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TABLE OF CONTENTS

MORE EU ASSISTANCE FOR THE WESTERN BALKANS

The European Commission carried a grant motion about € 272.5 million to assist Macedonia, Serbia and Montenegro and Kosovo. This amount could be appropriated for support of public institutions and creating the frame of the legitimacy. Within the confines of the **CARDS** Programme **(Community Assistance for Reconstruction, Development and Stabilization)** the three countries get different subsidies: Macedonia: € 34.5 million, Serbia and Montenegro: € 184 million, Kosovo: € 54 million.

The appropriation method of these amounts depends on the political atmosphere of the countries. The accent is (in place of the restoration of the infrastructure) on supporting the public sector, on the EU-harmonisation and on the reinforcement of the free market.

ABOUT THE CARDS:

The EU has been the single large assistance donor to the Western Balkans since 1990s. (The 'Western Balkans-expression' was produced by the European Union as well, with the aim to integrate these countries to the EU.) Since 1991, including 2001 the European Union has provided more than 6.1 billion Euros, and for 2001 over 845 million Euros have been made attainable for the three aid programmes (Phare, Obnova and CARDS).

In the 1990s the relationship between the European Union and the Western Balkan focused particularly on the crisis management and the reconstruction. The amount of these assistance programmes totalled 5.5 billion Euros. After the evasion from this period, the needs arose for the beginning of a long-term stabilization process. So in 1999 the European Union set up the Stabilisation and Association Process (SAP), which is now the cornerstone of its policy in line with the Western Balkans. The SAP is accompanied by a generous financial assistance programme, called Community Assistance for Reconstruction, Development and Stabilisation (CARDS) programme. The European Council lauched the CARDS Programme in December 2000, which supreme objective is to help the countries of the Western Balkan and to solve their regional problems: the reconstruction, the reforming and enhancing of the economic and policy framework, and to advance the co-operation between them. These two aims were established by the SAP, which is the final stage of the policy creating a contractual relation between countries of the region and the European Union. CARDS supports participation of Albania, Bosnia-Herzegovina, Croatia, Serbia and Montenegro and the Former Yugoslav Republic of Macedonia. For this purpose the Programme provides €4.65 billion in the period 2000 to 2006. To achieve its objective of facilitating the SAP, CARDS assistance will finance investments, institution-building and other programmes in four major areas:

- Reconstruction, democratic stabilisation, reconciliation and the return of refugees. Institutional and legislative development, including harmonisation with EU norms and approaches, to underpin democracy and the rule of law, human rights, civil society and the media, and the operation of a free market economy.
- Sustainable economic and social development, including structural reform.
- Promotion of closer relations and regional cooperation among SAP countries and between them, the European Union and the candidate countries of Central Europe.

THE THREE CONTRIES AND THE CARDS:

MACEDONIA

On 22 March 2004 the former Yugoslav Republic of Macedonia applied for the EU membership. On 1 April 2004 the Stabilisation and Association Agreement between Macedonia and the EC entered into force and the first meetings of the Stabilisation and Association Council and Committee have already taken place in Brussels, as well. From the present fund of the European Union, € 18.5 million will be contemplated for judicial and police reforms, and for fight against organized crime. The proposed activities in the field of public administration reforms mean: building administrative capacity in the areas of statistics and telecommunications, support of the decentralization process, and grants in fields of customs and taxation. The EC's assistance will support further implementation of Ohrid Framework Agreement and will help the country to strengthen the government's capacity of its full construction. The efforts will be focused on two areas:

- building capacities in the new Government sector responsible for implementation of the Framework Agreement and
- increasing the participation of minority ethnic groups in the public administration.

For these projects two million Euros are allocated, and same amount is intended for Macedonia's participation in the European Community projects. And finally € 10.6 million will be allocated for improving the economic and social development, with the aim to create a favourable atmosphere for the investments in the country.

Similar to the previous years, the General Technical Assistance Programme (GTAF) will also support the process of planning future programmes: now with 1.4 million Euros.

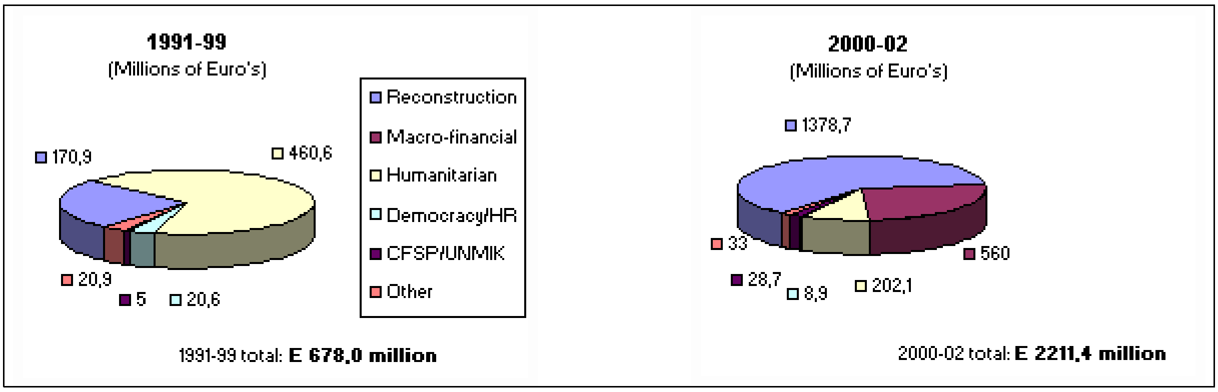
SERBIA AND MONTENEGRO

The Commission produced a recommendation on 12 April 2005 to open negotiations with the two republics of Serbia and Montenegro on a Stabilisation and Association Agreement (SAA). The Agreement establishes the first contractual relationship between the country and the EU and could lead to membership.

The grand objective of CARDS assistance to Serbia and Montenegro is to contribute to the state's progress in the SAP. It means, it is now concentrated in three main areas of intervention:

1. Support for good governance and institution building, focusing on public administration reform, justice and home affairs (e.g. strengthening the rule of law) and customs and taxation.
2. Economic recovery, regeneration and reform, focusing on energy, transport, environment and economic development.
3. Social development and civil society, focusing on university education, enhancing regional cooperation, vocational education and training linked to employment generation and civil society strengthening.

CHART 1. – FACTS AND FIGURES ON EC ASSISTANCE IN SERBIA AND MONTENEGRO:



Source: http://europa.eu.int/comm/external_relations/see/fry/index.htm

The European Commission has approved a Feasibility Report assessing the readiness of Serbia and Montenegro to negotiate a Stabilisation and Association Agreement (SAA) with the EU in 2005. This agreement will establish the first contractual relationship between Serbia and Montenegro and the European Union. The Serbian Prime Minister, Kostunica said that Serbia has been waiting for this day since October 2000. The European Commission (EC) has adopted its Annual Programmes for Serbia, Montenegro and the State Union of Serbia and Montenegro. To reflect the specific constitutional structure of Serbia and Montenegro and the EU's "twin track" approach, the total € 184 million from the 2005 CARDS Programme has been distributed in three different action programmes:

- €154.5 million assisting the Republic of Serbia,
- €22 million assisting the Republic of Montenegro and
- €7.5 million for the support of the administrative structures on the level of the State Union of Serbia and Montenegro.

The three programmes will help Serbia and Montenegro to realize reforms and modernisation efforts. The programmes also support Serbia and Montenegro's objective to move closer to the EU and reflect the priorities of the European Partnership published in 2004. Support will be given in the areas of democratic stabilisation, good governance and institution building and economic and social development.

KOSOVO

The main objective of the EU is from the very beginning in connection with Kosovo, to build a new future for the country. The European Union 's presence in Kosovo takes three major forms:

- ECHO: the Humanitarian Aid Office. It is the EU 's humanitarian arm providing emergency assistance to the people in need.
- The European Agency for Reconstruction. It finances and manages sustainable reconstruction and development programmes under the political guidance of the European Commission.
- The EU pillar of the United Nations Interim Administration in Kosovo (UNMIK). As part of UNMIK, the EU's role is to revitalise economic activity in Kosovo, rebuild what has been damaged by the war and create the conditions for a modern, open market economy.

TABLE 1. –THE THREE FIELDS OF THE EU SUPPORTS IN THE PERIOD OF 1998-2001 ARE:

EU support to Kosovo (in million of €)	1998	1999	2000	2001
Reconstruction assistance	7.5	127	275	320.0
Humanitarian aid		378(1)	50	12.5
Financial assistance (macro-economic)			35	30.0
TOTAL	7.5	505	360	362.5

(1) This amount was provided for supporting the region affected by the Kosovo crisis (Albania, FYROM, Montenegro). Out of the €378 million, €111.7 million were directly spent in Kosovo.
Source: http://europa.eu.int/comm/external_relations/see/fry/index.htm

In 2005, within CARDS Programme the EU spent € 54 million to assist Kosovo in its reforms and modernisation processes. The main objective of the programme is to help the country to build a stable future for a secure, democratic and multi-ethnic Kosovo. The support will be given in the areas of democratic stabilisation, good governance and institution building and economic and social development even as in Serbia and Montenegro.

One Step Closer to EU Membership

On 25 April 2005 Bulgaria and Romania signed the accession treaty with the European Union in Luxembourg. The objective date of the accession of the two countries is the beginning of 2007, consequently approximately 20 months remained until Bulgaria and Romania become full members of the Community. In the worst case, the accession will be delayed by one year to 2008 if the countries are not prepared for the membership and are not able to make the necessary reforms.

Background

At the end of '90s two groups were formed among the EU candidate countries. In the first group – the so-called 'Luxembourg countries' – countries as Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia were listed as the front-runners. In the second group ('Helsinki countries') those countries were included which lagged behind in the transition process (except for Malta), such as Bulgaria, Latvia, Lithuania, Malta, Romania and Slovakia. In the case of the second group accession negotiations were launched in 2000, while the other six applicants had already launched their negotiation process two years earlier, in March 1998.

By the end of 2002 most of the countries from the second group were able to make up leeway and their negotiation processes were also concluded at the end of 2002, as it happened in the case of the six 'Luxembourg countries'. The result was that ten, mostly Central and Eastern European countries joined the EU in May 2004, one year ago. Two candidate countries were excluded from last year's enlargement, Bulgaria and Romania. The two Southeast European countries were not able to close all their negotiation chapters until the end of 2002, thus they lagged behind in the European integration process.

At the end of 2004 Romania was able to close all remaining negotiation chapters, so the pre-accession session was completed. It was also a positive sign to Bulgaria, which already closed all chapters in mid-2004. The smaller candidate country followed the negotiation process of Romania attentively, because it was obvious that the accession of the two candidates was coupled. Fortunately, the accession negotiation process was finished in time in the case of both countries.

On 13 April 2005 the European Parliament (EP) voted to approve the accession of Bulgaria and Romania in 2007. Bulgaria received a total of 522 votes in favour with 70 against, while Romania received 497 and 93 votes respectively, so the members of EP supported Bulgaria's accession a little more. However, these votes cleared the way to the signing of the EU accession treaty held on 25 April.

Bulgaria and Romania still have work to do, they cannot sit back and wait for the membership. If they fail to make the necessary reforms, the accession can be delayed by one year to 2008.

In the case of Romania, there are concerns about justice and home affairs and competition policy. However, Commissioner Ollie Rehn has appreciated the Romanian government's efforts dealing with judicial reform and state subsidies, as well as fighting against corruption. In the case of Bulgaria, there are fewer problems than in Romania, but the case of the Bulgarian nuclear plant, corruption and the softness of the court system are needed to be mentioned.

EU-27

With the accession of Bulgaria and Romania, the number of the EU Member States will rise to 27. The population of the EU will increase by approximately 30 million people (+4,9%) while the territory of EU will grow by almost 350.000 km2 (+8,9%). Due to the fact that Bulgaria and Romania are relatively poor countries, the GDP of EU27 will not increase significantly (approximately +100 billion euro – or less than +1% - estimated in 2007) and the per capita GDP in EU will remain basically unchanged.

It is interesting to compare the two candidate countries' current and estimated economy (in 2007) regarding the main macroeconomic indicators. Due to the fact that Bulgaria and Romania have been able to increase their economic growth pace from the beginning of this millennium on the one hand, the state of their economy improved significantly, and on the other hand, the continuity of this trend is expected in the next few years, in medium term.

TABLE 2. –MAIN MACROECONOMIC INDICATORS, 2004-2007

		2004**	2005*	2006*	2007*
GDP/capita (euro, PPS)	Bulgaria	6900	7400	7900	8500
	Romania	7000	7550	8150	8800
GDP/capita (EU25=100)	Bulgaria	30.9	32.0	32.8	34
	Romania	31.4	32.7	33.8	35,2
CPI (%, annual average)	Bulgaria	6.2	4.2	3.9	4.0
	Romania	11.9	9.0	7.0	6.0
General Government Balance/GDP (%)	Bulgaria	1.7	-0.5	0.2	-0.2
	Romania	-1.0	-1.6	-1.4	-2.0
Current Account Balance/GDP (%)	Bulgaria	-7.2	-7.3	-6.8	-6.8
	Romania	-7.5	-7.8	-7.8	-7.6

** Forecasts, ** Preliminary data*

In both countries the real GDP growth is expected to be around 5-5.5% annually in the next two-three years, which means further convergence to the EU-average. The GDP growth in EU25 is expected to be around 1.5% and 2.5% in the current and the next year. It means that Bulgaria and Romania are expected to decrease the difference by 1%-point annually (from 30-31% in 2004 to 33-34% in 2007). However, the two Southeast European countries will become the poorest Member States of the EU at the time of the accession.

The inflation rate is relatively low in Bulgaria and it is expected to remain low in the next years too. In Romania, the disinflation process is ongoing, last year the annual consumer price index was still a two-digit one (11.9%). In 2005, the annual CPI can go under 10% and become one-digit for the first time after the transition. It also means that the country will be closer to the Maastricht criterion to have a low inflation rate.

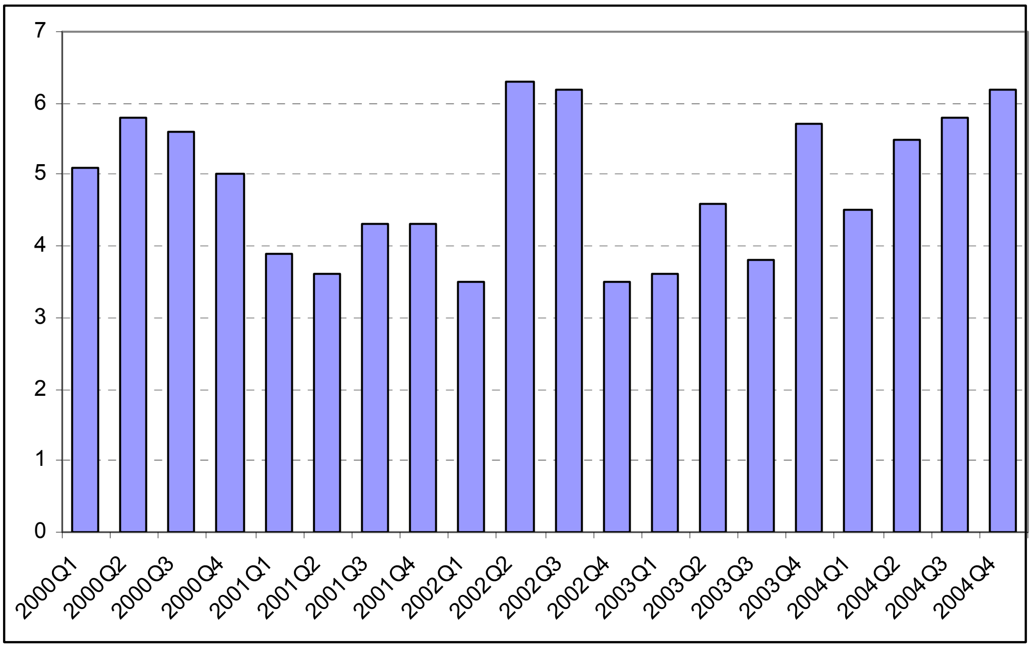
Government budget deficit is not a problem in these countries and it is not expected to change in the next few years. In Bulgaria there is a Currency Board Arrangement which desires low budget deficit or even a budget surplus, while in Romania the cooperation with IMF supported to keep the budget deficit low.

Current account deficit is now high in both countries due to the fact that in both countries domestic demand is a main fuel of the economy recently, while foreign demand is weak. Foreign trade deficit has widened in both countries in 2004 and thus, current account deficit reached more than 7% of GDP last year in Bulgaria and Romania. In medium term, this trend is expected to change, the C/A deficit per GDP ratio is not expected to increase significantly in the future due to the weakening domestic factor, the slowly improving foreign demand and rapid economic growth. Foreign imbalances are the weak points of the two candidates, however, the large current account deficit is easily financed by the huge amount of foreign direct investment inflows.

BULGARIA REACHED RECORD GDP GROWTH IN 2004

The GDP growth in the fourth quarter of 2004 reached 6.2% as against the same quarter of previous year in Bulgaria, according to the preliminary data published by the National Statistical Institute (NSI) at the end of March 2005. This growth rate was almost the as high as it was in the second half of 2002. The quarterly figures of GDP increased gradually in 2004. In the first quarter the growth was still 4.5%, which climbed to 5.5% and 5.8% in the second and third quarter respectively. In the whole year, Bulgarian GDP increased by 5.6% in 2004 owing to the good result in the second half of the year.

CHART 2. – GDP GROWTH IN BULGARIA, 2000-2004 (%)



Source: NSI Bulgaria

On the supply side, the services sector reached the highest annual growth rate, it reached 6%. Due to the fact that services sector has the largest share in gross value added (around 59%), the robust growth of the sector was a significant factor in last year's robust GDP growth. 2004 was a good year for the tourism sector in Bulgaria, which also contributed to the robust growth of services sector.

The performance of the industry sector was excellent too, the increase of the sector reached 5.3% in 2004. On the other hand, the primary sector increased in a moderate pace last year, the gross value added in agriculture sector increased by 2.2%. The share of industry sector was 30% in gross value added, while that of the agriculture sector was around 10%.

On the demand side, the consumption and gross fixed capital formation were the main engines of GDP growth. Private consumption reached 4.8% growth, while public consumption increased by even higher pace, 5.8% in 2004. Private consumption was fuelled by the increasing income and employment, as the dynamic credit growth. The stock of bank credits increased remarkably, by approximately 50% last year. This fact contributed largely to the rise of imports. On the other hand, the growth of fixed capital formation was also significant, it increased by 12% in last year.

The balance of goods and services had a negative impact on GDP growth because the balance widened by 19%. It was due to the fact that while exports grew by 13%, the growth of imports overpaced that of exports, it increased by 14.1%. It means that the GDP growth in Bulgaria was fuelled by mainly domestic factors and the foreign factors had an impact on GDP growth in a less extent.

TABLE 3. – GDP COMPONENTS, 2004

	Value at current prices	Volume indices 2003=100
	Thousand Levs	%
Gross Value Added (2+3+4=5+6)	32 941 932	105.4
by economic sector:		
Agriculture	3 580 795	102.2
Industry	9 878 176	105.3
Services	19 482 961	106.0
by type of ownership:		
private	25 203 231	107.5
public	7 738 701	99.4
Adjustments	5 066 474	107.0
Gross Domestic Product (1+7=9+12+15+18)	38 008 406	105.6
by final use components:		
Final consumption (10+11)	33 000 616	105.0
Individual	29 136 368	104.8
Collective	3 864 248	105.8
Gross capital formation (13+14)	8 938 669	.
Gross fixed capital formation	7 957 282	112.0
Change in inventories	981 387	.
Balance (exports - imports) (16-17)	-3 900 800	.
Exports of goods and services	22 209 800	113.1
Imports of goods and services	26 110 600	114.1
Statistical discrepancy	-30 079	.

Source: NSI Bulgaria

For 2004, the government targeted a GDP growth of 5.6 - 5.7%, which was achieved perfectly. In fact, this growth rate was the highest in the last 15 years since the beginning of the transition due to the strong two quarters in the second half of 2004.

The government's target for 2005 was around 5.0%, but owing to the good data in 2004 the Finance Minister increased the target figure to 5.5%.

The European Commission is also optimistic about the GDP growth of Bulgaria in current year, they forecast a pace of 6%, however, this pace is expected to slow to around 4,5% in 2006, according to the European Commission's Economic Forecasts Spring 2005 edition.

The dynamic growth in 2005 will stay on the basis of domestic factors, mainly on consumption and gross fixed capital formation. Due to the fact that in June 2005 elections will be held, on the one hand, the growth of public consumption is expected to remain high, on the other hand, the expected expansionary wage policy can have a stimulating impact on the private consumption. However, the tightening of the fiscal policy is expected after the elections and the impact of this adjustment can be the slower pace of GDP growth in 2006 and the improving external and domestic balances of Bulgaria.

THE DEVELOPMENT OF PUBLIC AND EXTERNAL DEBT IN CROATIA

The general government gross debt-to-GDP ratio in Croatia reached 53.8 % in 2004. This was an increase compared to 2003, when it was 51.6 % of GDP. In 2004 gross external debt as a percentage of GDP reached 82 %. In 2003 it reached 81.8 % of GDP. The share of external public debt in the total public debt was nearly 60 %.

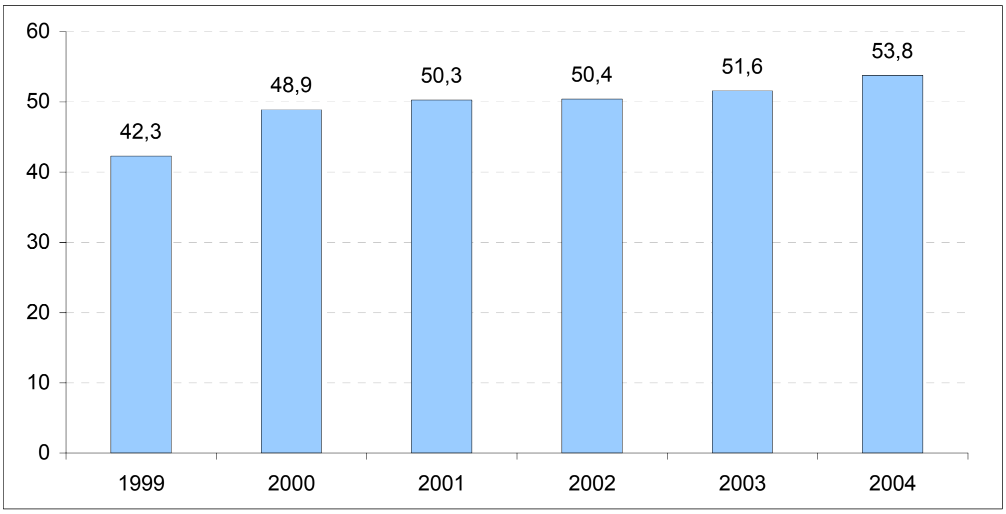
The public debt of the consolidated government includes the following items:

- the debt of the central government (70 %);
- the debt of extra-budgetary funds;
- the debt of local government units;
- government guarantees;
- the debt of the Croatian Bank of Reconstruction and Development (CBRD).

The general government public debt amounted to 110,151 million HRK in 2004. This means that the public debt not only increased as a percentage of GDP, but also in absolute terms, from 99,592 million HRK in 2003. The largest share of public debt was due to the increasing indebtedness of the central government. At the same time government guarantees have been decreasing. The budget remains the main source of risk in the Croatian economic policy. The need to reduce spending is getting stronger, but at the same time there are no firm measures taken to achieve this, and as a result spending was increasing at the end of 2004. According to expectations, in 2005 public finances will remain a cause for concern, as the government will remain under the pressure of various interest groups, both from within the government, as well as from the opposition. In 2005 the public debt-to-GDP ratio is expected to decrease slightly, compared to 2004, to 52.5 %, while the absolute amount of public debt is expected to increase to 114,946 million HRK.

The level of Croatia's public debt is well under the threshold defined by the Maastricht criteria, however in recent years an upward trend has been unfolding in its development, which is a reason for concern. In 1999 Croatian public debt as a percent of GDP reached only 42.3 %. Up to 2004 it was continuously increasing, to the earlier mentioned level of 53.8 %.

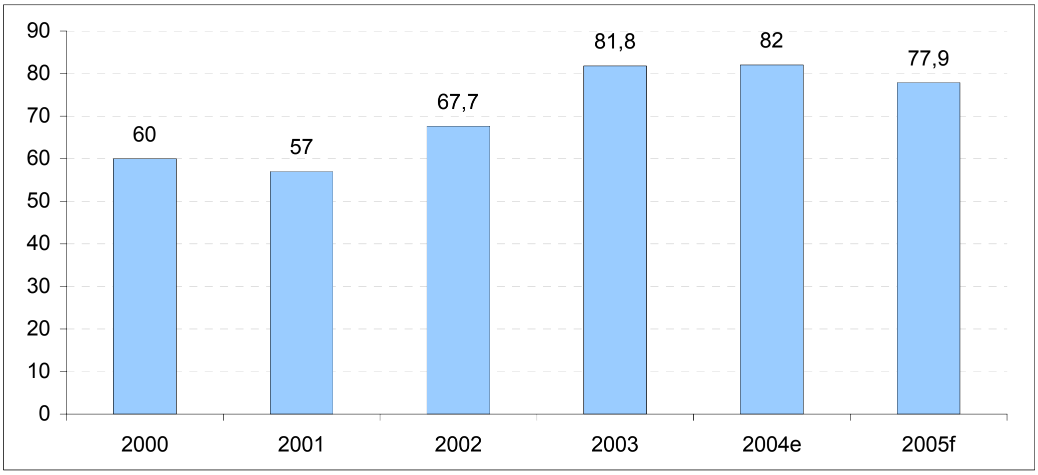
CHART 3. – PUBLIC DEBT AS A % OF GDP



Source: Privredna Banka Zagreb

In 2004 Croatian gross foreign debt as a percentage of GDP reached 82 %. This means that 60 % of Croatian public debt was financed from abroad. In 2005 it is expected that the share of domestic debt in the public debt will slightly increase and reach 48 %, after its level of 40 % in 2004. By 2007 the shares of external and domestic debt in the total public debt are expected to nearly equalize.

CHART 4. – EXTERNAL DEBT AS A % OF GDP



Source: Deutsche Bank Research
e: estimate, f: forecast

The growth rate of external debt was increasing from 2001 onwards, but was lower in 2004 than in 2003. In the first ten months of 2004 external debt as a percentage of GDP grew by 3 percentage points, while in the same period of the previous year its growth rate reached 9 percentage points. However the last quarter of the year 2004 brought a large increase in the level of external debt (compared to that of observed in the first three quarters of the year). At the end of December 2004 external debt of Croatia amounted to 30.2 billion dollars, which is 6.6 billion dollars higher than in 2003. This is lower than the increase observed during 2003, which amounted to 8.3 billion dollars.

The main contributor to the rise of the external debt of Croatia in 2004 was the banking sector, with a share of 33.7 % of total external debt. This is a rise compared to the 31 % share observed in 2003. In the last quarter of the year external debt rose by 3.7 billion dollars, 54.1 % of which was related to the external debt of banks. At the same time, the share of external debt of the government decreased compared to 2003, from 35.8 % to 32.9 % in 2004.