

# ICEG EC - MEHIB Southeast European Monitor

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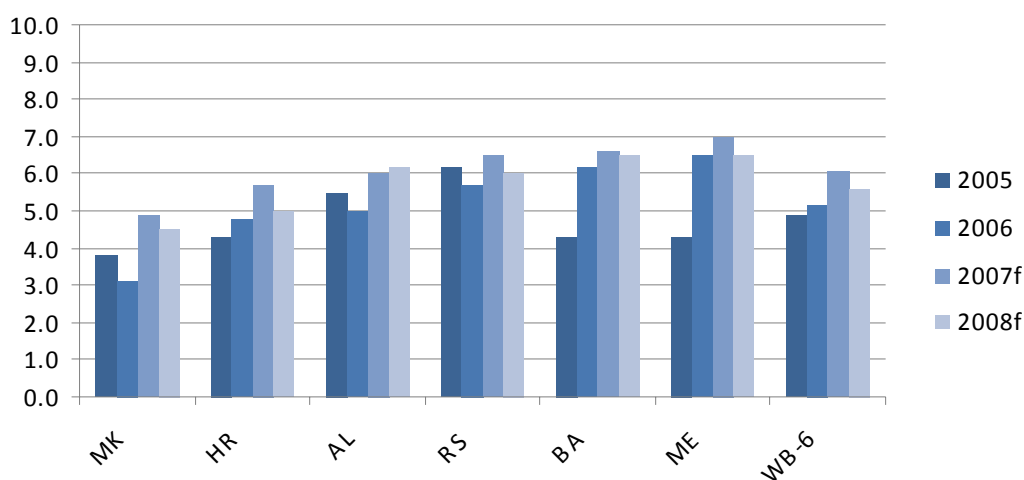
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## ICEG EUROPEAN CENTER'S LATEST QUARTERLY FORECAST ON THE WESTERN BALKANS – FOURTH QUARTER 2007

ICEG European Center published its latest quarterly forecast on the Western Balkan countries. According to the report, the political climate remained tense in most Western Balkan countries emphasis shifted towards foreign politics in almost all countries. April Summit of NATO is approaching where countries from the region can be invited to join the organisation. In line with that, name dispute between the former Yugoslav Republic and Greece continues. Montenegro signed Stabilisation and Association Agreement with the EU. And last but not least, the Kosovo issue is still not decided.

Economic growth accelerated significantly in 2007 according to our expectations. Real GDP growth reached 6.1% in average in the Western Balkan countries. It was 0.9 percentage point higher than that in 2006. Gross domestic product growth exceeded 6% in four out of the six WB countries. The still rapid economic growth was supported by high private consumption and investments, which reflects that domestic demand fuels most of these economies. On the other hand, net exports had a negative contribution to GDP growth except for the former Yugoslav Republic of Macedonia. In 2008 slight moderation of economic growth is expected. Accordingly average economic growth will decelerate to 5.6% in the WB countries, which still can be considered as high.

**CHART 1. REAL GDP GROWTH IN THE WESTERN BALKANS, 2005-2008 (%)**



Source: ICEG European Center Quarterly Report, Q4 2007; f - forecast

In line with global trends, food and energy prices increased significantly in the WB countries as well. Besides, the extremely warm and dry summer in 2007 had a severe negative impact (via droughts and wildfires) on the domestic food supply in most WB countries. Due to the aforementioned factors inflation accelerated in most countries in the region in course of the second half of 2007. Although, annual average inflation rates remained unchanged or increased slightly compared to the previous year, the limited impact of significant energy and food price hikes was basically due to the fact that these factors contributed negatively to the evolution of inflation only in the second part of the year. However, it results that inflation is not expected to decline significantly in the first half of the year due to base effect. Accordingly,

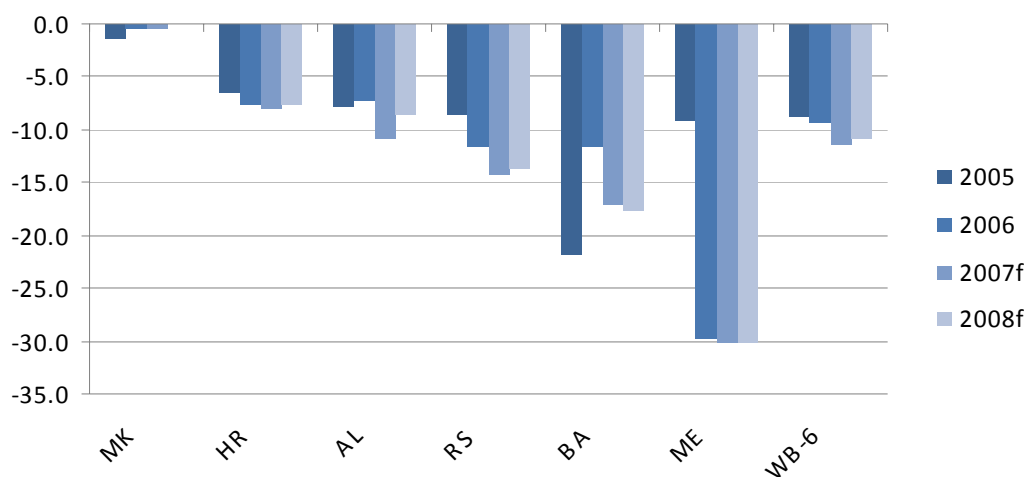
ICEG EC expects that 2008 annual average inflation will reach 4.4%, slightly higher than in 2007.

Fiscal positions are estimated to have worsened slightly in 2007 compared to the previous year. In most countries public spending has been increasing due to wage increases in the public sector and growing public investments. On the other hand, revenues have increased at a lower pace which is partly due to the increasing tax competitiveness for foreign investors. It is worth mentioning that more and more countries in the region apply low tax rates and /or flat tax regime in order to improve their business climate and enhance economic growth.

Still budget balances remained well under 3% of GDP in almost all countries, and surplus was achieved in Bosnia and Herzegovina and Montenegro. In 2008 no significant shift is expected and WB countries' budget balances remain on their 2007 level.

External imbalance remained one of the key macroeconomic issues in the WB regions in 2007 as well. Current account balance deteriorated in almost all WB countries. The average CA deficit increased to 11.3% of GDP from 9.2% in 2006. The increasing current account deficit was mainly due to the widening trade deficit in these countries. Imports were boosted by high domestic demand, namely consumption and investments. The only exception where current account deficit remained unchanged was the former Yugoslav Republic of Macedonia. In the FYROM export sector performed well in 2007 and export growth exceeded the growth pace of imports. In 2008 ICEG EC expects that external imbalance remains a key issue and current account balances will improve only slightly in this year.

**CHART 2. CURRENT ACCOUNT BALANCES IN THE WESTERN BALKAN COUNTRIES, 2005-2008 (% OF GDP)**



Source: ICEG European Center Quarterly Report, Q4 2007; f - forecast

Unemployment remained high but has been decreasing gradually in course of 2007 in the WB countries. In average unemployment rate decreased from 17.9% in 2006 to 17.6% in last year. Decreasing unemployment was supported by dynamic economic growth and improving business climate which resulted in the decreasing role of informal sector. It is also worth mentioning that labour costs increased considerably as well, therefore consumption was boosted by growing incomes of households.

In 2008 ICEG EC expects that last year's tendencies will continue and employment and unemployment figures will improve further. Accordingly, unemployment rate in average can go down to 17% in the WB region.

## E GOVERNMENT IN ROMANIA AND BULGARIA

eGovernment refers to the use by government agencies of information technologies that have the ability to transform relations with citizens, businesses, and other arms of government<sup>1</sup>. Aim of eGovernment is to deliver services online to citizens and enterprises in a more effective way. Well-established eGovernment services and network enable for citizens and companies to obtain information and handle cases through local and central public bodies' websites less expensively and more effectively, saving time and money. On the supply side the resulting benefits of operating and using eGovernment services can be efficient government management, less corruption, increased transparency, greater convenience, revenue growth and cost reduction. On the demand side usage of eGovernment services means time saving and cost reduction as well. Benefits of eGovernment are already clearly visible in several EU countries. For example electronic invoicing in Denmark saves taxpayers EUR 150 million and business EUR 50 million yearly. If introduced all over the EU annual savings could reach EUR 50 billion. Electronic procurement and invoicing could result in savings in total procurement costs of around 5% and reduction of transaction costs of 10%<sup>2</sup>.

eGovernment is one of the main goals of the eEurope 2005 Action Plan. i2010 Commission's initiative and i2010 Annual Reports highlight the role of online public services in information society developments. The i2010 eGovernment Action Plan indicates that effective and innovative public administrations are fundamental to a globally competitive Europe. In accordance with that Romania and Bulgaria as new Member States make efforts to catch up.

### ROMANIA

According to the most recent United Nations E-government Survey<sup>3</sup> Romania's eGovernment Readiness Index<sup>4</sup> score is higher in 2008 than three years ago, however it fell back in global comparison (*see table 1.*).

eGovernment has been actively promoted in the last years in Romania. Advancement of institutional and legal framework for eGovernment is of high importance for further development. The main policy and strategy producer, the Ministry of Communications and Information Technology was established in 2001 with the objective of implementing the Romanian government policy in this sector. The Ministry is responsible for defining the

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<sup>1</sup> World Bank definition

<sup>2</sup> European Commission: i2010 eGovernment Action Plan: Accelerating eGovernment in Europe for the Benefit of All, 2006

<sup>3</sup> United Nations: E-Government Survey 2008

<sup>4</sup> "The eGovernment readiness index is a composite index comprising the web measure index, the telecommunication infrastructure index and the human capital index. The web measure index provides with a comparative ranking on their ability to deliver online services to their citizens. The telecommunication infrastructure index is a composite index of five primary indices relating to a country's infrastructure capacity as they relate to the delivery of eGovernment services. The human capital index is a composite of the adult literacy rate and the combined primary, secondary and tertiary gross enrolment ratio." United Nations E-Government Survey 2008

restructuring policies, coordinating the privatisation process in the ICT sector, financing the main projects and promoting the development of Internet.

**TABLE 1. UN eGOVERNMENT INDEXES AND RANKINGS**

	<b>2005 Index</b>	<b>2008 Index</b>	<b>2005 Ranking</b>	<b>2008 Ranking</b>
Bulgaria	0.5605	0.5719	45	43
Romania	0.5704	0.5383	44	51
Hungary	0.6536	0.6494	27	30
Sweden	0.8983	0.9157	3	1
World	0.4267	0.4514		

*Source: United Nations: E-Government Survey 2008*

Reform of public administration through eGovernment is part of the political programme 2004-2008. In 2001 the National eAdministration Strategy and Action Plan was adopted by the Romanian government. Before EU accession lot of efforts were made in creating legal framework for eGovernment (for example Law on electronic Signature (2001); the Law on Free Access to Information of Public Interest (2001); the Law regarding the electronic payment of local taxes (2002), the Law on the processing of personal data and the protection of privacy in the electronic communications sector (2004) and the Ordinance concerning the award of public contracts, public works concession contracts and services concession contracts (2006).)

Parallel with regulatory framework the national eGovernment infrastructure has also developed. In 2003 an eGovernment portal was launched, providing a one-stop shop to public online services, and incorporating a transactional platform enabling users to register for interactive and transactional services. In Romania 11 public online services are provided for citizens and 8 for businesses. According to a recent survey on online public services<sup>5</sup> 35% of eGovernment services are fully available online. The online sophistication score is 57%. The online services for citizens are at low level, while services for businesses have an average of 84% at a transactional level.

Most eServices for citizens are still at their beginning phase, the sophistication stage reached overwhelmingly only 1-2 stage level (*see table 2*). It means practically that Romanian citizens can get information from websites of different authorities. On one hand services are restricted to obtaining online information and downloading forms in some areas (e.g. social security benefits, students grants, personal documents handling). On the other hand, others such as labour offices provide a full electronic case handling. Some public institutions already developed a high-level online service, like the National Library, but full list of eServices are not provided by other public libraries. The same is the case by universities. Only major universities offer the possibility to enrol online (registration for exams and courses).

Contrary to eServices for citizens, online services for businesses are relative well developed. However, two relative important areas (registration of a new company, applying for environment-related permits) stay still at low sophistication stage. Well developed online services facilitate firms' administration processes regarding corporate tax, VAT tax and customs declaration. Online public procurement and submission of statistical data services also save time for enterprises.

<sup>5</sup> Capgemini: The User Challenge Benchmarking The Supply Of Online Public Services. 7<sup>th</sup> Measurement, October 2007

Nevertheless, online availability of eGovernment services is only one side of the coin. Usage of eGovernment services by enterprises and citizens is another important indicator of public online services developments. Eurostat data represent a very low usage level in the case of citizens. In Romania only 5% of the population used the Internet for interaction with public authorities in 2007, while the same indicator represents 30% in the EU27. Possibilities of eGovernment are better exploited by enterprises; however, this is in strong relation with the online availability of business eServices. 42% of Romanian enterprises used the Internet for interaction with public authorities in 2007, while in 2004 only 31% of them handled cases through eGovernment. To compare, value for EU27 is 65% in 2007.

**TABLE 2. AVAILABILITY AND SOPHISTICATION OF eSERVICES FOR CITIZENS AND BUSINESSES IN 2007<sup>6</sup>**

<i>eServices for citizens</i>	<i>Sophistication stage</i>		
	<i>Romania</i>	<i>Bulgaria</i>	<i>Maximum</i>
1. <i>Income taxes: declaration, notification of assessment</i>	2	5	5
2. <i>Job search services by labour offices</i>	4	4	4
3. <i>Social security benefits</i>	2-3	0-1	5
4. <i>Personal documents: passport and driver's license</i>	1-2	0-1	4
5. <i>Car registration (new, used, imported cars)</i>	2	1	4
6. <i>Application for building permission</i>	1-2	0-1	4
7. <i>Declaration to the police (e.g. in case of theft)</i>	1	1	3
8. <i>Public libraries (availability of catalogues, search tools)</i>	1	1	5
9. <i>Certificates (birth and marriage): request and delivery</i>	No online service	2	3
10. <i>Enrolment in higher education/university</i>	1-2	2-3	4
11. <i>Announcement of moving (change of address)</i>	1	0	4
12. <i>Health related services (interactive advice on the availability of services in different hospitals; appointments for hospitals)</i>	2	2	4
<b><i>eServices for business</i></b>			
1. <i>Social contribution for employees</i>	4	3	4
2. <i>Corporate tax: declaration, notification</i>	4	3	4
3. <i>VAT: declaration, notification</i>	4	3	4
4. <i>Registration of a new company</i>	2	2	4
5. <i>Submission of data to statistical offices</i>	5	2	5
6. <i>Customs declarations</i>	4	3	4
7. <i>Environment-related permits (incl. reporting)</i>	1	1	5
8. <i>Public procurement</i>	4	2	4

Source: *www.epractice.eu*, accessed Febr. 4. 2008

## BULGARIA

Bulgaria ranks at 43rd place in the UN global eGovernment ranking list. Bulgaria performance is better in 2008 than in 2005 (see Table 1.). eGovernment in Bulgaria is considered as an element of the transition from industrial to information society. The new Member State has benchmarked Austria in its efforts to raise the standard and level of eGovernment, because in

<sup>6</sup> Stage 1 - Information  
 Stage 2 - One way interaction (downloadable forms)  
 Stage 3 - Two-way interaction (electronic forms)  
 Stage 4 - Transaction (full electronic case handling)  
 Stage 5 - Personalisation (pro-active, automated)



Austria both citizens and businesses have the possibility to access eGovernment services via a fully transactional electronic channel.

The adoption of strategic documents started in 2002. Between 2003 and 2005 20 online services were introduced. The administration has been supplied with hardware and software and communication connectivity. Plan for implementation of the eGovernment Strategy (2003 - 2005) has been drawn up and followed.

There are two actors responsible for strategy and policy making: Ministry of Public Administration and Administrative Reform and Directorate for eGovernment. Coordination responsibilities are divided between the newly established Information Society Coordination Council, State Agency for Information Technology and Communications and Coordination Center for Information, Communication and Management Technologies.

Similar to Romania Bulgarian legal framework regarding eGovernment developed mainly in the past years (Law on Electronic Document and Electronic Signature (2001); Access to Public Information Act (2003) serving the freedom of information legislation; Law for the Protection of Personal Data (2005); Law on eCommerce (2006)). An eGovernment law is under preparation.

A number of pilot projects for delivery of on-line administrative services have been implemented at central, regional and municipal level. The Bulgarian eGovernment portal is called the eGovernment Gateway and aims at a one-stop shop for all eServices offered by the administration.

eGovernment services in Bulgaria are still insufficient in number and functionality. Only 15% of eGovernment services are fully available online. The online sophistication of Bulgaria is at 67% compared to the EU average of 76%. Similar to Romania most eServices for citizens are still at a beginning phase (*see table 2*), however two services (income tax declaration and job search by labour offices) reached the highest level of online sophistication: forms from the websites can be downloaded, submitted and signed electronically. Regarding social security benefits, application of personal documents or car registration services Bulgarian citizens are able to obtain online information, but downloading of forms is not provided. Online services are neither provided by public libraries, however more advanced eServices are offered by university libraries. Online information is accessible at universities' sites, but online registration is not provided. Advanced eHealth services, like hospital appointments are not offered in Bulgaria.

eGovernment services for businesses are more advanced than for citizens, however it remains to achieve some stages compared to Romania and developed EU countries. Relating corporate and VAT tax declaration online information and form can be downloaded and signed electronically. Online registration of a new company is not yet provided, however forms and information are available online. There is an Internet site for small value electronic procurement of the public sector, but no general online facility for all.

In accordance with its advanced level, eGovernment business services are more often used by enterprises than citizens. In 2007 only 6% of the population used Internet for accessing information about public administration process, downloading forms and registering. In spite of the fact that online sophistication of Bulgarian eGovernment services for businesses is not so far advanced like in Romania, 45% of the enterprises used the Internet for interacting with public authorities in 2007.

## EXPORT-DRIVEN ECONOMIC GROWTH IN THE FORMER YUGOSLAV REPUBLIC OF MACEDONIA

The former Yugoslav Republic of Macedonia, which granted candidate status for European Union membership in December 2005, is characterized by a small and open, well-functioning market economy. Although the country has faced many difficulties during the period of transition towards free market economy, the former Yugoslav Republic of Macedonia was able to achieve macroeconomic stability and solid growth, primarily with the exchange rate policy of pegging its currency to the Euro. One of the main factors that contributed to the growth of economy is the great performance in the export sector, with a significant rise from the year of 2006 in particular. By improving the export performance the current account gap could be reduced, preserving macroeconomic stability as avoiding the loss of reserves and limiting the growth of the external debt of the country. Obviously, better results in export performance require enhanced competitiveness, which is related to the productivity of the economy in this case. Several studies have also proved that the growth strategy of the former Yugoslav Republic of Macedonia – as well as of other developing countries - is based on a so-called export-led economy. In addition, the Export-Led Growth (ELG) hypothesis stands for a positive link between exports performance and economic growth. Small and open developing economies are likely to rely on this hypothesis because of the fact that given the resources of production, export of goods is the most well functioning channel of development for them in the long run.

### PRICES AND GROWTH

In the former Yugoslav Republic of Macedonia the concentration of export in the production sector is very high, albeit the overall assessment is that it still remains low and uncompetitive on the world market. The recent boom in the export of especially iron and steel correspond with both the increase in prices on the world stock exchange – caused by the growth in the demand mainly from China and India - and the growth of the production of these materials. Moreover, the improvements in transport and infrastructure have also contributed significantly to production growth and to higher volume of exports as a consequence. A vice versa relationship can be observed since intensified export orientation involves greater volume of production as it is regarded a catalyst for the output growth.

**TABLE 3. EXPORT BY ECONOMIC USE OF GOODS (USD MILLION)**

Products	2006				2007				
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	
Production materials	241.72	334.74	425.81	391.37	1393.65	448.09	561.46	503.54	1513.09
Capital Goods	8.62	9.44	19.02	14.38	51.46	15.85	16.61	17.26	49.72
Consumption Goods	200.57	242.30	255.94	255.52	954.34	269.68	288.56	311.89	870.13
Others	0.09	0.30	0.69	0.19	1.27	0.01	0.00	0.01	0.02
<b>Total</b>	<b>451</b>	<b>586.78</b>	<b>701.47</b>	<b>661.47</b>	<b>2400.71</b>	<b>733.62</b>	<b>866.62</b>	<b>832.70</b>	<b>2432.95</b>

*Source: State Statistical Office of Republic of Macedonia*

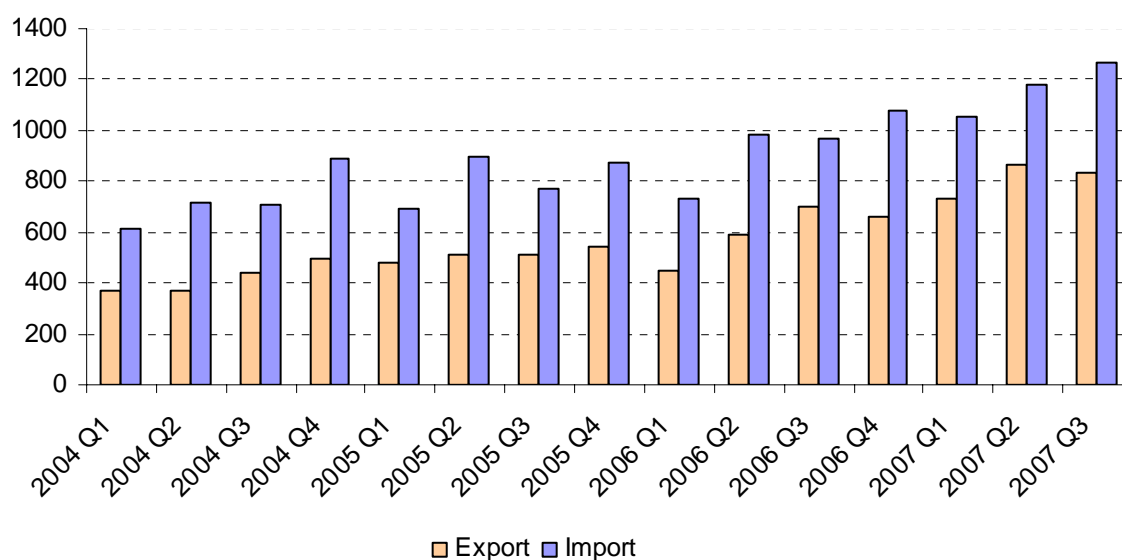
Empirical tests have also confirmed the assumptions of this bidirectional causality.<sup>7</sup> As for some specific results, according to the State Statistical Office of Republic of Macedonia, export of the aforementioned metals went up by more than two times from 2006 to 2007, and the average prices of the nickel, zinc and lead realised an annual growth of 80%, 54% and 44% respectively in the first quarter of 2007.

### FOREIGN TRADE - NEW HEIGHTS IN EXPORT

International trade scope of the former Yugoslav Republic of Macedonia in 2007 was USD 8 583.9 million, which has increased by 40.6% compared to the year before. The export value of all goods totalled up to USD 3 356.2 million while import coverage with export equalled 67.2%.<sup>8</sup> Trade deficit increased from the previous year by 37.4% and amounted USD 1 871.3 million as a consequence of the boom in exports. The most significant products are ferro-nickel, iron and steel products, – according to the positive development in world prices - clothes, textile and tobacco.

Considering its trade partners, 65.1% of total exports go to the EU-27 and 29.5% to the West Balkan countries, while almost one third of their imports (30.9%) come from the Developing countries, mainly from the surroundings. According to the total commodity international trade scope, FYR of Macedonia's most important trade partners are Serbia, Germany, Greece, Russia and Italy, and directing the export of metals towards Spain as a new market in the first quarter of 2007 should be mentioned as well. The participation of the export towards the European Union was increased by 6.3%, primarily due to the broadening of the market to Spain and Belgium.

**CHART 3. FOREIGN TRADE OF MACEDONIA (USD MILLION)**



Source: Eurostat, State Statistical Office of Republic of Macedonia

After a short downturn in January 2007 compared to last year's December, the former Yugoslav Republic of realised a gradual rise in the export of goods, registering a monthly increase of 9.9% already in February. On annual basis, export went up by 49.6% and was

<sup>7</sup>Marjan Petreski (June 2007): Export-led growth hypothesis: Empirical evidence from Macedonia, CEA Journal of Economics

<sup>8</sup>Source: State Statistical Office of Republic of Macedonia

valued EUR 152.2 million, mainly resulting from the higher export of wearing apparel, textile, iron and steel products. The greater activity of a larger metallurgical plant has also added to the higher exports, since increase in production followed the rise in demand and world prices. In March 2007, the total export of goods contributed to 73.5% in the total growth.

The second quarter of the year brought the best results considering the export of goods in the fYR of Macedonia; reaching historically highest levels in June on monthly basis in the last ten years, in the amount of EUR 229.1 million. A monthly growth of 7.9% was realised at the same time. Analysing by products, such growth mainly resulted from the increase registered in the export of tobacco, textile, wearing apparel and footwear besides iron and steel products. In June 2007, import of goods stood at EUR 300.3 million. With the simultaneous growth of both components of foreign trade, the deficit could be reduced by nearly 8% on monthly basis. Cumulatively, in the first eight months of 2007, the overall foreign trade totalled EUR 3 831.8 million, which was by 23.5% higher compared to the same period of the previous year. The dynamics of both export and import of goods further narrowed the trade deficit by 46.5% in the end of the third quarter of 2007 - while the export-import coverage ratio equalled 73.7% - although there was a short period of slowdown in September. Besides an annual decrease in the export, the import of goods increased, which led to a significant rise in the foreign trade deficit – by 48.4% on monthly basis – as a result of the worsening in the terms of trade, compared to the beginning of the year. However, since October 2007, monthly increase of the export of goods returned, originating primarily from better conditions in the trade of iron and steel products as well as clothing and textile.

Apart from short fallbacks during the year of 2007, the constant growth in export of goods - that characterised the foreign trade in the fYR of Macedonia - was backed by continuous records of increase in the industrial output. In October, increase on an annual basis of 10.5% was registered. Meanwhile, recovery in the mining industry has also contributed to higher export of ores and other natural resources. The cumulative increase in mining reached 12.8%. In general, the production volume in the first ten months of 2007 compared to the same period of the previous year was higher in half of the industries, which also proves the biggest demand in the world for metals and other products of manufacturing industry.

## SOUTHEAST EUROPE: COMPETITORS IN THE EU'S NEIGHBOURHOOD

After transition, Central and Eastern European countries found their way soon to economic restructuring and European integration, they became the front-runner countries. Meanwhile, political stability was more vulnerable and economic performance was weaker in general in the Southeast European countries. Economic restructuring and reforms progressed slowly there.

At the beginning of the new millennium aforementioned factors improved in the SEE economies. Political risks decreased and stability improved in comparison with the previous decade when wars and civil wars severely influenced the progress of the whole region. Stabilisation was followed by liberalisation and privatisation as well. Today two countries are EU Member states (Bulgaria and Romania), two countries are candidate countries (Croatia and FYR of Macedonia) and four of them are potential candidate countries (Albania, Bosnia and Herzegovina, Montenegro and Serbia). The development of European integration process is a key indicator to measure the stability of these countries.

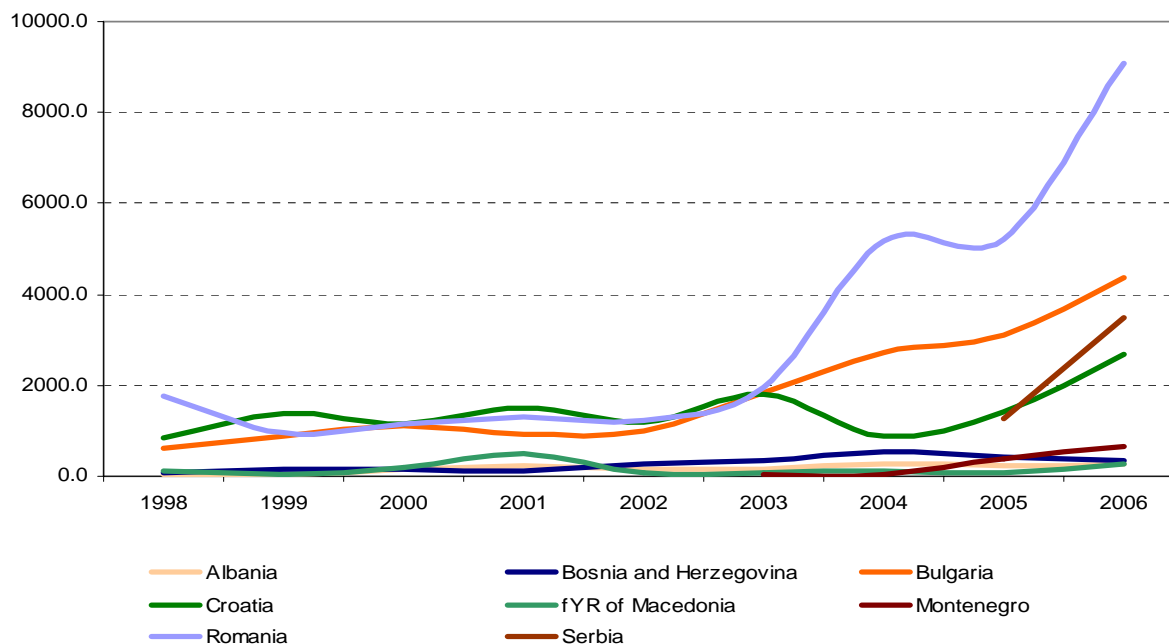
Economic performance of the region improved as of 2000 as well. Most Southeast European economy achieved 5-6% GDP growth in average in the last six-seven years. This growth rate exceeds the corresponding growth rate of the Czech Republic, Hungary, Poland or Slovenia. In conclusion, these countries started grow rapidly after ten years of recession and stagnation.

Development of these economies was observable in the evolution of foreign direct investments as well. While FDI inflows remained quite low before 2000 due to high risks, it took off in recent years. Between 2000 and 2006 FDI stocks increased from EUR 15 billion to EUR 83 billion in the nine SEE countries altogether.

Certainly, the region is not homogeneous; accordingly the distribution of FDI by country is not identical. The most favourite FDI spot is Romania (37% of all FDI in the region) due partly to the size of the economy and its relatively favourable business climate in comparison with other countries in the region. The other EU Member State, Bulgaria (18%) is also a preferred place of foreign investors in the region. It is worth mentioning that Bulgaria has become one of those few countries where FDI inflows per GDP ratio exceeded 10% in the last 4 years.

Besides the two EU Member states Croatia can be considered as an important FDI attractor country in the region (25%). This is mainly due to the fact that Croatia is the richest SEE country and foreign investors try to exploit the domestic market, mainly in services sector. Serbia has the third largest population in the SEE region, however, its share in FDI stock of the region reached only 10% at the end of 2006. Despite that, it is promising that foreign direct investments started to increase in 2005, economic reforms progressed and political risks diminished. The small countries (Albania, Bosnia and Herzegovina, FYR of Macedonia, Montenegro) have a quite small share in FDI stock and inflows were frequently influenced by a large privatisation deal (such as the sale of a big national energy or telecom company).

Why is that so? Why has foreign direct investments started to grow dynamically in the last 6-7 years? First, one of the key factors was the acceleration of the privatisation process in the region. In the first decade of transition the sale of state owned enterprises progressed slowly. When governments realized that privatisation and the increase of private property were essential factors to economic growth more and more SOEs has been privatized.

**CHART 4. EVOLUTION OF FDI IN SEE COUNTRIES, 1998-2006 (FLOW, MILLIONS OF EUROS)**

Source: national banks

Second, business climate of the region improved significantly in recent years. These countries realised that low costs and simple regulation could be competition advantage on international scene. It is worth mentioning the relatively low labour costs in several economies in the region. Today, Bulgarian and Romanian wages are the lowest in the European Union. For example, minimum wage in Bulgaria is one tenth of that in Austria or Belgium. Differences in average wages could be even higher in several cases. Certainly, low labour cost is not everything since the qualification of labour force is also important. However, assembly type manufacturing production that does not require high qualifications is much cheaper in these countries

Besides low wages, tax regimes have become simple and most countries has implied low tax rates. Tax competition started in Central and Eastern Europe but SEE countries joined the competition in last years. Now one can observe the lowest tax rates in these countries in Europe. Regarding only corporate profit tax rate, it is 9% in Montenegro, 10% in Albania, Bulgaria, Bosnia, the fYR of Macedonia and Serbia, and 16% in Romania. Furthermore, in many cases tax regimes use not only low tax rates but also changed to flat tax regime. These factors contributed to a relatively attractive business climate in these countries which could partly counterbalance the fears and risks of foreign investors towards this region. Actually, other factors, such as the quality of services or infrastructure are still lagging behind the EU average.

In next years the already started process is expected to continue. In line with European integration business climate will improve further and foreign investors are expected to appreciate this. Basically, the large economies (Bulgaria, Croatia, Romania and Serbia) are expected to capitalise this trend in the future.

Accordingly, the competitors are at and within the gate of European Union for the old Member states and for the front-runner CEE countries as well. However it is essential to emphasise that the SEE economies are not necessarily competitors in every level for the aforementioned

countries. In case of the latter countries foreign investments flow basically to production with higher quality and services where skills and qualifications are more important than labour costs itself.

Besides, the available labour force in FDI hot spots in the SEE region has been decreasing significantly and labour shortages can be observed in several sectors in Bulgaria and Romania as well. Wages started to increase rapidly in recent years, and those converge to the more developed economies. These tendencies will continue in the future years.