momentum but still driven mostly by domestic demand….

In 2003 GDP growth remained relatively strong in the majority of economies in South East Europe despite the weak external environment, the adverse effects of drought and stalled progress with reform due to political change in some countries. Compared with an aggregate GDP growth of 3-4% for Eastern Europe as a whole South East Europe exceeded this level and achieved an average of 4-5% continuing the comparatively better performance and the upward trend of recent years. The performance across the region is however mixed as Table 2 below shows and growth levels to some extent reflect the relatively low base of most of these economies (see section 7 for further examination of the economic development and growth of private investment).

Table 2 - Changes in real GDP in South East Europe 2001 -- 2004

	2001	2002	2003 (estimate)	2004 (projection)
Albania	6.8	4.7	6.0	6.0
Bosnia and Herzegovina	4.4	5.5	3.5	4.0
Bulgaria	4.0	4.8	4.5	4.8
Croatia	3.8	5.2	4.5	3.5
FYR Macedonia	-4.5	0.7	2.8	3.0
Moldova	6.1	7.2	6.3	5.5
Romania	5.3	4.9	4.9	5.0
Serbia and Montenegro	5.5	4.0	2.0	2.0

Source: Transition Report Update, EBRD, *April* 2004.

National accounts data indicates growth driven predominantly by domestic demand with rising real incomes, strong tourism season (e.g. in Bulgaria and Croatia) and fixed investment including public infrastructure (e.g. Croatia) contributing to aggregate output growth. While export performance is rising gradually in some countries the general pattern is more rapid growth of imports and negative net trade. In the other countries economic activity has been more subdued in line with the earlier stage of their reform and transition process and/or due to political stalemate. Nonetheless the overall picture is clear - South East Europe is a region where economic growth is progressing consistently and at higher rates than Western Europe and the bulk of Central and Eastern Europe. In that context the region is creating a better environment for business and investment but the region needs to equally demonstrate that key reforms affecting business are progressing if it is to match levels of private investment in Central and East Europe.

Progress with specific reforms identified by SEE countries….moderate performance in most countries

What has been the progress with reform? And specifically with those three high priority reforms ('Critical Time-bound Targets - Most Crucial Targets') selected by countries for publishing in the 2nd edition of the Monitoring Instruments in mid 2002? These targets were originally selected for completion in a 6-12 month period so they should therefore have been implemented, according to SEE country plans, by mid 2003. Figure 1 shows the comparative performance of the most crucial targets. In summary[2]:

- Albania, Bulgaria and Romania achieved all three targets.
- BiH, Croatia and Serbia and Montenegro (Montenegro) achieved 2 out of 3 targets.
- FYR Macedonia, Moldova and Serbia and Montenegro (Serbia) achieved only 1 out of 3 targets.

Where there has been lack of progress it has been mainly in introducing laws, establishing new institutions and bringing in new systems: for example, FDI laws and new strategies had not progressed as planned in Croatia, Moldova (Moldova subsequently reported the Investment law have entered into force on 23 March 2004) and Montenegro by end 2003. Similarly new company registration systems had not been finalised in BiH and Serbia although progress here is expected in early 2004 in BiH; and finally nearly two years after selecting the target Moldova had not made any progress in establishing a new Competition Authority.

Looking beyond these three most crucial targets the countries of the region had also selected three high priority targets (see section 4) in the 4 selected policy areas of FDI policy and promotion, enterprise and SME development, public and private governance and anti-corruption and anti-bribery for implementation by mid 2003. The pattern of comparative performance across the region with these targets[3] is very similar. With implementation varying from one third to half for most countries the overall regional performance can be best described as moderate. Only Romania achieved over 80% of the targets specified. If the region is to achieve its real potential to attract new investment and move to become a significant world destination for FDI then more commitment and concentration on *the targets selected by countries themselves* is needed.

Private investment levels are rising and FDI reached a new record level of $6 billion+ in 2003….

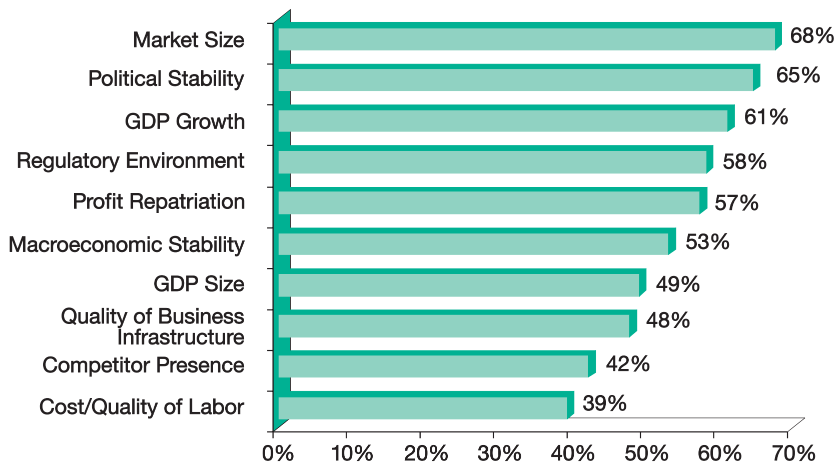
For the first time ever the region achieved a new FDI level of $6 billion+ in 2003 (see section 7). And for the first time ever four countries in the region (Bulgaria, Croatia, Romania and Serbia and Montenegro) each exceeded an annual level of $1 billion. This progressive performance in 2003 needs to

2. The status of most information in this Monitoring Instrument is at end January 2004 however where some countries provided further detail after this period and up to final printing in April 2004 this has been incorporated.
3. Some countries repeated the same targets under the general heading of 'Most Crucial Targets' and under the thematic policy areas.

be seen in the context of a region, which has struggled to maintain an annual average of $4 billion in 2000-2002 with falling global FDI levels in recent years. Feedback from private sector investors suggests that at least three countries (Bulgaria, Croatia and Romania) are now more regularly and systematically being considered by international investors where investment projects are planned. This is largely attributable to perceived greater region-wide stability and progress with transition, gradually closer political and economic association with the EU and relative competitiveness. At the same time the bulk of FDI in South East Europe is still driven by privatisation and some single major projects (e.g. in Serbia) are the reason for the new FDI levels in individual countries. Significant challenges remain for the smaller countries in the region to boost FDI levels and substantial efforts to address this are being made (for example, through the new investment promotion agency in Albania) but real progress seems likely to emerge only when such efforts are combined with deeper and effective reform to improve the business and investment environment and enhance the image of these countries as competitive investment destinations. More vital than FDI in the short term at least for some countries (e.g. Albania, Moldova) are emigrants' remittances that are stimulating domestic investment especially in areas such as construction and distribution services.

While privatisation has been the major factor in driving new privatisation over previous years the growth of greenfield private investment will become more crucial in coming years as privatisation opportunities decrease. SEE countries need to become more competitive and proficient at attracting mobile FDI and in understanding and meeting investor expectations. The need for a SEE regional perspective, regional approach and regional co-operation by all SEE countries is underscored by the determinants of FDI (see Figure 2), which shows that many international investors rate market size as the most important factor when looking at new investment destinations. Individual countries will need to project the wider regional market as the opportunity for investors if they are to achieve a major increase in FDI levels. This factor combined with the proximity of the EU markets make the SEE region more attractive to international investors.

Figure 2 - Top Determinants of FDI



Source: FDI *Confidence Index*, AT *Kearney*, 2002.

Transforming the image of the region remains a major challenge for South East Europe....

The question remains as to whether the 'pump priming' effect of the new investment attracted to the region through sale of state assets can be maintained and built upon through new 'greenfield' investment. And the full benefits of such investment derived. Experience in other regions (the Baltics, Central East Europe) suggests this progression but automatic progression can not be assumed and needs new visionary leadership and energetic persistence with reform. Bulgaria and Romania in particular are attracting increasing amounts of greenfield investments and this augurs well for progress similar to transition countries in Central and East Europe. For the region as a whole there are many challenges in moving to new and higher levels of FDI, not least in maintaining the political stability across the region and addressing remaining political conflict situations. The recent political strife in Kosovo has brought the region back into the headlines with the historic negative image of conflict and instability being portrayed. This affects all countries in the region as the factor 'political stability' -- as shown above -- rates high as a determinant of FDI.

At a lower level there are some very practical issues that should be considered and addressed in the shorter term:

- The communication and dialogue with private sector (both international and domestic companies) needs to be considerably strengthened. While significant steps and initiatives have been taken here especially by private sector groups such as the Foreign Investor Councils, many companies (in particular small business) still point to little or no regular and meaningful dialogue with policy makers, opaque regulatory systems, protracted slow moving efforts to address identified obstacles to business, and hidden costs through administrative/fiscal procedures imposed including corruption.

- While political change is a fact of life in the emerging democratic structures of the region it is also a fact that the lack of continuity in some institutional structures, laws and policies is slowing reform. The frequency with which, for example, investment promotion agencies and SME development agencies are dissolved or radically restructured has meant that building a professional culture of service to meet the policy and operational challenges and change needed is doubly difficult.

New regional leadership of the Investment Compact and region-led co-operation have been enhanced ...

Romania as co-chair of the Investment Compact has demonstrated regional leadership and 'ownership' of Investment Compact strategy and programmes through 2003 and into 2004. Other SEE countries have taken similar lead roles in various policy initiatives. This initiative and lead from the region, encouraged under the Investment Compact structures, has been an important signal to international investors of the political support in the region for reform and change.

In key structural policy areas such as investment policy, SME policy, taxation, regulatory reform, competition law and policy, and corporate governance new regional 'roundtables' or regional 'steering groups' have emerged through the Investment Compact activity (typically undertaken by SEE countries jointly with OECD and international institutions -- EC, EBRD, World Bank, FIAS, etc.) and are underpinning concrete steps to push for reform. This has lead to more peer review and regional dialogue on common issues for SEE countries. In the tax area, for example, in December 2003 the Ministries of Finance met at ministerial level to review how tax systems can be better used to promote private investment using as a basis for discussion the previous Investment Compact work and report done jointly with SEE countries. Fostering more regional exchange of experience and more dialogue on common issues are crucial not just to helping better policy reform but also to strengthening contacts and interaction within the region. Considerable further steps in all structural policy areas are needed to ensure true and lasting change and to achieve more even progress in all SEE countries -- the role of these regional policy networks and roundtables are important building blocks in regional cooperation as well as in promoting more balanced regional reform.

Investment Compact - New Regional Networks and Roundtables Build Regional Cooperation

The South East Europe Regional Roundtable for Investment Promotion (RRT)

The Regional Tax Network

The Network of Competition Authorities in South East Europe

The Regulatory Governance Initiative and Steering Group on Regulatory Reform

The South East Europe Corporate Governance Roundtable

The South East Europe Enterprise Forum

Some examples of the work of these regional groups is outlined below and more detailed descriptions provided in later paragraphs.

SEE Competition authorities tap into OECD knowledge and understanding: A meeting with SEE competition leaders was held in the OECD's Istanbul Centre for Private Sector Development on 26-27 May 2003, in order to follow up on recent progress and discuss needs for future action. Participants agreed upon conclusions based on the report "*Competition Law and Policy in South East Europe: A Programme of Action*" (April 2003), and launched a Network of Competition Authorities in SEE for continued co-operation, dialogue and capacity building. The competition authorities of Slovenia and Turkey also expressed an interest in taking part in this Network. A further regional meeting to assess progress is planned for mid 2004.

White Paper on Corporate Governance in South East Europe: The OECD and the World Bank group have combined their efforts to create and support Roundtables on Corporate Governance where national policy-makers, regulators and market participants can share experiences and debate corporate governance policies and reform. A regional Roundtable for SEE has been established as part of the work of the Investment Compact and through a broad based group of experts from within the region and from OECD countries a White Paper setting out the status of corporate governance in SEE was published in June 2003. This White Paper provides an agenda for future action on this subject in the region.

Progress is being made in conveying difficulties with certain tax incentives: The OECD report "*Tax Policy Assessment and Design in Support of Direct Investment: A Study of Countries in South East Europe*" (April 2003) cautions against the use of profit-based incentives (e.g. tax holidays) in favour of expenditure-based incentives - with the former facilitating aggressive tax-planning, leading to excessive erosion of the tax base (limiting tax revenues available for infrastructure development). These difficulties, elaborated in workshops with officials and in the OECD tax report, are now well understood by Finance Ministry officials (although more interaction is necessary with Investment Promotion Agency authorities, which may have a different perspective on some issues) and countries are beginning to move away from too much reliance on this incentive-type focus. Romania, for example, has decided to no longer offer tax holiday treatment to potential investors. Other SEE countries are also shifting towards greater reliance on a low statutory corporate income tax rate, accelerated depreciation provisions, and an expanded tax treaty network based on the OECD model, to attract investment.

Interest in establishing a Regional Tax Network. At the Ministerial conference held in Bucharest 4-5 December 2003, participants representing Ministries of Finance of all SEE countries expressed interest in the proposal, by the Romanian Minister of Finance, to establish a Regional Tax Network, to facilitate exchange of information and experience and build capacity in the tax policy area, working together with the Investment Compact and the OECD Centre for Tax Policy and Administration (CTPA). The Network is to proceed on both an informal and formal basis, with a series of workshops organised for 2004 under the CTPA's outreach programme, followed by a second Ministerial conference in Bucharest planned for end 2004, to consider the outcomes of these workshops and progress made in adhering to the Ministerial Statement and Action Plan (see Annex 2).

Tax policy design and administration play a central role in facilitating private investment from international and domestic sources and in promoting the development of a vibrant market economy. Developing a balanced approach between budgetary and private sector development priorities is a key economic policy objective for SEE countries. Direct investment is encouraged where the tax system is transparent and predictable, and when tax laws, regulations and administration provide for certainty, clarity and stability. Tax incentives, if not properly designed, targeted and administered may create undesirable tax-planning and avoidance opportunities for domestic and foreign investors, and may result in revenue losses well in excess of those anticipated.

Investment Compact - Facilitating Exchange of Experience in Tax Policy Treatment of Investment

Bucharest Meeting at a Ministerial Level on SEE Tax Policy Assessment and Design

Under the initiative of the Romanian Co-chair of the Investment Compact, the Ministry of Public Finance of Romania and the OECD, through the Investment Compact for South East Europe and the OECD Centre for Tax Policy and Administration (CTPA), organised the Ministerial Conference on Tax Policy Design and Investment in South East Europe, in Bucharest, on 4 - 5 December 2003. A preparatory meeting with SEE senior tax officials, investment policy makers, heads of investment promotion agencies, international organisations and business representatives preceded the ministerial session and was devoted to reviewing the role of taxation in the investment decisions and to discussing how to strengthen the tax policy frameworks for direct investment.

The Conference provided a platform for dialogue on substantive tax issues relevant to attract foreign and domestic private investment in the SEE countries. It was part of the process of consultation and co-operation among the SEE countries on investment policy, initiated with the Ministerial Declaration on "Attracting Investment to South East Europe: Common Principle and Best Practices", signed in Vienna by the SEE Ministers of Economy on the 16 July 2002, and continued with at the second Conference of the Ministers of Economy held in Vienna on 10 and 11 July 2003.

SEE Ministers and Deputy Ministers of Finance as well as SEE Ambassadors in Romania endorsed the Ministerial Statement "Tax Policy in Support of Investment", and fully supported its principles and action plan. A salient output of this Conference is the Regional Tax Network, a first step in regular policy consultation that will facilitate exchange of information and experience and build capacity in the tax policy area, by working together with the CTPA. A proposed 2004 Action Plan designed to address the practical needs of the SEE countries in this area, will involve SEE tax policy officials in the OECD workshops on tax incentives, tax modelling, tax treaties, taxation of financial instruments and transfer pricing guidelines.

Investment regimes in South East Europe are improving…

There has been measurable progress in improving the investment regimes in the region; for example, in moving to national treatment standards for all investors (e.g. Romania is actively pursuing an agenda of adherence to OECD investment instruments), in tackling regulatory procedures, in putting in place new laws and institutions to build investment levels and in focusing on issues affecting small business.

During 2003 the Investment Compact initiated a process to remove rules and practices which explicitly treat international investors differently than national ones in South East European countries, and thus contradict the principle of National Treatment. Responding to a request by the Ministers of Economy and designated Ministers dealing with business and investment in SEE countries for guidance in this field, National Treatment reviews were conducted in 2003 for all SEE countries, by the OECD and a network of regional experts, in cooperation with the SEE Country Economic Teams. This was accomplished through a process involving survey questionnaires, individual meetings, dialogue and peer review in which all SEE countries and the private sector participated. The results of this review are published in the report *National Treatment of International Investment in South East European Countries: Measures Providing Exceptions* (OECD, October 2003).

Investment Compact -- Providing Guidance on Matching International Standards of Treatment of Investors

OECD and SEE countries work together to identify and remove unjustified exceptions to National Treatment of International Investment

National treatment is a key feature of a favourable investment climate, providing to non resident foreign investors and foreign controlled enterprises established in the country, treatment no less favourable than that accorded to domestic enterprises in like circumstances. It is embodied in numerous bilateral investment treaties and the OECD Investment Instruments. The application of the National Treatment principle in all countries of the Region of South East Europe thus represents a tangible medium-term goal for SEE countries as part of their reform agenda to create a high-quality investment environment. Success here will constitute a strong message to the investor community of the political will of the countries of the Region to match recognised international standards of investor treatment and to provide for equality of competitive conditions.

The implementation of National Treatment principles throughout South East Europe will continue to be specifically reviewed in subsequent *Monitoring Instruments* of the Investment Compact and at the annual SEE Ministerial meeting to be held in Vienna in July 2004. Progress in this field will help SEE countries approach an OECD standard recognised by the business community as a key element of an internationally competitive business location.

The National Treatment report can be accessed at URL: http://www.investmentcompact.org/pdf/NationalTreatment.pdf

The report shows that the laws of most countries contain relatively few discriminatory elements. However, a number of significant exceptions remain and the uneven implementation of formal non discriminatory rules still raises concern. Most of these barriers are the heritage of the past and have very little economic justification. Most widespread exceptions take the form of licensing and approval procedures (often of a trans-sectoral nature) specifically faced by international investors, discriminatory measures barring them from real estate acquisition, and limits on participation in equity. While many of these issues were known to the SEE policy and business communities on an anecdotal basis, this review process is the first to establish detailed targets for each country on a comparative regional basis and monitor implementation through a regular monitoring instrument and peer review in which all SEE countries and the majority of OECD countries are participating.

Combined with the work on improving investment policies in the region the countries collaborate in a unique regional co-operation in promoting the region to international investors. Most SEE countries do not have the resources for promoting and attracting FDI worldwide. They lack regular and direct contact with potential investors and frequently do not have the capacity or skills (e.g. presentational experience and skills, sectoral knowledge) to be highly competitive versus many OECD countries. The Regional Roundtable provides therefore a very practical and useful forum that complements their national efforts, facilitates regional sharing of experience and learning and has been welcomed by all SEE countries.

Investment promotion capacities are being strengthened and direct contact with investors increased…

Direct contact with potential investors substantially improved: The work of the Investment Compact extends beyond sharing successful practice from OECD countries. The RRT provides an incremental link to potential investors i.e. on top of the ongoing programmes of SEE promotion agencies. Through the SEE Regional Roundtable on Investment Promotion the Investment Compact in recent years has facilitated outward missions to target investor countries. RRT members compete in the marketplace for scarce international investment, which requires both a high quality business environment, and, increasingly, a professional investment promotion effort by the host country. But in many areas SEE countries uniquely use co-operation with one another to develop the overall business image of the Region and to bring much-needed new attention and investment to SEE. The OECD Investment Compact provides strategic advice and networks support to meet these objectives.

Investment Compact - A Unique Regional Co-operation in Promoting Private Investment

The South East Europe Regional Roundtable on Investment Promotion (RRT) - Implementing Practical Policy Development

"Our individual messages to investors are more powerful when we cooperate jointly and present the 60 million SEE market" were the closing words of Chairman Marian Saniuta (President of the Romanian Foreign Investment Promotion Agency, ARIS), in conclusion of the RRT's meeting held in Bucharest in September 2003 -- the first RRT he was chairing. He was reflecting the shared opinion of the investment promotion agencies (IPAs) and other groups from the SEE region participating in the RRT:

Albanian Investment Promotion Agency (ANIH), Foreign Investment Promotion Agency of Bosnia and Herzegovina (FIPA), Bulgarian Foreign Investment Agency (BFIA), Bulgaria Economic Forum (BEF), Trade and Investment Promotion Agency of Croatia (TIPA), Agency for Foreign Investments of FYR Macedonia, Moldovan Export Promotion Organisation (MEPO), Romanian Agency for Foreign Investments (ARIS), Chamber of Commerce and Industry of Romania and Bucharest (CCIRB), Serbia Investment and Export Promotion Agency (SIEPA), and Agency of Montenegro for Economic Restructuring and Foreign Investment (AMERFI).

During the course of 2003 the organisations joined their forces in the RRT, with support from the Investment Compact, and held three "outward missions" to meet investors from OECD economies - Italy (Padova, April 2003 in cooperation with ICE), Switzerland (Zürich, September, in cooperation with SOFI), and Japan (Tokyo, May 2003, in cooperation with JICA and UNIDO and this programme is being sponsored once again by Japan in 2004.) They also maintained a joint presence in three SEE Region investment events (Sarajevo, June; Bucharest, September; and Sofia, December.) These activities brought the number of participants in RRT-related events close to 2000 since the start of the Roundtable activity in July 2000.

RRT's investments missions discovered a rapidly rising investor interest in SEE. Private sector awareness and interest in examining new investment opportunities has increased. Many in the business community expect that the European Union's expansion into Central Europe will bring added incentive for international business to look seriously to areas further east and southeast as locations for competitive investments. Though there remains much to do to reform the investment environment many businesses that participated in RRT missions this year are recognising that, in terms of economic reform, real progress is being achieved. This is corroborated by the rising FDI amounts in the Region.

In 2004 RRT plans to intensify efforts in practical promotion and training, to undertake a sectoral focus and a stronger communications strategy. Investment missions are in preparation in general promotion (Belgium - Flanders Region), general promotion and training (Japan - organised by JICA and UNIDO in cooperation with the RRT - this is the third such mission by IPAs from the region to Japan), automotive (Germany), agro-industry (Netherlands) and tourism (Switzerland). Several other OECD countries have expressed interest in hosting RRT missions too (Czech Republic, Norway), or in repeating programmes of previous years. In addition the RRT will participate in the business forum to be held prior to the SEE Ministerial Conference in Vienna on 8-9 July 2004 and the RRT is the main organiser of the 'Investor of the Year' awards held annually and on this occasion to be held during the Ministerial programme in Vienna.

In summary, the network of investment promotion agencies in the region has improved capacities and strategies. Investment Promotion Agencies are moving to become more competitive and effective agencies in promoting new investment and developing their strategies. Under the framework of the **SEE Regional Roundtable on Investment Promotion** they lead the promotion of the region and they collaborate to promote not just their countries but the region as a whole to potential investors.

Small business: The Investment Compact is promoting better policies to create new employment and regional development….

In 2003 the Investment Compact, working with Ministries and responsible agencies in the region conducted an evaluation of the performance of small business policy. Using extensive OECD work over many years with transition countries the research undertaken involved small business companies in every SEE country as the central source of information and feedback. Based on the main dimensions of policy the general view across the region was that policies were ineffective or deficient in many areas (see indicators below). These evaluations, undertaken jointly by OECD, EBRD and the EC provide valuable feedback from small business and a useful guide to policy makers on comparative performance of policies. Small business is vital for all SEE countries and especially for regional and local locations. The EPPAs will provide input to ***Monitoring instruments*** as further evaluation of the scope and effectiveness of policies is undertaken. The EPPA process is consistent with the EU Small Business Charter and therefore underpins EU association and accession policies and programmes.

Members of the SEE Regional Roundtable for Investment Promotion

Albanian Investment Promotion Agency (ANIH)

Croatian Investment Promotion Agency (CIPA)

Chamber of Commerce and Industry of Romania and Bucharest (CCIRB)

Foreign Investment Promotion Agency of Bosnia and Herzegovina (FIPA)

Agency for Foreign Investments of the Republic of Macedonia

Romanian Agency for Foreign Investments (ARIS)

Bulgarian Foreign Investment Agency (BFIA)

Agency of Montenegro for Economic Restructuring and Foreign Investment (AMERFI)

Bulgaria Economic Forum (BEF)

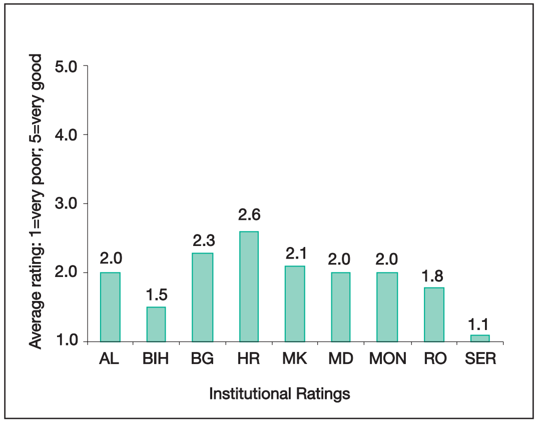
Moldovan Export Promotion Organisation (MEPO)

Serbia Investment and Export Promotion Agency (SIEPA)

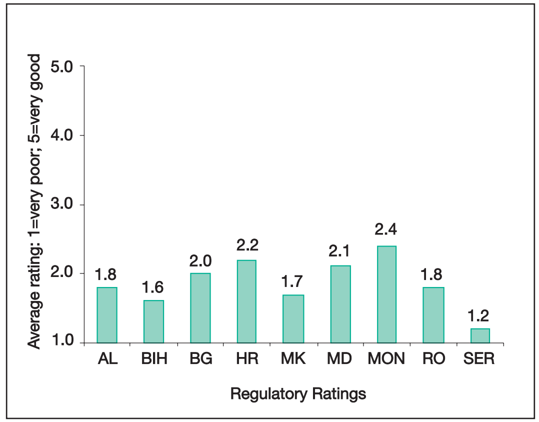
Investment Compact -- Providing Guidance on Measures to Promote Enterprise and Small Business

Enterprise Policy Performance in South East Europe Region: How Small Businesses Rate Policy Dimensions in each SEE Country

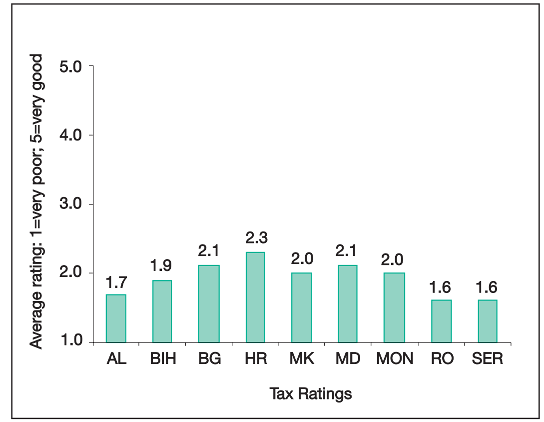
Institutional Framework for SME Policy



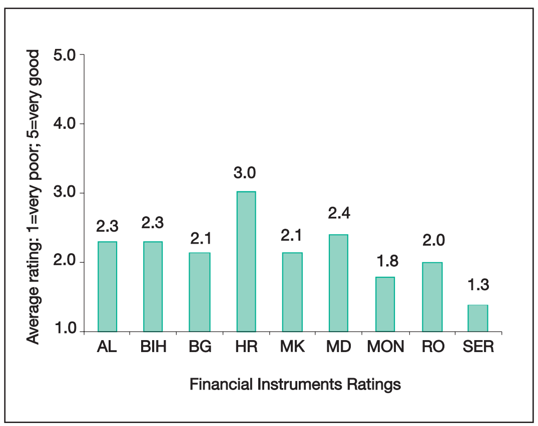
Rule of Law and Regulatory Environment



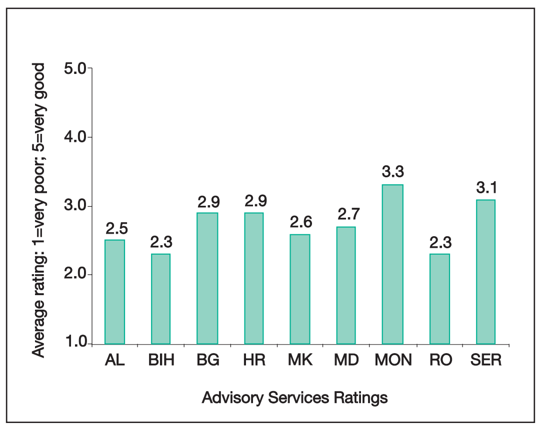
Tax Policy for Small Businesses



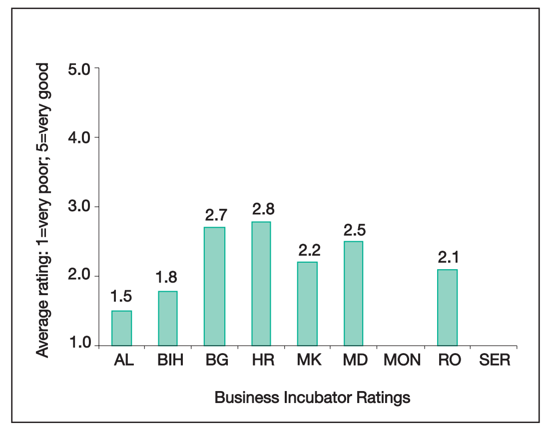
Financial Instruments for Fostering Small Businesses



Advisory Services Supplied to New and Small Businesses



Business Incubator Support to Start-ups



* Data not available for Serbia and Montenegro

Regulatory reform is crucial to improve the business environment….

A fundamental objective of regulatory governance is to improve economic efficiency, innovation and competitiveness. The direct and indirect costs of poor regulatory governance are increasing as competition for investment in global markets intensifies. Since the launching of the *Regulatory Governance Initiative* in South East Europe in 2001, the region has experienced significant progress in the implementation of regulatory governance reforms. The 2003 *Review of Regulatory Governance* in South East Europe clearly finds that the countries in the region are at the stage where a political commitment to further accelerate the reform process can make a critical contribution. This review also highlighted a number of areas where further progress can be made.

Against this background, the Ministerial Statement *Pushing Ahead with Reform: Removing Obstacles to* FDI *in South East Europe*, signed in Vienna on 11 July 2003 at the annual Ministerial Meeting of the Investment Compact, recognised "the importance of achieving further significant progress in the areas of regulatory reform, public and private governance, and combating corruption more effectively and encourage further work in these policy areas". Ministers agreed that these areas should play a more central role in government policy and indicated that their 2004 meeting will place major emphasis on reviewing progress achieved in these areas

The Investment Compact - Working to Make Regulatory Reform Happen

Making regulatory governance a political commitment

On the proposal of the Romanian co-chair of the Investment Compact, SEE country representatives have agreed to establish a *Steering Group on Regulatory Governance* under the co-ordination of the RGI. The aim of the Steering Group is to accelerate the regulatory reform process in the region and to prepare for the 2004 Ministerial Meeting of the Investment Compact (the *Bucharest Process*).

The first meeting of the Steering Group took place in Bucharest on 11 December 2003 back to back with the RGI Seminar on *Reducing Administrative Barriers to Business Creation and Development*. It took stock of the work accomplished by the Regulatory Governance Initiative. Further, the meeting concentrated on important aspects of the preparations for the 2004 Investment Compact Ministerial Meeting such as developing Regulatory Governance Action Plans, setting out governance reform priorities coupled with a clear path for their implementation and the dialogue with the business and international communities. The extensive experience and expertise of OECD and FIAS/World Bank is a central part of this process. The second Steering Group meeting, planned tentatively for May 2004, will review the Action Plans, which will feed into a regional report for Ministers. This Steering group meeting will be held together with the RGI Seminar on *Establishing an Administrative and Judiciary Environment facilitating Investment and Growth*.

Private sector voice and involvement in policy dialogue and reform has been strengthened…

Foreign Investors Councils in Albania, Bulgaria, FYR Macedonia, Moldova, Romania, Serbia and Montenegro (as well as OECD countries such as Turkey) group the country representatives of major international companies from OECD countries with direct investment and operations in South East Europe. They share the four following common goals at country level:

1) to improve the investment and business development climate 2) to assist members in conveying business and operational difficulties and proposing suitable reform measures to relevant authorities 3) to formulate concrete proposals to improve the business environment and provide

constructive feedback to government on policies 4) to co-operate with government authorities in undertaking action to implement policies. The strategy of the Investment Compact has therefore sought to strengthen the role of such Councils (as well as other bilateral private sector associations) in working with governments and policy makers in the region.

A Regional Network of Foreign Investor Council was endorsed and established by private sector representatives at the SEE Ministerial meeting in Vienna in July 2003. It has strengthened the voice of private sector in policy formulation and implementation and provides valuable inputs and partnership to governments and policy makers in the transition challenge. New Foreign Investor Councils (e.g. in Serbia and Montenegro and Moldova) have been instigated with active Investment Compact advice and support. A meeting of the Regional Network in Belgrade in December 2003 (held in conjunction with a Business Advisory Council mission to Serbia) took further steps to build cross regional sharing, dialogue and joint action by the investors in the region on key issues affecting the business environment. On the occasion of the 2nd Vienna Ministerial Conference held in July 2003, in partnership and with the support of the OECD-Investment Compact, the representatives of Foreign Investors Councils agreed to form a Regional Network of Foreign Investors Council in South East Europe, which currently represent almost 80% of the total stock FDI in the SEE countries.

This regional network should further strengthen the voice of foreign investors and the business image of the region, improve the operational environment for intra-regional business, address issues of a regional nature or issues which would require a regional approach (e.g. customs duties and procedures, taxes, cross border trade and investment operations and cross border infrastructures), provide a forum for region-wide sharing of information and experiences, and support regional approach to EU accession, and integration of the region into worldwide markets.

Investment Compact - Strengthening the Partnership and Contribution of Private Investors to Policy Reform

The Regional Network of Foreign Investors Councils in SEE

The 1st Meeting of the South East Europe Regional Foreign Investor Council Network took place in Belgrade on December 9-10, 2003 see www.regionalfic.org. In partnership with the OECD and in co-operation with the "Business Advisory Council to the Stability Pact" (BAC), the "Business and Industry Advisory Committee to the OECD" (BIAC) and other relevant private sector bodies, the Regional Network of FICs aims to:

1. **Share information between FICs (e.g. constitution, membership procedures and work programmes, 'White Book' documenting good progress and issues requiring reform and attention) and how FICs can play a constructive role in dialogue with governments and policy makers. Inform other private sector groups, both within and outside the region, and promote cooperation that will facilitate policy change.**
2. **Build practical 'case experience' on common issues (e.g. different application of same law in different countries) across the region and strengthen the national message of individual FICs with regional experiences.**
3. **Present joint statements, where relevant, regarding common and concrete priorities to SEE governments, donor countries and International Financial Institutions, at high level regional meetings and other international fora.**
4. **Develop better partnership and peer pressure with SEE governments at national and regional levels in liaison with OECD-Investment Compact for South East Europe and other institutions.**
5. **Seek joint actions on key common issues affecting members of the network across the region.**

Political awareness and commitment to reform in SEE has been strengthened…

The Annual Ministerial meetings of SEE ministers (held in Vienna in 2002 and 2003) have monitored progress and renewed the high political support and commitments for concrete reform measures. These meetings review progress with previously identified priorities and provide an important forum for ensuring high level political visibility within SEE countries of action taken or not take on key reforms. In addition, as previously described, the initiative of the Romanian regional co-chair of the Investment Compact in organising a Ministerial Meeting of Finance Ministers in 2003 provided additional political level review and dialogue on measures that need to be pursued. In OECD missions to SEE countries discussions have been held with parliamentary representatives, for example, with such representatives in Moldova in relation to the proposed new investment law. There are plans to extend such contact in 2004 in liaison with the Stability Pact office and some OECD countries.

OECD countries and new entrants to the European Union are providing constructive partnership in Investment Compact activities…

The active involvement of OECD countries in Investment Compact work (e.g., in hosting promotion groups from the SEE region, in co-leading initiatives on competition, etc.) and in particular the sharing of experience by recent transition countries such as Slovenia (e.g. its experience in adhering to OECD Investment Instruments and standards), Hungary, Czech Republic, etc. has strengthened significantly the Investment Compact activity.

Given the geographic proximity of these countries to the SEE region, their history of involvement and investment (for exemple, Slovenia is a significant investor in BiH and Serbia and Montenegro as well as a major trade partner with Croatia) and their recent move to market economy structures it is expected that they, in particular, as well as other adjacent OECD countries (Austria, Italy, Greece, Turkey, Poland, Slovakia), can provide strengthened partnership and cooperation in reform efforts in 2004 and beyond.

4. COUNTRY COMMENTARIES ON CRITICAL TIME-BOUND TARGETS 2002 - 2003

Albania

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
1	Put into operation Investment Promotion Agency	Done	The Albanian Agency for Foreign Investment Promotion (ANIH) was created by an Act of Parliament (Law no. 8877) approved in April 2002 and became fully operational one year later. The Agency is currently structured in four units: Strategy and Policy Advocacy, Investor Servicing and Marketing and Promotion, with the Information Unit backing up the work of the first three. ANIH is operating on a three-year Business Plan, prepared with the support of MIGA and UNCTAD. A Procedural Manual and an Ethical Code for the agency staff have been adopted. One of the first priorities of the agency is to establish a databank containing relevant information on the country and on business opportunities for private investors, and to develop a user friendly and well documented web-site (www.anih.com.al). ANIH is a member of the Regional Round Table for Investment Promotion. The agency had a positive start of operations and it has built up a team of qualified and motivated experts. However, its annual budget is very limited compared with the budgets available for the IPAs located in Central and Eastern Europe and it needs additional resources and capacity building to effectively implement its programmes. The agency intends to play an important role in policy advocacy, providing inputs for the elaboration of measures supporting private investors. In order to fill this role the agency needs dialogue with the associations representing private investors in Albania, the Foreign Investors Association of Albania and various national associations.
2	Implement a mechanism for publishing all key legislative acts, regulations and executive documents issued by ministries and administrative bodies	Done	The State Publication Centre (SPC) started its operations in December 1999, with the task of publishing the official gazette and all legislative and regulatory acts. The SPC has already published all the main codes such as civil, civil procedure, the

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
			customs code, and the labour code, in English and Albanian. In 2002 the Centre embarked on a project supported by the World Bank and implemented by a local software company to make all the country laws and regulations available on Internet. This has been recently completed.
3	Finalise study on administrative barriers	Done	In 2002 the Albanian government asked FIAS to conduct a study on the administrative barriers faced by private investors as a first step towards designing and implementing a comprehensive government programme aimed at removing bureaucratic bottlenecks and streamlining administrative procedures. The study, which included a survey of 500 companies, was completed in March 2003 and subsequently discussed with the relevant ministries, executing agencies, business association, universities, major professional think-tanks, economic journalists and other interested actors at a National Conference organised by Ministry of Economy. As a follow up, the Council of Ministers established in May 2003 a Task Force, comprising the Ministries of Economy, Finance, Justice, Territory Adjustment and Tourism, Industry and Energy. This Task Force is in charge of the preparation and the implementation of an Action Plan on Removing Administrative Barriers and the Council of Ministers assigned the Ministry of Economy to chair and co-ordinate the task force. Four technical groups were established, covering tax administration, customs administration, land and construction, appeal system, and are composed of experts from government institutions, the business community, academia and NGOs. The Action Plan was approved by the Council of Ministers in August 2003, together with the introduction of monitoring the action plan implementation and reporting to Council of Ministers with the aim to complete the process within 12 months time. During the first two months of activity of the Task Force, some concrete result has already been achieved. For instance, the Council of Ministers has approved the removal of some licensing requirement for companies operating in non food sectors

	Critical Time-bound Targets related to Promotion of Private Investment	Status	Comment
4	Improve legislation and procedures on land property rights, including setting up land administration offices and improving cadastral services.	In Progress	The government Action Plan on the reduction of administrative barriers includes a section devoted to land property rights and construction permits. The government has approved a new draft law on land restitution, drafted in conformity with the National Strategy on Rural Development and has presented it to parliament for final approval.
5	Improve the institutional framework for FDI through establishment of the IPA.	Done	See 1. above
6	Conclude FTA agreements with all SEE countries by end 2002.	Done	In line with the Memorandum of Understanding for Trade Liberalization and Facilitation of SEE Countries, Albania has completed FTA negotiations with all signatory countries in the Region (i.e. FYR Macedonia, Croatia, Bosnia and Herzegovina, Bulgaria, Romania, Serbia and Montenegro and Moldova) meeting the deadline set by the MoU. Albania has signed and ratified 8 FTAs, while a number of the remaining agreement have already entered into force: FTA between Albania and FYROM, entered into force since July 2002; FTA between Albania and Croatia, entered into force since June 2003; FTA between Albania and Bulgaria, is implementing since September 2003; FTA between the Government of Albania and UNMIK, entered into force since October 2003; FTA between Albania and Romania, entered into force by 1 January 2004, while FTA between Albania and B&H, is ratified since April 2003; (the Albanian side is still waiting for the same decision by Bosnian side, in order to start the implementation), and The FTAs between Albania and S&M and Albania and Moldova are scheduled to be ratified on February 26, 2004.

	Critical Time-bound Targets related to Enterprise Development and SME Support	Status	Comment
7	Establish an SME Development Agency and develop a network of SME support centres.	Done	The new SME agency became operational in the second half of 2003. An SME strategy has been approved and an SME consultative committee, including representatives from a number of private sector organisations has been established. The agency is operating on a limited budget, which does not allow the establishment of a network of SME support centres at this stage. However, the government is trying to mobilise donor funds to support the activity of the agency.
8	Facilitate and improve administrative procedures for SME development.	In Progress	The target is related to the implementation of the government action plan for the implementation of the recommendations contained in the FIAS study. The government already has abolished the requirement of obtaining a general licence for companies operating in non-food sectors.
9	Improve access to credit for SMEs by introducing a credit guarantee scheme.	In Progress	A feasibility study, financed by Italy, is in the final phase of elaboration. Completion is expected for the first quarter of 2004.The government has requested financial assistance from Italy to establish a credit guarantee scheme.

	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	Status	Comment
10	Privatise strategic sectors such as telecommunications, savings banks and insurance companies to increase competition and economic efficiency.	In Progress	The Savings Bank of Albania has been sold in December 2003 to Raiffensen Bank for a total of USD 126 million. INSIG, the state insurance company is going through a pre-privatisation restructuring phase and its capital base has been enlarged with the entry as minority shareholders of the EBRD and IFC. The privatisation of Albanian Telecom has been further delayed, after a first privatisation tender failed for lack of offers in 2003. Over the last few months the company balance sheet has been cleared of arrears towards other telecom operators, in preparation for a new privatisation tender

	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	Status	Comment
11	Improve legal and institutional competition framework with a view to establishing an independent authority by 2004.	Done	(1) *Adoption of a legal framework approximated with* EU *competition legislation* The Law no. 9121 "On the Protection of Competition" has been approved by the Albanian Parliament on 28.7.2003. The law incorporates all the main features of EU Directives on competition policy, in relation to cartels, abuse of dominant position and concentrations. The law is applicable to all sectors of economy. (2) E*nsure the administrative capacity to enforce the competition law* The law stipulates the establishment of an Independent Competition Authority, which will have the Competition Commission, as a decision-taking body, being elected by the Albanian Parliament and the Secretariat as an investigative structure. The Competition Authority, which shall be in charge of law enforcement has to be established during 2004. As the Competition Commission is to be elected very soon, and also the budget for first 4 months of 2004 has been approved (the budget for the next period will be covered by the reserve fund), the main objective and challenge will be to make this structure operational. EU assistance under the CARDS programme, together with the GTZ technical assistance, will be of great importance for achieving this objective.
12	Improve enforcement of commercial laws, rules and regulation	In Progress	The Company Law and Commercial Register Law are currently under revision. An inter-ministerial committee with the support of external advisors has elaborated a draft and has been reviewed by the Business Advisory Council.

	Critical Time-bound Targets related to Priorities Related to Fighting Bribery and Corruption	Status	Comment
13	Increase customs revenues and prevent corruption through concrete action plans in accordance with the international obligations and the European standards.	In Progress	The government committed to establish a post-clearance control unit of around 10 senior inspectors concentrating on valuation, classification, origin, exemption, and suspension claims.

	Critical Time-bound Targets related to Priorities Related to Fighting Bribery and Corruption	Status	Comment
14	Increase of professionalism and quality of measures taken against contraband.	In Progress	The government is conducting training programmes for Customs and Tax Administration officials, with the support of the EC and other donors.
15	Improvement of legal framework to reduce the level of fiscal and customs evasion and corruption.	In Progress	As a first measure the Ministry of Finance has introduced the obligation of issuing an invoice for every transaction. The obligation to produce the invoice covers both the seller as well as the buyer.

Bosnia and Herzegovina

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
1	Harmonise customs tariffs at BiH (State) level	Done	A new state Law on custom tariffs came into force on 1 January 2003. The Law is harmonized with EU standards. Although the law is now unified at the State level, customs administration as such remains at the Entity level. BiH authorities are still working on the establishment of a unified customs administration at the State level. The private sector (e.g. Association of Employers) considers that the existence of two separate customs administration at entity level which "do not use the same tools" and "do not have the same interpretation of regulations", remains a serious impediment to business. The government reports that the adoption of a BiH State Law on Customs Policy is presently targeted for 31 July 2004.
2	Adopt the Law on Consumer Protection to introduce quality standards and curb counterfeit	Done	A Law on Consumer Protection has been adopted. The current priority is the establishment of a Competition Council. Authorities expected this to be implemented during 2003. Funds for the Competition Council have been provided. The Law on the execution of the budget of the institutions of BiH and the International Obligations of BIH for 2003 approved a sum of 600,000 KM for Competition Council operations. The next stage will include amendments to the Law on Consumer Protection, as the existing one is not harmonized with EU standards (EC is expected to provide technical assistance). A Consumer Protection Council is also expected to be established following the setting up of the Competition Council. One member of the latter will be an *ex officio member* of the former.
3	Design and implement streamlined company registration process throughout State	In Progress	The project is reported to be moving to the implementation phase. UK Department for International Development (DFID) is providing technical assistance. A draft BiH State Law on Business Registration is expected to be ready for submission to the Council of Ministers in March 2004, following difficult and

			long negotiations with Entity governments and the Brcko District. A fully functioning business registration system is expected to be in place within six months following the adoption of enabling secondary legislation at the Entity level. This implies a best case scenario of target fulfilment at end-2004, some 18 months past the deadline the government self-imposed in September 2002. Greater political support for the project is needed at entity level to speed up the process. The "Bulldozer Initiative" by the Office of the High Representative (OHR) has undertaken action to drive progress. It now appears that full implementation is expected in March 2004 at the earliest.
	Critical Time-bound Targets related to Promotion of Private Investment	**Status**	**Comment**
4	Harmonise customs tariffs at BiH (State) level	Done	(See No. 1 above.)
5	Simplify and harmonise the company registration system	In Progress	(See No. 3 above.)
6	Reform of regulations and procedures on land ownership and use at municipal level	In Progress	This is still in drafting stage. A Working Group consisting of representative of State and Entity governments is drafting a new law on land ownership and use, with technical assistance from the GTZ.
	Critical Time-bound Targets related to Enterprise Development and SME Support	**Status**	**Comment**
7	Ensure institutional support for SMEs	Done	A new Sector authority for Development and Entrepreneurship is established within the Ministry of Foreign Trade and Economic Relations of Bosnia and Herzegovina. Federation of BiH established a Ministry of Development, Entrepreneurship and Crafts. Republika Srpska adopted a new SME Law, and is proceeding with the Establishment of an Agency for SME Development.
8	Ensure financial support/incentives for SMEs	In Progress	Financial support and incentive schemes available to SMEs remain generally deficient. However, the government reports that the draft budget of Republika Srpska allocates €1.5 million for SME support in 2004.

	Critical Time-bound Targets related to Enterprise Development and SME Support	Status	Comment
9	Reduce regulatory burdens on businesses	In Progress	Upon the request of BiH authorities FIAS has recently agreed to undertake a new project to support the implementation of reforms aimed at removing the administrative barriers to investment. In addition, the Council of Ministers and the Department on Coordination for Development Strategy of BiH (PRSP) prepared an Action Plan for the Implementation of Priority Reforms that were already adopted by Council of Ministers and Entity governments. A recent report by the government indicates that of the 75 specific reform measures included in the Action Plan, 63 have been accomplished in the period July-November 2003, and that the full programme is expected to be completed by 1 March 2004.
	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	**Status**	**Comment**
10	Improving effectiveness and transparency of the Judiciary	In Progress	The restructuring of the legal system is underway, in order to reduce number of courts and prosecutors on municipality and Cantonal level, and a complete reform of judiciary system in BiH is being expedited by Office of the High Representative (OHR). A Bosnia and Herzegovina Court and Prosecutor Office has been established. The Law on BiH Court has been amended, and now includes councils for issues related to organised and business crimes as well as corruption. The drafting of a new Law on Single High Judicial and Prosecutorial Council of BiH is underway by the High Judicial and Prosecutorial Council Group, the Independent Judicial Commission and the OHR, and its adoption is planned for March 2004.
11	Adopt a consumer protection law at state level	Done	(See No. 2 above.)
12	Focus on drafting and adoption of law on obligations and commercial contracts	In Progress	The Law on obligations is in Parliamentary procedure.

	Critical Time-bound Targets related to Priorities Related to Fighting Bribery and Corruption	Status	Comment
13	Public administration reform	Done	The State Parliament adopted a Law on Civil Service. Its bye laws for implementation are planned to be in place by 31 May 2004. According to the Law, the newly established Civil Service Agency (CSA) is responsible for the recruitment and evaluation of civil servants working for the State Government. Entity governments have also adopted Laws on Civil Service that are similar to the State-level legislation and have set up Entity level CSAs. Compatible central registers of civil servants have been established at the State level and in Republika Srpska and the CSAs of these have launched a project to develop a joint training curriculum for civil servants. The government of the Federation of BiH (FBiH) has set up a Commission for the selection and appointment of a Director for the CSA of FBiH.
14	Custom reform	In Progress	(See also No. 1 above.) BiH authorities are still working on the establishment of a unified customs administration at the State level. The project on a new State customs policy is being conducted under the guidance of the European Commission, according to EU standards, and will be implemented through CAFAO, and with support from the Office of the High Representative (OHR).
15	Tax reform	In Progress	The Law on Indirect Tax was adopted by state and entity parliaments by the end of 2003. The Parliamentary Assembly of BiH has approved the Law on the Indirect Taxation System and the Law on Indirect Taxation Office. The tax administration is situated in Banja Luka and a Director has been appointed. The Laws on "The Rights and Duties of Employees of the Authority", "Remittance and Distribution of Indirect Tax Revenue" and "Methods of Payment to Central Account", as well as the "Law on VAT" are planned to be adopted by 31 July 2004.

Bulgaria

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
1	Adopt a uniform corporate tax rate of 23.5% and revoke the municipality tax as from 2003.	Done	The corporate tax rate and the municipality tax were consolidated at the uniform rate of 23.5% from the first of January 2003. The government plans to further reduce the corporate tax rate to 19.5% in 2004.
2	Improve the performance of the judiciary system, particularly on civil code cases, by enacting amendments to several laws and procedures.	Done	**Civil Procedure Code** - amendments concerning better performance of the judiciary system (adopted 11 November 2002). Those amendments include: • Rationalizing summoning procedures • Reducing the duration of court proceedings by bringing more precision to the possibilities for postponing a case • Increasing the value of pecuniary claims that are non-contestable before the Supreme Court of Cassation • Reducing the possibilities for returning cases from the cassation instance to the appellate instance **Drafting a new Civil Procedure Code is envisaged under a PHARE 2003 project - to be adopted by the end of 2005** **Changes to the Law on the Legal Authority** (adopted July 2003) • Judges, prosecutors and investigators obliged to declare their incomes • Junior judges, prosecutors and investigators to be attested before receiving a non-replacement status • The position of a judge, prosecutor or investigator requires legal capacity received through graduation from the newly established National Institute of Justice • Supreme Judicial Council maintains a public register (incl. an electronic version) of all its decisions **Changes to the Constitution (adopted end Sept. 2003)** • Length of service of judges, prosecutors and investigators before attesting for non-replacement status increased from 3 to 5 years

			• Adoption of a new cause for dismissal as a result of losing non-replacement status - serious offence or systematic failure in implementing the official obligations, as well as activities damaging the prestige of the judiciary authority • Functional instead of general immunity for the judges, prosecutors and investigators in the form of criminal and civil irresponsibility for their official acts, unless a deliberate crime of general character is committed; prosecution starts only after a permission by the Supreme Judicial Council in case of enough evidence
3	Adopt the Law on Amendments and Supplements to the Commercial Law.	Done	Amendments to the Commercial Law aimed at speeding-up and facilitating the bankruptcy proceedings (adopted June 2003) • 2 stages of appeal (instead of 3) • 7 days for written objections of the creditor • 7 days for creditor's action for establishment of existence of unaccepted claim • Court's definition for approval of the list of claims accepted by the receiver in bankruptcy cannot be appealed • Requirements for the receiver in bankruptcy: – Yearly professional qualification courses – Obligatory insurance for damages caused by receiver's guilty negligence • Control & monitoring by a special surveyor for the recovery procedure • Sale of property - special procedure – Creditor's committee determines the method to convert the bankruptcy estate into cash – The sale takes place at the receiver in bankruptcy's office – The buyer must pay the price within 5 days of the sale – The court assigns the property to the buyer on the day following the day of payment – The buyer of the movable property becomes its owner even if the debtor had no such rights

	Critical Time-bound Targets related to Private Investment Policies and Promotion	Status	Comment
4	Restructure the Bulgarian Foreign Investment Agency (BFIA)	Done	BFIA was duly restructured during 2003. The following functional improvements have been made: Currently all BFIA staff work on developing investment projects (information providing, active marketing activities or project management). Each BFIA expert works for projects in a separate industry. Most of the experts have specialized in keeping contacts with companies/institutions from a given country/region. BFIA has been developing its database for projects and investment sites. BFIA has played a lead role in organising regional promotional activities (e.g. missions to Japan) under the SEE Regional Roundtable on Investment Promotion.
5	Amend legislation to abolish any discrimination on the purchase of real assets by foreign nationals.	In Progress	According to the amendments of the forthcoming Investment Encouragement Law the restrictions concerning buyers from the EU and the European economic zone will be removed from the date of the EU membership of Bulgaria.
6	Introduce new fiscal incentives to promote direct investment.	No Progress	This priority will be transferred to later Monitoring Instruments in 2004.
	Critical Time-bound Targets related to Entrepreneurship and SME Development	**Status**	**Comment**
7	Simplify the administrative and legal framework for SMEs and introduce one stop shops in most municipalities.	In Progress	So far, the following steps have been taken: • Law on restricting the administrative regulation and control of the economic activity - adopted June 2003 (a main provision in this Law is that municipalities can no longer create own licensing and registration regimes) • Constant lightening of the licensing & registration regimes and reducing their number - 124 out of 361 as of July 2003 (12 more since March) • **Transparent regulatory system** - Register of the existing regimes www.government.bg/ras (created February 2003). The Register is maintained by the SME Agency and includes:

			– legal framework of the regulatory regimes – procedure description – forms of documents needed – E-submission of documents is forthcoming • **E-government of Bulgaria** (high quality, fast access, low cost) http://egateway.government.bg – Opened on 30 September 2003 – Services provided (1st stage): • Current address registration (the Bulgarian service was commended at the EU Ministerial Conference in Italy in July 2003) • Commercial register check up • Check up on social security contributions paid in by the companies and received by the employees – More than 20 e-government services will be provided by year 2005 • Latest requests for public procurement tenders, submitted by Bulgarian companies are currently available on the web site of the SME Agency • The process of introducing "one-stop-shop" desk in the municipalities is ongoing.
8	Improve the financial environment for SMEs including establishment of a credit guarantee scheme.	Done	For the last 9 months, lending policies of the banks have become more open. The number of the banks offering SME lending programmes has increased. New venture capital funds have started operations too. Bank loans for households and individuals rose by 66% and those for companies - by 51% in the 1st half of 2003. USAID guarantees the credit portfolio of the United Bulgarian Bank in the part dedicated to financing SMEs and efficient energy projects. Grants for SME projects are in the range USD5-150,000 and deadline - until Nov. 2004.

	Critical Time-bound Targets related to Entrepreneurship and SME Development	Status	Comment
9	Support innovation and technological development.	In Progress	Current development: • **The EU Phare project Consulting Services for SMEs and Technology Grant Schemes** aims at improvement of the Bulgarian SMEs competitiveness and their technological modernization. 25 July 2003 was the deadline for receiving letters of interest by SMEs. Technology grants will be in the range EUR 10-50,000.The project is running. • Under the **EU Phare project High-tech Business Incubators - Grant Scheme for R&D**, R&D projects will be carried out in Bulgaria by SMEs preferably working in one of the following sectors: IT; Telecommunications; Microelectronics and micro-mechanics; Biotechnology and pharmaceuticals; Genetic engineering; Medical and health technologies; Environmental protection and sustainable resources usage technologies; Chemical industries; Energy and power effectiveness. Grants are in the range EUR 10-50,000. The deadline for application submission is 24 Nov. 2003.
	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	**Status**	**Comment**
10	Amend the law on the protection of competition and adopt secondary anti-trust legislation.	Done	Amendments to the Law on the protection of competition were adopted in January 2003 (State Gazette No 9/31.01.2003) and came into force on 4 February 2003. They introduced a number of concepts of the EU rules and strengthened the investigative powers of the Bulgarian Commission for the Protection of Competition by introducing on-site inspections. The Law on the protection of competition contains now the main principles of the EC anti-trust rules as regards restrictive agreements, abuse of dominant position and merger control. In addition, secondary legislation in the form of two block exemptions for R&D agreements and specialisation agreements was adopted in June 2003.
11	Enact and implement the Law on State Aid in line with EU guidelines.	Done	New legislation consistent with EU directives was adopted in 2002.

Croatia

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
1	Conclude drafting and enact amended Investment Promotion Law.	In Progress	Passed first reading in the outgoing Parliament. As the deadline for a second reading has passed, the draft law would have to return to the new Parliament resulting from November 2003 elections and go through a complete process starting with a first reading. If the new government chooses to continue to pursue a new law, under optimistic assumptions a bill can be adopted, at the earliest, during the 2nd Quarter of 2004. *There is no evidence that there has been a systematic effort to consult representatives of international business community on the content of the draft law. This target has not been restated in the 2004 critical time-bound targets adopted by Croatia.*
2	Establish an Agency for Trade and Investment Promotion.	Done	The Agency has been established by a Government Decree in September 2002 *Despite the formal establishment of the Agency in September 2002 Croatia has lost a full year before making an earnest effort to make it operational, despite the availability of domestic budgetary funding as well as donors willing to provide support.* *However, there are signs that a real effort began in early November 2003 to make the Agency operational, with the appointment of a new Managing Director, as well as Management Board consisting of representatives of four ministries (Economy and SMEs, Finance, Foreign Affairs and Tourism) and three business representatives.* *The establishment of a fully functional Trade and Investment promotion Agency is a measure which is keenly monitored by the representatives of international business community and donors consulted by the IC in Croatia. Success in this area requires an effective mandate and adequate resources and would send a clear message on the Government's commitment to economic reform.*

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
3	Amend the Law on Protection of Market Competition to harmonise it with EU standards.	Done	The law on Protection on Market Competition has been enacted by the Croatian Parliament in July 2003. The Government maintains that it is fully harmonised with EU standards in this area. *While the international community consulted recognises that the text of the law is satisfactory, they also believe that Croatia needs to strengthen its enforcement record in the area of competition policy.*
	Critical Time-bound Targets related to Promotion of Private Investment	**Status**	**Comment**
4	Amend the Law on Free Zones.	In Progress	Passed the first reading in the Parliament. Preparations for the second reading in the Parliament under way. *There has been no change in the status of this item since the March 2003 edition of the MI. This subject has not been restated in the 2004 critical time-bound targets adopted by Croatia.*
5	Adopt the Law on Industrial and Technology Parks.	In Progress	The first draft was completed in the first half of 2003. However, given the policy standstill in the second half of 2003 and the change of government since then, the draft has so far not left the Ministry of Economy. *There has been no change in the status of this item since the March 2003 edition of the MI. This subject ha snot been restated in the 2004 critical time-bound targets adopted by Croatia for 2004.*
6	Further develop programmes to reduce administrative barriers to FDI.	In Progress	This commitment consists of the implementation of the Action Plan adopted by the Government on 14 February 2002, in line with the recommendations of the FIAS study. Numerous initiatives are at various stages of completion. *Representatives of the international donor community have expressed considerable disappointment with what was seen as a lack of commitment in this area by the previous government.*

	Critical Time-bound Targets related to Enterprise Development and SME Support	Status	Comment
7	Create favourable credit environment for entrepreneurship development.	Done	A number of favourable credit lines specially designed to foster entrepreneurship have been put in place: • A general purposes credit fund has been created by means of budgetary funds in co-operation with local government and commercial banks to support entrepreneurship. • Specific support is provided for export oriented entrepreneurs. • Favourable financing is provided for companies that introduce new technologies. • Financial support provided to small entrepreneurs in the tourism sector. The international development co-operation community consulted by the IC maintain that, although the government has put in place many loan guarantee programmes, most resources in this area are absorbed by large enterprises and, as such, are used to support “dying industries” or traditional sectors such as shipyards. Business and international observers are concerned that enterprise policy to date has not incorporated a strong emphasis on fostering innovation.
8	Develop institutional framework for SME support.	Done	• Established the **Croatian Agency for SMEs (HAMAG)**, which is in operation since 14 January 2003. • Provided financial and logistical support for the **Entrepreneurship Promotion Institutions**: • Entrepreneurial Centres • Entrepreneurial Zones • Entrepreneurial Incubators
9	Integrate with and carry out international programmes for SME development.	In Progress	Croatia has signed up to the EU Charter for Small Business and it is participating in the Charter implementation process. Croatia has also established a National Competitiveness Council, an initiative supported by USAID.

	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	Status	Comment
10	Implement competition law and legal, institutional and regulatory framework to enforce competition.	Done	A new Law on Protection of Market Competition (2003) established the Competition Council, headed by a President as the authority overseeing the Agency for Protection of Market Competition (APMC), which deals with the antitrust cases concerning the evaluation of concentrations and agreements among undertakings, and the prevention of anti-competitive practices. In addition, according to the State Aid Act (2003), APMC is responsible for administering state aid.
11	Further liberalise the energy market.	In Progress	• The Energy market is partially liberalised for certain categories of consumers; implementation is gradual. • Restructuring of the vertically incorporated enterprises is completed in conformity with EU directives in this area. • The Croatian Energy Regulatory Council has been established and started operation. • An Independent System Market Operator (ISMO) has been established and started operation.
12	Draft law on consumer protection through legislative procedures.	Done	The Consumer Protection Act has been adopted by the Parliament on 29 May 2003 and published in the Official Gazette No. 96/03.
	Critical Time-bound Targets related to Priorities related to Fighting Bribery and Corruption	**Status**	**Comment**
13	Adopt the Law on the Office for the Prevention of Corruption and Organised Crime.	Done	The law was adopted in October 2001. *This item was listed, although achieved at the time, as a target in the Monitoring Instruments of 2002-3.*
14	National Program For The Fight Against Corruption with Action Plan.	In Progress	The program is adopted and the implementation is in progress. This subject has been included in the 2004 critical time-bound targets adopted by Croatia for 2004.
15	Adoption of the Law on Prevention of Conflict of Interest in pursuance of public offices.	Done	The law was adopted on 16 October 2003.

FYR Macedonia

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
1	Improve the institutional framework for FDI promotion.	In Progress	The government has completed the elaboration of a new Programme for Stimulating Private Investment, with support of UNDP and MIGA, and prepared a strategic document outlining the government investment policy. The Programme includes a review of the system of incentives for foreign investors in line with a National Treatment approach and proposes the establishment of a new executive Investment Promotion Agency. The Law for the establishing new IPA is currently in Parliament for final approval, expected in the first quarter of 2004.
2	Abolish the tax on financial transactions (0.5% per transaction).	Done	Target fulfilled in December 2002.
3	Amend the Competition Law, lowering the threshold for prior notification of mergers and acquisitions to the Anti-Monopoly Act.	In Progress	The Monopoly Authority under the Ministry of Economy is elaborating amendments to art. 26-17-28 and 29 of the Competition Law, related to the minimum threshold required for the notification of mergers and acquisitions. There has been no further progress since the last edition of the Monitoring Instruments.

	Critical Time-bound Targets related to Promotion of Private Investment	Status	Comment
4	Improve the institutional framework for FDI promotion.	In Progress	See Most Crucial Target no. 1
5	Abolish the tax on financial transactions.	Done	See Most Crucial Target No. 2
6	Completion of the privatisation/liquidation programme for the remaining 40 loss making State Owned Enterprises.	In Progress	During 2003 a further eight companies belonging to initial list with the World Bank of 40 state-owned loss-making companies were sold. The list has been recently reviewed and now includes a total of 22 companies, to be sold or liquated by June 2004. All the remaining loss-making companies are disposed of through liquidation. The process has been so far managed by the Privatisation Agency, but as it is coming to an end, the

	Critical Time-bound Targets related to Promotion of Private Investment	Status	Comment
			government has decided to disband the agency and to transfer the management of the remaining stake holdings owned by the state in Macedonian companies to the State Pension Fund. The Privatization Agency is due to be closed down at the end of March 2004.
	Critical Time-bound Targets related to Enterprise Development and SME Support	**Status**	**Comment**
7	Elaborate a programme for the reduction of administrative barriers, focusing on company registration procedures and customs administration.	In Progress	The government is committed to implement the recommendations listed in a FIAS study on administrative barriers completed in 2002. A Steering Committee, co-ordinated by the ministry of economy has been established, but most of the recommendation are still to implemented.
8	Implementation of the recently approved SME strategy.	In Progress	The new Law on Agency for entrepreneurship has been recently enacted by the Parliament. The Law foresees the establishment of a new Agency for Entrepreneurship that will replace the previous Macedonian Development Agency.
9	Improve credit access for SMEs through the establishment of a Micro-finance Bank.	Done	The Pro-Credit Bank, specialised on micro lending entered into operations in 2003, after a long gestation period. The bank has a capital of USD 8 million. The shareholders are KFW, IMI, the IFC and the EBRD. As the Pro-Credit Bank has only recently commenced it is too early to assess its impact on the credit market.
	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	**Status**	**Comment**
10	Introduce amendments to the competition law lowering the threshold for prior notification of mergers and acquisitions to the Anti-monopoly Authority.	In Progress	See Most Crucial Target No. 3
11	Establish a regulatory agency for the energy sector in view of this sector's privatisation.	Done	The Energy Regulatory Commission was established by the Macedonian Parliament in June 2003 as an independent body, in

			charge of determining the tariff regime for the regulated energy supplies, defining the conditions for access to the public energy infrastructure, granting licenses, disputes settlement between companies or other parties regarding shared energy resources and services that are under regulated regime, etc. The establishment of the energy regulatory is a key step in preparation for the privatisation of the state power company (ESM). The company is currently under a phase of restructuring while the government is finalising its privatisation strategy.
	Critical Time-bound Targets related to Priorities related to Fighting Bribery and Corruption	**Status**	**Comment**
12	Obligation to declare participation in private companies by government members.	Done	New regulations requiring the disclosure of any participation held by government members in a private company were introduced at the beginning of 2003 as part of the government anti-bribery and corruption plan. The regulations are currently been applied.

Moldova

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
1	Submit to Parliament new FDI Law, incorporating "national treatment" concept and revised investor incentives.	In Progress	Following a first review by the Council of Ministers in July 2003, at the end of November 2003, the Ministry of Economy, in co-operation with the Ministry of Finance, completed the elaboration of the new draft of the Investment Law, incorporating the concept of national treatment, through a progressive phasing out of positive and negative discriminatory measures affecting foreign investors, and with the intention of extending the system of guarantees and the level of protection granted to private direct investors. *In December 2003 the Ministry of Economy sent the draft for advice and consultation to the International Organisations, including the World Bank Group (IFC and FIAS), the IMF and the OECD and to the organisations representing the private sector in Moldova, with the aim of completing the consultation process in January 2004. Substantial revision of the law was deemed necessary in order to meet international good practice and the OECD Investment Compact in cooperation with FIAS and IFC provided advice and suggestions here. The law will be submitted for parliamentary approval in early 2004 (advised as 'entered into force' on 23/3/2004).*
2	Implement new Civil Code to provide a stable legal framework regulating commercial contracts and transactions.	Done	The new Civil Code was adopted by parliament in June 2002, however its coming into force, initially planned for the 1st of January 2003, was delayed, waiting for the approval of a new Law on Court Procedures. Finally, with Law No. 1125-XV of June 13, 2003 the Parliament approved the coming into force of the new Civil Code as from July 12, 2003. *While the target is rated as 'Done' insofar as the parliament has approved a bill there remains substantial work in dealing with related legislation and implementation.*
3	Put into operation Competition Agency: appoint agency head, senior staff and allocate budget.	Not Done	The Law establishing the Competition Protection Agency was adopted by Parliament in June 2000. However, the implementation of the new law has since then been stalled due to delays

			in the nomination of the chairman and general director of the new agency and lack of a budget allocation. *At the beginning of 2003 the government considered to bring under the new agency the independent sector regulators (energy, telecoms). The International Financial Institutions and the business community raised concerns over a possible limitation of the independence of the sector regulators and later the government dropped the proposal. Since then there has been no new development concerning the establishment of the competition agency.*
	Critical Time-bound Targets related to Promotion of Private Investment	**Status**	**Comment**
4	Update the legal and institutional framework for FDI.	In Progress	See Most Crucial Target No. 1
5	Enact a stable tax policy for private investment; review the current incentives system to eliminate exceptions to national treatment.	Done	The government is committed to ensuring the stability of fiscal system and the forecasting of state income. Currently the fiscal legislation provides tax incentives specially targeted to foreign investors. The new Investment Law will introduce National Treatment, with a progressive phasing out of the special regime for foreign investors.
6	Improve pre- and post- privatisation procedures by amending the privatisation law and reviewing privatisation contracts.	Done	In March 2003, the parliament approved a number of amendments and improvements to the Privatisation Law, in relation to the privatisation procedures, to post privatisation audits and the terms and conditions for the renegotiation of the privatisation contracts. *Although the amendments made the privatisation process more flexible, investors still complain that the post privatisation audits and contractual obligations remains too heavy and they are deterring new investors from bidding for state assets.*
	Critical Time-bound Targets related to Enterprise Development and SME Support	**Status**	**Comment**
7	Complete a study of administrative barriers and develop a policy and action plan to reduce barriers to business development.	In Progress	The government has requested FIAS to conduct a study on administrative barriers to private investment, as a first step towards developing a government plan for improving the regulatory framework. FIAS and the government have identified the sources for the financing of the study that should take place in 2004.

	Critical Time-bound Targets related to Enterprise Development and SME Support	Status	Comment
8	Reform the business inspection system and increase transparency of business regulations.	In Progress	The government has introduced in April 2004 new regulations concerning the number of inspections per company that can be carried out by the tax administration and other state inspectorates, limiting the number of tax inspection to once very two years and those of other state bodies to one a year. *Private sector organisations have long complained of frequent inspections with no specific objective, other than to extract bribes, impose fines and interfere with private companies operations. The new government regulations appear to date to have add only a limited impact in the way the state inspectorates operates.*
9	Complete initial feasibility study for the establishment of a credit guarantee scheme.	In Progress	Moldova established in 1993 a state Fund for Support of Entrepreneurship and Small Business Development, which is entitled to provide credit guarantees to small business. However, due to the lack of funding and the lengthy approval process, the impact of the Fund is limited. The government has conducted a review of the Fund operations and made some changes in the guarantee approval process and it is considering establishing a larger credit guarantee facility, managed either by the Fund or by a new ad hoc institution.
	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	**Status**	**Comment**
10	Draw up sectoral strategies for regulated sectors as required under the World Bank Structural Adjustment Credit.	In Progress	The drafts of the sectoral strategies have been developed by the respective ministries and submitted to the Ministry of Economy to be later included in the new Strategy for Poverty Reduction.
11	Put into operation the new agency dealing with consumer protection and competition issues.	Not Done	See Most Crucial Target no. 3

	Critical Time-bound Targets related to Priorities related to Fighting Bribery and Corruption	Status	Comment
12	Obligation of income and property declaration for all public servants.	Done	New Parliament regulations require that all high level public officials and members of the government have to declare their personal income and private property.
13	Creation of the Centre for Anti-corruption and Economic Crimes.	Done	The Government Decision No. 335 of 11.02.2002, Official Journal of RM, No. 24-25 of 14.02.2002 established the Centre for Anti-Corruption and Economic Crimes and ordered the disbanding of four financial and economic state control bodies. *However, the impact of the Centre appears to have been very limited. According to the private sector companies they complain that the creation of the centre led to an increase in company inspections and controls (over 4000 in 2003), while bribery and corruption remain widespread.*

Romania

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
1	Establish and put into operation Romanian Agency for Foreign Investments (ARIS).	Done	In order to promote the Romanian investment climate, ARIS conducted an awareness campaign in order to attract foreign investors. ARIS created a website -- www.arisinvest.ro -- and also got involved in the creation of a CD-ROM concerning "Romania's Investment Guide". ARIS website contains general information for foreign investors interested in joint projects with Romania. According to statistical data provided by the eight local Romanian Development Agencies, between October 2002 and June 30, 2003, there have been 206 registrations of new foreign investments in Romania, for a total amount of USD 1.812 billion. Out of those 206, 70 have been finalized (having a total amount of USD 622 million). Between August 2002 and the end of June 2003, 87 investments have been finalized, for a total amount of USD 837 million. The main fields of interest for foreign investors are energy, telecommunications and metallurgy. According to the National Office of the Trade Registry, by August 31st 2003, the number of companies with foreign direct investment was 94,761, compared to 90,378 at December 31st 2002. The increase is 4.6% in the number of foreign direct investment companies, for the first 8 months of the year. Also, according to the same document, the increase of investment in USD was of 8.7%, the highest month being July 2003 with 3.7%. In order to improve the relationship between foreign investors and the Romanian business environment, ARIS created a Consultative Council that would analyze and promote reform for the Romanian private sector. This Consultative Council is also involved in the elaboration of the strategy for the promotion of foreign investments in Romania, and in finding solutions to special cases related to foreign investment that could arise. The Council is formed by the Foreign Investor's Council, The Association of Foreign Investors in Romania, the Romanian National Bank, The Romanian Commercial

			Bank, Employer's Association, Professional Associations, The National Council of SMEs, and the Romanian Regional Development Agencies. This Council is mainly working on attracting foreign investors in Romania and implementing best practices in this field. Dialogue with the private sector was substantially encouraged by two Government retreats, led by the Prime Minister, at which investors had full opportunity to meet Ministers and express views on reforms needed. Many investors took the opportunity to express their positive views on progress made and confirm their plans for continued investment.
2	Ensure the full operation of the recently established National Credit Guarantee Fund for SMEs.	Done	The Fund was effectively created through Government Ordinance 1211/2001, as commercial company, having one shareholder, the Romanian State. The Romanian State was represented by the Ministry of SMEs. The social capital for 2002 has been ROL 194 billion. For the current year, the amount is ROL 294 billion and the estimation for 2006 is ROL 1,200 billion. The Fund's mission is to support the development process for the SME sector in Romania by facilitating SME access to financing instruments offered by commercial banks and other financing institutions. The main activity consists of guaranteeing credits or other financial instruments that SMEs can obtain from commercial banks and other financing institutions. The Fund has also additional activities, such as: technical consultancy; operational assistance and consultancy for business; management and business consultancy; create and disseminate IT programs, and management programs for data related to the business field. Currently, the Fund has ten regional offices, in the main geographical and business developed areas. The Fund management board intends to create one regional office in each of Romania's counties - meaning a total number of 42 offices (including Bucharest). This measure is aimed at providing direct and quick support to the representatives of the SME sector in Romania. Initially, the Fund has signed a convention with 9 Romanian banks that are providing credits for SMEs. The number of banks that have signed a convention with the Fund increased to 12, the new three being ROMEXTERRA, Romanian International Bank - RIB and Eurom Bank.

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
			Managed by former SME Minister, the Fund has its own website, which is www.fngcimm.ro. The Fund is currently charging varying commissions for different types of guarantees offered. This measure was imposed in order to maintain the Fund among the competitive institutions acting in this field on the market. The commissions vary between 1.5% and 3.5%, according to the reimbursement deadline and the guarantee currency. The amounts in EUR guaranteed by the Fund for 2003 vary between 75,000 and 400,000, depending on the type of juridical person interested. The procedure includes between 7 and 25 analysis days of the project file complexity before a final decision is transmitted to the bank.
3	Adopt implementation procedures for the new VAT Law.	Done	Over the years Romania introduced a number of laws and regulations concerning the application of VAT. The VAT law was amended in 2002 (law 345/2002), with new application norms introduced in June 2002, followed by three supplementary norms (Ordinance 36/2003, Governmental Decision 22/2003 and 348/2003). Given all those change, the government decided in September 2003 to review and update the basic VAT law. However, the previous Ordinance and Governmental Decisions have not been abrogated and therefore the complexity of the VAT regime has not really improved. The current legislation allows for two different VAT Refund procedures, including a Fast Track system that eliminates the prior control of the Ministry of Finance at the firm's headquarter. Unfortunately, companies have so far made little use of the fast track system, introduced to cut the time required to process VAT refunds, given the need to provide a personal liability statement that may be questioned in future by tax inspectors.
	Critical Time-bound Targets related to Promotion of Private Investment	**Status**	**Comment**
4	Set up the Romanian Agency for Foreign Investments (ARIS).	Done	See CTT Most Crucial Target No.1 above

	Critical Time-bound Targets related to Promotion of Private Investment	Status	Comment
5	Introduce a new corporate tax law and adopt and enforce the related implementation procedures.	Done	Law 414/2002 passed on June 26th, 2002 replaces Government Ordinance 70/1994 and is the current act regulating corporate tax since July 1st, 2002. Government Decision 859/2002 covers the methodology of implementation and enforcement of Law 414, such that since its passing, the new regulations are fully functional and applicable in Romania. *The current Corporate Tax Law is 414/2002. It is still enforced until the new Fiscal Code is implemented. The Fiscal Code draft contains all provisions related to corporate tax (Chapter 2, articles 13 to 18), and to the taxable profit (Chapter 3, articles 19 to 28).* *The Fiscal Code draft was approved by the Romanian Government in its session of October 2nd, 2003. It entered the Romanian Senate on October 24, and was adopted by the Senate on its session on November 28, 2003. It entered the Chamber of Deputy on November 29, 2003 and was published in the Official Gazette on December 23rd 2003. The Fiscal Procedure Code was published on December 29th 2003 and will enter into force on January 1st, 2004 .The enforcement date of the Fiscal Code is January 1st 2004. The implementation norms will be adopted in early 2004.*
6	Introduce a new labour code and adopt and enforce the related implementation procedures.	Done	On December 18, the Labour Code was modified by law 541/2003, introducing an amendment on the Labour Books: they will be preserved until 2007. *The Romanian Labour Code has been adopted on January 24, 2003. It has been adopted by law 53/2003. It has been enforced on March 1st, 2003. Several decisions and ordinances of the Romanian Government followed its implementation. Those normative acts are meant at clarifying the interpretations of the Labour Code, in order to make it more accessible to the public and therefore, easier to implement. For the moment, the representatives of the business environment have made several propositions related to the update of the Labour Code. Both representatives of the domestic and foreign investors (For additional details see - the Position of the members of the American Chamber of Commerce in Bucharest concerning the Romanian Labour Code, and the Addition to the White Paper of the*

	Critical Time-bound Targets related to Promotion of Private Investment	Status	Comment
			Foreign Investors Council in Bucharest) in Romania agree that the Labour Code still needs improvement. There are several major issues that need reform, in order to make the Romanian labour market attractive for investors. *The bureaucracy remains substantial - e.g. the paperwork concerning monthly data that the employer has to provide to Labour public institutions. Another issue is related to some restrictive provisions for the employers (the impossibility of dismissing personnel on the basis of profit optimisation reasons, the impossibility of exceeding 48 hours payment per week, - overtime included - the obligation to pay a premium to employees who agree to a non competition clause, etc). It is necessary to amend the Romanian labour code, in order to really improve the Romanian business environment.*
	Critical Time-bound Targets related to Enterprise Development and SME Support	**Status**	**Comment**
7	Render fully operational the recently established National Credit Guarantee Fund for SMEs.	Done	See CTT Most Crucial Target No. 2 above.
8	Implement export assistance for the SME sector.	Done	Government Decision 840/2002, issued on July 31st, established the national multi-annual programme for export assistance for SMEs for 2002-2005. Under the programme, eligible SMEs can receive subsidies of maximum 80 million lei (out of the 20 billion allocated yearly), for such activities as participating at international fairs, publishing advertising materials, building an Internet site, attending training programmes in the field of export promotion, and similar activity. The SMEs must contribute to the respective action with at least 40% of the total cost. The Government Decision awarding the funds for 2003 is currently finalized and ready to be published. The Romanian Government is conducting - under the authority of the Ministry of Economy and Trade - an export promotion programme. One component of this program is the Export Assistance for SME.

			The program was created through the Government Ordinance 64/2003, concerning the approval of mechanisms related to financial support from the State budget necessary for the enforcement of the promotion program for SMEs. The implementation procedure for this programme is created by the Order 35/February 19, 2003 that sets in its annex all necessary elements to a good development and implementation of the program. The Order presents the Guide for the implementation of this programme that contains all details related to the development of the programme. Although developed by the Ministry of Economy and Trade, the National Agency for SMEs is strongly involved in all procedures and steps described in this above mentioned guide. *This programme had only 20 billion ROL allocated for 2003, from a total of 50 billion ROL that had been initially allocated to this activity. The first meeting of the Consultative Committee for the Development of SMEs held on October 10th 2003, did not emphasize enough the importance of this project and the advantages that it could bring for the sector itself.*
	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	**Status**	**Comment**
9	Strengthen the judicial system with regards to bankruptcy procedures and banking operations.	In Progress	A new Law of bankruptcy in the banking sector, as well as a new Banking Law are both included in the legislative agenda for 2003. On January 1st, 2003, Regulation no. 7/2002 regarding the new loan classification guidelines became applicable. In April 2003, the new safety regulations regarding credit cooperatives (establishing stricter solvency and exposure benchmarks as well as rules for lending to borrowers in special relation with the cooperative) will become fully applicable. *The law dealing with bankruptcy was issued in 1995, law 64. It was then modified by Government Ordinance 38/2002, in order to adapt the legislation to the Romanian business environment evolution. According to the Romanian Ministry of Justice, there is still need for improvement in this field of activity. As a consequence, on the Ministry of Justice website, a new proposition of amendments to the bankruptcy law was posted. Comments and suggestions from interested parties in this matter are welcomed. For the moment, the law is not yet adopted. Among the advantages of adopting a*

	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	Status	Comment
			new bankruptcy law, the acceleration and streamlining of the judicial reorganization of bankruptcy seems one of the most important.
10	Apply corporate governance principles to the remaining state-owned enterprises and public sector companies.	In Progress	APAPS (Privatisation Agency) convened a working group between February 16th and 23rd in order to finalize the Government Ordinance project regarding the application of corporate governance principles to the state-owned enterprises and public sector companies. *Introduction of corporate governance procedures to the remaining state-owned enterprises and public sector companies continues to be on the top priorities list of the Romanian Government. It has been part of the Government's Action Plan for the improvement of the business environment for the last two years. It is still part of the Action Plan, under section IV, point 15: Implementation of the corporate governance principles*[4]. *The plan for 2003 was for the APAPS to finalize the draft regulatory acts concerning the approval of the corporate governance and administration contract principles by the end of May, and to submit this draft for public debate by June 2003.The first draft prepared in 2003 was withdrawn from the Romanian legal procedure, in order to be re-drafted and adapted to the current internal Romanian situation.* *Currently, there is a second proposition of normative act issued by the same institution - APAPS - that is under consultation within Romanian Ministries. (i. e. it entered the Romanian Ministry of Industry and Trade on November 20th, 2003).* *Approval of those principles before the end of 2003 seems now hardly possible.*
11	Adopt measure to resolve post-privatisation disputes.	Done	Government Ordinance no. 40, adopted on February 2, 2003, modified Ordinance no. 25/2002 which regulated the execution of privatisation contracts. The new regulations, among others, clarified the aspects of resolving post-privatisation disputes,

4 In the Government's Action Plan, this point appears under the heading "Measures from the Plan of Actions for 2002, in various implementation stages".

			meeting most of the requests submitted by the Foreign Investors Council and other organizations. *The measures that would resolve post-privatization disputes are contained in the law 137/2002, adopted on March 28, 2002. Chapter VII on this law mentions the way of resolving disputes in privatization cases. The law mentioned above was amended by the Ordinance 208/2002 that modifies, among others, articles 40 and 41 of Chapter VII.* *Currently there is no special law treating post-privatization issues. They are just mentioned within other normative acts dealing with privatization, for example the two mentioned earlier. The Government Ordinance 269/2000, dealing exclusively with post-privatization issues, was rejected by law 23, in 2002. It is therefore no longer enforced.*
	Critical Time-bound Targets related to Priorities related to Fighting Bribery and Corruption	**Status**	**Comment**
12	Establishment of an institutional and legal framework for fighting bribery and corruption.	Done	The National Committee for the Prevention of Crime, set up by GD no. 763/2001, is in charge of devising, integrating, correlating and monitoring the Government policy for crime prevention at national level. Within this Committee, a Central Group for Analysis and Coordination of Corruption Preventing Activities was created, with the following main objectives: monitor the implementation of corruption preventing programs; develop inter-institutional cooperation and the relation with the civil society; build a database; and inform the National Committee for the Prevention of Crime. This Central Group set up within the Committee will assure the implementation and will monitor the National Program for the prevention of corruption, as well as the National Plan of Action against corruption, both adopted in December 2001. The Group operates under the chairmanship of the Head of The Prime Minister's Control Department. On December 12th, 2002, the Government adopted a set of Measures for the Acceleration of the National Strategy against Corruption. Through Emergency Ordinance no. 43/2002, issued on April 4th, the National Anti-Corruption Prosecutor's Office (PNA) was

Critical Time-bound Targets related to Priorities related to Fighting Bribery and Corruption	Status	Comment
		established, as a specialized department attached to the Supreme Court Prosecutor's Office. The Prosecutor's Office began operating on September 1st, 2002, and has regional offices all over the country. PNA currently has exclusive investigation and prosecution authority over corruption-related crimes. *In 2001, the Romanian Government decided to strengthen its fight against corruption. It started its activity by a Governmental Decision, 1065/2001 - published in the Official Gazette on November 15th 2001, presenting the National Action Plan to fight corruption adopted by the Romanian Government and also the National Program for corruption prevention. The programme contains a component focusing on the legal framework. This component is aimed at streamlining the legal framework, at placing the legal framework on the codes basis, and on adopting specific normative acts that would create the legal basis for all preventive measures on corruption.* *The institutional framework is also supported by several normative acts that have been adopted in Romania, and are aimed at helping eliminate corruption: The Law Anti-corruption 161/2003, the Law 39/January 20, 2003, concerning the prevention and the fight against organized crime, The Penal Convention concerning corruption - adopted by a total of 42 states and also by Romania, and the law 78/2000, concerning finding, sanctioning and also preventing corruption acts*[5] *(There is currently a project for the amendment of law 78/2000, in order to update it to all requirements and necessities to fight corruption).* *An MoU on this subject between the OECD and Romania, signed in 2002, is being reviewed with the aim of revitalising action in 2004.*

5 There is currently a project for the amendment of law 78/2000, in order to update it to all requirements and necessities to fight corruption.

Serbia and Montenegro: *Serbia*

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
1	Simplify the acquisition of construction rights.	Done	The process of acquisition of construction rights has been simplified. The documentation required for the issuance of construction permits has been reduced to a single document. In addition, the law on planning and construction has been adopted on April 22, 2003. However, the area of construction rights would however require further improvements regarding notably the transfer of construction rights and their conversion into land ownership.
2	Enact economic legislative reforms: Laws on Concession, Secured Transaction, and International Arbitration.	In Progress	Concession Law: The law has been adopted on May 27, 2003 Adoption of Secured Transaction Law: The Law has been adopted on May 27 2003 International Arbitration Law : A draft has been prepared but has not been yet submitted to the parliament. This matter relates to the difficult economic and legal harmonisation process between the Republic of Serbia and the Republic of Montenegro and is in discussion at the Union Level.
3	Simplify incorporation and registration procedure.	In Progress	A draft law has been prepared but has not yet been submitted to the parliament. The adoption of the law on registration of business entities has been selected as a priority target once again for 2004.
	Critical Time-bound Targets related to Promotion of Private Investment	**Status**	**Comment**
4	Simplify the acquisition of construction rights.	Done	The process of acquisition of construction rights has been simplified. The documentation required for the issuance of construction permits has been reduced to a single document. In addition, the law on planning and construction has been adopted on April 22, 2003. The area of construction rights would however require further improvements regarding notably the transfer of construction rights and their conversion into land ownership.
5	Enact economic legislative reforms: Laws on Concession, Secured Transaction, and International Arbitration.	In Progress	See CTTs Most Crucial Target No.2

	Critical Time-bound Targets related to Enterprise Development and SME Support	Status	Comment
6	Establish a credit guarantee fund for SMEs.	Done	A credit guarantee fund for SMEs has been established on May 27 2003. However, the extremely low level of fund available does not allow for making it fully operational.
7	Introduce tax facilities for SME start-up.	Done	A number of tax facilities have been introduced which benefit SMEs. A tax credit of 40% of investments in fixed assets in a given year, and up to 70% of total tax, has been introduced for "small" enterprises, which includes SMEs. However, no comprehensive strategy and set of tax facilities exists for SMEs.
8	Improve dissemination of information on institutional support to SMEs.	Done	The Agency for the Development of SMEs and Entrepreneurship has established a network of ten regional agencies to better address the need expressed by SMEs for better information on the current and future institutional support available.
	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	**Status**	**Comment**
9	Draft and enact an effective competition law.	No Progress	No progress has been made in this area, however it is considered crucial by foreign and domestic investors alike. Due to the difficult economic and legal harmonisation process between the Republic of Serbia and the Republic of Montenegro Serbia and Montenegro it is currently stalled.
10	Simplify the procedures for creation and registration of enterprises.	In Progress	See CTT Most Crucial Targets No. 3
	Critical Time-bound Targets related to Priorities related to Fighting Bribery and Corruption	**Status**	**Comment**
11	Adoption of the Law on Public Procurement, the Law on Tobacco, the Law on the Agency for Security and Information and the Law on Tax Administration and tax procedures.	Done	The laws on tobacco, on the Agency for Security and Information and on the tax administration and tax procedures have been adopted respectively on February 25 2003, March 19 2003, July 10 2003. However, the law on public procurement has not been adopted yet. The area of public procurement requires further improvement regarding possible conflicts of public and private

			interest in the performance of public positions. The adoption of the draft law on avoiding conflict of interest has therefore been selected as a priority target in the 2004 Monitoring Instruments. Also, the establishment of the Agency for Security and Information will be reinforced by the formation of an Anti-corruption Agency entitled to sanction breaches in anti-corruption provisions which is listed as priority target in the 2004 Monitoring Instruments.
12	Strengthening of the actions taken under the Law on organisation and authority of state institutions in fighting organised crime.	Done	The number of staff involved in fighting organised crime has been increased while the use of IT technology has been introduced. Following the assassination of the former Prime Minister Z. Djindjic, numerous successful operations have been conducted against organised crime.
13	Adoption of a set of laws to improve the judicial organisation.	Done	Several amendments to the existing legislation have been passed since March 2003 regarding the Law on Court Organisation, Law on Judges, Law on Public Prosecutors Office, Law on High Judicial Alliance, Law on Court and Public Prosecutors seats and districts.

Serbia and Montenegro: M*ontenegro*

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
1	Adopt a new strategy for FDI, following the approval of Law on FDI, targeting in particular the tourism sector	In Progress	The Strategy for FDI has not been adopted yet as it is still to be commented on by some international institutions. The adoption of the strategy should take place in the first quarter of 2004. However, the Republic of Montenegro has adopted a Master Plan for Tourism which is expected to be the main driver of economic growth and around which the new FDI strategy should be articulated.
2	Establish local business centres and incubators, innovation centres and technology parks	Done	Following the establishment of a European information centre in May 2002, 3 three regional and two local business centres have been established and are now operational. While four more regional centres are planned and the project to set up the business incubators has been adopted for implementation in 2004.

	Critical Time-bound Targets - Most Crucial Targets	Status	Comment
3	Ensure implementation of newly approved legislation affecting the business sector	Done	The Company Law, Bankruptcy Law and the Law on Public Procurement have been implemented. Interested staffs have received special training on how to best implement these laws. As far as the bankruptcy law and the law on public procurement, the private sector has been involved in the implementation process to further ensure the effectiveness of these legislations. However, the adoption on January 15 2003 of the VAT Law and its successful implementation remain an impediment in the area of Serbia - Montenegro business operations due to the absence of VAT in Serbia. The harmonisation of VAT rates might be another challenge to the economic and legal harmonisation process of the two republics.
	Critical Time-bound Targets related to Promotion of Private Investment	**Status**	**Comment**
4	Adopt a new strategy for FDI, following the approval of Law on FDI, targeting in particular the tourism sector	In Progress	See CTT Most Crucial Target No.1
5	Identify strategic priorities for the Agency for Economic Restructuring and Foreign Investment Promotion.	Done	The strategic priorities of the Agency have been established and are being implemented. They include notably the accounting and payment system reform the setting up and development of a “quality system”, legislative activities, public campaign and education. It also includes foreign investment and promotion activities where substantial improvement have been made through the development of investment promotion tools building on the best practices of other SEE and CEE countries.
	Critical Time-bound Targets related to Enterprise Development and SME Support	**Status**	**Comment**
6	Implement recently approved laws (enterprise law, set of tax laws, public procurement law, labour law, bankruptcy law).	Done	The Company Law, Bankruptcy Law and the Law on Public Procurement have been implemented. Interested adminis-trative staffs received special training to best implement these laws, and regarding bankruptcy and public procurement, the private sector was involved in the implementation process. In the area of labour law, interested administrative staffs have

			received appropriate training. The Law on VAT is in force since January 15, 2003, and six tax laws harmonised with EU legislation have been adopted.
7	Improve operational and institutional support for SMEs by establishing 7 local business centres.	Done	The operational and institutional support to SMEs has been improved through the establishment of three regional business centres, two local business centres which are operational, while four more regional business centres are already planned and the project to set up the business incubators has been adopted for implementation in 2004.
8	Conduct training programmes for entrepreneurs and financial institution officers.	Done	Management training programmes have been implemented for the staff of regional and local business centres for both new and current managers of SMEs. Training and development programmes for the European Information Centre and the SME Development Agency are underway.
	Critical Time-bound Targets related to Public and Private Governance (including Competition Policy and Regulatory Reform)	**Status**	**Comment**
9	Implement the recently approved Enterprise Law.	Done	The law has been implemented and interested administrative staff are receiving special training.
10	Adopt the Competition Law drafted by the Ministry of Economy, Ministry of Finance and the Legislative Secretariat.	In Progress	The adoption of this law is part of the difficult economic and legal harmonisation process between the Republic of Serbia and the Republic of Montenegro, Serbia and Montenegro and is currently stalled, notably on this issue.
11	Reduce the grey economy through legislation on money laundering and employment and strengthen the customs and tax administrations.	Done	The Anti-Money laundering law has been passed on September 24, 2003. The government employment project has been adopted on April 2003. So far, more than 8,000 new jobs have been created and around 18,000 illegally employed persons have been legalized through this program. The Agreement on Customs Cooperation and Mutual Assistance with Serbian Customs Administration has been implemented and contributes to reduce grey economy.

	Critical Time-bound Targets related to Priorities related to Fighting Bribery and Corruption	Status	Comment
12	Adoption of the Anti-corruption Law.	In Progress	The Law on Anti-corruption is in parliamentarian procedure.
13	Adoption of the Law on Money Laundering.	Done	The law has been passed on September 24, 2003. The implementation is in the initial phase and it is too early to comment on its efficiency. However, the creation of sub-legal acts on establishing the Administration for preventing money laundering and the appointment of its director are ongoing.
14	Reinforcement of the institutional framework for fighting bribery and corruption.	Done	The Anti-Money laundering law has been passed on September 24, 2003. The Agreement on Customs Cooperation and Mutual Assistance with Serbian Customs Administration has been implemented and contributes to reduce grey economy, and the Law on Anti-corruption is in parliamentarian procedure.

5. SUMMARY OF NEW CRITICAL TIME-BOUND TARGETS FOR 2004

Table 3 - Summary of Critical Time-bound Targets - Most Crucial Targets[6]

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Romania	Serbia and Montenegro	
								Serbia	*Montenegro*
1	Establishment of the Credit Guarantee Fund for the SMEs	Design and streamline company registration process throughout the State.	Adoption of the Law on Investment Promotion.	Develop industry clusters in the wood, textile and metal sectors.	Implementation of the Government Program for stimulating investments.	Review and update the legal framework according to the Civil Code.	Enforcement of the new Fiscal Code and the related implementation procedure.	Adoption of a National Strategy for Attracting FDI.	To obtain the approval by the Government of the Republic of Montenegro of the National Strategy on FDI by FIAS and adoption of the Strategy.
2	Establishment of the independent Authority for Competition	Adopt an export promotion strategy.	Elaboration of the National Investment Promotion Strategy.	Develop in co-ordination with local (regional) governments and throughout the country, a data base on commercial locations which enable defined ownership of commercial property.	Start-up of a new Agency for foreign investment promotion.	Establish the mechanism of permanent cooperation/ consulting with Foreign Investors Council (FIC).	Simplifying the actions regarding the process of registration and authorisation of SMEs. Exercising periodical (annual) surveys to monitor and evaluate the impact of the governmental regulations on business environment aiming to reduce the administrative barriers at the firms' entry/exit on the market.	Adoption of the Bankruptcy Law.	Implementation of the Project: "Competitiveness enhancement of domestic enterprises".
3	Establishment of the Public Information Offices within public institutions.	Fully implement the Law on indirect taxation.	Adoption of the Law on Entrepreneurship Promotion.	Fully enforce the new Construction Law.	Changes in the Law on Investment Funds for facilitation of the foundation procedure and introduction of tax incentives for attracting foreign investment funds specialized for "emerging markets".	Update the Fiscal Code Title I and II in order to extend the corporate tax incentives to national investors, according to the new draft law on investments.	Penal liability of the legal persons to be put into force with the implementation of the new penal code.	Adoption of the Foreign Trade Law.	Adoption of Moneyval (Committee of the Council of Europe for anti-money laundering) measures to fight money laundering.

6. The numbering of the Critical Time-bound Targets does not denote an order of priority. It has been included for ease of reference in future monitoring.

Table 4 - Summary of Critical Time-bound Targets related to Promotion of Private Investment in 2004[7]

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Romania	Serbia and Montenegro	
								Serbia	*Montenegro*
1	Improving and simplifying the procedures for the construction permits in order to reduce the administrative barriers for businesses.	Design and streamline company registration process throughout the State.	Adoption and implementation of a new Investment Encouragement Law.	Develop in co-ordination with local (regional) governments and throughout the country, a data base on commercial locations which enable defined ownership of commercial property.	Implementation of the Government Program for stimulating investments.	Final adoption of the law on investments and elaboration of the mechanisms for implementation.	Strengthening the cooperation between the public institutions and the private sector.	Adoption of the Law on Investment Fund.	To obtain the approval of the National Strategy on FDI by FIAS and adoption of the Strategy by the Government of the Republic of Montenegro
2	Drafting and approving the special law for the arbitration, to be used in the conflicts solutions.	Adopt an export promotion strategy.	Preparation of an Investment Promotion Strategy	Develop industry clusters in the wood, textile and metal sectors.	Start-up of a new Agency for foreign investment promotion.	Update the Fiscal Code Title I and II in order to extend the corporate tax incentives to national investors, according to the new draft law on investments.	Enforcement of the new Fiscal Code and the related implementation procedures.	Adoption of amendments to the Company Law.	Improve the institutional framework for FDI promotion.
3	Implementation of the concession contract for the construction of the new terminal of the Tirana International Airport "Mother Tereza", in the amount of around USD 100 million.	Further develop programmes to reduce administrative barriers to FDI.	Improvement of the regional services for investors. Preparation of Investment Services handbook.	Improve competitiveness in the wood, textile and metal industry sectors.	Changes in the Law on Investment Funds for facilitation of the foundation procedure and Introduction of tax incentives for attracting foreign investment funds specialized for "emerging markets".	Establish the mechanism of permanent cooperation/ consulting with Foreign Investor Council (FIC).	Ensure the compliance of the investment legislation with the EU regulations.	Adoption of a National Strategy for attracting FDI.	Improvement of capacities in the area of policy development for FDI promotion.

7. The numbering of the Critical Time-bound Targets does not denote an order of priority. It has been included for ease of reference in future monitoring.

Table 5 - Summary of Critical Time-bound Targets related to Enterprise Development and Small and Medium-sized Enterprise Support in 2004

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Romania	Serbia and Montenegro	
								Serbia	*Montenegro*
4	Establishment of the Credit Guarantee Fund for the SMEs.	Ensure financial support and incentives for SMEs.	Improvement of the legal framework for the SMEs activities	Develop an action program for facilitating innovation in SMEs.	Implementation of the Government Program for measures and activities for development of entrepreneurship and foundation of competitive SMEs.	Participation of Moldova in the activities of European Charter for Small Enterprises.	Simplifying the actions regarding the process of registration and authorisation of SMEs.	Adoption of the Law on Registration of Business Entities.	Implementation the Project: "Competitiveness enhancement of domestic enterprises".
5	SME Performance Monitoring System according to the EU standards.	Adopt a new SME Law in the Federation of BiH.	Strengthening the administrative capacity of the institutions providing services to SMEs	Create a policy framework to support schools for craftsmanship and develop the education of craftsmen.	Adoption of legislation for credit - guarantee funds in Macedonia.	Elaboration of the draft law on micro-financing institutions.	Development of a new entrepreneurial attitude.	Adoption of the Bankruptcy Law.	Elaboration of a programme of reduction of administrative barriers to SMEs in four areas: company registration, business management, employment and business wind up; and to reduce tax and contribution applicable to SMEs.
6	Establishment of the Donors Forum for supporting the SME development in Albania.	Reduce regulatory burdens on business.	Mid-term review of the implementation of the National Strategy for SME Promotion 2002-2006 and its upgrade to National Strategy for Entrepreneurship Development.	Establish a central craftsman register.	Foundation of institution for micro financing of start up businesses.	Re-examination of the list of paid services that inspection bodies offer to private companies in order to reduce the number of such services.	Promotion of the products and services.	Adoption of a National Competitivene ss strategy.	Implementation of a database of the Supply and Demand of Cooperation between SEE SMEs and between structures supportive of SME development.

Table 6 - Summary of Critical Time-bound Targets related to Public and Private Governance in 2004

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Romania	Serbia and Montenegro	
								Serbia	*Montenegro*
7	Establishment of the independent Authority for Competition.	Further liberalise the energy market.	Ongoing implementation of the Law on Restricting the Administrative Regulation and Control of the Economic Activity	Fully enforce the new Aliens Act.	Introduction of new Law against Limitations on Competition, in accordance with the EU legislative.	Review and optimisation of inspection bodies' system with view to reducing the negative impact on entrepreneurial activities.	Adoption and implementation of the legal act regarding the principles of Corporate Governance.	Adoption of the Anti-monopoly Law.	Adoption of the Competition Law.
8	Establishment of the market surveillance structures network.	Adopt the Law on Obligations.	Increase the diversity of e-government services	Update the land title books.	Restructuring and privatization of AD "Elektrostopanstvo of RM".	Review and update the legal framework according to the Civil Code.	Exercising periodical (annual) surveys to monitor and evaluate the impact of the governmental regulations on business environment aiming to reduce the administrative barriers at the firms' entry/exit on the market.	Adoption of the Foreign Trade Law.	Implementation of employment incentives.
9	Drafting the law "On the state aid".	Establish a Competition Council.	Increasing awareness of the state aid rules, in particular among aid grantors, the business community and the judiciary, and strengthening the expertise of the Commission for Protection of Competition in the area of state aid control	Fully enforce the new Construction Law.	Establishment of Energy Agency and Development of Energy Strategy.	Analysis of the practices for minimal tax reporting and introduction of the single profit tax for some categories of small enterprises.	Entering into force of the updated legislation related to competition and state aid policy.	Adoption of the Rules of Corporate Governance and implementation of IAS standards and of preparatory measures.	Adoption and Implementation of the Law on Consumer Protection.

Table 7 - Summary of Critical Time-bound Targets related to fighting Bribery and Corruption in 2004

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Romania	Serbia and Montenegro	
								Serbia	*Montenegro*
10	Establishment of the Public Information Offices within public institutions.	Adopt a Law on indirect taxation.	Criminalizing some corruption activities.	Fully enforce the Law on the Office for the Prevention of Corruption and Organised Crime.	Introduction of transparent procedures in issuing licences, permits, certificates, transparent public procurement procedures and transparent FDI contracts.	Start negotiations for concluding bi- and multi-lateral intergovernmental agreements on cooperation in fighting corruption at international level between Moldova and European States.	National assessment on the judiciary system's integrity and resistance to corruption.	Adoption of the law on avoiding conflicts of interest (or Anti-corruption Law).	Adoption of Moneyval (Committee of the Council of Europe for anti-money laundering) measures to fight money laundering.
11	Drafting, approving and implementing of the Prime Minister Order "For simplifying the procedures and the criteria of the public services offering by the public administration institutions".	Establish a Commission for the introduction of V.A.T.	Implementation of the new conflict-of-interest provision according to the amendments to the Law on Civil Service, adopted in Oct. 2003.	Fully enforce the National Program For The Fight Against Corruption With Action Plan.	Eliminating legal possibilities for existence of anonymous founders of trade companies.	Start the controlling activities over the process of public procurement from state budget sources and from the loans guaranteed by the state.	National anticorruption program for public information and awareness rising.	Adoption of measures in the areas of institutional governance and capacity building.	Adoption of the Law on Conflict of Interests and of the Code of Ethics for Public Servants, and setting up of a specialised body in charge of their implementation.
12	Increase the transparency with taxpayers through establishing of the services taxpayers manual, as well as the publication of the related legislation electronically and in hard copy.	Reform the inspection system.	Adoption and implementation of an Action Plan on National Strategy on Combating Corruption for the period 2004-2005.	Fully enforce the Law on Prevention of Conflict of Interest in Pursuance of Public Offices.			Penal liability of the legal persons to be put into force with the implementation of the new penal code.	Formation of Anti-corruption Agency entitled to sanction breaches of anti-corruption provisions.	Adoption of GRECO (Group of States of the Council of Europe for fighting against corruption) measures to fight Money Laundering.

6. COUNTRY ASSESSMENTS

For each SEE country a summary note on the progress of reform and key issues is provided in this section. Significant new international investors in each SEE country in 2003 are shown in the tables following each country commentary.

6.1. Albania

Recent economic performance

Since the end of the Kosovo conflict, Albania managed to achieve a sustained rate of economic growth, while maintaining a relatively stable economic framework, keeping inflation and budget deficit under control. Over the last five years Albanian had an average annual real GDP growth of 6.4%, the best performance in South East Europe. After slowing down to 4.7% in 2002, caused mainly by disruptions in power supply, the growth rate accelerated again in 2003. Early estimates indicate that last year the economy grew at around 6%, pushed by a strong internal demand supported by higher remittances and by an increase in exports, mainly garments and footwear for the Italian market. The forecast for 2004 is equally positive, with real GDP expected to grow at around 6%. Thanks to the recent phase of sustained economic growth Albania has made progress in filling the gap that separates it from the rest of the region, both in terms of GDP per capita and in the level of economic development. At the same time the quality of the physical infrastructure, particularly in the energy and transport sectors remains one of the poorest in South East Europe and is a major constraint to long term growth.

The process of privatisation of major state assets, after stalling in the first half of 2003, has made significant advances. In December 2003 the Government completed the long standing privatisation of the Savings Bank of Albania, selling 100% of the shares to Raiffeisen Bank for USD 126 million. With the sale of the Savings Bank, controlling over 50% of bank deposits but excluded during the pre-privatisation restructuring phase from the loan market, Albania has finally completed the privatisation of the banking sector.

Progress was made in the restructuring of INSIG, the state insurance company, with the EBRD and IFC taking a minority stake in view of a future privatisation, and in the financial restructuring of Albania Telecoms, in order to make the company more attractive to potential buyers after last year's tender process did not succeed.

Total FDI in the first three quarter of 2003 amounted to USD 98.3 million, against an inflow of USD 94.1 million for the same period in 2002. Most of the investment was generated by the expansion of existing operations, led by the two mobile phone companies. This is a sign of growing confidence by investors already operating in the country, but also an indication of the careful approach taken by newcomers. However, the privatisation of the Savings Bank, completed at the end of December 2003, will have a significant impact on the level of FDI inflow, either on 2003 or on 2004 data depending on the completion date of the actual transaction. The government target for 2004 is to nearly double the FDI inflow compared with 2002, bringing it to USD 300 million. A first positive result has already been achieved in January 2004 with the assignment to a consortium of German companies of the concession for the redevelopment, expansion and management of Rinas, after an international tender procedure. The concession contract is significant both in terms of the amount involved (over USD 80 million) and its structure, being the first large infrastructure project developed as a private-public partnership in Albania.

Progress with reform and the implementation of the Monitoring Instruments targets

In 2003 the Albanian government made some promising steps in implementing economic reform and establishing a constructive dialogue with the business community. At the end of 2003 Albania had fulfilled all the three Critical Time- Bound Targets listed in the September 2002 Monitoring Instrument Report. The FIAS study on Administrative Barriers to private investment was completed in March 2003. The report highlighted a number of issues hampering private investment from licensing requirements, to customs administration and tax administration procedures, particularly in relation to VAT refunds and tax audits, land property rights and construction permits. The government responded to the FIAS report by setting out an action plan and by establishing an inter-ministerial task force. An initial step has been taken, with the abolition of the licence for non food-enterprises. Early on the government also modified the law giving to the tax administration wide discretional powers to freeze company bank accounts if the tax administration had a claim against the company, thereby fulfilling one of the most pressing requests from the business community. More recently the government has modified also the procedure for the calculation of import duties, bringing it in line with the WTO norms. However, much more remains to be done to upgrade the efficiency and the integrity of the public administration in line with standard good practice. In particular the government should focus on improving the record of the customs administration, on further reducing the discretionary powers of customs officials, make sure that VAT refunds take place within the 30-day statutory time set by the law, on improving the quality and reducing the frequency of company tax audits. Some progress has also been achieved in strengthening the policy institutional framework for small business. The SME and an Export Promotion Agency are now operational and SME policy consultative committee has been set up, but there is still a question about adequate funding from the budget and from international donor. The Albanian government, with technical assistance from Italy, is planning to establish a credit guarantee scheme for SMEs. The introduction of the scheme is listed as one of the three most crucial targets for 2004. Its implementation, together with the more intense competition in the credit market generated by the privatisation of the Saving Bank should increase the share of bank lending to the financing of Albanian companies, currently relatively modest and below the regional average, reduce the reliance on internal generated funds, remittances and the informal credit market. However, a recent "*Enterprise Policy Performance Assessment*" (see www.investmentcompact.org), conducted by the OECD and the EBRD, stressed that in order to develop a dynamic credit market, the Albanian government needs to introduce and implement measures directed at speeding up the resolution of disputes on land titles, to complete the property restitution and to continue to improve the land and property registers.

Assessment

The Albanian government has shown over the last year a positive and energetic determination to deal with some of the issues affecting the investment climate and it has established a regular channel of consultation with the business community, however the overall progress in implementing economic reform remains uneven across the various policy areas. The business community would wish that the Albanian government focus on strengthening the public administration, on the fight against bribery and corruption, on reducing the weight of the informal sector and on eliminating the distortions caused by the unfair competition generated by companies operating informally. Many of the targets set by Albania in the framework of the Monitoring Instruments for 2004 put the accent on increasing the transparency of the public administration and improving the flow of communication between the government and the business community. These are positive steps, but they need to be supported by a more continuous and determined action to improve the level of public governance, including a monitoring of the performance here, the reduction of the discretionary power of public officials and the introduction of effective tools to stop irregular and illegal practices.

Top Five Foreign Direct Investors in Albania in 2003

Major Investors		Sector	Country of Origin
1	**AMBO**	Pipeline development (oil & gas)	USA
2	**AMC Mobile**	Telecommunication	GREECE
3	**Vodafone**	Telecommunication	GREECE
4	**Lock Heed Martin**	Transport	USA
5	**General Electric**	Infrastructure, transport	USA

6.2. Bosnia and Herzegovina

Recent economic performance

The dependence of the economy of Bosnia and Herzegovina on foreign aid has been falling steadily in the last several years, although it remains one of the highest in the world. Net Official Development Aid as a percentage of Gross National Income was around 14 percent in 1998 and 1999, about 8.5 percent in 2000 and 2001 and has fallen to 5.3 percent in 2002 (OECD DAC Statistics.) The reduction in aid has contributed to a decelerating GDP growth rate through 1999-2003 (falling to around 3.5 percent in 2003), though a mild rebound is forecast for 2004-5, partly based on the expectation of some progress in implementing the structural reform agenda.

Underlying a relatively stable macroeconomic performance, with moderately good GDP growth and low inflation, lies a "real" sector performance still characterised by a high unemployment rate (42 percent in 2002), very low and stagnant if not falling employment rate, a highly restrictive labour protection system and consequent high and *rising* real wages for the protected segment of the labour market. The return of sustained economic growth in Bosnia and Herzegovina is dependent, much more than elsewhere in the rest of South Eastern Europe, on success with reforms to place the basic elements of a business friendly institutional framework that is also unified across the country.

Progress with reform and the implementation of the Monitoring Instruments targets

The previous - 3rd - edition of the Monitoring Instruments had noted that economic and institutional reform in the half year preceding March 2003 had been severely constrained. Since then some activity in legislative drafting or institution building did continue. However, to date there is no evidence of a breakthrough in any of the four broad reform areas tracked by the Monitoring Instruments. There has been no change in the overall status of fulfilment of the three critical time-bound targets since the March 2003 edition, with two out of three "done", and the implementation of a streamlined company registration system throughout the State remaining largely behind schedule. On the latter, the draft State Business Registration Law is expected to be ready for submission to Council of Ministers in March 2004. A fully functioning system is expected to be in place within six months after the State-level legislation is adopted and the Entity-level enabling secondary legislation is in place. This implies a best-case scenario of full implementation no earlier than end-2004, some 18 months past the 2002 commitment. The international community has already used every means to emphasise the practical importance of the government demonstrating strong ownership and a sense of urgency in the implementation of this project. It still remains a test case in the necessary effort to create a single economic space in the country.

Of the twelve top policy priorities adopted by Bosnia and Herzegovina in September 2002, four have resulted in significant concrete actions by the beginning of 2004, which is one more than in March 2003. This concrete item of progress in the last year or so - within the context of the Monitoring Instruments targets - concerns the setting up of a Sector Authority for Development and Entrepreneurship within the Ministry of Foreign Trade and Economic Relations and parallel institutional strengthening in the Entities aimed at SME support.

The other - modest - achievements of the 2002-2003 monitoring cycle include the new State law which has harmonised customs *tariffs* between the Entities as of 1 January 2003. While this represents a significant step, the creation of an effective single economic space also requires a unified customs *administration*, which is the aim of a new draft law presently targeted for adoption by 31 July 2004. There has also been some legislative and institution building activity in the areas of consumer protection and competition policy. A new Law on Consumer Protection has been adopted as early as 2002, but the Consumer Protection Council, which is necessary for the Law's implementation, is still in formation, which is linked to the establishment of a Competition Council (as the two Councils are to have one joint member). The latter action is included in the country's targets published in the present edition of the Monitoring Instruments. Other key new reform targets adopted by Bosnia and Herzegovina in 2004 include the implementation of a Law on Indirect Taxation. The Office of the High Representative (OHR) has already carried out certain actions in January 2004 to appoint the first Chairman of the Governing Board of the Indirect Taxation System and establish the Indirect Tax Policy Commission.

The private sector and the international donor community, consulted by the Investment Compact in relation to the present edition of the Monitoring Instruments, broadly agrees with the 2004 reform targets selected by Bosnia and Herzegovina, even if some organisations feel insufficiently consulted by the government on the selection of these targets or on policy in general. Employers' representatives in particular note the continuing tendency of the government to draft laws "alone", and urge the government to make the consultation of stakeholders an integral part of law making to improve the implementability of laws. Additional priority issues identified by the private sector, but not covered in the Monitoring Instruments include the following:

- resolution of the internal debt issue
- streamlining of bureaucracies especially in the areas of taxation and customs administration
- reform of the privatisation procedures and acceleration of the privatisation of large-scale industrial concerns
- completion of telecommunications sector privatisation in the Republika Srpska and the start of telecommunications privatisation in the Federation of Bosnia and Herzegovina
- merging of the banking Supervisory Agencies in the Entities

Assessment

The complexity of Bosnia and Herzegovina's constitutional and political structure makes the challenge of achieving reform more difficult and protracted. It is possible to assert however that the country is making some tangible, albeit modest progress to reform the regulatory and institutional environment affecting private investment. This said, the country has not yet gone beyond the stage of putting in place the basic legal and institutional frameworks, except in some areas such as investment promotion, where it can boast one of the more active, energetic and competitive Investment Promotion Agencies of the Region, namely, FIPA.

The limited progress with reform in Bosnia and Herzegovina registered in the Monitoring Instruments since 2002 has come after very long and difficult negotiations, among the different elements that make up the complex political system of the country, and between them and the international community (for instance, in the company registration system issue, or the harmonisation of customs administrations throughout the State.) There is a clear sense, at every step, that the concerned international community has to bargain hard with Bosnians in order to convince them to reduce the economic and social restrictions they inflict upon themselves. There exists also an emerging impression that, perhaps the international community has so far obtained a very modest yield in return for what is, in relation to the size of the country, a massive economic and security burden that it is shouldering in Bosnia and Herzegovina. It remains to be seen whether the latest initiatives to jump-start the reform effort to a new level, such as the "Bulldozer Initiative" by the OHR will deliver substantial results. This innovative approach initiated by OHR needs corresponding action by government and policy makers to speed up and deepen reform efforts

In conclusion, the economic reform process in Bosnia and Herzegovina is progressing, but its pace continues to be constrained by the inability of constituent governments (State and Entities) to develop and agree on a systematic and energised legislative and implementation agenda. Until there is a concerted effort to zero-in on the critical tasks, the country will continue to lag behind its regional counterparts and fail to stimulate significant investor interest.

Top Five Foreign Direct Investors in BiH in 2003

Major Investors		Sector	Country of Origin
1	**HRVATSKE TELEKOMUNIKACIJE HT**	Telecommunication	CROATIA/GERMANY
2	**HYPO ALPE-ADRIA BANK**	Banking	AUSTRIA
3	**PETROL**	Trade	SLOVENIA
4	**ALAS INTERNATIONAL BAUSTOFFPR**	Production - cement	AUSTRIA
5	**MERCATOR**	Trade	SLOVENIA

6.3. Bulgaria

Recent economic performance

Bulgaria has continued to enjoy political stability, which has allowed the economy to grow in excess of forecasts: **GDP increased** by 4.8% in 2002 compared to earlier estimates of 4%, and by 4.2% in the first three quarters of 2003. Industrial output increased by an impressive 16% in the same timeframe. Annual growth for 2003 is estimated to have been 4.6% despite the sluggish performance of the world economy and the reduced competitiveness of Bulgarian exports outside the Euro Zone, due to the appreciation of the Lev (which is bound to the Euro in the currency board arrangement). The inflation rate has increased to 5.6% in 2003 (compared to 3.8% in 2002) but has been kept under control. Official unemployment has declined from 17.5% at the end of 2002 to 13.5% at end-2003, but has been on a rising trend since the last quarter of 2003. Growth is projected to slow down slightly in 2004 and 2005 (to 4.0% and 3.6%, respectively) due to increasing inflationary pressures, slower job growth and consumer spending, and reduced demand from Turkey, one of the main outlets of Bulgarian exports. These factors are likely to be only partially compensated for by continued foreign direct investment (FDI), and by capital spending for the re-equipment of recently privatised firms.

FDI estimates have been revised upwards for both 2002 (US$ 873 million, compared to an earlier estimate of US$ 468 million) and 2003 (US$ 864 million in the first three quarters alone, not counting the proceeds of the privatisation of DSK bank, which was sold to OTP, of Hungary, in October). Total FDI flows for 2003 are expected to exceed the US$ 1.5 billion mark marking a welcome improvement on 2002. These encouraging FDI data, however, hide a substantial decline in fresh equity capital inflows, which accounted for only 25% of total FDI in the first three quarters if 2003 (compared with 67% in 2002). Seventy percent of total FDI in the first three quarters of 2003 was accounted for by increased liabilities of direct investment enterprises to the foreign investors, in terms of loans, trade credits, and debt securities. The remaining 5% of total FDI flows was due to reinvested earnings of existing foreign-owned firms.

Progress with reform and the implementation of the Monitoring Instruments targets

The government's policy approach has been largely driven by two main objectives: advancing in the process of EU accession, still scheduled for 2007, and satisfying the commitments to the IMF, which is expected to replace the current stand-by arrangement with a precautionary one in 2004. Progress in implementing the **economic liberalisation measures** required for EU entry has been satisfactory, except for the delayed completion of privatisation of Bulgartabac and of the BTC telecommunications firm. Fiscal policy is almost on target with respect to the IMF agreements, but the **budget deficit target** for 2004 has been raised from 0.5% to 0.7% of GDP, and the objective of balancing the budget has been pushed back from 2005 (general elections year) to 2006.

All **Critical Time-bound** Targets listed in prior editions of the MI have been met: the corporate tax rate has been unified at 23.5 % and is scheduled to be further reduced; the municipality tax has been revoked; constitutional obstacles to the reform of the judiciary, regarding the status of judges, their career advancement path, their immunities, and their mandate have been removed; the Commercial Law has been suitably amended to simplify and rationalise the process of market exit (receiverships and bankruptcies). Reasonable progress has also been accomplished with respect to **Priority Issues**: A law to restructure the SME Promotion Agency, and to merge it with the Export Promotion Agency, has been agreed by the Council of Ministers and is awaiting parliamentary action to be enacted; VAT collection and the claim of VAT refunds have been simplified; incentives have been introduced for investment in low employment regions; much progress has been made in streamlining administrative procedures for businesses and for reducing red tape, even though the target of implementing the one-stop-shop concept for company registration will not be reached before 2005;

the Competition Law has been strengthened and a Commission on the Protection of Competition has been created and empowered; State Aid legislation has been aligned to EU directives; a credit guarantee scheme targeting SMEs and geared to facilitate their access to bank credit is under preparation for government review; Prokredit, a financial institution set up with EBRD's help to provide micro-credit facilities is hugely successful; strict rules have been adopted in the legislation to fight corruption of the civil service, the judiciary, and corporate officers, in line with OECD guidelines.

Despite these advances, however, **serious substantive issues remain outstanding**. The removal of administrative and bureaucratic obstacles to business development has made less progress than the number of abolished or simplified regulations seems to indicate: new rules and regulations have been introduced, also to satisfy EU requirements (e.g., environment protection), and are enforced by a poorly trained and unmotivated bureaucracy. A major overhaul of the civil service in general is sorely needed, as is improved training and better pay for civil servants. Official corruption remains a major issue. The lack of effectiveness of the judiciary, partly due to the insufficient number of judges, and partly to their inadequate training, is still a fundamental constraint to the credibility of the rule of law in the business environment. The land ownership registry system (cadastre) is in shambles, and the rules and procedures for applying and obtaining construction permits are cumbersome, unclear, and arbitrarily applied, often providing opportunities for official corruption. Support for SME development remains largely on paper. Municipalities in particular are unequipped to handle their share of responsibilities in this area. The restructured SME agency needs urgent attention in completing the formalities of change and in facilitating it to move forward with its action plan. There is no official support for R&D, especially as regards SMEs, so much so that even EU grant funds targeting R&D remain largely under-utilised. The banking system's credit to finance investment is largely inaccessible to SMEs because of lack of collateral.

Assessment

Bulgaria continued to make steady but slow progress on the path to reforms. The investment climate is generally business friendly, and official institutions are responsive to the needs of large businesses, as borne out by the activities of the Council of Economic Growth, which brings regularly together the five Bulgarian business associations with relevant ministries to discuss issues affecting business development. However, the main criticism cited in the previous edition of the MI remains valid: this favourable climate does not trickle down to the smaller enterprises, which remain hostage to an inefficient, often hostile, and sometimes corrupt bureaucracy at the middle and lower levels. Significant legislative reforms have been enacted, but their actual implementation at the grassroots level leaves much to be desired. The absence of a reliable and reasonably quick judicial system, able to enforce the law remains a major obstacle to the improvement of the investment climate, as is the unpredictability of the application of land ownership laws, and of the rules restricting construction permits. There is consensus among private sector representatives and officials of international organisations active in Bulgaria on the priorities that should be set for their further reform agenda:

1) Real reform of the judiciary, possibly to be carried out in phases, beginning with the branches of the system which most affect business, such as bankruptcy courts;
2) Overall reform of the civil service, reducing the number of redundant staff, seriously cracking down on corruption, but improving the level of training, the motivation, and the standing of civil servants, including decorous pay and job security;
3) Improve the quality of the SME administration, providing an adequate staffing and budget allocation to the Agency, and a suitable reporting relationship to a ministry able to provide uniform and consistent guidance;
4) Reform of the cadastre and of the rules and procedures regarding real estate ownership and construction permits;
5) Facilitate the SME's access to bank credit, and support and incentives R&D investment by businesses.

Top Five Foreign Direct Investors in Bulgaria in 2003

Major Investors		Sector	Country of Origin
1	**OTP**	Finance	HUNGARY
2	**PETRECO**	Gas	UK
3	**LITASKO**	Trade	MAN ISLAND, SWITZERLAND
4	**MIROGLIO**	Textiles	ITALY
5	**ENTERGY - ENEL**	Energy	UK, ITALY

6.4. Croatia

Recent economic performance

It is generally agreed that in living memory Croatia has been ahead of the rest of South East Europe in terms of general social and economic development indicators. However, it is also fair to say that recently the country -- in terms of the drive to build a vibrant market economy, growth domestic companies and a competitive business environment -- has been resting on its laurels. In recent years Croatia continued to achieve a relatively high GDP growth rate (4.6 percent p.a. in 2003, and a forecast of 4.5 percent in 2004), with inflation expected to rise from a moderate 2.6 percent in 2003 to 4.2 percent in 2004 (IMF), while the current account deficit is widening. In addition to a relatively mixed macroeconomic performance, several indicators show that Croatia's long-term development performance is well below potential and has not been picking up.

Employment growth between 2000 and 2003 has been virtually zero and the observed marginal decline in the unemployment rate (still high around 14 percent in 2003, ILO definition) mostly reflects exit from the labour force. Concurrently, the private sector share in employment remains one of the lowest in the Region (at 56 percent in 2000) and has risen only moderately since the mid-1990s (EBRD). **Merchandise exports** have grown at a dismal 0.6 percent per year between 1992 and 2002 (from US$4.6 billion to US$4.9billion). Croatia's market share in EU imports halved between 1993 and 2002. Although Croatia was not assisted by a preferential trade regime with the EU in a way comparable with CEE, it is also evident that neither has it implemented a strong export-driven growth policy. The policy, institutional and strategic approach to, for example promoting private investment, especially international investment needs greater focus and coordination at Ministry/Agency levels, enhanced dialogue with private investors and more rapid progress given the many natural advantages that Croatia offers. Feedback from business and investors suggest a country that is still putting off fundamental structural reform and fails to benefit from existing opportunities for international trade and FDI-driven integration with the developed market economies.

FDI inflows into Croatia in stark contrast to other SEE countries reached per capita levels comparable to CEE around 1996 but have remained more or less stagnant since 1999. A more detailed analysis suggests that equity investments have fallen consistently and sharply since 1999. Indeed, the total inflow figure for 2003, which promises to be above 2002 (US$1180 million in January-October 2003 vs. US$1123 for all of 2002), includes a substantial surge in reinvested earnings which reach 57 percent of total inflow, up from between 7 to 14 percent in all previous years. While this may to some extent imply the maturing of successful existing FDI, it also points to a virtual stop of "greenfield" investment as of mid-2003.

Progress with reform and the implementation of the Monitoring Instruments targets

The reform of policy and institutional environment affecting investment has also come to a virtual stand still in Croatia by late-2003. While the announcement of early elections in the Autumn had clearly exacerbated this, **the lack of a more determined and coordinated reform effort** was evident by early 2003.

Concerning the specific targets adopted by the government in the Monitoring Instruments' 2nd, 3rd and the present 4th editions, Croatia displays a poor fulfilment rate and probably **the worst record in policy continuity**. Of the twelve critical targets published in the 2nd and 3rd editions, six are reported as "done", though some of these include purely administrative actions such as the establishment of a Trade and Investment Promotion Agency, which only recently appointed a Managing Director. Only one of the twelve new targets in the present edition represent a continuity of a previously unfulfilled target (the implementation of the national action plan to fight against corruption.)

A comparison between policy branches shows the worst record in the area of investment promotion and the best in enterprise policy and SME development. Concerning investment promotion Croatia has by now lost the better part of two years in terms of creating a strong and competitive FDI promotion agency, first adopted as a critical time-bound target in September 2002.The new hope which emerged in November 2003 with the appointment of a new Managing Director and a Board of TIPA still remains to bear fruit as a new economic policy team and programme is being established by the new government that has emerged from November 2003 elections. Concerning the reduction of administrative barriers to business, donors express considerable frustration given that the previous government showed little ownership of the FIAS report recommendations and made little effort to make use of available donor support to implement them. While enterprise policy reform represents a relatively bright spot, the SME ministry which has carried it out has now been merged with the Ministry of Economy and the policy team in this area is being reorganised. During the past twelve months there has also been some limited progress in developing good quality legislation in the area of competition policy. However the government needs to strengthen the enforcement record and more effort is needed to make Croatia's practice in competition policy enforcement and state aid compatible with international norms.

Assessment

With genuine reform and economic transformation underway in other parts of the SEE Region (such as in Romania and Bulgaria), it is now a realistic possibility that Croatia may lose its development ranking leader position in the Region within the foreseeable future, unless a decisive turn is made in government policy and approach with respect to fundamental institutional and policy reform.

The new government that has emerged from the 23 November 2003 elections is thought by the international community to have a greater chance to implement decisive policy reform, given that it is built on a relatively stronger coalition and has given encouraging signals in its initial statements. The process of Croatia's process of integration with the EU has also been given a new impetus. Now that the new government's economic policy team is in place and preparing its action plans, Croatia has a window of opportunity to demonstrate a genuine determination to embark on an outward-oriented development path, which should be seized very quickly.

Top Foreign Direct Investors in Croatia in 2003*

Major Investors		Sector	Country of Origin
1	**ROTHMANS GERMANY**	Buying and selling of own real estate	GERMANY
2	**MERCATOR D.D.**	Retail sale in non-specialized stores	SLOVENIA
3	**MOBILKOM AG AUSTRIA**	Telecommunications	AUSTRIA
4	**HYPO ALPE ADRIA BANK AG KLAGENFURT**	Financial services	AUSTRIA

* foreign direct equity investment (without reinvested earnings and other capital); 1st and 2nd quarter of 2003 (data for the whole year is expected by the end of the March 2004)

6.5. FYR Macedonia

Recent economic performance

In 2003 the Macedonian economy made further progress in recovering from the sharp contraction suffered in 2001, during a phase of internal ethnic strife. However the recovery remains weak and fragile and rate of unemployment stubbornly high at around 37% of the total workforce, the highest in SEE, excluding Kosovo. GDP growth in 2003 will be close to 3%, marginally higher than in 2002. However, in the second half of the year the industrial production growth rate has accelerated, thanks mainly to the metallurgical sector, and there are some indications of a revival of foreign and domestic private investment. Provided that the current phase of relative political stability continues, the expectations are that economic growth will progressively accelerate in 2004 and 2005, returning to the pre-crisis level.

In spite of the difficult conditions the government has succeeded in maintaining a stable economic framework, limiting the budget deficit at around 2% of GDP and achieving a high degree of price stability, in line with the objectives of the IMF programme.

FDI inflow remained at the same nominal level of last year, at around USD 100 million. In the absence of any significant privatisation and green-field operation, the expansion of existing operations accounted for most of the new investment, as investors operating in the country have finally started to implement investment plans put on hold during the crisis.

The government is still committed to complete the sale or the liquidation of a number of remaining loss-making state enterprises in spite of the potential large employment losses, as part of an industrial sector restructuring programme supported by the World Bank, and then to disband the Privatisation Agency. Some progress been achieved in 2003, with the sale of a further eight companies, but the programme, will have to be extended well into 2004.

Progress with reform and the implementation of the Monitoring Instruments targets

After two years of stalled progress, the government, elected at the end of 2002, put a considerable effort into restarting the economic reform process and reshaping the central government institutions supporting the business sector. In March 2003, at the time of publication of the previous edition of the MIs, Macedonia had only met one Critical Time-bound Target, relating to the abolition of the so called war tax.

Over the last six months considerable progress has been made in fulfilling a second target, dealing with the improvement of the institutional framework for investment promotion. The government elaborated with the support of UNDP and MIGA a comprehensive programme for stimulating private investment, including a review of the current system of tax incentives for foreign owned companies and plans for establishing a direct investment promotion agency, Macedonia being the only country in South East Europe without an Investment Promotion Agency (IPA). At the end of December 2003, the programme was still going through the process of parliament approval, therefore the target can not yet be considered fully met. However, the government has listed once again the implementation of the Programme and the establishment of the IPA as among the most critical targets for 2004.

The third target, the introduction of a number of amendments to the competition law has been met, with the entry into force of the new competition law on the first of January 2004.

Progress has been made also in the SME policy area. The new micro-finance bank, supported by the IFC and the EBRD has started operations, while the government has approved a new programme for entrepreneurship and small business support and established a new SME agency, after disbanding a previous similar government agency, with a more defined mandate and better internal governance structure. Steps have been made to implement the government's anti bribery and anti-corruption strategy.

Assessment

The Macedonian government over the last year has taken a number of positive steps in order to rebuild the confidence of foreign and local investors and improve the business climate that had significant deteriorated during the phase of ethnic strife. The government's objective is to spur domestic and foreign investment by creating a relatively low tax business friendly environment, fully open trade and investment. Being aware of the limited size of its domestic market, Macedonia has been one of the driving forces of the initiative to create a system of free trade agreements in South East Europe, while entering into an association agreement with the EU. However, so far the response of domestic and foreign investors has been cautious and somewhat wary of a risk of a return of political instability during the implementation of Ohrid agreement.

The government needs to continue to urgently pursue the implementation of its reform programme, focusing on simplifying the regulatory environment and implementing the recommendations of a recent FIAS report, on improving the transparency of the public administration and on continuing the fight against bribery and corruption, while deepening the process of policy consultation with the private sector. The rebuilding of the investors confidence is a delicate process that may be easily driven out of track by political or economic shocks, but Macedonia by strengthening its dialogue with existing investors and by taking more concrete and measurable steps on specified reforms especially those dealing with small business, should be able over the next twelve months to progressively enhance this confidence.

Top Five Foreign Direct Investors in FYR Macedonia in 2003

Major Investors		Sector	Country of Origin
1	**IMI**	Financial services	GERMANY
2	**LHB BANK**	Financial services	GERMANY
3	**TOBACHNA LJUBLJANA**	Tobacco industry	SLOVENIA
4	**ERA VELENJE**	Fairs and exhibitions	SLOVENIA
5	**OST HOLDING**	Publishing and printing	AUSTRIA

6.6. Moldova

Recent economic performance

Over the last three years Moldova enjoyed a phase of sustained economic growth, fuelled by a surge of exports, particularly to Russia, and a higher inflow of remittances. Estimates for GDP growth in 2003 range between 6.5% and 7%. GDP grew at 7.2% in 2002. However, the recent phase of economic growth only partially compensated for the slow progress experienced in the early phase of transition. The country suffered a sharp fall in GDP after independence and the contraction was compounded by the conflict with the breakaway region of Transdniester. Moldova has today the lowest per capita income in South East Europe, is the least advanced in terms of privatisation and economic restructuring and has the lowest level of FDI per capita.

The macro-economic framework has remained substantially stable, as the government continued to pursue a tight fiscal policy and managed even to achieve a small budget surplus. In spite of the good export performance the trade balance remained heavily negative, at around 8% of the GDP. The country trade links with Russia and other Former Soviet Union republics are still dominant and trade diversification has been limited, if compared with the rest of South East Europe. Moldova is heavily dependent on energy imports from Russia and exports of agro-business products to Russia and Ukraine. However, the light industry export processing sector is growing fast thanks to competitive labour costs, in spite of the poor regulatory environment and the fact that Moldova does not enjoy the same degree of access to the EU market as the other countries of SEE.

Since mid-2003 the relations between Moldova and the International Financial Institutions entered into a critical phase. The IMF suspended the release of the tranche under its three year lending programme as the government did not meet the conditions set in the letter of intent, particularly in relation to the regulatory regime for the energy market. The World Bank has also suspended structural adjustment loan disbursements. Multilateral lending will probably not resume until the second quarter of 2004, provided that the government reaches an agreement with the IMF and the World Bank over the next three year economic programme. This may put major strains on the 2004 state budget, as Moldova faces a heavy foreign debt repayment schedule.

Progress with reform and the implementation of the Monitoring Instruments targets

Since the last edition of the Monitoring Instruments, in March 2003, Moldova has made marginal progress on the implementation of the Critical Time-bound Targets, resulting in the worse performance among all the SEE countries. Out of the three targets, only one has been met, while the fulfilment of two other targets has been delayed to 2004. The new Civil Code, initially planned for January 1st 2003, and the law on Civil Code finally entered into force after Parliamentary approval in July 2003, together with the new procedural code. While the target is rated as 'Done' there remains the greater challenge of full implementation of related legislation and effective implementation of the civil code.

The Law on Investment passed, designed to clarify the regulatory environment and strengthen the guarantees offered to private investors, including the application of national treatment to all investors, had not yet completed (as of Jan 2004 but later advised to be in force in March 2004) its drafting and approval process. It has to be noted that for the first time the government has taken the initiative to consult broadly with the international organisations (IMF, World Bank, FIAS, IFC, OECD Investment Compact), as well as with the private sector representatives. The Law is currently going through a new revision before the final parliament approval. It remains to be seen if the advice and recommendations made are accepted and fully adopted in the new law. The establishment of the Competition Agency, planned for 2003, remains stalled, seemingly by lack of political consensus and lack of budget resources.

After a long phase of strained relations with the business community, the Moldovan Government made last year some positive steps aimed at establishing a constructive dialogue with the private sector. The recent establishment by international investors of a Foreign Investors Council (FIC) should provide the government with a valid and constructive counterpart. This follows the pattern of all other SEE countries. The government has listed strengthening policy dialogue with the FIC and other private sector organisation as one of its most critical time bound targets for 2004. Again it remains to be seen how cooperative and constructive the government and policy makers are to this new initiative from the private sector. At time of publication of this report the process of registering the FIC was being delayed by bureaucratic procedures and a seeming lack of understanding of the positive role and function of such a FIC initiated and driven by the private sector. The government, under pressure from the private sector and the IFIs, has recognised the need to reform the regulatory environment and overhaul the current system of inspections and company audits by state bodies. The Ministry of Economy plans to conduct in 2004, with the support of FIAS, a review of administrative barriers faced by companies. At the same time the government intends to improve the clarity and consistency of the legal framework, following the introduction of the civil code.

Assessment

The improvement of the macro-economic situation has not led to a corresponding improvement in the business and investment climate. The conclusions of a recent survey conducted by the World Bank, as well as the Enterprise Policy Performance Assessment conducted by the OECD and the EBRD are that the operational climate remains tenuous and there are some indications that it may have further deteriorated in 2003. State interference and intrusion in private sector operations and bribery and corruption are endemic problems in Moldova. A general picture of slow moving and 'reluctant' reform still applies according to feedback from various sources.

The government needs to build up its credibility towards the private sector by taking concrete actions, starting by adopting more transparent rules and limiting the powers of the various state inspectorates, a widely used channel for interfering with company operations, for distorting competitions in favour of powerful groups and extracting bribes. The beginning of a new dialogue with the private sector is a first step in the right direction, but as stated above the real value and effectiveness of this will ultimately depend on true partnership by the government in fostering and enabling the private sector to be constructive and independent discussion partners rather than going in the direction of extended control of the private sector. The formulation of a realistic Business Improvement Action Plan, drafted with the support of the domestic and foreign investors and the International Institutions, containing clear and precise deadlines for implementation, could be an important tool for the Moldovan Government.

Top Five Foreign Direct Investors in Moldova in 2003

Major Investors		Sector	Country of Origin
1	**EFES BREWERIES INTERNATIONAL**	Beer and Soft Drinks	NETHERLANDS
2	**GLASS GLOBAL GROUP**	Glass Production	USA
3	**SA "PAROM"**	Wine and Spirits	RUSSIA
4	**ASHBROOK INVESTMENTS LTD**	Wine and Spirits	UK
5	**ROXTON FINANCE LLC, PLC**	Wine and Spirits	USA

6.7. Romania

Recent economic performance

During 2003 Romania continued to enjoy political stability. Implementation of reforms progressed further mainly with a view to EU accession, as negotiations are expected to be largely completed in 2004. The **GDP growth** rate has remained close to 5% p.a. on average since 2001 and this level is projected to prevail also in the next two years: GDP grew by 4.4% p.a. in the first quarter of 2003, but the rate increased to 4.9% in the last quarter. **Exports** continued to perform well, despite the economic slow-down in the EU. The Government signed several bilateral free trade agreements with most of Romania's neighbouring countries. Still, Romanian industries have to improve their competitiveness in the domestic and foreign markets. The **inflation rate** decreased more than anticipated, from 30% in 2001, to 18% at the end of 2002 and to 14.1% at the end of 2003, with an annual average of 15.4%. The Government projects the inflation rate to fall to single digit levels by end-2004. Food prices, however, are expected to rise in 2004 due to the poor wheat harvest in 2003. Unemployment rate dropped from 10.2% in 2002 to 9.5% in 2003, and it is expected to decrease further to 9% in 2004. FDI flows, although relatively modest by the worldwide standard of middle-income economies, remained among the highest in the region, at US$ 1,121 million in the first 10 months of 2003 (compared to US$ 1097 million during all of 2002), and are expected to continue at the same level through 2004.

Progress with reform and the implementation of the Monitoring Instruments targets

The Government was reshuffled in May 2003. The number of Ministries was reduced from 23 to 14. Some Ministries were transformed into Agencies, others were integrated in already existing structures. This caused some temporary disturbance in the business environment. The Business

Environment Improvement Team was transferred from the Ministry of Prognosis and Development to the Ministry of Economy and Trade, and the Ministry for SMEs and Cooperatives became the National Agency for SMEs. Close cooperation with the representatives of the private sector, however, was maintained and enhanced under the new set-up, as was transparency and ease of communication between the Government and the private sector. The Executive Director of the Foreign Investors' Council, Ms. Ruxandra Stan, was formally appointed as liaison officer between the business environment and the Prime Minister's cabinet. A foreign advisor was appointed within the Romanian Agency for Foreign Investments. The "First Economic Retreat" was organised by the Government to secure the cooperation of the private sector in the implementation of its reform program, and was attended by more than 100 representatives of foreign investors and international economic partners..

Since the March 2003 edition of the Monitoring Instruments, **all three Critical Time-bound Targets have been implemented**: The VAT law has been revised in September 2003, introducing a fast-track procedure under which VAT refunds are payable prior to the Ministry of Finance's audit. The National Credit Guarantee Fund for SMEs has expanded its scope of activities, and plans to open regional offices in all counties. The Guarantee Fund has now signed conventions with twelve commercial banks. The effectiveness of ARIS, the agency for investment promotion, has improved as borne out by the good FDI inflow performance in 2003.

Progress has been made also in the **improvement of the legal framework**. The law on transparency in public administration, the law on silent approval, the law on anticorruption, the Fiscal Code, were all adopted before the end of the year, consistently with the Government's agenda reflected in the last MI. Starting in 2004, the Ministry of Finance intends to set up, with the support of the OECD Centre for Tax, Policy and Administration, a "Regional Tax Network" which will put regional tax officials in permanent contact with each other and with the central authorities to facilitate policy consultations and to build capacity in the area of tax administration. The National Authority for Control has been set up to supervise centrally, under a Minister's supervision, the agencies in charge of auditing private and public institutions.

Regarding the completion of the privatisation process, in 2003, IFC and EBRD have both acquired 12.5% of the capital of **BCR**, the Romanian Commercial Bank, for a total of USD 222 million. An additional 8% of BCR's share capital is about to be sold to the bank's employees. As for the privatisation of **PETROM**, the national oil company, seven potential bidders have been selected in December 2003, including companies from Greece, Hungary, Poland, Austria, USA, Russia and Switzerland. These companies are expected to present their proposals shortly. As a result of the advancements in the previously agreed privatisation program, the World Bank has started preparation of a new loan, the Private Adjustment Loan.

Assessment

Despite the progress made, Romania has not fully achieved the status of "market economy" in the European Commission annual report, which noted that Romania "can be considered as a functioning market economy once the good progress has continued decisively". In response to the EU report, the Government issued a set of priorities to be achieved by December 2004. These include special anticorruption measures such as strengthening the institutional system to fight corruption, ensuring the efficient functioning of the National Anticorruption Prosecutor's Office, reducing the perceived level of corruption, and implementing more effectively the provisions of the National Programme for Prevention and Fighting Corruption and the National Action Plan for Fighting Corruption. The Government's priorities also include expediting the reform of the public administration, of the judicial system, and of the energy sector; reducing inter-company arrears; strengthening financial discipline; improving the business environment; implementing more effectively the *acquis communautaire* particularly with respect to agriculture, the use of pre-accession funds and cohesion funds, the environment, and the security of borders.

The Government's priorities coincide largely with the critical time bound targets proposed for the 2004 edition of the MI. They represent the necessary follow-up to the National Action Plan for the improvement of the business environment issued two years ago, which in turn reflected the PSAL II Loan Agreement with the World Bank. The main pending issues for the 2004 agenda, which the Government needs to focus on, include: the need for a normative act on corporate governance; a new bankruptcy law; amendments to the Labour Code in order to make the Romanian labour market more flexible and thus more attractive to foreign investors; improvement of the facilities and of the administrative framework to support SME's start-ups, operations, and exports.

Top Five Foreign Direct Investors in Romania in 2003

Major Investors		Sector	Country of Origin
1	**RENAULT SA**	Production of motor vehicles	FRANCE
2	**BEARBULL SAS**	Retail trade in non-specialised stores	FRANCE
3	**LNM HOLDINGS NV**	Production of ferrous metals and semi-products	DUTCH ANTILLES/UK
4	**THE ROMPETROL GROUP NV**	Petroleum procession	NETHERLANDS
5	**TERAPIA HOLDING BV**	Activities of management companies	NETHERLANDS

6.8. Serbia and Montenegro

6.8.1. *Serbia*

Recent economic performance

Since the last ***Monitoring Instruments*** edition of March 2003, the economic reform process in Serbia has lost much of its momentum with legislative and executive paralysis caused by political dissension within the government coalition and a later stage by the electoral campaigns for the presidential and general elections. Serbia is emerging from the latest round of elections with what is perceived as a weak and still confused political framework and this may result in a further dilution of the country commitment to economic reform.

However, in spite of political instability, on the macro-economic front, Serbia managed to preserve a relatively stable framework. GPD is estimated to have grown around 3% in 2003, a much lower rate than recorded in the previous three years, when real GDP growth averaged around 5% and lower also in relation to the IMF programme target of 3.5-4.5%. The service, construction and trade sectors were the largest contributors to GDP growth, while the industrial sector is still adjusting to the more liberal trade environment put in place after the end of the Milosevic regime. Industrial production dropped by more than 3%

in 2003. The government continued to pursue a prudent fiscal policy that together with large privatisation revenues helped to contain the budget deficit below 4% in 2003. Inflation was substantially reduced, from an average of 21% in 2002 to 11% in 2003 and it is expected to fall further in 2004.

The trade balance has continued to deteriorate, further highlighting the problems faced by the industrial sector in adjusting to a more competitive environment, with the trade deficit reaching 20% of the GDP and imports growing much faster than exports. The trade deficit has been more than offset by capital inflows in the form of remittances and official transfers, loans from international organisations and FDI. This last item has been particularly dynamic in 2003. For the first time ever Serbia exceeded $1 billion in FDI albeit due to large privatisations in the tobacco and the oil sectors. However there has been no significant "green-field" FDI in 2003. The postponing of the introduction of VAT from January 1st 2004 to July 2004, together with the unsettled political scene, may have contributed to delaying the establishment of new ventures. SIEPA, the Serbian Investment Promotion Agency, forecast an FDI inflow of 1 billion USD for 2004 whereas the FIC sees about half this level being achieved. This is an ambitious target that can only be reached by speeding up the privatisation process of small and medium size enterprises, already well under way, and by completing a number of large privatisations, mainly in the banking and telecommunication sectors.

Progress with reform and the implementation of the Monitoring Instruments targets

The paralysis of the legislative activity over the last six months has affected the performance of Serbia in relation to implementation of the Monitoring Instruments Targets set in 2002. At end of December 2003 only one among the three most crucial targets has been met so far, relating to the simplification of the procedures for obtaining construction rights. The other two targets, both requiring the passing of new legislation have not been fully met, although significant progress has been made on those areas.

The overall view is that while Serbia has made over the last year some very significant progress in implementing a number of legislative measures approved in the first phase of the programme of economic reform, particularly in relation to privatisation and banking sector reform., the progress has come close to stalling as a number of key piece of economic legislation remained blocked in parliament. And in addition the follow through in effective operation of legislation and institutions remain a major task.

Part of these difficulties were caused by the process of harmonising the economic legislation between Serbia and Montenegro) within the framework of the State Union. The clause in the State Union Treaty of Serbia and Montenegro, which could allow Montenegro and/or Serbia to become independent in 2005, has acted as a deterrent against raising the level of harmonisation. The issue of harmonisation had major implication for a number of key pieces of legislation. One example is given by the legislation on competition. Failure to reach an agreement between the two republics has postponed the review of the current legislative framework and establishment of an independent competition agency. It also prevented legislative reform on the protection of intellectual property rights which Serbia would like to see addressed at the Union Level.

Following the assignation of Prime Minister Djindjic, the government stepped up significantly the fight against organised crime with positive results, and improved legislation in the area of the fight against corruption and money laundering.

Assessment

The stalling of the reform process has starting to affect the economy and the investment climate. Investors report a slow down in business operations and signs of a deterioration of the investment climate, such as the introduction of restrictive changes on the tax and legal framework applied to foreign companies and expatriates and lack of new measures of liberalising the access to the domestic market in a number of sectors, from retailing to energy and telecommunications..

According to the 80 major international companies with direct investment in Serbia, grouped in the Foreign Investors Council, the 12 top policy priorities set out in the MI for 2004 match their own priorities. Foreign investors also indicate the Law on Enforcement Procedure and Law on Civil Procedure, the Public Procurement Law, the Securities Law, the VAT Law, and the setting up of legal provisions for the Protection of Intellectual Property Rights as part of their priorities.

Regarding non legislative measures, foreign investors list the adoption of the national competitiveness strategy, the adoption of measures in institutional governance and capacity building to fight corruption, the adoption of a national strategy for attracting FDI and the creation of a new anti-corruption agency.

Having embarked on economic reform much later than the other SEE countries, Serbia can not afford at this stage to slow down the pace of reform, without risk of losing ground in the process of integration with the European Union and with the Region. Serbia needs particularly to complete the upgrading of its legal framework and the restructuring of its industrial sector through a mix of company privatisation and liquidation complemented by fresh new investment from international sources.

There are some positive signals that the restructuring process is starting to happen. The privatisation process has so far been generally successful and on schedule. The industrial sector has started to get organised in productive clusters, with the support of a programme financed by USAID and the government is devoting a growing attention to the small business sector, with the establishment of an SME agency, a credit-guarantee fund and the upgrading of the company registration system.

Over the last year the government has established a fairly effective system of consultation with the organisations representing private investors and in particular the Foreign Investors Council. The Investment Compact has provided guidance and support in this area. It is important that this dialogue will continue also through the current political change period in order to contribute to keep the reform process on track.

Top Five Foreign Direct Investors in Serbia in 2003

Major Investors		Sector	Country of Origin
1	**PHILIP MORRIS**	Tobacco	US
2	**LUKOIL**	Oil	RUSSIAN FEDERATION
3	**BAT**	Tobacco	UK/US
4	**UNIWORLD**	Tourism	US
5	**HELLENIC SUGAR INDUSTRY**	Food	GREECE

6.8.2. *Montenegro*

Recent economic performance

In 2003 Montenegro has continued to outperform Serbia, in relation to all major macro-economic indicators. Last year real GDP growth was estimated to be between 8 and 9%, led by the revival of the tourism sector. Thanks to additional revenues brought by the introduction of VAT in April 2003 and by the expansion of the tax base through a reduction of the weight of the informal economy, the Republic has been able to reduce the fiscal deficit to less than 0.5% of the GDP. As Montenegro has adopted the EURO as the national currency, the inflation rate, estimated at around 8% in 2003, remains a cause of concerns and a risk that could substantially erode the competitiveness of the republic both in the tradable goods sectors as well as in the tourism sector.

In fact the government of Montenegro has identified tourism as the main driver of its future economic development. A master plan for tourism has thus been completed and it is currently being implemented. The master plan is based around upper class tourism 30% and mass tourism 70%. A substantial amount of private investment is required to upgrade to current international standards the large hotel facilities built in the seventies and early eighties. For this purpose, the government has launched a privatisation programme specially designed for the hotel and tourism sector, but so far it has raised only limited interest among foreign investors. Russian companies have been so far the most interested buyers.

FDI inflows to Montenegro have decreased from 117 million euros in 2002 to 52 million euros in 2003. However, the challenge for Montenegro regarding FDI is slightly different from other SEE countries and from the Republic of Serbia. Most major potential foreign investors are already in the country - Serbia and Montenegro - but in Belgrade / Serbia, whose larger market makes it the entry point for investors in Serbia and Montenegro. While most foreign investors could consider expanding investment and operations to Montenegro by the opening of company branches and subsidiaries, one major obstacle remains. Despite the existence of the State Union of Serbia and Montenegro, the legislation of the Republic of Montenegro requires from foreign investors already established in Belgrade/Serbia to incorporate a totally new company and to comply with new, additional and separate accounting requirements and different administrative procedures, in order to operate in Montenegro. However, due to the market size and the higher operational costs of Montenegro in relation to Serbia, international companies with already direct investment in Serbia indicate that setting up a new operation just for Montenegro is not, in most cases, financially viable.

Progress with reform and the implementation of the Monitoring Instruments targets

In 2003 Montenegro has managed to keep up the momentum in terms of economic reform, implementing many of the legislative acts introduced in 2002. Most of the reform targets that were still in progress in the March 2003 edition of the MI have been completed. There has been some progress in the fight against the endemic corruption and in formalising the previously large informal sector.

The reform of the company registration system has led to a sharp increase in new company registrations, while cost and time has been brought close to the best OECD benchmarks. The government is pursuing a determined policy to simplify the regulatory environment and to support SMEs. Montenegro has one of the most dynamic SME agencies in the whole region with a substantial budget, provided mostly by donors.

Assessment

Montenegro is pursuing with determination its strategy of building a liberal and open business environment, putting integration with the EU and regional economy, ahead even to the integration with Serbia within the new Union State of Serbia and Montenegro.

This strategy has however several implications, in terms for instance of increased dependence from the tourism sector and external support, and requires the enforcement of a strict fiscal discipline. Investors, while welcoming the constitutional agreement reached with Serbia over the structure of the Union State, remain concerned about the medium term prospect of economic stability and the ability of the Montenegrin government to raise sufficient funding for the development of the hard and soft infrastructure needed to support the development of the tourism sector.

Top Five Foreign Direct Investors in Montenegro in 2003

Major Investors		Sector	Country of Origin
1	**NOVA LJUBLJANSKA BANKA**	Banking Sector	SLOVENIA
2	**BEPPLER & JACOBSON**	Tourism	UNITED KINGDOM
3	**UNIS TOURS**	Tourism	BOSNIA AND HERZEGOVINA
4	**BRUNSWEEK**	Tourism	GREECE
5	**PEMI BAU**	Tourism	GERMANY

7. FOREIGN DIRECT INVESTMENT OUTLOOK

An improving relative position in global FDI flows, albeit from a low level….

FDI inflows into the SEE Region (see Table 8) have held up despite the sharp FDI downturn in most of the emerging markets since 2000. Inflows in the SEE as a group are estimated to have surpassed five billion US$ for the first time in 2003 (rising in fact to $6 billion), representing a 30 percent increase with respect to 2002. An annual FDI inflow of one billion US$ or more can now be observed in four jurisdictions (Bulgaria, Croatia, Romania and Serbia). Projections indicate that the new "plateau" that the Region has reached in terms of overall FDI volume will be maintained in 2004. But it should also be borne in mind that these overall figures are given in US$, while much FDI inflow into SEE originates from the euro zone whose currency has appreciated with respect to the dollar by an estimated 19 percent during 2003.

Table 8 - FDI inflows in US$ millions

Countries	1999	2000	2001	2002	Country Estimates 2003	Projections 2004
Albania	41	143	200	135	175	300
BiH	90	150	130	321	259	350
Bulgaria	819	1,002	689	874	1,361 (c)	1,500
Croatia	1,637	1,126	1,502	1,124	1,250(d)	1,058
FYR Macedonia	32	176	442	78	53	133
Moldova	40	143	149	116	100	120
Romania	1,041	1,040	1,373	1,097	1,547 (f)	2,000 (f)
Serbia and Montenegro	112	25	165	592 (475)*e* (117)*e*	1,352 (1,300)*e* (52)*e*	(1,000)*e*
TOTALS	**3,812**	**3,805**	**4,650**	**4,337**	**6,097**	**6,461**

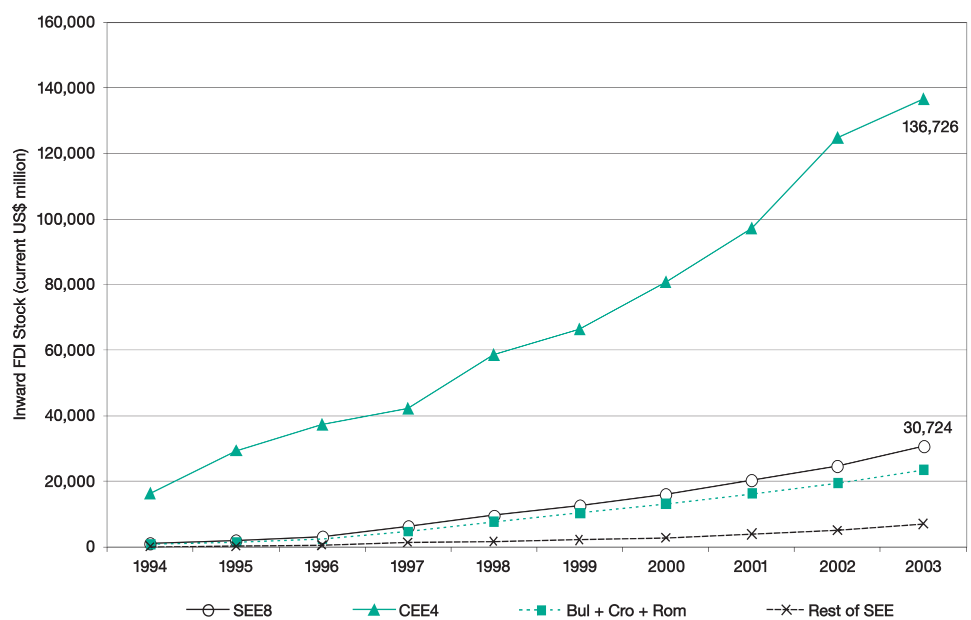
FDI stock still far behind Central and Eastern Europe (CEE)....

The rising overall volume of FDI is a welcome confirmation that the SEE Region is progressing towards a better market economy environment. But it does not answer two crucial questions in a satisfactory way: (a) is the growth rate of FDI high enough for the region to establish itself in the global FDI market as a significant destination and catch up with competitive regions such as Central and Eastern Europe (CEE)? (b) to what extent the FDI inflow record to date is due to one-off factors (such as privatisation sales), and to what extent a sustained rise in FDI can be expected in the medium term?

The descriptive analysis below provides alternative perspectives to shed light on the above questions. All data in this section need to be interpreted with caution, given the short time series available and the measurement problems with FDI data however the analysis does give useful insights into trends in SEE.

As depicted in Figure 3, in terms of total absolute amount of inward FDI stock, the SEE Region as a group continues to be dwarfed by four Central European countries (CEE4: Czech Republic, Hungary, Poland and Slovak Republic), although the two regions have roughly comparable populations (about 55 million in SEE8 against 64 million in CEE4 in recent years). FDI stock in CEE4 has approached US$140 billion while SEE8 is estimated to have reached US$30 billion by the end of 2003. It is clear from Figure 3 that in terms of overall weight in global FDI flows the SEE Region is still far from occupying a position comparable to CEE in the eyes of actual and potential investors.

Figure 3. Absolute Level of Inward FDI Stock



Partly reflecting lower GDP per capita in SEE.

The wide gap between SEE8 and CEE4 in terms of FDI stock performance (measured in US$) is partly the cause partly the effect of the wide gaps between the two regions in terms of total and per capita GDP. These gaps appeared between 1990 and 1994 and since then have not been narrowed considerably. Table 8 shows that total and per capita GDP has dipped substantially in SEE countries in the early 1990s, whereas following the brief downturns at the start of the transition process the CEE countries quickly returned to growth and could maintain a substantially rising *dollar* GDP through 2003. This meant that CEE represented a consistently growing market from the point of view of the international investor throughout the 1990s. With the limited data available on a small sample of countries it is not possible to bring out the causality relationship between FDI inflows and growth. However, a number of basic relationships can be established. A higher GDP per capita implies a higher purchasing power worker in the CEE countries on average. FDI contributes to GDP growth. But at the same time, *other things being equal*, a higher GDP per capita translates into larger domestic market and therefore attracts more FDI to serve that market, whereas a low and/or stagnant GDP per capita limits FDI intake. It can be inferred that the growth of FDI per capita and GDP per capita went "hand-in-hand" in CEE countries. If FDI has clearly become a strong growth engine in the second half of the 1990s, in the early 1990s it was clearly not yet the principal engine of economic growth in Central Europe. SEE on the other hand has seen substantial rises in its dollar GDP only towards the beginning of 2000s, a period when its per capita FDI stock also began to approach CEE4's levels in mid-1990s.

Table 9. Gross Domestic Product (GDP) and GDP per capita at current prices and market exchange rates

	GDP (US$ Billions)				GDP per capita (US$)			
(Weighted averages)	1990 (*)	1994	1998	2003	1990 (*)	1994	1998	2003
CEE4	142	190	284	405	2,219	2,947	4,403	6,281
SEE8	166	78	104	138	2,720	1,311	1,781	2,520
Bulgaria + Croatia + Romania	121	54	76	105	3,297	1,518	2,163	3,081
Rest of SEE	46	24	28	33	1,857	998	1,204	1,605

(*) Excluding Bosnia and Herzegovina in 1990, where GDP data are not available for that year.

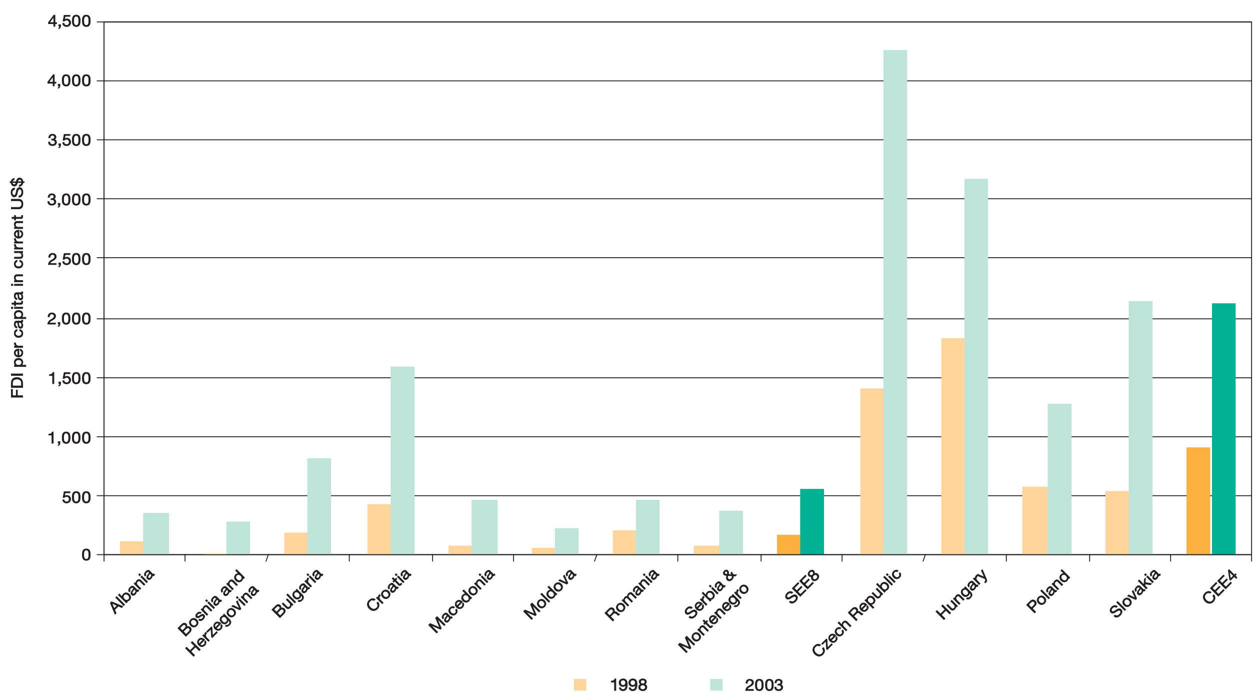
(Table 9 is not a growth analysis per se, because it uses GDP measured at current prices and expressed in US$, which thus reflect currency movements and price level changes, as well as real growth. It is used here to indicate the absolute differential between income/product levels between the Regions and over the period of observation).

FDI per capita far behind CEE...

Figures 3 to 6 provide different but complementary illustrations of the gap between SEE8 and CEE4 in terms of FDI stock per capita and the extent to which the former may be catching up with the latter.

As shown in Figure 4, at US$555 the FDI per capita level in SEE8 in 2003 is about a quarter the level (US$2,123) observed in CEE4 in the same year, or slightly more than half of CEE4's level in 1998 (US$907). Croatia is clearly more comparable to CEE4 in this respect, while several SEE countries (Bulgaria, Romania, Macedonia) are now approaching per capita FDI levels found in Poland and Slovakia area around 1998. The absolute gaps have increased between the two regions over the period of comparison, in terms of FDI per capita (just as they did in terms of FDI volume, as the two regions are experiencing more or less stagnant population.)

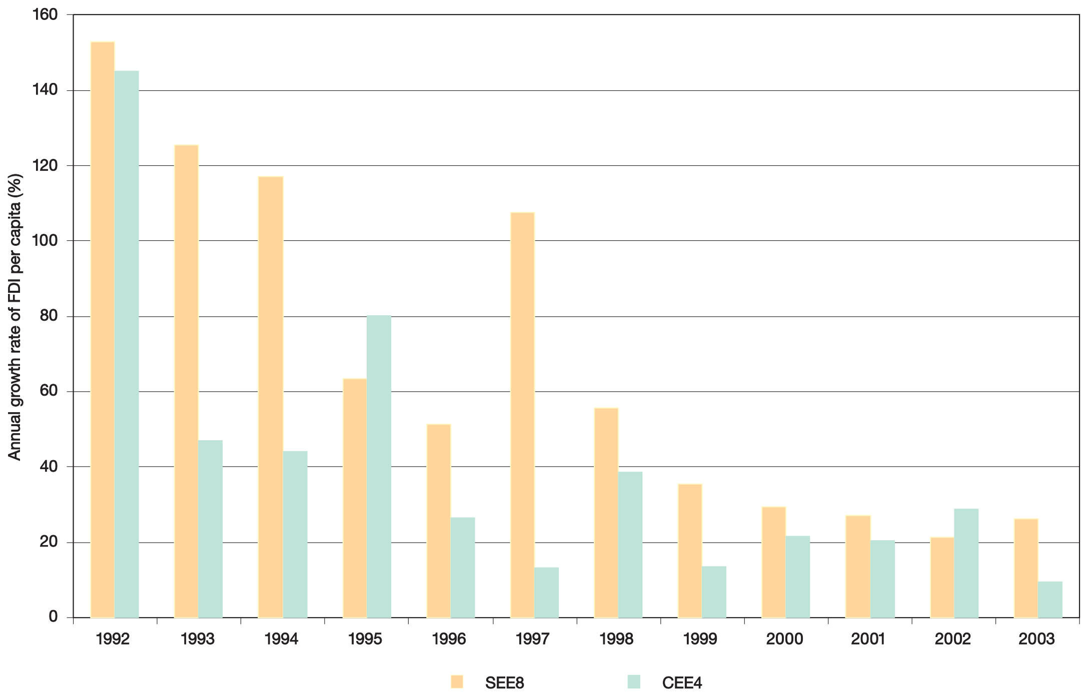
Figure 4. FDI Stock Per Capita in SEE and CEE Countries: 1998 vs. 2003



But FDI modestly catching up...

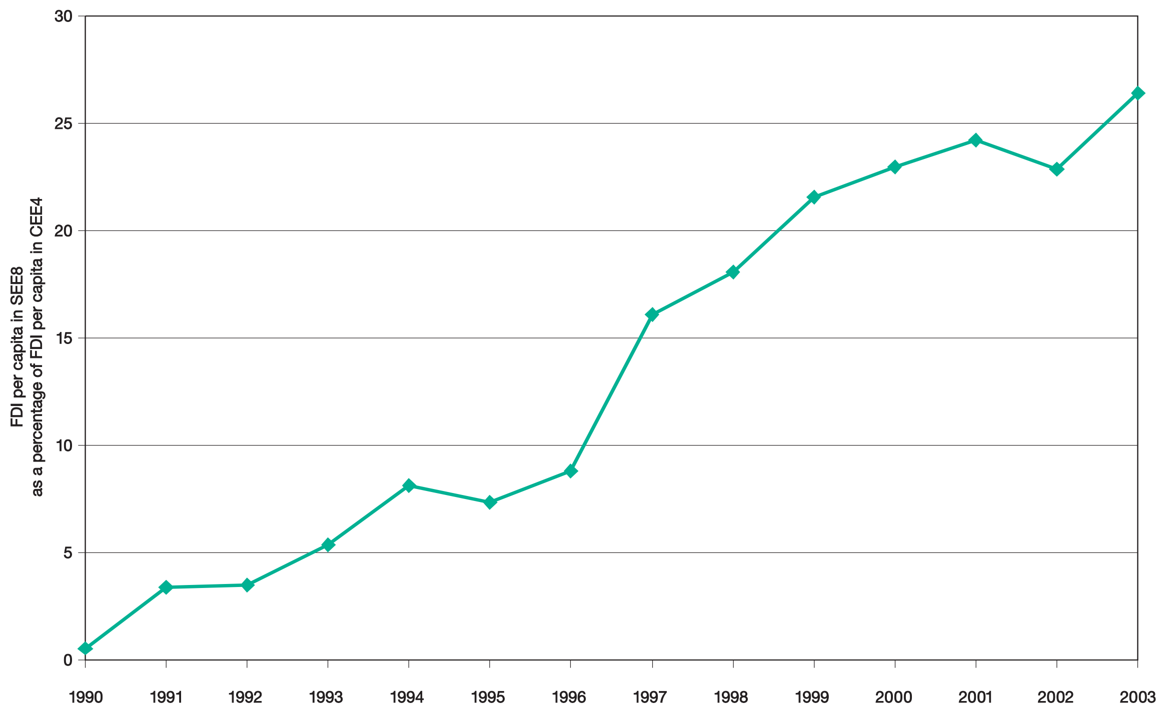
Turning to the growth rate of FDI per capita, Figure 5 compares the two regions under consideration in aggregate terms throughout the period for which there is relatively complete data available (1992-2003). It is clear that, with the exception of two years (1995 and 2002) SEE8 has experienced a faster growth rate of FDI per capita than CEE4 throughout this period. In some years the growth performance of SEE8 has been significantly above that of CEE4, sometimes double it, although the growth differential between the two has narrowed in recent years. This is of course primarily a reflection of typically high rates observed when growing from a low base, which was the case with the FDI stock in the SEE8 area. But it also implies that, basically, the massive headway that CEE4 still displays with respect to SEE8 in FDI per capita was really put in place at the very start of the transition period.

Figure 5. Growth of FDI Per Capita in SEE8 vs. CEE4, 1992-2003



The performance of SEE8 in terms of growth of FDI per capita has been superior to CEE4 for most of the 1990s. And yet, the higher growth in SEE8 was not sufficient to close the gap with CEE4 significantly, given that CEE4 itself has been one of the most dynamic and successful regions in the world in terms of FDI attraction. Figure 6 shows that FDI per capita in SEE8 has risen from about 10 percent of the level found in CEE4 in the mid-1990s to about 25 percent of it by 2003. However, this is not necessarily a comforting finding. At about the quarter the level of FDI per capita found in CEE4, the SEE countries can compare themselves (in very general terms) with where CEE4 were around 1997, but without an unprecedented worldwide FDI boom (of late 1990s) foreseen ahead.

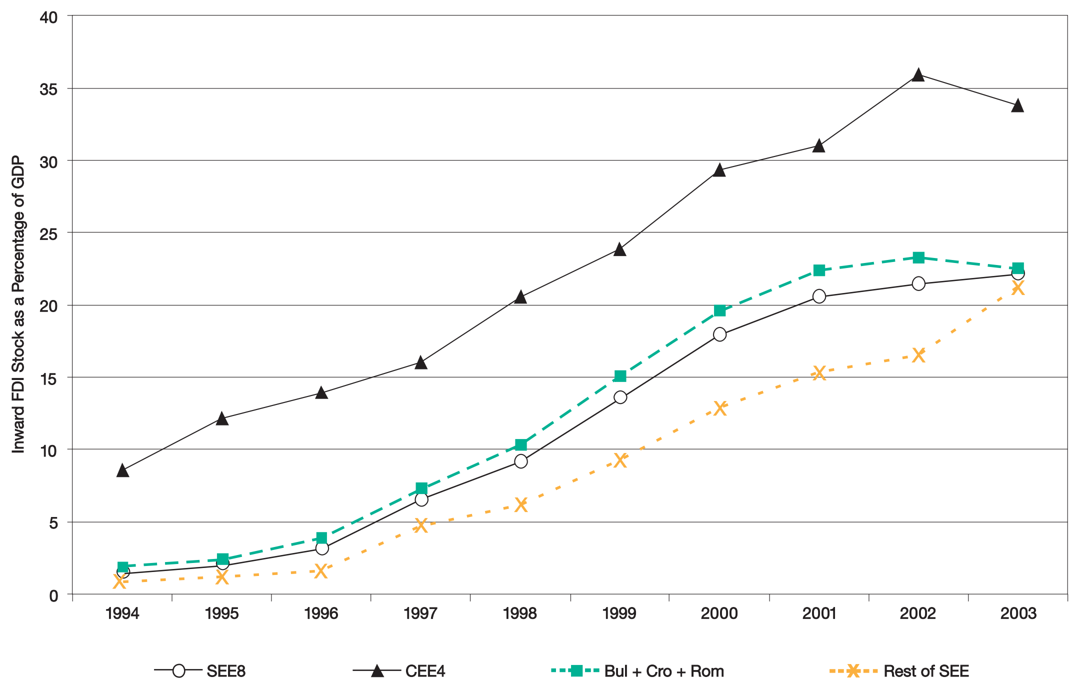
Figure 6. FDI Per Capita in SEE8 as a Percentage of FDI Per Capita in CEE4, 1990-2003



Nevertheless, FDI now represents a strong potential influence on SEE economies….

Even if SEE countries are behind CEE in the development of inward FDI, FDI has become a significant factor in their (relatively smaller) economies. FDI stock per unit of GDP (Figure 7) is one way to measure the potential impact of FDI in the host economy. Although SEE is still below CEE4 in this respect, it has nevertheless been catching up at a fast rate. Indeed, it can be argued that, although FDI in the SEE Region in absolute or per capita terms has a long way to go, because the business and investment in the former region remains more modest, what FDI already exists occupies a relative position comparable to CEE some 3-4 years ago, and can exercise a strong impact on future economic growth.

Figure 7. FDI as a percentage of GDP



Limits of comparison with CEE and some conclusions of FDI performance…

Very significant differentials in economic performance in general, GDP per capita growth in particular, have been established between CEE and SEE at the very beginning of the transition process. Thus, as a worldwide FDI "boom" unfolded through the mid- and late-1990s, the two regions were not starting from the same level of attractiveness to global FDI, even from sheer size.
SEE's growth disadvantage was compounded by slower and piecemeal reform. In most countries of the SEE Region (especially in former Yugoslavia, but also to some extent in Bulgaria) a strong push to carry out market economy-oriented reforms has taken hold only towards the end of the 1990s. The accumulation of FDI stock in the SEE region was modest until 1998, reflecting limited progress with reforms and disruption caused by war. The CEE Region was able to benefit substantially from the global FDI boom of 1990s, whereas SEE was barely touched by it.

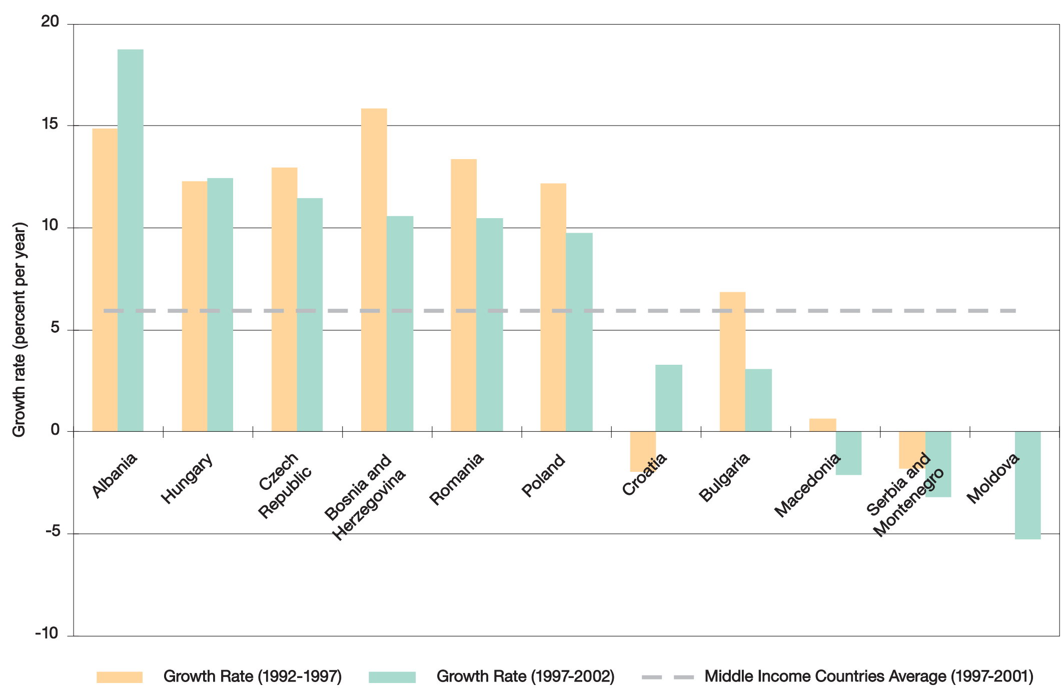
These taken together partly explain the vast gap between CEE and SEE in terms of both their relative position in the global FDI picture as well as the relative position of FDI within their business environments.

Catching up with the CEE, itself one of the fastest growing regions in the world in FDI stock terms may indeed be an over-ambitious comparative target for some time to come. A practical and useful perspective to assess whether integration into world markets is emerging is to assess performance in attracting export-oriented FDI.

Export Competitiveness and FDI.

One way to gain an insight into the sustainability of FDI inflows in SEE is to look at the outward orientation of the economies in general, measured by exports. FDI can flow into a country to purchase productive assets of any sort to serve domestic and/or international markets. However, in the case of smaller economies (which all SEE and indeed CEE countries are, on a global scale) we can expect that high and sustained levels of inwards FDI (after a surge associated with privatisations) are associated with the country's ability to attract export-oriented FDI which is seeking opportunities to utilise a country's comparative advantages as a production base to serve international markets. The performance of CEE Region is strongly correlated with their comparative ability to participate in this global process. Thus an analysis of the trade-FDI linkage can give an additional perspective on SEE's prospects to build upon its achievement thus far, by taking an increasing share of export-oriented FDI flows worldwide. To what extent have SEE countries shown the signs of a good and improving export performance?

Figure 8. Export Growth

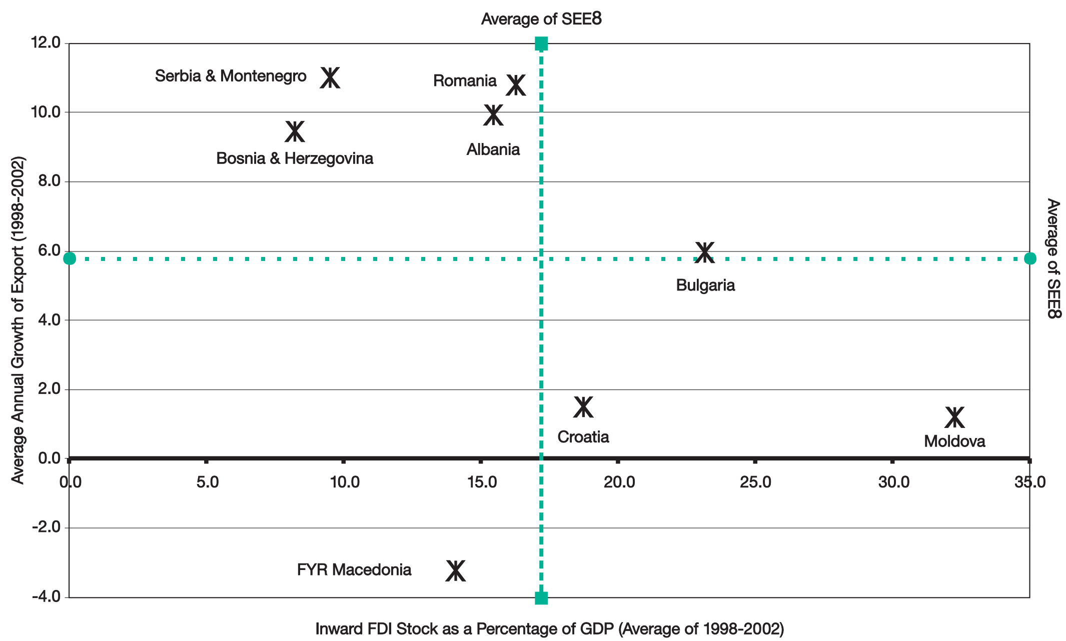


A number of salient country facts emerge from Figure 8. Most SEE countries are far from replicating the strong and sustained export growth registered by the CEE since the early 1990s. Many are below the average achieved by middle income developing countries as a whole, which are SEE's true competitors on a global scale. Considering its relatively more advanced industrial and technological level, it is interesting to note the very modest export performance of Croatia. Among the lower income economies, the surge of exports from Bosnia and Herzegovina mostly reflects post-war recovery from very low levels. Albania's remarkable export growth rate is also starting from very low levels. While Bulgaria was one of the more outward-oriented economies of the Region to begin with, its export growth has been disappointing and has gone down in the last five years or so, which correspond to the acceleration of Region-wide reform agenda. Among the larger SEE economies, Romania is the only country that can be said to be experiencing a significant export performance that is comparable to the experience of CEE during most of the transition period.

Export-oriented FDI feeble in most of the Region; Romania and to a lesser extent Bulgaria may be poised to begin to attract more of it….

Figure 9 provides a complementary perspective on the same issue by contrasting trade performance with success in attracting FDI. Figure 9 plots average FDI/GDP ratio against the growth rate of exports for the period 1998-2002. None of the countries with above average FDI/GDP ratio (Bulgaria, Croatia, Moldova) is associated with an above-average export performance. Indeed, all of the countries with strong export performance have below average FDI/GDP ratios (Albania, Bosnia and Herzegovina, Romania, Serbia and Montenegro). Bulgaria combines an above average FDI/GDP ratio with an average export performance (which, as we know from Figure 7, has been faltering in recent years.) Macedonia is below average on both counts.

Figure 9. FDI vs. Export Performance



This cursory descriptive analysis points to an important finding regarding FDI inflows into the SEE Region. While more or less the entire Region has been riding on a gradually rising wave of FDI in recent years, in a number of countries the increasing presence of foreign capital in the economy does not appear to be driving a deeper international integration of production. Croatia, arguably still the most advanced economy in the Region, is the leading underperformer in this respect, followed by Macedonia. But in Romania and to a lesser extent Bulgaria the significant FDI inflows of the last 5 years or so may be beginning to have some impact on the countries' exports. The extent to which FDI-driven enterprises are engaged in exports and take part in global value-chains requires further study. However, there is good anecdotal evidence that FDI inflows into Romania and Bulgaria are increasingly associated with the use of these economies as a production base to serve demand in developed market economies. Elsewhere in the Region much of the FDI is still likely to be associated with capital seeking to serve domestic markets, largely through acquisitions in network industries and services (financial services, telecommunications, energy distribution, etc.) As these markets are tiny on a global scale, large surges in FDI in the past several years do not provide any encouragement for the expectation that similar flows will continue in the future, unless the countries in question make a decisive effort to upgrade their investment environment, including by implementing the measures they have committed to in the context of these Monitoring Instruments.

Sources of data used in Chapter 7:

For Table 8: National bank of respective countries and IMF - EBRD (a) Source: Investment Promotion Agencies and Ministries of Economy of respective countries; (b) Source: "EBRD Transition Report 2002"; (c) Source: Bulgarian Foreign Investment Agency; (d) Investment Compact projection based on first three quarters' total of 1,180 million USD indicated by the National Bank of Croatia; (e) Serbia and Montenegro -- separate figures for each shown in brackets; Source: Serbia Investment and Export Promotion Agency for Serbia and Agency of Montenegro for Economic Restructuring and Foreign Investment for Montenegro; (f) Source: ARIS .

For Table 8 and Figures 3 to 9: FDI Stock from UNCTAD World Investment Report, 2003 and EBRD Transition Report 2003. Population and GDP data from World Bank, World Development Indicators CD-ROM edition, 2003. FDI data for 2003 are obtained from Investment Promotion Agencies of the SEE Region (see Sources of Table 8). Population and GDP data in national currency for 2003 are from national statistical offices, the latter converted to US$ at market exchange rates obtained from IMF, International Financial Statistics, CD-ROM edition, 2003.

ANNEX I: 2003 MINISTERIAL STATEMENT AND JOINT BUSINESS STATEMENT PRESENTED TO THE MINISTERIAL CONFERENCE

2nd Meeting of the Ministers of Economy from South East Europe

Vienna, 10 - 11 July 2003

Ministerial Statement

PUSHING AHEAD WITH REFORM: REMOVING OBSTACLES TO FDI IN SOUTH EAST EUROPE

1. Ministers renew their commitment to the implementation of the Vienna Ministerial Declaration on "Attracting Investment to South East Europe: Common Principles and Best Practices" (July 2002) and agree to continue to strengthen regional co-operation in the investment policy area. In particular, they confirm their commitment to actively participate in the Investment Compact Monitoring Process and endorse the value of regional co-operation, sharing regional experience and peer review.

2. Ministers welcome the assessment of policy reforms made in the two editions (September 2002 and April 2003) of the Monitoring Instruments published since their last meeting. They note that, as indicated by the Monitoring Instruments, significant steps have been made in the area of investment policies and promotion, and that good progress has been made in other areas such as tax policy, regulatory reform, customs and SME support.

3. At the same time Ministers recognise the need to complete progress on priority reform targets, to bring the direct investment regulatory framework in line with best international practices and to improve the investment climate throughout the region. Ministers call upon the Country Economic Teams to establish new, performance-oriented, time-bound targets for reform in the context of the Investment Compact Monitoring Process.

4. Ministers value the contribution made by the international business community through their statement presented at the Ministerial conference. Ministers commend the valuable input provided by the international investors' organisations to the policy reform process at the national level in many countries of the Region. In that context they also take note of the Belgrade Declaration of the Heads of State and Governments of the South East Europe Co-operation Process made in April 2003 which invites the Business Advisory Council of South East Europe to provide concrete proposals to that co-operation process. In particular, Ministers appreciate the steps taken by investors in the region to establish a regional network of international investor organisations, which will further strengthen policy dialogue and facilitate new investment.

5. Ministers recognise the value of regular and prior consultations with the business community, including representatives of the international business community, regarding policy priorities and effective solutions to investment policy issues, both at country level and regional level. This should include mechanisms for effective and regular consultation on the evaluation of existing policies as well as the introduction of new policy measures, and provide business feedback on the strategic direction of agencies dealing with infrastructure and investment policy implementation, including the investment promotion agencies, export credit agencies, SME and development agencies.
6. Ministers welcome the national treatment country reports prepared by the Investment Compact and call upon each participating State to follow the recommendations contained in these reports in the context of the Investment Compact Monitoring Process. In particular, they agree to take the following key measures over the next year, taking into account the legal situation in each country:

   - reduce licensing and approval procedures and special registration procedures, including reciprocity requirements for foreign investment to the level necessary for normal company law registration
   - take decisive steps with the view to allowing the acquisition of real estate by foreign investors for the purpose of investment
   - reduce reporting requirements for foreign investment for statistical purposes to a minimum necessary
   - establish transparent laws, regulations, procedures and practices regarding government procurement with a view to ensuring full national treatment
   - streamline measures relating to work and residence permits so as to allow the movement of key personnel for investment
   - promote the development of an effective services sector, in particular by removing obstacles to foreign direct investment in the areas of financial and professional services

7. Ministers confirm their resolve to implement the above-mentioned commitments and call upon the Investment Compact Project Team to update the list of exceptions to national treatment, monitor progress achieved in removing or reducing them, and prepare a report for their 2004 meeting at ministerial level.

8. Ministers recognise the importance of achieving further significant progress in the areas of regulatory reform, public and private governance, and combating corruption more effectively and encourage further work in these policy areas taking into account recommendations by the Investment Compact Project Team. Ministers agree that these areas should have a more central role in government policy and indicate that their 2004 meeting at ministerial level will be devoted to review progress achieved in these areas.

9. Ministers recognise that inadequate physical infrastructure constitute a significant obstacle to investment in South East Europe and call upon the Stability Pact member countries and international institutions to accelerate the implementation of programmes for the improvement of regional infrastructure, using the capacities of business networks such as the Business Advisory Council for South East Europe, in close co-operation with the Special Coordinator of the Stability Pact.

10. Ministers thank the co-chairs of the Investment Compact and the Stability Pact Special Co-ordinator for having promoted their 2003 meeting at ministerial level, and the Austrian Minister of Economic Affairs and Labour for having hosted it. Ministers express their appreciation for the leadership role played by the Regional co-chair, Romania, in the Investment Compact process. They also express their appreciation to the representatives of the international business community for their valuable inputs. Ministers agree to reconvene in mid-2004.

ADOPTED in Vienna, on the 11th day of July in the year two thousand and three:

Arban Malaj
Minister of Economy of the Republic of Albania

Mila Gadzic
Minister for Foreign Trade and Economic Relations of Bosnia and Herzegovina

Nikolay Vassilev
Deputy Prime Minister and Minister of Economy of the Republic of Bulgaria

Krunoslav Placko
Deputy Minister of Economy of the Republic of Croatia

Ilija Filipovski
Minister of Economy of the Republic of Macedonia

Veceslav Afanasiev
Deputy Minister of Economy of the Republic of Moldova

Mircea Geoana
Minister of Foreign Affairs of the Republic of Romania

Mihajlo Kovac
Ambassador, Ministry of Foreign Affairs of Serbia and Montenegro

Goran Pitic
Minister of International Economic Relations of the Republic of Serbia

Slavica Milacic
Minister of Foreign Economic Relations and EU Integration of the Republic of Montenegro

JOINT BUSINESS STATEMENT

Private Sector Partnership in Stimulating Reform and Investment in South East Europe

Presented to the 2nd Ministerial Conference of the Investment Compact for South East Europe
Vienna, 10-11 *July* 2003

Preamble

On the occasion of the 2nd Ministerial Conference of Ministers from South East Europe this Statement is presented to Ministers by the network of foreign investor associations/councils active in South East European Countries, including **Foreign Investors Association of Albania; Foreign Investors Association of Bosnia and Herzegovina; Bulgarian International Business Association; foreign investor representatives in Croatia, Foreign Investors Council of the FYR Macedonia; foreign investor representatives in Moldova, Foreign Investors Council of Romania;** and **Foreign Investors Council of Serbia and Montenegro** jointly with the **Business Advisory Council for South East Europe** (BAC SEE), the **Business and Industry Advisory Committee to the OECD** (BIAC), and in cooperation with the **Foreign Investors Association of Turkey** (YASED), the **Black Sea Economic Co-operation Business Council** (BSEC) and other individual private sector representatives.

I. International Private Investment in South East Europe

1. The organisations ("Business") presenting this Statement endorse the view that a regulatory and institutional environment that generates business confidence and fosters international and domestic private investment is key to sustained economic growth in the South East European Region ("the Region").

2. Business welcomes the priority given by the Stability Pact through the Investment Compact and the Business Advisory Council to South East Europe to focus on implementation of reform and to foster sharing of experience and joint action with all Stability Pact partners including OECD countries on initiatives to improve the investment environment and promote investment in the Region as a whole.

3. Business appreciates this opportunity provided by the Investment Compact 2003 Ministerial Conference to engage in a constructive dialogue with Ministers on reform issues at the Regional level.

4. In that context business believes that enhanced regional co-operation at all levels is mutually beneficial and a fundamental necessity to underpin economic growth and social development in the Region leading to closer integration with the rest of Europe and world markets.

5. Business recognises that, taken together, the countries of South East Europe constitute a market of sufficient size and scope to attract significant and strategic investment by foreign direct investors.

II. Recent Progress and Achievements

6. The Monitoring Process conducted by the Investment Compact reveals significant and progressive activity aimed at removing barriers to investment in the Region. Nevertheless, Business deems it crucial that more rapid, tangible and decisive action on the part of public authorities be undertaken to complete the effective implementation of the ongoing legislative and regulatory initiatives in the Region.

7. Business welcomes that the countries of the Region have to a great extent all reached or are close to reaching their targets in terms of carrying out the basic legislative and administrative actions needed to facilitate a better regulatory environment for international investment. Business urges the countries to continue to address with equal determination the removal of obstacles to business and investment and to pursue improved governance, regulatory reform and streamlining, and effective competition policy.

8. Business recognises that recently there has been an encouraging growth of interest in investing in South East Europe though the share of "greenfield" investment attracted is still comparatively low. Business regrets that a basic shortcoming in South East Europe remains the overall low level of investment in general, including investment by domestically-controlled companies, and the relatively slow pace of new investment.

III. Key Challenges Ahead and Business Recommendations for Reform

9. Business is committed to a constructive partnership and dialogue with the governments of the Region in order to help create a better understanding of practical economic and legal reforms required and underpin the political leadership and resolve needed for their implementation. Business recommends tangible actions by national governments to address the following issues in South East European countries:

   - Strengthen international and national efforts to liberalise the movement of persons, capital, goods and services in South East Europe through reform, regional co-operation and real implementation of international agreements, including bi-lateral, regional and multilateral free trade agreements, with a view to make South East Europe as much as possible a single market.
   - Business welcomes the proposed recommendations of the 2003 Ministerial Conference on the removal of measures specifically discriminating against international investors (that is, move to national treatment status) and calls for the speedy implementation of these recommendations
   - Note that further action is needed throughout the region to eliminate obstacles to business and investment, which are faced by all enterprises, international and domestic, including SMEs.
   - Recognise the fundamental importance of reform in the areas of public and corporate governance, and of regulatory reform. In this context Business welcomes that the 2004 meeting of the Ministers within the Investment Compact framework will concentrate on these issues.
   - Intensify real implementation of the rule of law, the fight against corruption and other illicit activities such as smuggling.
   - Develop further initiatives to adapt human resources to the needs of a competitive modern market economy based on the fact that the countries of the Region are characterised by relatively high standards of educational attainment in the labour force.
   - Review policy approaches to the tax treatment of international investment in accordance with OECD norms. In this context Business welcomes the planned meeting of Finance Ministers expected to be hosted by Romania in the second half of 2003 within the framework of the Investment Compact.

- Set up a legislative and regulatory framework necessary to encourage the use of public-private partnerships (PPPs) and to foster more collaboration between public and private sectors, in particular in improving the provision of high-quality basic infrastructure (such as in transport, water, sewage, telecommunications, health and office buildings), which are critical to attract other private investment.
- Continue and strengthen the unique collaboration by all SEE countries under the SEE Regional Roundtable on Investment Promotion in linking with investors, instigating new initiatives that highlight investment opportunities and building a new image for the Region.

10. Business invites all governments to take due recognition of the constructive and more detailed country-specific recommendations delivered to governments by Foreign Investor Associations/Councils (for example, White Book reports) and other international business organisations active in South East Europe.

IV. A Regional Network of Foreign Investor Associations: Strengthening the Business Voice in South East Europe

11. Business has taken the initiative to establish representative organisations in all countries of South East Europe, and international companies have an active presence in such national business associations.

12. Business stresses the importance of national consultative mechanisms between government and business on public policy issues and recommends this practice be facilitated and promoted in all countries.

13. Business acknowledges the contribution of many national and international networks among the private sector bodies active in South East Europe, such as the Association of the Balkan Chambers, national chambers, other bilateral chambers and similar groups that contribute to policy dialogue.

14. Business notes and welcomes that the heads of state and government of the Region have, in their Belgrade Declaration of April 2003, invited BAC SEE to submit concrete proposals to the South East European Cooperation Process.

15. Business recommends that, in the spirit of the regional cooperation that is growing in South East Europe, a joint and co-ordinated Regional policy advocacy by international business be instituted to complement the activity of national associations and establish a structured dialogue amongst them.

16. Business proposes to form a Regional Network of Foreign Investor Associations/ Councils to help strengthen business-government dialogue in the Region and improve the investment environment.

This Network will:

- Strengthen the voice of foreign investors in the Region and the business image of the Region
- Seek to improve the operational environment for intra-regional investment and trade by undertaking joint action where relevant on common issues that could benefit from a regional approach (e.g. customs duties and procedures, tax/double tax agreements, cross border trade and investment, cross border infrastructure)
- Support the regional approach to EU accession and integration of the Region into world markets

- Offer national Foreign Investor Councils a new platform to strengthen the regional message from existing investors in the Region to donor countries and international financial institutions
- Provide an opportunity to share experience among the foreign investor councils and organisations.
- Build practical case experience on common issues across the region (e.g. different application of similar laws in different countries).
- Engage in a policy dialogue with the governments of the Region (at regional meetings such as this Ministerial meeting), donor countries and international financial institutions regarding common concrete priorities and pace of reform.
- Foster business contacts/partnerships among national councils of foreign investors across the region.
- Work jointly with the BAC SEE in contributing to and making use of the request addressed to the BAC SEE by the Belgrade Declaration.
- Welcome and seek co-operation with other private sector organisations (e.g. bilateral joint chambers of commerce between OECD and SEE countries in the Region) in addressing all of these issues.

17. Business welcomes the recognition given to the value of regular and prior consultations with the business community regarding policy priorities and economic reform in the proposed 2003 Vienna Ministerial Statement on *Pushing Ahead with Reform: Removing Obstacles to FDI in South East Europe*.

18. Business organisations endorsing this statement are resolved to consult again with SEE governments in mid-2004, within the framework of the 3rd Ministerial Conference of the Investment Compact for South East Europe, in order to take stock of progress in addressing issues raised in this Statement.

19. Business thanks the Ministers of the South East European countries and the Austrian Minister of Economic Affairs and Labour hosting the Ministerial for having facilitated participation and partnership, as well as the Österreichische Kontrollbank for having hosted the meeting of Regional business.

ANNEX II: 2003 MINISTERIAL STATEMENT ON TAX POLICY IN SUPPORT OF INVESTMENT

1st Meeting of the Ministers of Finance

Bucharest, 4 – 5 December 2003

Ministerial Statement

TAX POLICY IN SUPPORT OF INVESTMENT

The Ministers of Finance of the Countries participating in the Stability Pact for South Eastern Europe, meeting in Bucharest on the 5th of December 2003:

1. considering the need of the Countries of South East Europe to attract and retain a larger volume of private investment in order to support economic development, generate employment and accelerate the process of economic integration at regional and European levels,

2. expressing their appreciation and full support to the work initiated under the framework of the Investment Compact by the Ministers of Economy of the Countries of South East Europe at their first meeting in Vienna in July 2002 and continued in their second Vienna ministerial meeting of the 10th and 11th July 2003,

3. recognising the contribution to policy debate and regional co-operation provided by 'The Declaration on Attracting Investment in South East Europe: Common Principle and Best Practices' issued by the Ministers of Economy of the Countries of South East Europe in Vienna on the 18th of July 2002, and the contribution to the tax policy debate provided by the OECD's Centre for Tax Policy and Administration,

Adopt the following Statement:

4. Tax policy design and administration play a central role in facilitating private investment from international and domestic sources and in promoting the development of a vibrant market economy. Tax systems function best when forming an integral part of a comprehensive effort to secure an enabling environment to private investment. Developing a balanced approach between budgetary and private sector development priorities is a key economic policy objective of all countries of South East Europe.

5. Tax policy has a definite but overall limited impact in influencing direct investment decisions over the geographical location of real (e.g. manufacturing) business activities. Where investors view the business environment as characterized by significant political, economic, or governance risk, the immediate focus should be on addressing policies and administrative practices that contribute to these risks. Attempts to use taxation to compensate for structural factors that are impeding to investment are unlikely to succeed.

6. Direct investment is encouraged where the tax system is transparent and predictable. Tax laws, regulations and administration should aim for certainty, clarity and stability. As a first step towards transparency, all taxes, duties and similar charges should have an explicit legal basis. All income and profits tax laws and regulations should be consolidated into a single Act, supplemented with publicly available explanatory materials and supporting information.

7. Critical to enabling cross-border investment and protecting the domestic tax base is a well established tax treaty network to address international juridical double taxation, provide certainty of tax treatment through the dispute resolution (mutual agreement) mechanism, and enable countries to ask their tax partners to help them enforce their tax laws.

8. Tax incentives should only be provided if they can be reasonably anticipated to meet a cost/benefit test that accounts for direct revenue loss and tax administration costs, and are not in violation of international obligations.

9. The evaluation of tax incentive programs, regular tax expenditure reporting and the inclusion of 'sunset provisions' in (new) tax incentive legislation are useful tools for improving tax policy management.

10. Tax incentives, if not properly designed, targeted and administered may create undesirable tax-planning and avoidance opportunities for domestic and foreign investors, and may result in revenue losses well in excess of those anticipated. Tax incentives may also prove to be unsustainable for the state budget and give cause for unexpected changes in the tax treatment of direct investment, thereby increasing investors' perception of risk.

11. Regular consultations involving tax and investment policy makers and Investment Promotion Agencies and business are helpful in improving tax policy design and assessment, and the coherence of tax and investment policies.

Action Plan:

Ministers agree to the following actions, in line with internationally recognized best practices in tax policy design, implementation and assessment:

12. Undertake regular reviews of tax systems to ensure that they are not impeding to direct investment, taking into account findings of the 2003 OECD report, *Tax Policy Assessment and Design in Support of Direct Investment – A Study of Countries in South East Europe*.

13. Establish a mechanism of regular policy consultation with the key government institutions in charge of elaborating and implementing tax and investment policies and the organisations representing private investors, both domestic and foreign.

14. Undertake evaluations of main tax incentive programs (including those about to expire under sunset provisions, and those that are open-ended) to ensure that such programs are meeting a cost/benefit test, and are transparent and consistently and fairly implemented. Reports on tax incentive evaluations should be prepared and made available to independent parliamentary committees and the public.

15. Integrate tax expenditure accounting with the central government budget process, involving regular reporting in budget documents of main tax expenditures, the public purpose of tax expenditure programs, their duration, and intended beneficiaries; and estimates where possible of the costs of all major tax expenditure programs.

16. Develop tax databases and simulation models to enable assessments of effective tax rates at the disaggregate level (on taxpayer groups and sectors), and to support tax expenditure accounting, and tax incentive evaluations.

17. Strengthen administrative abilities to negotiate, apply and interpret tax treaties to encourage direct investment and protect the domestic tax base.

18. Adopt/strengthen thin-capitalization and other anti-abuse rules to protect the domestic tax base from aggressive tax planning, in consultation with business.

19. Adopt transfer pricing rules which are consistent with the OECD 1995 Transfer Pricing Guidelines.

Ministers welcome the workshops organized by the OECD Centre for Tax Policy and Administration (Annex 1) and agree to designate tax officials to participate in these activities. Ministers agree that, if funding is available, it would be desirable to have an on-going monitoring of the implementation of these recommendations.

Ministers thank the Co-chairs of the Investment Compact, Romania, Austria and the OECD for having promoted the Ministerial Conference of the SEE Ministers of Finance and in particular Romania for having organised, with the support of the OECD, and hosted the event. Ministers finally express their appreciation to the representatives of the international business community, the Heads of the Investment Promotion Agencies and the representatives of the International Organisations for their valuable inputs. Ministers agree to reconvene by the end of 2004 to take hold of the progress achieved in implementing the Action Plan.

Endorsed in Bucharest on the fifth of December two thousand and three by:

Albania

Bosnia and Herzegovina

Bulgaria

Croatia

The Republic of Macedonia

Moldova

Romania

Serbia and Montenegro

Annex 1: ACTION PLAN: WORKSHOPS ON TAX POLICY DESIGN AND ASSESSMENT

Undertake evaluations of main tax incentive programs (including those about to expire under sunset provisions, and those that are open-ended) to ensure that such programs are meeting a cost/benefit test, and make reports on tax incentive evaluation available to independent parliamentary committees and the public: P*articipation of* SEE *tax policy officials in the* 2004 OECD *workshop on* Tax Incentives (*Vienna*, 1-5 *March*).

Integrate tax expenditure accounting with the central government budget process, involving regular reporting in budget documents of main tax expenditures, the public purpose of tax expenditure programs, their duration, and intended beneficiaries; and ii) estimates where possible of the costs of all major tax expenditure programs. Develop tax databases and simulation models to enable assessments of effective tax rates at the disaggregate level (on taxpayer groups and sectors), and to support tax expenditure accounting (and tax incentive evaluations): P*articipation of* SEE *tax policy officials in the* 2004 OECD *workshop on* Tax *Modeling* (*Vienna*, 19-23 *April*).

Strengthen administrative abilities to negotiate, apply and interpret tax treaties to encourage direct investment and protect the domestic tax base: P*articipation of* SEE *tax policy officials in the* 2004 OECD *workshop on* Tax *Treaties* (*Vienna*, 14-18 *June*).

Adopt/strengthen thin-capitalization rules to protect the domestic tax base from aggressive tax planning, in consultation with business: P*articipation of* SEE *tax policy officials in the* 2004 OECD *workshop on* T*axation of* F*inancial* I*nstruments* (A*nkara*, 6-10 *September*).

Adopt transfer pricing rules which are consistent with the OECD 1995 Transfer Pricing Guidelines: P*articipation of* SEE *tax policy officials in the* 2004 OECD *workshop on* T*ransfer* P*ricing* G*uidelines* (*Budapest*, 7-11 *June*).

ANNEX III: INVESTMENT COMPACT PUBLICATIONS[8]

INVESTMENT COMPACT POLICY REFORM REPORTS, ASSESSMENTS AND OTHER PUBLICATIONS

I. Monitoring Process and Instruments:

Progress in Policy Reform in South East Europe: Monitoring Instruments, 1st Edition (June 2001)
Progress in Policy Reform in South East Europe: Monitoring Instruments, 2nd Edition (September 2002)
Progress in Policy Reform in South East Europe: Monitoring Instruments, 3rd Edition (March 2003)
Progress in Policy Reform in South East Europe: Monitoring Instruments, 4th Edition (April 2004)
Ministerial Declaration, "Attracting Investment to South East Europe: Common Principles and Best Practices" (July 2002) The Ministerial Declaration is available in English, French, German, Albanian, Bosnian, Bulgarian, Croatian, Macedonian, Romanian, and Serbian.
Ministerial Statement, "Pushing Ahead with Reform: Removing Obstacles to FDI in South East Europe" (July 2003)
Business Statement at the 2003 Ministerial Meeting, Private Sector Partnership in Stimulating Reform and Investment in South East Europe (July 2003)
Investment Compact for South East Europe Brochure (September 2002)

II. Enterprise and SME Development:

Enterprise and Policy Performance Assessment of Bulgaria (December 2002)
Enterprise and Policy Performance Assessment of Romania (December 2002)
Enterprise and Policy Performance Assessment of Serbia (March 2003)
Enterprise and Policy Performance Assessment of Croatia (May 2003)
Enterprise and Policy Performance Assessment of Moldova (May 2003)
Enterprise and Policy Performance Assessment of Bosnia and Herzegovina (October 2003)
Enterprise and Policy Performance Assessment of FYR Macedonia (October 2003)
Enterprise and Policy Performance Assessment of Montenegro (October 2003)
Enterprise and Policy Performance Assessment of Albania (June 2003)
Regional Synthesis: Enterprise and Policy Performance Assessment of South East Europe (December 2003)

III. Public and Private Governance:

Competition Law and Policy in South East Europe: A Programme of Action (April 2003)
Review of Regulatory Governance in South East Europe (May 2003)
Regulatory Authorities South East Europe (October 2003)
White Paper on Corporate Governance in South East Europe (June 2003)

8 Copies may be downloaded from the website or the published copy obtained from Kimberly Pagels-McKnight (Kimberly.Pagels-McKnight@oecd.org) or Georgiana Pop (Georgiana.Pop@oecd.org).

IV. FDI Policy and Promotion:

Tax Policy Assessment and Design in Support of Direct Investment: A Study of Countries in South East Europe (April 2003)
A Survey of the Role of Taxation in Foreign Direct Investment in South East Europe (April 2003)
Putting the Policy Frameworks in Place: Experiences from Slovenia and South East Europe (December 2002)
National Treatment of International Investment in South East European Countries: Measures Providing Exceptions (October 2003)
White Book: Proposals for Improvement of the Investment Climate in Serbia (March 2003)[9]
Regional Roundtable for Investment Promotion Business Opportunities (August 2003)
Regional Roundtable for Investment Promotion Success Stories (August 2003)
Regional Roundtable for Investment Promotion Business Card (September 2003)
Strategic Investment Promotion: Successful Practice in Building Competitive Strategies (June 2002)
Investment Guide for South East Europe 2001 (September 2000)[10]
Investment Guide for South East Europe 2002 (September 2001)
Investment Guide for South East Europe 2003 (September 2002)
Investment Guide for South East Europe 2004 (September 2003)

9 The SIC Serbia and Montenegro was established.with the support of the OECD Investment Compact Team, and the White Book prepared by SIC members is an annual review.
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