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FOREIGN DIRECT INVESTMENTS IN THE SOUTHEAST EUROPEAN (SEE) COUNTRIES IN COMPARISON WITH THE 8 NEW MEMBER STATES (NMS8)

INTRODUCTION

As a result of the transition process, the former Eastern bloc and Yugoslavia divided into three groups of countries. The first group is comprised of the front-runner transition countries such as the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia, or eight of the ten so-called New Member States. In the second group one can find the CIS countries, which include 12 former Soviet Republics¹. The third group constitutes the Southeast European countries, consisting of Albania, Bulgaria, Bosnia-Herzegovina, Croatia, the Former Yugoslav Republic of Macedonia (FYROM), Romania and Serbia and Montenegro.

Certainly these groups are not homogeneous; however, the three groups are distinguishable. Each group has its own characteristic which differentiates itself from the other groups. In case of the NMS, the relatively successful restructuring and transition process, the more advanced market economy, or the EU membership, while in case of the CIS countries, the slower progress in transition, the less developed economy, or the fact that these countries have slight chance to be a member of the EU in this or next decade, are all special features which characterise the given group.

Actually, the third group is quite interesting. In this group one can find countries which are not members of the EU but there are several official acceding and candidate countries, such as Bulgaria and Romania or Croatia, while the rest of the group is potential candidate country. Regarding the performance of their transition process, these economies were not as successful as the NMS; however the dynamism of the progress advanced significantly in the last few years. Nowadays, it seems most countries in the SEE region aim to close the gap between itself and the front-runner transition countries by implementing important measures similar to those adopted in the NMS, or even more significant.

One of the most important lessons from the economic transition process of the NMS is that foreign direct investment played an important role in restructuring the former centrally planned economies into market economies, integrating the national economy into the world economy and increasing the competitiveness of the economy. Besides privatisation which was a necessary consequence of the transition, these countries aimed at becoming more and more attractive for foreign investors by improving their business climate to draw more and more foreign capital into the economy. Nowadays, privatisation process is basically over and green-field investments constitute the majority of foreign direct investment inflows.

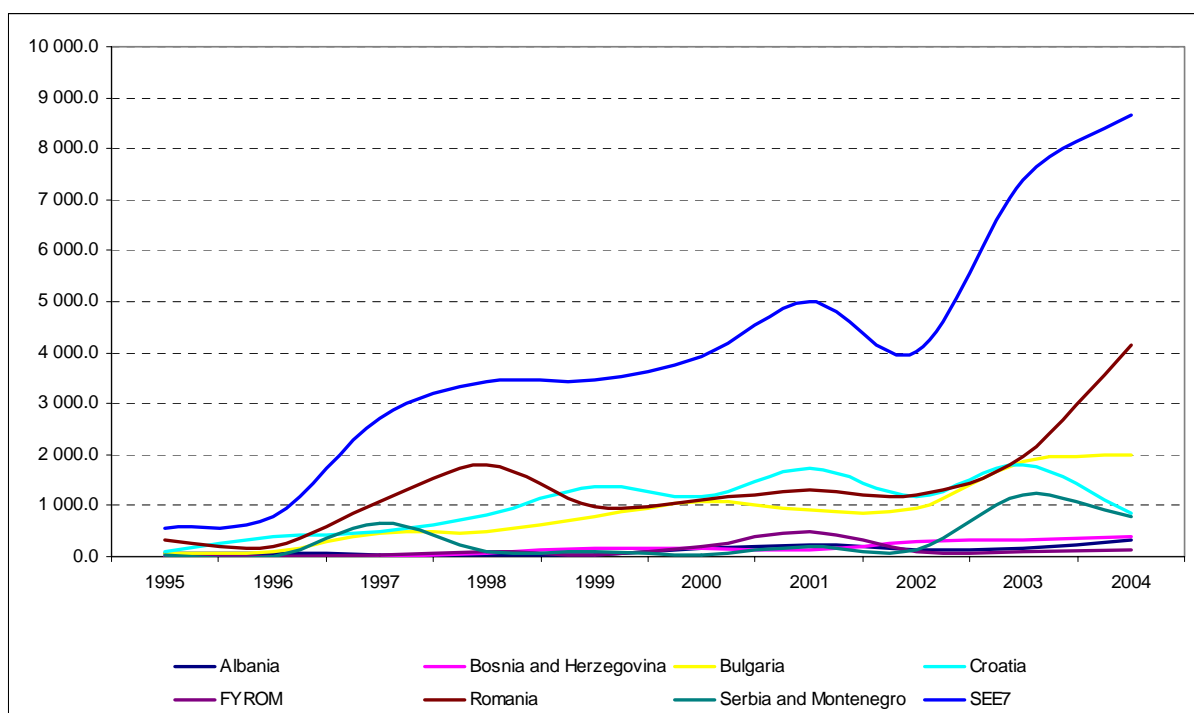
In the SEE countries this development started later, privatisation is still an ongoing process while the increasing competition for foreign direct investments is an exogenous factor to every country in the region. The main aims of this paper are to analyse the foreign direct investments inflowed into the SEE economies and to examine the business climate improvements in these countries in comparison with the eight New Member States.

¹ In fact, the CIS is a confederation of 11 former Soviet Republics, namely Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Ukraine, and Uzbekistan. Turkmenistan is not a permanent member of the CIS since 26 August 2005 but is an associate member.

FOREIGN DIRECT INVESTMENTS

As it was mentioned earlier the SEE economies were less attractive for foreign investors during the first 10 years of transition, namely in the 1990s. It was the consequence of several factors, such as the wars fought between the countries in the Western Balkans after the disintegration of Yugoslavia and the slower progress in economic and political reforms. Regarding the foreign direct investments inflows one can see that the annual average amount of FDI inflowed into the SEE region was quite low in the last decade. The total annual FDI remained under EUR 4 billion in every year in that period, which is quite low considering the population of the region (the SEE region's population is close to 55 million). The FDI inflow started to grow in the new millennium and the dynamism of this growth is significant. In the 2003-2004 period the FDI inflows reached EUR 16 billion which is remarkable.

GRAPH 1. - EVOLUTION OF FDI IN THE SEE COUNTRIES, 1995-2004 (MILLIONS OF EUROS/ECU)



Source: UNCTAD

It is observable in the graph above that the foreign investors' primary targets were Romania, Bulgaria, Croatia and Serbia and Montenegro in the last few years. These four "large" countries account for about 90% of FDI inflows in the region. Accordingly, it means the "small" countries (Albania, Bosnia-Herzegovina and the FYR of Macedonia) were not really attractive for foreign investors; their share in population reaches 18% which is significantly higher than that in FDI inflows.

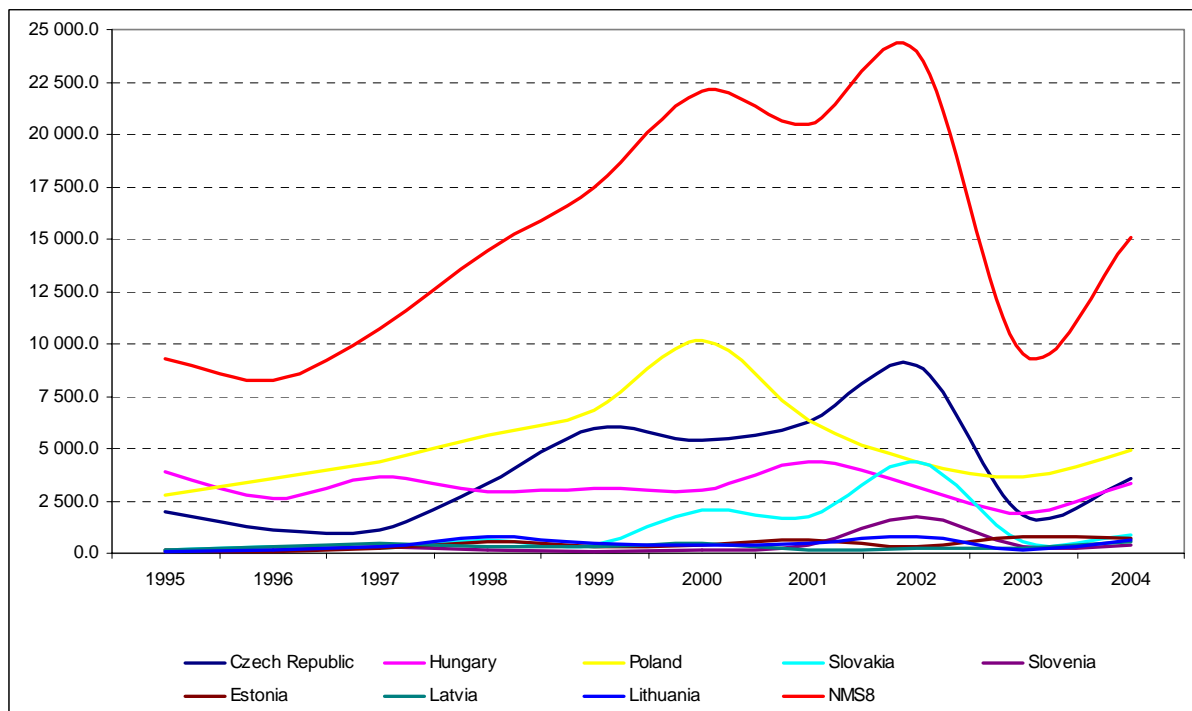
Nowadays, Romania is the most attractive target in the region. In the last two-year-long period the foreign direct investments increased by approximately EUR 6 billion or nearly 38% of the FDI inflowed into the SEE region chose Romania as the place of investment. In fact it is not a surprise that Romania accounted for the largest part of FDI in the last years considering the country's size.

On the other hand, the performances of Croatia and Bulgaria are both significant, their annual FDI inflows averaged around EUR 1-2 billion in the last years. Besides that Serbia and Montenegro is worth mentioning because its annual inflows increased to around EUR 1 billion

in 2003 from almost zero. Though, it is true that this positive process is mainly due to the launch of privatisation in Serbia and Montenegro and the FDI inflows were linked to some large sales in that period.

During that period, the path of FDI inflows in the NMS was similar to a rollercoaster. In 2002 the FDI inflows into NMS-8 reached its peak (EUR 24 billion) and it decreased sharply (to EUR 9.5 billion) in the very next year. It means that these economies were more influenced by the weakening performance of the world economy. On the other hand, the privatisation revenues also decreased due to the fact that privatisation is almost over in that region, the largest sales were concluded. Accordingly, green-field investments accounted for a significant part of the FDI inflows.

GRAPH 2. - EVOLUTION OF FDI IN THE NMS8 COUNTRIES, 1995-2004 (MILLIONS OF EUROS/ECU)



Source: UNCTAD

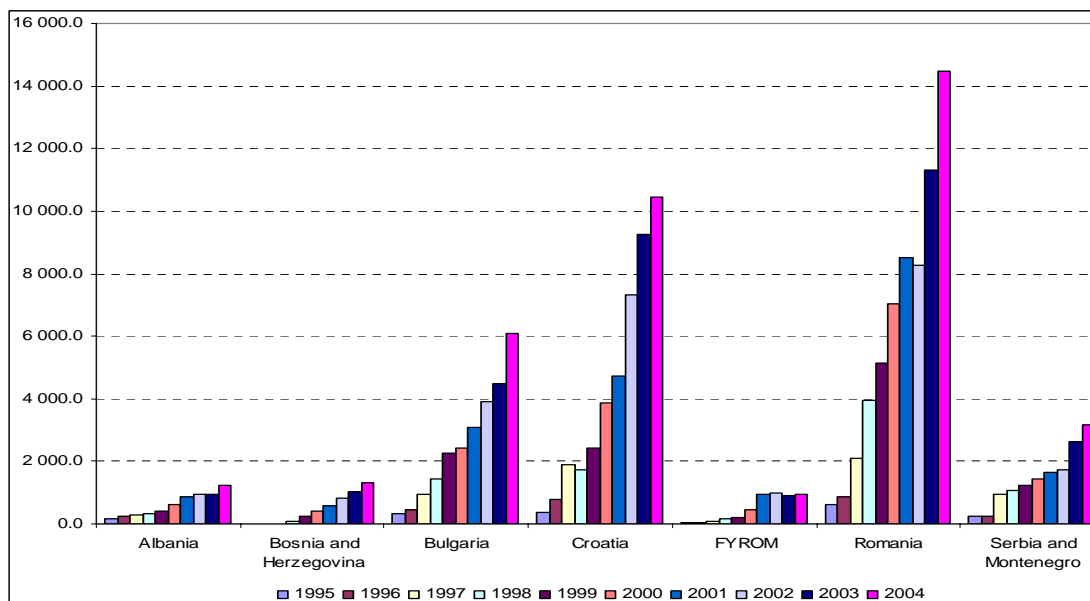
In case of the eight NMS, the same concentration of targets is observable as in case of the SEE countries. In the four "larger" countries, or the so-called Visegrad countries (the Czech Republic, Hungary, Poland and Slovakia) account for almost 90% of FDI inflows in the region which is mainly explainable by the size of these countries. The share of these countries in the population of the region is around 87.5%. Thus, it is a difference between the SEE countries and the NMS, namely the small countries are not under-represented in the FDI pattern.

Regarding the stock figures, the aforementioned factors are underpinned, the most important investment targets were Romania, Croatia, Bulgaria and Serbia and Montenegro between 1995 and 2004 in the SEE region. In that group the amount of FDI stock exceeded EUR 10 billion only in Romania and Croatia. In Bulgaria this figure was EUR 6 billion, while in Serbia and Montenegro it reached almost EUR 3.2 billion at the end of 2004. In these four economies the

In the other three "small" economies FDI stock was around EUR 1.0-1.3 billion in each. In case of these countries the evolution of FDI stock was mainly influenced by some larger-scale

privatisation deals, the best example is the FYR of Macedonia where the privatisation of the national telecom company in 2001 resulted in a significant jump of FDI stock.

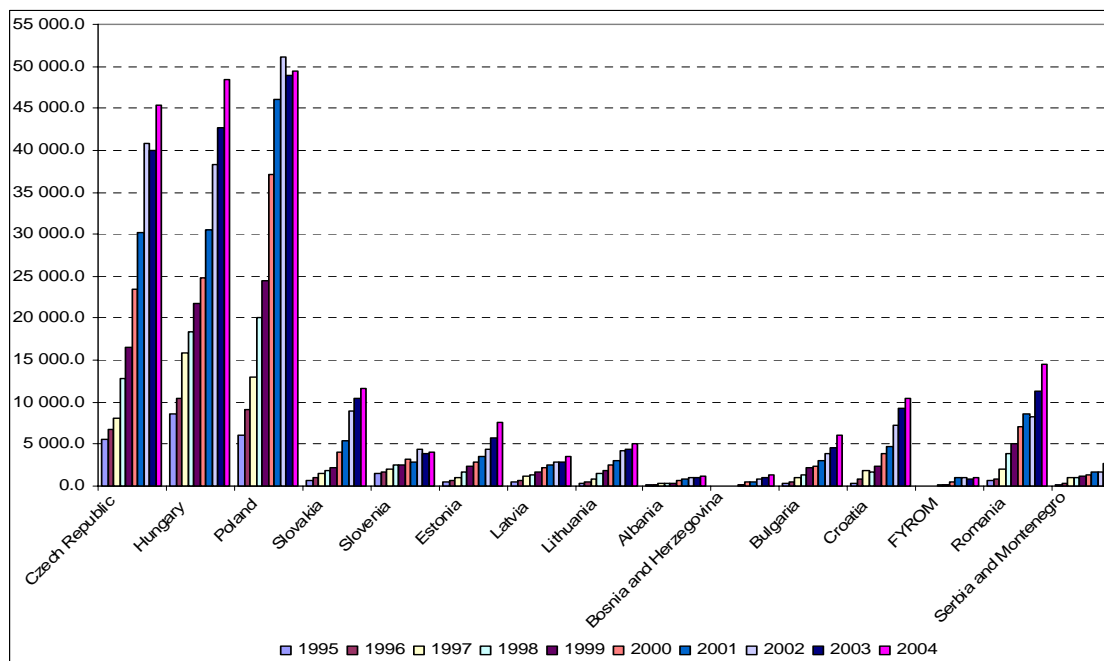
GRAPH 3. - FDI STOCK IN THE SEE COUNTRIES, 1995-2004 (MILLIONS OF EUROS/ECU)



Source: UNCTAD

If one compare the FDI stock figures in the SEE region and in the eight New Member States it is easily observable that even those countries which have higher FDI stock figures greatly lag behind the front-runner NMS countries, namely the Czech Republic, Hungary and Poland. In these three economies the FDI stock figure is between EUR 45 and 50 billion which is threefold-fourfold higher than that of the best performers (Romania and Croatia) in the SEE region.

GRAPH 4. - FDI STOCK IN THE SEE AND THE NMS8 COUNTRIES, 1995-2004 (MILLIONS OF EUROS/ECU)



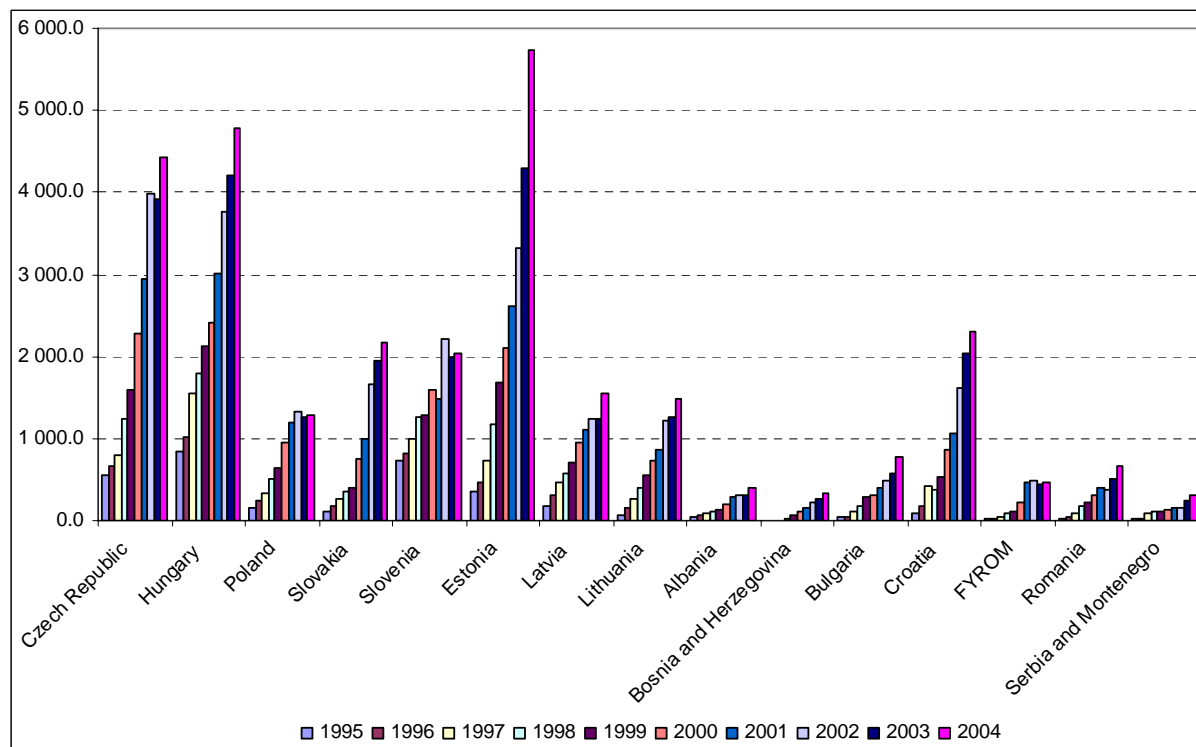
Source: UNCTAD

The figures of these best performers in the SEE region is rather comparable with that of Slovakia or Estonia from the NMS, however, the population of these countries are significantly lower than that of the aforementioned NMS countries.

Certainly, it is worth comparing the per capita stock figures which reflects a clearer picture on the FDI stocks in these countries. It was expectable that the levels of per capita FDI stocks of the Czech Republic and Hungary are significantly higher than that of Poland due to the difference in population, while Estonia has the highest per capita FDI. Generally, the per capita FDI exceeds EUR 1000 in every New Member States.

The figures of the SEE countries are really low, in most cases the per capita FDI stock level is less than EUR 1000. Romania, the best performer in total FDI is only the third in the region after Croatia and Bulgaria, in this respect. The per capita FDI is less than EUR 700. In the other four countries the figure is only between EUR 300 and 500.

GRAPH 5. - FDI STOCK/CAPITA IN THE SEE AND THE NMS8 COUNTRIES, 1995-2004 (MILLIONS OF EUROS/ECU)



Source: UNCTAD

It seems only the figure of Croatia is comparable with that of the NMS, the per capita FDI exceeded EUR 2000 at the end of 2004. This is the same level as in Slovakia and Slovenia, while higher than that of Poland, Latvia or Lithuania.

Regarding the most important investor countries in the SEE region, one can find that mainly the neighbouring developed countries are the major foreign investors in the region. The largest investors in the SEE region are Austria, Germany, Greece, Italy and the Netherlands.

In the larger countries the shares of the largest investor country is between 13% and 26% which is not high and represents a relatively diversified investment portfolio (mainly in case of Bulgaria and Romania).

TABLE 1. - TOP 5 INVESTORS IN SOME SEE COUNTRIES

1	ALB		BIH		BUL		CRO		ROM	
	2	3	2	3	2	3	2	3	2	3
1	ITA	47.9	CRO	15.5	GRE	13.3	AUT	25.7	NED	15.5
2	GRE	34.2	SLO	13.6	AUT	11.8	GER	20.7	AUT	12.2
3	MKD	2.2	AUT	13.4	NED	9.0	USA	14.7	FRA	11.1
4	USA	2.0	KUW	9.9	GER	8.7	HUN	6.0	GER	8.0
5	TUR	2.0	GER	9.2	BEL&LUX	8.4	LUX	5.9	USA	6.5

Source: Southeast Europe Investment Guide 2005; 1- Rank, 2- Investor Country, 3- Investor's share (%)

In the smaller countries the concentration of the foreign investors is higher, which is the consequence of the less investments. Thus, one can find such an "exotic" investor like Kuwait in Bosnia-Herzegovina which reflects well that the major European investor countries avoided these small countries as an investment target.

In the last years several SEE countries were able to improve their business environment year by year. Their business climate improved significantly in the last few years and the FDI inflows also increased dynamically. In conclusion, we can state that several countries in the SEE region will become competitors of the NMS, not in short term but rather in the medium or long term.

CROATIA - ON THE WAY OF ACCESSION

Only after a month that on 3 October 2005 the accession negotiations started between the European Union and Croatia and Turkey, the Commission of the EU accepted an extensive enlargement strategy, based on the findings of the 2005 Commission's Progress Reports, for the new accession partners Croatia and Turkey and other potential Western Balkan candidate countries. In the strategy the EU has emphasized its commitment to helping the candidates with more transparent but strict enlargement policy and strengthening its engagement towards enlargement, including more effective information of the accession countries about issues concerning enlargement, goals and challenges.

The accession negotiations, as it can be seen in the timetable below, could have started already in March 2005, but, as it is broadly known, they were hampered by post-war political reasons. Now, after that the Chief Prosecutor of the International Criminal Tribunal for the former Yugoslavia (ICTY) stated that Croatia was fully cooperating with the ICTY, even the last obstacle delaying the negotiations was liquidated (though the cooperation is continuously monitored and lack of commitment may result in termination of the accession process).

TABLE 2. EVOLUTION OF EU-CROATIA RELATIONSHIP FROM 2000

November 2000	Zagreb Summit launches the Stabilisation and Association Process
29 October 2001	Stabilisation and Association Agreement signed
21 February 2003	Croatia applies for EU membership
June 2003	Thessaloniki summit confirms accession perspective of Western Balkans countries, including Croatia
April 2004	European Commission issues positive opinion on Croatia's application for EU membership application
June 2004	European Council confirms Croatia as candidate country
December 2004	European Council sets 17 March 2005 as start date for negotiations (conditional upon full cooperation with ICTY)
1 February 2005	Stabilisation and Association Agreement enters into force
16 March 2005	EU postpones start of accession negotiations (but adopts framework for negotiations with Croatia)
26 April 2005	First meeting on Croatia's cooperation with the ICTY
3 October 2005	Opening of accession negotiations
9 November 2005	Commission accepts enlargement strategy for Croatia and Turkey

Source: European Commission

In the 'Croatia: Accession Partnership 2005' program the Commission laid down the priorities which should be fulfilled by Croatia in the short (to be accomplished within one to two years) and medium term (within three to four years) to solve the problems identified in the Progress Report. This timetable gives the opportunity to Croatia to join the EU in 2009.

According to the document Croatia has already achieved substantial progress in the field of overtaking and implementing EU legislation but there are still a few backlogs to be eliminated. Amongst them the following points are the main clauses of the 'Negotiating Framework for Croatia':

- Reform the judicial system
- Make further progress in relation with minority and human rights, to facilitate the return of refugees and the regional cooperation
- Brake down corruption
- Strengthen and reform administration.

Consequently – a result of Croatia's well-advanced economic development – the requirements are mainly concentrating on political issues (not a miracle in the case of an economically well-developed country which still bears post-war political distortions)

Even so the following paragraphs concentrate on the economic issues of the Accession Partnership of Croatia: disregarding political deficiencies we are reviewing the economic background and the economic requirements raised by the EU. (The broader view is that Croatia is economically developed so well, that it could be an EU member any time if only economic reasons based the decision, but according to the EU there is still need for improvement in a few cases.)

ECONOMIC PRIORITIES AND REQUIREMENTS

The economic criteria can be approached from two aspects: tasks related to the development of the broader macroeconomic environment and tasks related to the EU law and policies. In the following, for obvious reasons, we concentrate on the former, we do not go into details relating the more standard part of the accession process.

MACROECONOMIC ENVIRONMENT

The first group of tasks is dedicated to establish a favourable macroeconomic environment (concentrates on macroeconomic policies, fiscal and monetary policies, environment, privatisation, etc.).

Recommendations aim to shape a most favourable macroeconomic environment, partly aiming to reach the optimal capacities of the economy and the smooth transition into the common market and partly to prepare the economy to the latter, but obligatory membership in the Economic and Monetary Union.

1. Already on the short term: implementation of prudent macroeconomic policies, facilitating stability and the effectiveness of monetary policy. Fiscal consolidation should take effect in particular in the area of subsidies (parallel with privatisation of state-owned enterprises) and social spending (including first steps towards health care and pensions).

2. If the accomplishment of short-term tasks is successful in the next two years, as part of it, it will facilitate the medium term objectives: implementation of a sustainable medium-term fiscal framework, arm-in-arm with the continuous reduction of public spending, deficits and debt in the share of GDP. (Ergo it is priority for Croatia already on the not-so-long medium term, to achieve or at least approach to the Maastricht criteria, to enable Croatian economy to take over the common currency as early as possible.)

3. Based on the progress of the first two years a comprehensive reform of the health care and pension systems should take effect in 2008-09.
4. With the aims of reducing the subsidies and restructuring the economy privatisation (or liquidation) of state-owned enterprises should be accelerated on the short term, especially in designated industries, like steel and shipbuilding industry or agriculture.
5. In the case of public utilities (telecom, energy, oil) the EU gives the opportunity to Croatia to choose between privatisation and restructuring.
6. On the medium term Croatia should complete the privatisation process with selling all of the shares in companies held under the Privatisation Fund.
7. In connection with the above the EU experienced lack of financial discipline in the case of the large, state-owned companies, this problem is to be solved by 2009 as well.
8. Not independently from the point just discussed, the ongoing land reform should be accelerated too, with particular emphasis on (creating modern and efficient) registration and privatisation of agricultural land. The process should be completed by 2009. The EU's main goal in this case is to develop a presently non-existent effective land and housing market.
9. Simplifying the rules of market exit and entry. At the moment registration of newly founded enterprises takes much longer than it is usual amongst EU-members, whilst the already adopted bankruptcy rules are not yet fully implemented in practice. According to the reports, there are still legal obstacles ahead of the smooth and quick implementation of developments of private enterprises, these should be removed with the full adoption and implementation of the concerning EU rules. The same applies to foreign direct investments, which are still hindered with bureaucratic tools in favour to domestic entrepreneurs.

These priorities apply on the short and medium term as well. Continuing the ongoing reform of education and labour market is dedicated as a medium term task, considering the complexity and rigidity of the area.

OBLIGATIONS OF MEMBERSHIP

The second bunch of objectives aims to help the accession partner to become able to assume the obligations of membership, namely to accomplish the overtaking and implementation of the EU's mutual economic measures, e.g. the legal background of the four freedoms (free movement of goods, services, capital and – later – workforce) or the regulation of different branches, policies and characteristics of the economy. (e.g. taxation, statistics, social policy, competition, financial services, IT, agriculture, transport, energy, etc.). These points generally arise from basic values which are laid down in the *acquis*, therefore they mean standard criteria, automatically applied to candidates.

THE ROLE OF THE WORLD BANK CREDITS IN THE FYR OF MACEDONIA

At the end of October 2005, the World Bank approved USD 30 million for the First Programmatic Development Policy Loan (PDPL 1) for the FYR of Macedonia. This project supports the Government in its effort to improve the investment climate and strengthen public sector governance. PDPL 1 is the first in what is expected to be a series of three loans over a three to four years period. The PDPL series will also support the Government's efforts to carry out intensive structural and institutional reforms required for EU integration. "The reforms that the Programmatic Development Policy Loan supports are designed to promote sustainable economic growth and job creation", says Bruce Courtney, head of the World Bank team designing the project. "If consistently and persistently implemented, the reform program will address over time many the key obstacles to improved living standards in FYR Macedonia. The reform program is also consistent with country's aspiration for eventual EU membership."

THE POSITION OF THE MACEDONIAN ECONOMY

One can say that the stabilisation of the Macedonian economy advances slowly. To be awake to the different political problems, it is a great outcome that the country could preserve the macroeconomic stability and the financial balance and could keep on the rate of the inflation at a low level. All the same it did not come about the break-through in the regulation of the economy on the sustainable growth field, and the fight against the unemployment did not achieve its objectives. The position of the higher than 30% unemployment rate remained unsolved. The net mean wage was less than EUR 200 in 2004 and it has not increased compared to the last year.

The speeding up of the economic development and the building of the sustainable growth line are the key issues of the newest government program. The government considers the poverty and the social diversification as the biggest problem in the country. The competitiveness of the Macedonian products has not picked up in the past few years, and to achieve the expansion of the export-oriented industry sector, a new strategy is needed to be worked out.

ABOUT THE RELATIONSHIP WITH THE EU

In November 2005, the European Commission has published its new enlargement pack for 2005. This document includes the "land reporting" of the pledge and the potential pledge countries, the opinion about the accession instance of the FYR of Macedonia, and the strategic document about the future of the enlargement process. The most important announcement of the pack was that the Commission advised to grant the "pledge status" to the former Yugoslav Republic of Macedonia. Macedonia's prime minister said the decision was a "one-way ticket" to full EU membership. "Now the question is when we are going to become a member and the answer will depend on how fast the reforms take place," PM Vlado Buckovski said in Skopje.

In Brussels, EU Enlargement Commissioner Olli Rehn praised the way in which the country's ethnic tensions had been resolved. "Four years ago, in 2001, the Former Yugoslav Republic of Macedonia was at the brink of a civil war, now in 2005, it is seriously knocking on the EU's door," he said. "The country is a European success story in terms of political stability and democratic development," Rehn said. But he added that: "Accession negotiations should only be opened once (Macedonia) has reached sufficient compliance with membership criteria." This

decision will have a great impact on Macedonia from the year 2007. And hopefully this new event will give a new movement to the country to meet the requirements. The former Yugoslav Republic of Macedonia submitted an application for EU membership on 22 March 2004. The country's ability to implement major reforms in areas such as strengthening the rule of law, combating organized crime, corruption and illegal migration, improving border management and document security, and generally improving administrative and implementation capacity is stressed as essential to this day. These objectives are assisted by international financial institutions.

RELATIONSHIP WITH THE WORLD BANK

The FYR of Macedonia joined the World Bank and the International Development Association in 1993. Since this year, the World Bank helped the country to promote private sector development, supported structural reforms through adjustment lending and analysis, strengthened the social safety net, and improved infrastructure.

The Country Assistance Strategy (CAS) is the World Bank's work plan in a country and defines the level and type of assistance to be provided, usually for a period of three years. The strategy is in close partnership with the government and in consultation with representatives from the civil society. The strategy is in line with the priorities of the government and the people of the country. The CAS presents a program of support that seeks to build on the country's marked progress in macroeconomic management and structural reform since the elections. Its main priorities are:

- To promote the efficient management of public resources and tackle corruption,
- To promote the creation of jobs through sustainable private sector driven growth,
- To promote reconciliation, build human capital and protect the most vulnerable.

On 9 September 2003, the World Bank adopted its new CAS for FYR Macedonia for 2004 - 2006. This strategy presents a program of support that seeks to build on the country's improved macroeconomic management and progress on implementation of structural reforms.

Since 1993, the World Bank has approved USD 600 million for 25 projects in Macedonia. These projects have provided support in agriculture, health, education, private finance as well as other sectors. From 1993 till 2001, the World Bank supported the FYR of Macedonia by providing the country long-term loans at no interest through its concessional lending arm - the IDA. Although the FYR of Macedonia was to graduate from IDA financing in 2001, the conflict of 2001 and the country's vastly changed circumstances led the World Bank to grant the country exceptional access to additional IDA funds.

The World Bank approved a USD 14 million loan for the Real Estate Cadastre and Registration Project (RECRP) for Macedonia in March 2005. This project assisted the government in its effort to improve the business environment and facilitate foreign and domestic investment. The objective of the project were: the establishment of the real estate cadastre system and the registration of rights; improve institutional processes and procedures to provide efficient registration services; and help developing capacity to formulate policies in order to achieve efficient property markets.

On 21 June 2005 the World Bank approved USD 11.3 million loan for the Business Environment Reform and Institutional Strengthening Project (BERIS) for Macedonia. This

project assisted the government in its efforts to improve the business environment and facilitate foreign and domestic investment efforts.

On 15 September 2005, the World Bank approved a EUR 15 million for the Railways Reform project for the FYR of Macedonia. This project promoted the government's efforts to reform Macedonian Railways and improve its productivity and effectiveness. FYR Macedonia's strategic location puts it at the center of international routes linking Turkey, Greece, and Bulgaria to the rest of Europe. Efficient and effective operation of the roads and railways, which link the former Yugoslav Republic of Macedonia to the region, will become increasingly important to realising the country's growth potential. Macedonian Railways, which operates the country's railways, is one of the largest loss-making companies among public sector enterprises. Total debt at the end of year 2004 was EUR 143 million (3.3% of GDP). The Government has made out that the project is essential in the transport sector. The reform should focus on better accountability, labour restructuring and targeted investments.

And last but not least, in October 2005, the World Bank has assisted the country with USD 30 million. This loan is exactly as important for Macedonia as the older loans. Macedonia needs some help to be able to catch up with the other candidate countries. The decision of the European Commission set up new assignments for the country. Although the country's economy has advanced in the last years, it needs assistance from the EU and from the International Institutions, for instance from the World Bank as well.

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