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TAX REDUCTION SUGGESTED IN BULGARIA

The macroeconomic fundamentals of Bulgaria have substantially improved during the last some years. By now the economic situation has become stable. The GDP growth rate in 2004 was 5.6% and it is expected to be the same in 2005. Due to the successful fiscal policy, the government debt-GDP ratio was lowered by half over the past four years and fell to 35.9 % last January. After having a slight surplus in 2003, the government budget had a substantial surplus of 1,256.6 mn BGL in 2004. (See SEE Monitor 2005/3. p. 6-7.) The inflation rate also declined from 5.6 % in 2003 to 4.0 % in 2004. The unemployment rate is still high but continuously declining; it was 18.2 % in 2002, and then 13.7 % and 13.3 % in 2003 and 2004, respectively. The ratio of the budget to the GDP has an internationally low level; about 39 % (see Table 1.)

The continuously improving macroeconomic conditions made it possible that the government could revise and reduce various taxes several times. Prime Minister Simeon Saxcoburggotski's centrist cabinet has introduced several cuts to corporate and income taxes since coming to power in 2001. The current macroeconomic situation allows the new government to take office after general elections due in June 2005 is to decide on the possible further tax cuts.

In 2004 the standard corporate tax rate was 19.5%. Special tax rate applied to insurance companies as well as lottery and gambling business. At the beginning of 2005 the corporate taxes were slashed from 19.5 % to 15 %. The one-off tax on social and representative expenses dropped from 20% to 17%. Insurance companies will be subject to corporate taxation under the general provisions of the law, and general insurance companies will pay an additional tax of 3% on the amount of policies. Many experts suggest that the corporate tax rate could be reduced further.

Economic policy analysts urge that corporate tax cut has to be the priority of the future cabinet. There is an economic rationality to introduce a flat income tax. According to their arguments the next cabinet will be facilitated to cut the corporate tax down to rates ranging between 15 and 10 %.

Some of these analysts state that corporate tax rate might even well go down to 10 %. That is, a 10% flat rate for all direct taxes – corporate tax, income tax, social security tax. According to their calculation it is possible to achieve a considerable reduction of the direct taxes and at the same time to maintain a balanced budget or even budget surplus. Their proposal contains the following reforms in the tax system: a) decrease of the corporate tax to 10% (19.5% in 2004), b) decrease of the income tax to 10% (12-29% in 2004), c) decrease of the social security tax to 10% (42.7% in 2004), d) abolition of the dividend tax (15% in 2004).

Opponents of such proposals argue that several other details of the terms of the suggested changes have to be still elaborated. Thus the feasibility of the introduction of a 10% flat-rate tax in the course of the next 12 to 18 months is very much debated.

VAT rate is also considered to be relatively too high by the same analysts. They argue that this is the right moment to reduce its rate from the current 20 % to 18 %. The current favourable macroeconomic situation may ease the introduction of such changes because the expected temporary tax income decline will not cause significant problems for the budget.

The social security burden here is one of the heaviest in Europe. By 2009, the present ratio of 70:30 (employers-employees) is supposed to be levelled of (50:50). In case of reducing the insurance rates, the real-term contributions of the employees will not go up, while those of the employers will creep down.

The main aims of the further tax cuts are to support the efforts of attracting more foreign investment and adapting the economy to the European Union standards. The country aims to join the European

Union in 2007. In 2004, foreign investment in Bulgaria doubled from 2003 and their total value exceeded euro 2 billion (USD 2.6 billion). (See SEE Monitor 2005/2. p. 3-5).

The structure of the personal income tax system has been gradually simplified and the number of tax brackets has been reduced. The fundamentals of the present system are to prevail.

In 2005, the personal income tax rates were reduced by 2 percentage points, and the highest rate of 29% was eliminated. The tax free monthly income is increased from BGN 120 to BGN 130, the lowest tax rate becomes 10%, and the highest – 24%. For the time being there is no plan or suggestion to modify the present personal income tax system significantly (Table 2).

TABLE 1.
PLANNED REVENUES IN THE GOVERNMENT BUDGET OF 2005

	mln.levs	as % of GDP
Total Revenues	16 067.0	38.9
1. Tax Revenues	13 093.9	31.7
<i>Direct taxes</i>	6 412.4	15.5
Corporate taxes	981.6	2.4
Income tax	1 216.6	2.9
Social security tax	4 214.2	10.2
<i>Indirect taxes</i>	6 341.9	15.3
VAT	4 185.0	10.1
Excises	1 916.8	4.6
Customs duties	240.1	0.6
<i>Other taxes</i>	341.6	0.8
2. Non-tax revenues	2 451.0	5.9
3. Aid	520.1	1.3

TABLE 2.
PERSONAL INCOME TAX

Tax rate (in %)	Annual income until 2004		Tax rate (in %)	Annual income from 2005	
	in BGLeva	in euro		in BGLeva	in euro
0%	to 1,320	- 674.9	0%	to 1,560	- 797.6
15%	1,321 - 1,800	675.0 – 920.3	10%	1,561 – 1,800	797.7 – 920.3
22%	1,801 - 3,000	920.4 – 1,533.9	20%	1,801 – 3,000	920.4 – 1,533.9
26%	3,001 - 7,200	1,534 – 3,681.3	24%	3,001 -	1,534 -
29%	7,201 and above	3,681.4 -			

CROATIA: DELAYS IN STARTING ACCESSION NEGOTIATIONS?

One week before the planned starting date of Croatia's accession negotiation, it seems the Western Balkan country is in trouble in fulfilling the necessary criterion of launching the negotiations. In the Presidency Conclusions of Brussels Summit December 2004, the EU decided to open the negotiations on 17 March 2005 "provided that there is full co-operation with ICTY" or the International Criminal Tribunal for the former Yugoslavia. Actually, it was a reaffirmation of the Presidency Conclusions of June 2004, which has urged the country to locate and transfer the remaining indictee to Hague as soon as possible.

The European Commission has started to criticise Croatia at the end of January 2005 when EU Enlargement Commissioner Olli Rehn issued a warning to Croatia in which the Commission stated that the March date would be delayed if Ante Gotovina, a fugitive general was not transferred to Hague. As the Commissioner declared the Croatian government had the ability to locate and transfer the General. The Commissioner said this statement was based mainly on information from UN Chief Prosecutor. According to Carla del Ponte, the Croatian Government has been at least in indirect relation with General Ante Gotovina. Moreover, it was also expected that General Gotovina was hiding in Croatia or in the Federation part of Bosnia and Herzegovina.

Two weeks later, Jean-Claude Juncker, Luxembourg's Prime Minister, whose country holds the presidency in the first half of the year, and thus he spoke on behalf of the European Council, actually repeated the warning to Croatia. He also emphasised that the negotiations would not start until the Croatian government locate and transfer the fugitive general to Hague.

Carla del Ponte, the tribunal's Chief Prosecutor prepared a report in which she accused Zagreb with stalling and protecting General Ante Gotovina. Due to this severe report, the EU also repeated its opinion on starting accession negotiations, which would not be started until the fugitive general was transferred to the ICTY. In fact, the mood of the EU towards Croatia changed in February 2005.

Box. 1.

General Ante Gotovina is a former Foreign Legion veteran. In France he was convicted of kidnapping, bank robbery and extortion in the 1980s. In Croatia the General is a war hero who led the last blitz campaign against the Serbs ten years ago in the 1991-95 war. After the successful campaign General Ante Gotovina was responsible for the murder of dozens of elderly people and ethnic cleansing of more than 100.000 Serbian civilians. Since 2001 the General's whereabouts has been unknown. According to the tribunal, he is hiding in the hills of Croatia with his men.

Considering the other part, Croatian government maintains its statement that they do not know where Gotovina is hiding. Prime Minister Ivo Sanader said that there was no evidence that the fugitive general was in Croatia. The Croatian Prime Minister said he understood that the chief prosecutor wished General Ante Gotovina be transferred to Hague, but he stressed that "every claim must be backed with relevant evidence".

The Prime Minister also expressed his hope that the negotiation process would start on the planned date. Mr. Sanader remained optimistic related to this issue. He also added that the postponement of the launch of negotiations would strengthen anti-European forces and radicalism in Croatia.

In line with these events, Ante Gotovina offered via his lawyer that he would surrender if his trial could be conducted in Croatia. Certainly, the EU rejected this offer immediately.

Thus, it became a delicate issue in the relationship of the EU and Croatia and now it seems it cannot be a win-win situation. If the fugitive general is transferred to Hague the public support of the government will weaken, while local election is approaching, which will be held in April 2005. If Ante Gotovina remains hidden, the EU will not start the negotiations on 17 March and the delay may also cause political disadvantages both in Croatia and also in international terms.

Box 2.

Negotiation Framework proposed by the Commission

Croatia needs to fulfil the so-called 1993 Copenhagen criteria, which examine the political and economic situation of Croatia and the ability to adopt the obligations of the membership. In case of Croatia, it is also an important factor that the country needs to cooperate with ICTY, which is a necessary precondition of launching the negotiation process.

The negotiations will start with an examination phase. The EU legislation and standards are broken down into 35 chapters and the negotiations will be conducted chapter by chapter. To follow-up on Croatia's progress, the Commission will monitor the fulfilment of the commitments made during the accession negotiations.

Source: European Commission, DG External Relations

From the aspect of the EU, the postponement of the start of the negotiation has a strong message not only for Croatia but for all the former Yugoslav states (especially Serbia). The EU insists on the transfer of Ante Gotovina because of the fact that this would be a strong message to Serbia: in fact, the European integration of these countries is possible only if the issue of war crimes is solved. While, on the other hand, the postponement of EU entry talks also holds a negative message to Western Balkan states, which are considering the European integration of Croatia as a guide.

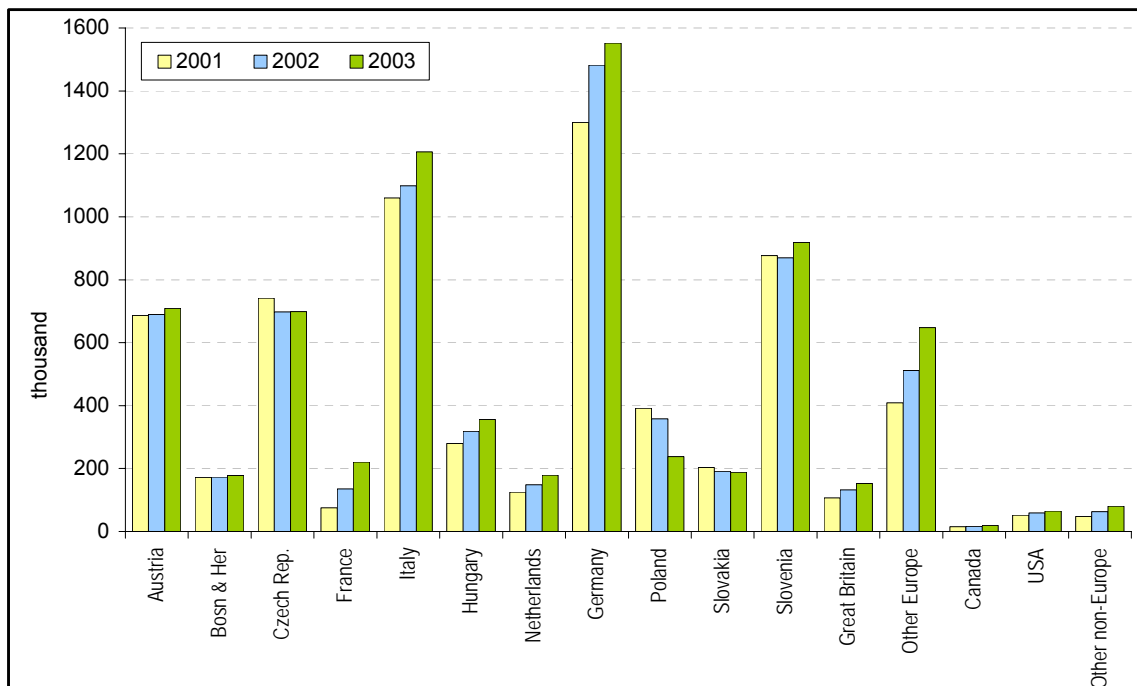
From the aspect of the economy, it seems that the economic actors have confidence that Croatia's EU accession will not delay. In the middle of February 2005, Kuna depreciated only less than 1% against the euro due to the negative messages but only for a short time. During the almost two and a half months of 2005, Croatian Kuna appreciated by 2,5% against the euro in nominal terms. On the whole, it means that these political factors had negligible impact on the Croatian economy.

One week before the planned date of start of membership negotiations, on 10 March the EU member countries will discuss whether the EU start accession negotiations. This will be a meeting at the level of ambassadors, which will be followed by another meeting at the level of foreign ministers. The final decision will be taken on 16 March.

TOURISM IN CROATIA

The tourism industry plays an important role in the Croatian economy. In 2004 the year-on-year increase of tourism income was 7 percent, with the income from tourism reaching EUR 7 billion in the whole year. All in all 9.4 million people visited Croatia in 2004, which is a 6 percent increase compared to the previous year. The number of overnight stays increased by 2 percent in the same period, reaching 47.8 million. The arrival of foreign tourists, as well as domestic tourism has been increasing in the Southeast European country in the past years. The most important country of origin of foreign tourists in Croatia is Germany. In 2003 1,552,000 German tourists visited the country, and they spent 11,056,000 nights there. The second nation with the greatest number of arrivals in Croatia in 2003 was Italy (1,206,000), with incoming Italian citizens spending less than half the amount of nights (5,323,000) in Croatia, than Germans. Fewer tourists came from Slovenia than from Italy, but the average number of tourists nights spent in Croatia was higher than one night in the Slovenian case. A high number of Austrians, Czechs and Hungarian also visited Croatia, however the number of Czech tourists has been following a decreasing trend. The number of French tourists spending their holidays in Croatia has also been increasing in the past years, as well as the number of Irish tourists. Tourists from Non-European countries did not play an important role in the Croatian tourist industry.

CHART 1.
TOURIST ARRIVALS BY COUNTY OF ORIGIN

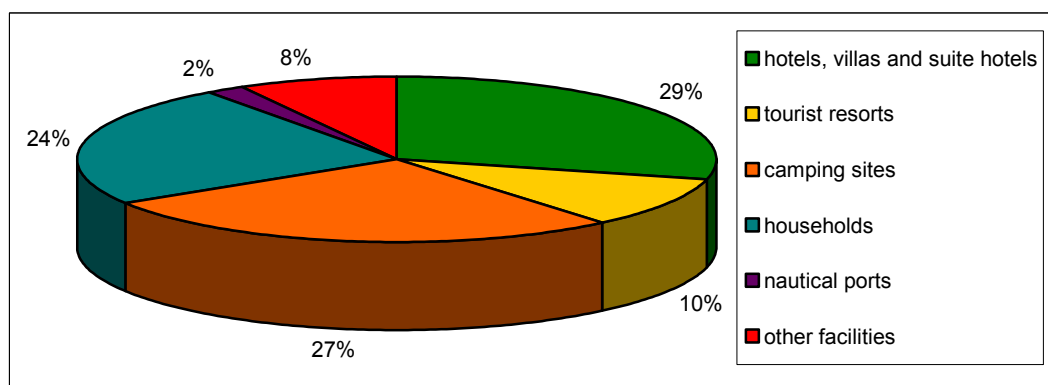


Source: Crostat

Even though Croatia was not a very popular place to spend the holidays for tourists from the United Kingdom, British tourists were the biggest spenders in the summer of 2004. According to the survey conducted by the Zagreb Institute of Tourism between June and September, the tourists from the UK spent 115 euros per day, while the French took the second place concerning spending, with 100 euros per day. The average spending of all tourists visiting Croatia was 49 euros per day. This reflects a 42 percent increase compared to the daily tourist spending in 2001. Italians spent 55 euros a day on average, while Germans and Austrians 52 euros, Hungarians 47 euros, and the Dutch 46 euros.

The structure of tourist nights by types of accommodation facilities changed only slightly between 2001 and 2003. The share of tourist resorts (including hotel resorts, hotel-apartment resorts, apartment resorts, and tourist resorts) decreased from 12 percent in 2001 to 10 percent in 2003, while the share of households, private rooms, apartments, suites and summer houses increased from 22 percent to 24 percent in the same time period. The share of hotels, villas and all suite hotels, camping sites, nautical ports and other facilities remained unchanged. The development of capacities also reflected the changes in the structure of types of accommodation facilities. The number of beds in tourist resorts has been decreasing, while in all other types of accommodation it was increasing.

CHART 2.
STRUCTURE OF TOURIST NIGHTS BY TYPES OF ACCOMODATION FACILITIES, 2003



Source: Crostat

According to the Croatian Ministry of Tourism, EUR 250 million will be invested in hotel building and expansion, and EUR 40 million in the building of camp sites during 2005, the same amount as in the previous year. There is a chance that this amount will increase, as the Croatian Bank for Restructuring and Development created a credit facility for the tourism industry with favourable interest rates. For those companies where 30 percent of overnight stays is by foreign guests and where the owners are willing to supply themselves exclusively from Croatian sources, the CBRD is prepared to give loans with a 2 to 4 percent interest rate.

Magnum Hr International, a company owned by the Austrian Real 4 You in Vienna is making large investments in the Croatian tourism sector. It has already purchased two hotels in Opatija: Palma and Astoria, besides other hotels on the island of Losinj. Magnum has also started investing in nautical tourism. After refurbishment, the Palma and Astoria hotels are expected to open their doors to tourists in May.

MONTENEGRO WANTS TO LEAD ITS FORTUNE UNDER ITS OWN HAND

Montenegro is going to hold a referendum about being independent from Serbia in February, 2005 – as the Prime Minister of the Montenegrin Polity, Milo Djukanovic said. Vojislav Kostunica, the Serbian Prime Minister defeated the motion and called the initiative the broad contravention of the Agreement in Belgrad in 2002. The Montenegrin politician argued that Montenegro separated from Serbia could achieve the EU membership faster. As he said, the advocates of the nationalism are shooting out in Serbia and making the approach to the European Union more complicate. The key of the ambitions of the two republics towards the EU is to harmonise their economic framework, which has not come true yet. There are two currencies afloat, the processes of the privatisation move on absolutely independently, the liberalization of the foreign trade has different levels and there is no unitary customs and tax frame. Djukanovic said that the offer of Podgorica is still valid and Serbia has to decide whether it wants to cross with the independence of Montenegro or they make it together.

ECONOMIC OVERVIEW

The swift collapse of the Yugoslav Federation in 1991 was followed by highly destructive warfare, the destabilization of republic boundaries and the break-up of important interrepublic trade flows. The Milosevic-era mismanaged the economy, it was the period of the economic sanctions. The output of Serbia and Montenegro dropped by half in 1992-1993. Hyperinflation denoted with the establishment of a new Currency Unit in June 1993, and the prices have not been relatively stable since 1995. The damage to Yugoslavia's infrastructure and industry during the NATO air strikes in 1999 left the economy only half the size it had been in 1990. After the changing of former Federal Yugoslav President in October 2000, the Democratic Opposition of Serbia coalition government began an aggressive market reform program. After renewing its membership in the IMF in December 2000, Yugoslavia continued to reintegrate into the World Bank and the European Bank for Reconstruction and Development. The World Bank-European Commission assists the country's economic restructuring with 1.3 billion USD. An agreement rescheduling the country's 4.5 billion USD government debts was concluded in November 2001, and it wrote off 66% of the debt. The Republic of Montenegro severed its economy from Federal Control and from Serbia and continues to maintain its own central bank, collects customs, tariffs, and manages its own budget. The legal tender in Montenegro is the Euro and in Serbia it is the Dinar. The complexity in the political relationships of Serbia and Montenegro, the slow progress of the privatisation, legal uncertainty over property rights and scarcity of foreign-investment are holding back Serbia and Montenegro's economy, in which the high unemployment rate is the key problem.

TABLE 3.
THE MAIN ECONOMIC DATA FROM 2001-2003:

	2001	2002	2003
GDP-growth (at constant prices in %)	5,3	3,8	2
Exports-growth (in %)	10,5	19,5	11,5
Imports-growth (in %)	30,3	30,7	18,8
Unemployment rate (in %)	5,7	8,6	10

Source: Statistical Office in Serbia and Montenegro

Serbia and Montenegro's macroeconomic situation in 2004 was marked by a high growth of retail prices, exports and industrial production, rampant spending earnings. The growth of retail prices

reached 13,7% in the last year, and it is significantly higher than the expected level. The IMF asserted that the government needs to keep under control its policy of wages in the public sector and should harmonise it with the productivity growth. In 2004 the budget deficit stood at 4,5% of the GDP. It should be noted that it is significantly lower than in 2003, but it has to be reduced. The government has to solve the problem of the growing inflation and the foreign trade deficit as soon as it possible.

As we can see, the country has to bridge a lot of economic problems to be able to get closer to its aim, to the EU membership. But is it true that the only way to this is the Montenegrin split from Serbia?

ABOUT THE OPINION OF THE EU

The new State Union between Serbia and Montenegro was finally formed in February 2003 in large part under EU pressure. It soon became clear that the process of harmonising the two economies, as envisaged in the agreement, would be extremely costly, both politically and economically. Over the years the economic system of the two states have become fundamentally different. So, by 2004, the European Union has realized that its original hopes would not bear fruit, and proposed the more flexible „twin-track” approach. It means that the EU considers the preparedness to the integration of the two republics separately. There are two major problems:

- The prosecutions of war criminals and the co-operation with the International War Crimes Tribunal for Former Yugoslavia, and
- the differences in the economic system of Serbia and Montenegro and the necessity of their harmonisation.

The „twin-track” program has been initiated to resolve the latter problem. But this approach means not by a long chalk that the EU agrees with the Montenegrin initiative. The boot is on the other leg! Some analysts say EU leaders fear that Montenegrin independence could spur the separatist drive in Kosovo and reopen Pandora’s box of border adjustments throughout the region. The worries of the European Union about this proposal was outlined by the high commissioner’s spokesman of the foreign and security policy in the EU. As he said, the EU membership of Serbia and Montenegro could become true if the country focuses with its all strengths on the achieving of the economic and political reforms. The EU emphasizes that Serbia and Montenegro have to establish a democratic political system, advance the political and economic reforms, and have to get closer to the integration in 2005. But to solve these problems is the key not the split but the efficient actuation of the State Union.

SUMMARY

The most important objective of Montenegro is to be an official EU member as soon as possible. But it wants to achieve this aim in a special way. It wants to be independent from Serbia. It is not a question that the State Union in this form is inefficient. But many experts (especially from the European Union) think, that the split could make political atmosphere for the approach to the EU to become harder. The economic consequences would be likely not so considerable, because now the two states enjoy essentially autonomy, only their foreign affairs and security processes are collective. The solution of the problem could be the reformation of the system, and if Montenegro really wants to go closer to the EU, it will have to think about this approach.