

Investment Reform Index 2006

Progress in Policy Reforms

to improve the Investment Climate in South East Europe

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The Investment Compact supports SEE with practical tools to increase investment, growth and employment and support the European Union (EU) integration process.

The Investment Compact member countries are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Moldova, Montenegro, Romania and Serbia. The work of the Investment Compact is actively supported and financed by the following OECD countries: Austria, Flanders (Belgium), Czech Republic, Ireland, Italy, Japan, Norway, Slovenia, Switzerland, United States and the European Commission (www.investmentcompact.org).

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The Stability Pact for South Eastern Europe is a political declaration and framework agreement adopted in June 1999 to encourage and strengthen cooperation among the countries of South East Europe and to facilitate, coordinate and streamline efforts to ensure stability and economic growth in the region (www.stabilitypact.org).

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Foreword

Apart from market size, and macroeconomic and political stability, government policy is the single most important factor influencing investment flows. It is also one of the areas where governments have the greatest leverage to act. The objective of the Investment Compact, an initiative of the Stability Pact for South Eastern Europe and the Organisation for Economic Co-operation and Development (OECD), is to assist the countries of South East Europe (SEE) in improving the investment climate.

This report constitutes one of the pillars of the Investment Compact's work. It provides governments with an overview of each country's performance on investment policy reform and will support them in setting priorities and further improving the investment environment. The report is based on the Investment Reform Index (IRI), a novel tool used to measure – on a comparative basis – where countries stand on policy reform. The IRI is based on a broad and comprehensive approach to investment policy. It encompasses all major policy areas that affect the investment environment, including anti-corruption, competition, tax, trade policy, regulatory reform and human capital.

The IRI report is the result of an intense collaborative effort between the OECD Investment Compact team, OECD experts in each of the policy areas considered, Country Economic Teams in each SEE country, representatives of the private sector and a network of consultants based in the region.

Evaluation, through the IRI process, of progress on policy reforms will continue to be conducted annually to provide ongoing impetus for reform.



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Abbreviations

ATM	Autonomous Trade Measure
BEEPS	Business Environment and Enterprise Performance Survey
BIAC	Business and Industry Advisory Committee
BIT	Bilateral Investment Treaties
BICIS	Bulgarian Integrated Customs Information Systems
CAA	Competition Authority of Albania
CARDS	Community Assistance for Reconstruction, Development and Stabilisation
CEFTA	Central European Free Trade Agreement
CEN	European Committee for Standardization
CENELEC	European Committee for Electro-technical Standardisation
CIT	Corporate Income Tax
CEE	Central and Eastern Europe
EA	Europe Agreement
EA	European Cooperation for Accreditation
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECOFIN	Economics and Finance
EFTA	European Free Trade Association
EME	Emerging Market Economics
EPPA	Enterprise Policy Performance Assessment
ETF	European Training Foundation
ETSI	European Telecommunications Standards Institute
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investors Advisory Service
FIC	Foreign Investors Council
FTA	Free Trade Agreement
FYR	Former Yugoslav Republic
GDP	Gross Domestic Product
GSP	Generalised System of Preferences
GTD	General Taxation Directorate of Albania
GVH	Gazdági Versenyhivatal (Office for Economic Competition of Hungary)
IBFD	International Bureau of Fiscal Documentation
ICEG	International Centre for Economic Growth
ICSID	International Centre for Settlement of Investment Disputes
ICT	Information Communication and Technology
IIPA	International Intellectual Property Agency
IFS	International Financial Statistics

ILAC	International Laboratory Accreditation Cooperation
IMF	International Monetary Fund
IOTA	Intra-European Organisations of Tax Administrations
IP	Intellectual Property
IPA	Investment Promotion Agency
IPAEI	Institute of Public Administration and European Integration
IPR	International Property Right
IRI	Investment Reform Index
ISO	International Organization for Standardisation
ITD	International Tax Dialogue
JUS	Yugoslav Standards
M&A	Merger and Acquisition
MFN	Most Favoured Nation
MNC	Multinational Corporation
NGO	Non Governmental Organisation
NTB	Non-Tariff Barrier
OECD	Organisation for Economic Cooperation and Development
OHR	Officer of the High Representative
OPEC	Office for the Protection of Competition of the Czech Republic
QSCB	Body for Quality Systems Certification of Moldova
PISA	Programme for International Student Assessment
PIT	Personal Income Tax
R&D	Research and Development
RFTA	Regional Free Trade Agreement
RIA	Regulatory Impact Analysis
RSLO	Regional Secretariat Liaison Office
SAA	State Aid Act
SAA	Stabilisation and Association Agreement
SEE	South East Europe
SEECF	South East Europe Cooperation Process
SIDA	Swedish International Development Agency
SIGMA	Support for Improvement in Governance and Management
SME	Small and Medium-sized Enterprise
SPAI	Stability Pact Anti-corruption Initiative
TIPA	Training Institute of Public Administration
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TTC	Trade and Transaction Cost
TTFSE	Trade and Transport Facilitation in Southeast Europe
UEIPA	Unemployment Security and Employment Incentives Act
UNCITRAL	United Nations Commission on International Trade Law
UNMIK	United Nations Mission in Kosovo
USAID	United States Agency for International Development
USSR	Union of Soviet Socialist Republics
VAT	Value Added Tax
VET	Vocational Education and Training
WAIPA	World Association of Investment Promotion Agencies
WCO	World Customs Organization
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

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¹ A Country Economic Team is made of representatives of Ministries of Economy, other ministries and government agencies dealing with the IRI dimensions as well as the main private sector organisations. Country Economic Team leaders act as coordinators and contact points in each SEE country (see also Annex C. List of Contacts).



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Executive Summary

The Investment Reform Index 2006: Is Policy Reform Making a Difference to the Investment Environment in South East Europe?

South East Europe (SEE) has great potential as an attractive investment location. It neighbours the European Union, one of the richest economic areas of the world, and enjoys virtually unrestricted trade access to this vast market. South East Europe also boasts a relatively well-qualified and inexpensive workforce and has a considerable endowment of natural resources, including some of Europe's most beautiful coastal areas. Furthermore, substantial external support in the form of financial aid and technical assistance (averaging more than EUR 6 billion annually over the past five years) has contributed to the region's economic and social development.

To what extent have SEE governments leveraged these assets with effective government policies to attract investment and stimulate growth?

According to the Investment Reform Index (IRI) which measures where countries stand in policy reform to improve their investment environment,² there is still an important gap between the level of government policies adopted in SEE and the level required to achieve the region's full investment potential.

To be sure, as a region it has made considerable progress in some policy areas. South East Europe now ranks close to Central and Eastern Europe (CEE) in investment policy, trade liberalisation

and corporate tax rates. Policy coordination within SEE governments has greatly improved: the fact that each of them has been able to coordinate between Ministries and deliver on the complex Investment Reform Index self-evaluation process within a short timeframe is a case in point.³ On the economic front, many achievements can be highlighted. GDP growth rates in the region are now above 5%, inflation is under control and Foreign Direct Investment (FDI) inflows steadily increased from EUR 4.6 billion in 2002 to over EUR 10.6 billion in 2005. The most recent credit ratings signal greater stability and investor confidence. And SEE now benefits from a real entrepreneurial culture.

However, economic growth and selected policy reforms have not reduced unemployment in the region, which is over 20% in the Western Balkans. The financial infrastructure is still weak, with interest rate spreads averaging 7%. This is 60% higher than in CEE and twice as high as in the euro area. FDI inflows continue to depend heavily on privatisation; 90% of inflows are concentrated in four countries. Trade deficits are high, reflecting the low propensity to export; intra-regional trade and investment are still at the infancy stage.

In a number of policy areas, particularly those related to public governance – regulatory reform, anti-corruption, competition – the region's performance is less impressive. Medium- to long-term strategic areas such as human capital have not received enough attention.

² Dimensions covered by the IRI in 2006 are: Investment Policy, Investment Promotion and Facilitation, Tax Policy, Anti-Corruption and Business Integrity, Competition Policy, Trade Policy, Regulatory Reform and Human Capital.

³ See Chapter 1.

Accession to the European Union (EU) is a strong impetus, but more could be done to achieve far-reaching policy reform.

The process of European integration drives the reform agenda throughout the region. It provides a model to follow, with clear targets, timelines and resources; it is also a catalyst for political consensus on reform.

EU accession has accelerated the reform process, particularly in Bulgaria and Romania, which lead the region in implementing investment and competition policy. Nevertheless, more can be done in all the SEE countries in areas not directly associated with the *acquis communautaire*, such as regulatory reform, investment promotion and human capital.

In this regard, a programme such as the OECD Investment Compact, which draws on the experience of OECD member countries, can provide SEE countries with expertise and support that are complementary to the EU agenda (and that can support efforts to pursue a more comprehensive approach to policy reform).

Reforms are not proceeding at the same pace and some SEE countries still need to make further efforts in establishing the basic legal and institutional framework for key policy dimensions related to investment.

Reforms in the region are occurring at different rates and are at different stages. Bulgaria, Romania and (to a certain extent) Croatia have completed a first phase of policy elaboration and institutional building and are currently engaged in policy implementation with respect to most of the dimensions covered by this report. The challenge for them is to ensure the sustainability of the reform process.

Outside Bulgaria, Croatia and Romania, other SEE countries have demonstrated solid reform in specific areas such as regulatory reform (Moldova, Serbia), trade (Albania, FYR Macedonia, Moldova, Montenegro, Serbia), tax (Montenegro, Serbia) and investment promotion (Serbia).

However, the same countries lag behind in establishing the basic legal and institutional

framework for some key dimensions, particularly:

- Anti-corruption: Albania, Bosnia and Herzegovina, Montenegro, Serbia;
- Regulatory reform: Albania, Bosnia and Herzegovina, FYR Macedonia;
- Human capital: Albania, Bosnia and Herzegovina, Moldova, Serbia.
- Competition: Moldova, Montenegro, Serbia.

Policy inconsistencies send conflicting signals to investors.

SEE governments have not always pursued a consistent approach to policy making. For example, while SEE countries have significantly reduced tariffs and abolished import and export licenses, they have not yet addressed high non-tariff barriers to trade such as technical, sanitary and phytosanitary standards, accreditation and conformity assessment. In the area of tax policy, despite very competitive corporate tax rates ranging from 9 to 20%, tax administration is still very weak, with high compliance costs, delays in VAT reimbursement and ineffective mechanisms for dispute settlement.

A key priority for SEE countries should be to ensure more policy consistency, and to avoid giving conflicting signals to investors, by establishing a sound mechanism for policy coordination.

The gap between the leading reformers in the region, and other SEE countries is widening.

Leading reformers in the region – Bulgaria, Croatia, Montenegro, Romania, Serbia – are increasingly distancing themselves from their counterparts. One statistic is telling in this respect: Albania, Bosnia and Herzegovina, FYR Macedonia and Moldova still represent only 9% of FDI flows in the region down from 14% in 2002. This second group of countries should represent the first priority of regional reform efforts and international support which also requires a massive and sustained effort. UNMIK/Kosovo – which was not included in the 2006 IRI assessment but will be included in 2007 – should also be associated with these priority countries.



Time is running out for the region to achieve its full investment, growth and employment potential.

Competition to attract international mobile investment is more intense than ever. Much available capital has already been invested elsewhere, particularly in CEE. A solid and balanced policy and institutional framework, at the country and regional level, is needed in order to develop a competitive edge, overcome the limitations of small and fragmented markets, and convince investors that the SEE region can be a reliable and competitive location for investment.

Without further reforms, the Western Balkans and Moldova risk being marginalised by competition from both CEE countries (which are increasingly active in the higher-value, more capital and technology intensive sectors) and low-cost, labour-intensive producers, for example in Asia and North Africa.

As SEE countries continue to make progress, they will need to intensify regional cooperation

on trade and investment to reduce policy imbalances and create the critical mass to attract investors. Adoption of a Regional Framework of Investment in June 2006 and the signing of a new regional Free Trade Agreement (FTA), which will be pursued through simultaneous enlargement and amendment of the Central European Free Trade Agreement (CEFTA) by the end of 2006, are strong signals of a willingness to step up regional cooperation.

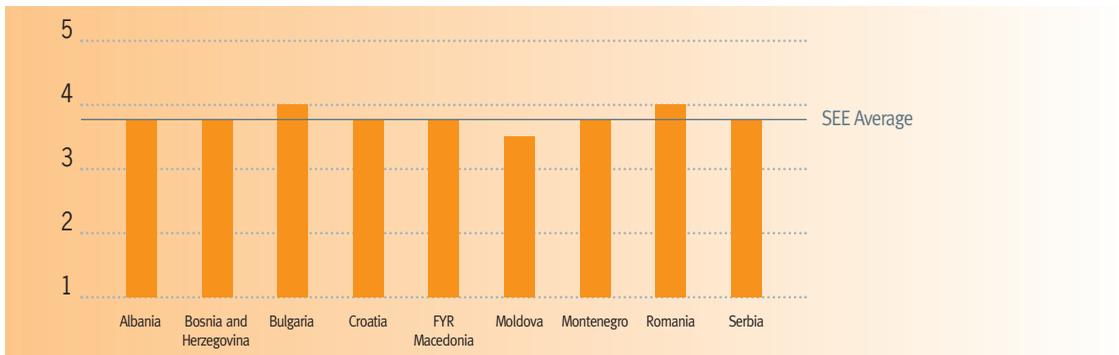
SEE countries also need to reduce their dependence on donors and increase their ownership of the reform agenda. Moreover, the region as a whole needs to communicate its achievements more effectively – internally and externally – in order to benefit fully from its efforts thus far.

The Investment Reform Index can be used by individual countries and the region to better communicate and evaluate, and then define, priorities for improvement to make a real difference to the investment environment.

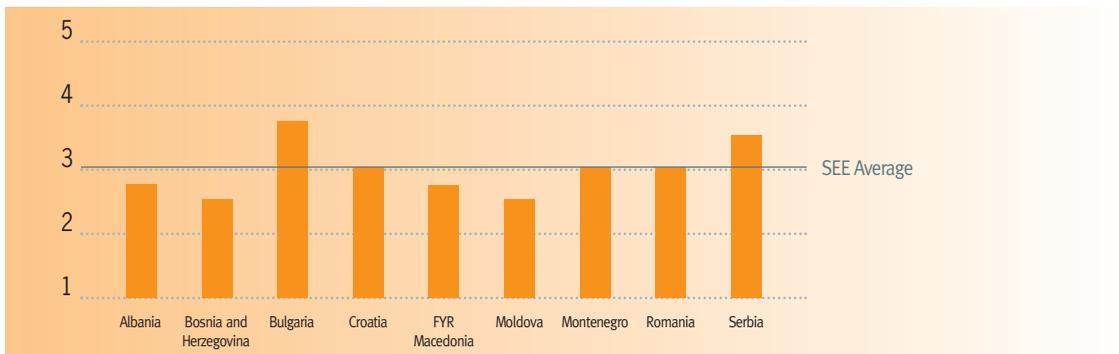
OVERALL INVESTMENT REFORM INDEX SCORES⁴

The following policy dimensions were assessed by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the target countries following the process described in the Chapter 1 of this report. This resulted in the following scores describing the current situation in each of the nine countries covered by the IRI.

INVESTMENT POLICY

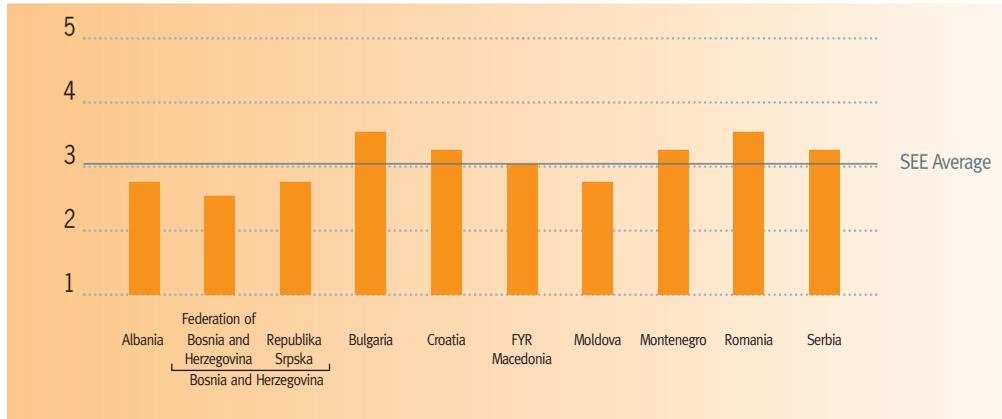


INVESTMENT PROMOTION AND FACILITATION

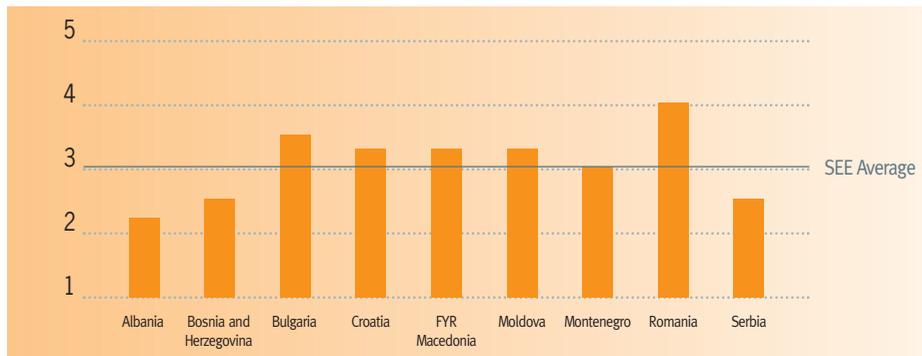


⁴ Each policy dimension is rated on a scale of 1 to 5 (weaker to stronger). The indicators for the dimensions are weighted, with a range from 1 (least important) to 3 (most important). For a detailed breakdown of indicators and scores please refer to: www.investmentcompact.org. Scores for Competition Policy are not included in the 2006 edition of the IRI evaluation.

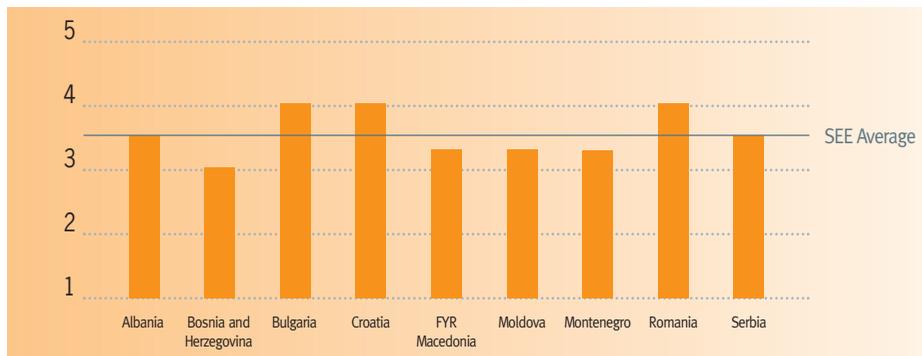
TAX POLICY



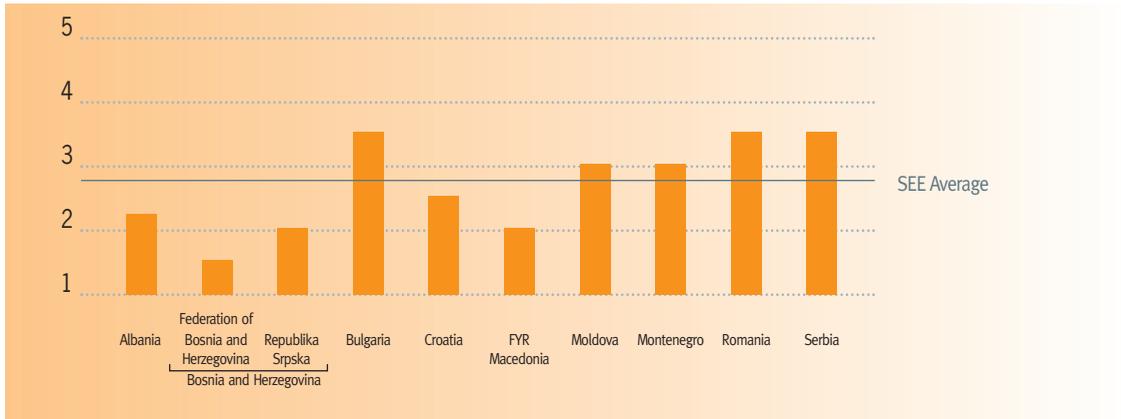
ANTI-CORRUPTION AND BUSINESS INTEGRITY



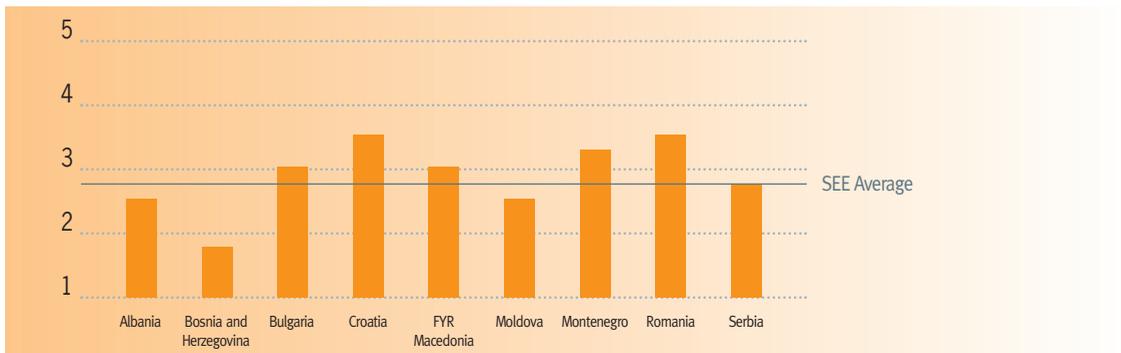
TRADE POLICY



REGULATORY REFORM



HUMAN CAPITAL



Source: OECD Investment Compact.



MORE ADVANCED AND LESS ADVANCED POLICY DIMENSIONS

FOR THE SEE REGION:

POLICY DIMENSIONS THAT ARE MORE ADVANCED

- Investment policy
- Trade policy
- Tax policy

POLICY DIMENSIONS THAT ARE LESS ADVANCED

- Human capital
- Regulatory reform
- Anti-corruption and business integrity
- Investment promotion and facilitation
- Competition policy

Source: OECD Investment Compact.

FOR EACH SEE COUNTRY*:

COUNTRY

POLICY DIMENSIONS THAT ARE MORE ADVANCED

POLICY DIMENSIONS THAT ARE LESS ADVANCED

Albania

- Investment policy
- Trade policy

- Anti-corruption and business integrity
- Regulatory reform
- Tax policy
- Human capital
- Investment promotion and facilitation
- Competition policy

Bosnia and Herzegovina

- Investment policy
- Trade policy

- Human capital
- Regulatory reform
- Anti-corruption and business integrity
- Tax policy
- Investment promotion and facilitation
- Competition policy

Bulgaria

- Investment policy
- Trade policy
- Investment promotion and facilitation
- Tax policy
- Competition policy

- Human capital
- Anti-corruption and business integrity
- Regulatory reform

Croatia

- Trade policy
- Investment policy
- Human capital
- Tax policy
- Anti-corruption and business integrity

- Regulatory reform
- Investment promotion and facilitation
- Competition policy

Source: OECD Investment Compact.

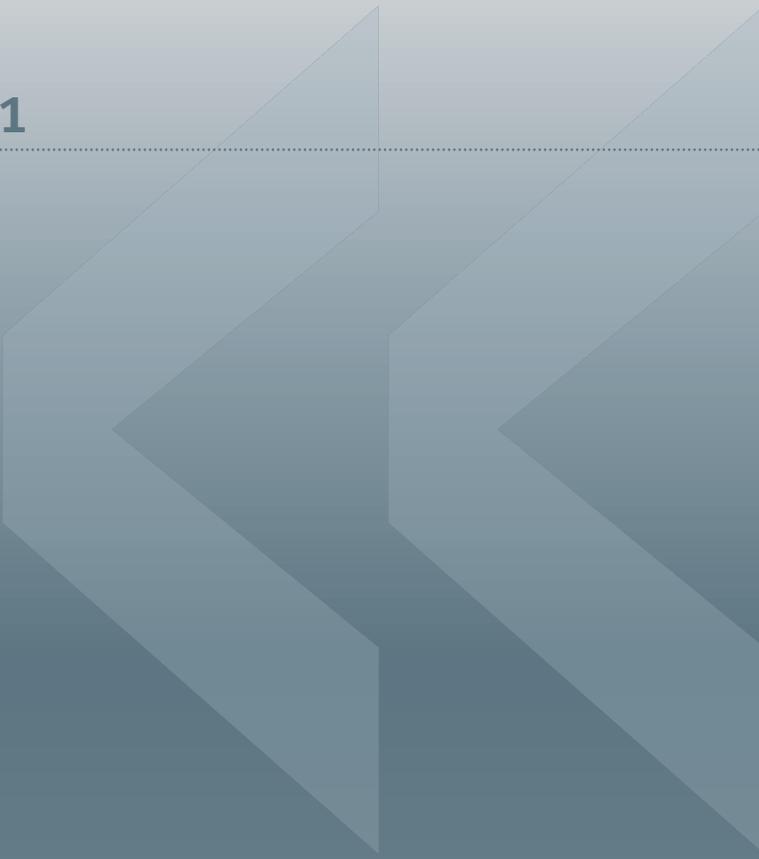
*Based both on absolute scores and policy dimension scores relative to SEE average except competition policy which is based on the policy findings and recommendations in the Chapter 7. Competition Policy.

FOR EACH SEE COUNTRY (CONT.):

COUNTRY	POLICY DIMENSIONS THAT ARE MORE ADVANCED	POLICY DIMENSIONS THAT ARE LESS ADVANCED
FYR Macedonia	<ul style="list-style-type: none"> • Investment policy • Anti-corruption and business integrity • Trade policy • Human capital 	<ul style="list-style-type: none"> • Regulatory reform • Investment promotion and facilitation • Tax policy • Competition policy
Moldova	<ul style="list-style-type: none"> • Investment policy • Anti-corruption and business integrity • Trade policy • Regulatory reform 	<ul style="list-style-type: none"> • Human capital • Investment promotion and facilitation • Tax policy • Competition policy
Montenegro	<ul style="list-style-type: none"> • Investment policy • Tax policy • Human capital • Regulatory reform 	<ul style="list-style-type: none"> • Anti-corruption and business integrity • Investment promotion and facilitation • Trade policy • Competition policy
Romania	<ul style="list-style-type: none"> • Investment policy • Trade policy • Anti-corruption and business integrity • Human capital • Tax policy • Competition policy 	<ul style="list-style-type: none"> • Investment promotion and facilitation • Regulatory reform
Serbia	<ul style="list-style-type: none"> • Investment policy • Regulatory reform • Investment promotion and facilitation • Trade policy • Tax policy 	<ul style="list-style-type: none"> • Anti-corruption and business integrity • Human capital • Competition policy

Source: OECD Investment Compact.

Part 1





Introduction



Chapter 1

The Investment Compact and the Investment Reform Index

The Investment Compact and the Investment Reform Index

1.1 Introduction to the Investment Compact

The Investment Compact is a regional programme designed to improve the investment environment and encourage private sector development in South East Europe (SEE). This region includes Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia (FYR Macedonia), Moldova, Montenegro, Romania, Serbia and UNMIK/Kosovo.⁵ Under the Stability Pact for South Eastern Europe, the programme has its own institutional infrastructure, including a Project team and an annual Ministerial conference. The Project team is located in the OECD Directorate for Financial and Enterprise Affairs.

The Investment Compact promotes policy reform and implementation in South East Europe. It delivers results via shared policy commitments

set out in the SEE Regional Framework for Investment⁶ and practical tools such as the Investment Reform Index (IRI), which uses collaborative benchmarking to evaluate where countries stand on investment reform. The Compact also supports the design and implementation of improved policies through regional and country-specific advisory projects that address the most important weaknesses identified by the IRI. Evaluation of government policies, setting country priorities and support in implementation are part of an annual process to achieve impact (see Figure 1.1).

An independent external evaluation conducted in 2004 found that the Investment Compact provides 'good value for money' and 'has clearly contributed to improving the investment environment in SEE'.⁷

FIGURE 1.1 – THE INVESTMENT REFORM PROCESS



⁵ UNMIK/Kosovo has not been included in the 2006 IRI process but will be for the 2007 edition.

⁶ The Regional Framework for Investment was endorsed by the SEE countries at the 2006 Conference of SEE Ministers of Economy (Vienna, 27 June 2006). It provides a reference for the elaboration, implementation and evaluation of national policies related to investment in the region. The ten areas covered are: Investment Policy, Investment Promotion and Facilitation, Tax Policy, Anti-corruption and Business Integrity, Competition Policy, Trade, Regulatory Governance, Human Capital and Employment, Corporate Governance, SME Policy.

⁷ A.T. Kearney management consultancy, April 2004.

1.2 Why it is important to monitor policy reform

Monitoring and evaluation based on clearly defined indicators is integral to the development of sound policies. It allows policy makers to assess the extent to which policy objectives have been fulfilled. It also provides a basis for identifying strengths and weaknesses and making necessary adjustments. Monitoring can ensure better coordination and consistency between policies. When carried out on a comparative basis with peers, it can provide further impetus for reform.

The monitoring and evaluation of government policy can be a complex exercise. There is always a time lag between policy development, implementation and impact. In addition, it is often difficult to isolate the impact of any single measure, or to establish direct causality between policy and results.

However, the experience of OECD countries suggests that there is a positive correlation between sound government policies and investment, particularly when these policies are combined in the right manner to create a critical mass of reforms.

1.3 The Investment Reform Index

The Investment Reform Index (IRI) is a tool which SEE countries can use to measure – and communicate progress on – policy reform to improve the business climate. The IRI timeframe is November 2005-September 2006.

The IRI allows SEE countries to benchmark progress relative to their peers in SEE. It provides direction on how to make improvements within each policy dimension through adopting OECD good practices.

Specifically the objectives of the IRI are:

1. Structured evaluation:

- Evaluate progress in investment reform by SEE countries on a comparative basis;

- Define countries' position on a scale of 1 to 5 (weaker to stronger), corresponding to the various dimensions of reform;
- Illustrate level 5 with good practices from other countries, particularly in Central and Eastern Europe (CEE).

2. Targeted support for improvement:

- Prioritise regional and country level support needs based on IRI evaluation;
- Provide 'how to' support based on good practice examples from OECD countries and follow up projects coordinated by the Investment Compact.

3. Regional collaboration and peer review:

- Encourage more effective peer review through a common evaluation framework;
- Promote dialogue between CEE and SEE based on good practices in CEE.

4. Public and private sector involvement:

- Offer a simple and transparent communication tool for potential investors;
- Establish a measurement process that encourages public-private consultation.

The IRI has been structured to assist governments in evaluating and improving policies to promote private direct investment. Obviously governments need to reconcile policy inputs from the IRI with a wider reform agenda.

Structured around the Policy Framework for Investment⁸ which incorporates good practices from OECD countries, the Investment Reform Index goes beyond the typical components of investment policy (e.g. national treatment of FDI, the network of bilateral investment protection treaties, investment incentives) to cover other areas affecting the investment environment, such as competition, trade policy and human capital. The specific IRI dimensions covered in 2006 are: investment policy, investment promotion and facilitation, tax policy, anti-corruption and business integrity, competition policy, trade policy,

⁸ OECD (2006), *Policy Framework for Investment*.

regulatory reform⁹ and human capital. Evaluation of small and medium-sized enterprise (SME) policy is part of a separate process conducted in cooperation with the European Commission in the framework of the European Charter for Small Enterprises (see Appendix 1.1).

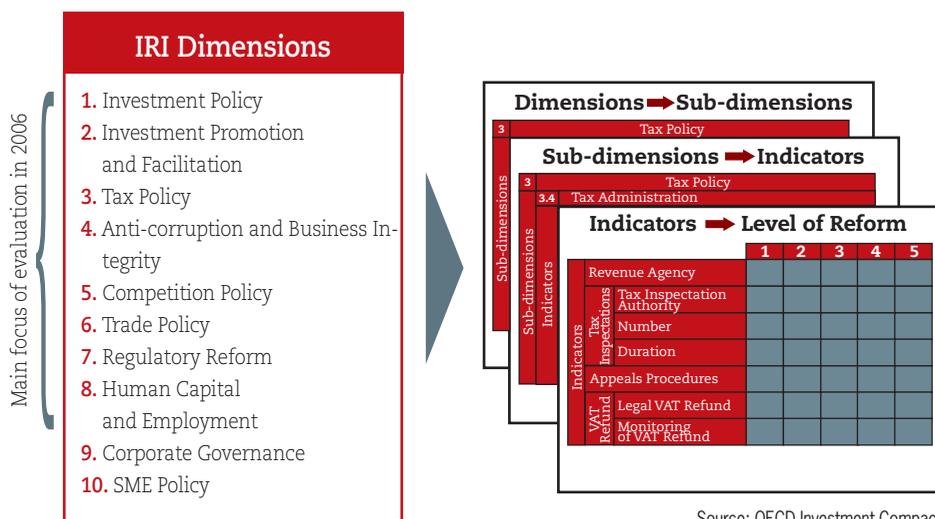
Each policy dimension is further divided into sub-dimensions. For example, the sub-dimensions of tax policy are corporate tax regime, tax administration, compliance costs and transparency. Sub-dimensions are divided into indicators structured around five levels of policy reform with 1 the weakest and 5 the strongest (see Figure 1.2).¹⁰

Each sub-dimension and indicator are assigned a weight in order to calculate the total score for each policy dimension. The weighting system ranges from 3 (most important) to 1 (least important).

Scoring of different levels of policy reform is based on a combination of quantitative and qualitative inputs, including:

- The OECD Investment Compact database, developed over the last five years;
- Available secondary data, e.g. reports from the World Bank, the European Commission, the European Bank for Reconstruction and Development (EBRD) or Foreign Investors Councils;
- Data provided directly by governments, e.g. government strategies, recent laws, action plans, monitoring data;
- Direct individual and group interviews with the private sector in each country.

FIGURE 1.2 – BREAKDOWN OF THE IRI STRUCTURE



⁹ The OECD Policy Framework for investment refers to regulatory governance. The IRI refers only to regulatory reform and is treated as such in this report.

¹⁰ The measurement of reform levels for each indicator typically follows the following approach:

Level 1. There is no law or institution in place to cover the area concerned;

Level 2. There is a draft law or institution, and there are some signs of government activity to address the area concerned;

Level 3. A solid law or institution is in place to cover the area;

Level 4. Level 3 + concrete indications of effective policy implementation of the law or institution;

Level 5. Level 3 + significant record of concrete and effective policy implementation of the law or institution. This level comes closest to good practices in OECD countries.

1.4 The Investment Reform Index process

The Investment Reform Index is the result of a structured participative process involving governments, the private sector and the donor community.

The Investment Reform Process incorporates measurement of policy reform, definition of country priorities and coaching in the implementation of country priorities, with support from the OECD. In early 2006, following an initial assessment based on available secondary data, the Investment Compact provided each SEE government with a toolkit to use in order to conduct self-assessments corresponding to the IRI dimensions.¹¹ The Investment Compact team then carried out a series of country missions to collect primary data and discuss these self-evaluations with governments. A draft evaluation of each country was reviewed and discussed with each government, as well as with the private sector and other international organisations, thus involving a broad range of interested parties (see Box 1.1).

Countries that participated in the IRI process include: Albania, Bosnia and Herzegovina¹²,

Bulgaria, Croatia, FYR Macedonia, Moldova, Montenegro, Romania and Serbia. UNMIK/Kosovo, which currently enjoys observer status in the Investment Compact programme, did not participate in the 2006 IRI evaluation but plans to do so in 2007.

1.5 Strengths and limitations of the Investment Reform Index

The IRI not only serves as a management tool which governments can use to identify priorities for reform. It can also be an effective tool for communicating success and progress.

This tool encourages structured policy debate between the public and private sector, and exchanges of good practices between policy experts in the region. The combination of comparative scoring, an emphasis on government participation, and incorporation of relevant good practices from CEE countries creates a strong impetus for effective policy reform. As a management tool, the IRI not only provides comparative measurements; it also provides concrete guidance on how to effect improvements by applying good practices.

BOX 1.1

STEPS IN THE INVESTMENT REFORM INDEX PROCESS

1. First round of country missions conducted by the Investment Compact to present and explain the IRI (October 2005-January 2006);
2. Finalisation of the IRI toolkit and first evaluation of SEE countries by the Investment Compact team, based on available secondary sources (January 2006);
3. SEE countries conduct self-evaluations corresponding to the IRI dimensions (February-March 2006);
4. Investment Compact team conducts second level measurement, with support of local consultants, to further incorporate:
 - a. Primary data from each SEE country;
 - b. Input from specialised government bodies (e.g. competition authorities, investment promotion agencies);
 - c. Input from the private sector (e.g. Foreign Investors Councils, Chambers of Commerce) (February-March 2006);
5. Second round of country missions to discuss the self-evaluations and the IRI results with governments (April 2006);
6. Finalisation and publication of the IRI (November 2006).

Source: OECD Investment Compact.

¹¹ See the Investment Compact website (www.investmentcompact.org).

¹² The IRI evaluation of Bosnia and Herzegovina is based on the current situation at the state level, except tax policy and regulatory reform. The evaluation of these two dimensions has been performed at the level of the Federation of Bosnia and Herzegovina and the Republic of Srpska due to the existence of different policy frameworks.

1.5.1 Strengths of the IRI methodology

From a methodological point of view, the IRI has several advantages:

- It combines original data collected by the OECD Investment Compact with existing data from sources such as the European Commission, the World Bank and EBRD to provide governments with a broad overview of strengths and policy priorities, offering countries a unique and common reference point for policy priorities.
- Use of a common 'scoreboard' facilitates public-private consultation and encourages action. This can also help public officials to communicate better with respect to policy progress and areas where more reform is necessary.
- The IRI incorporates regional 'good practices' taken from CEE countries. These are the most relevant recent examples from which SEE countries can learn.
- Finally, indicators have been structured to be fully compatible with the European Union (EU) accession process in SEE, and to cover other dimensions important for the investment climate which are not included in the *acquis communautaire*.

1.5.2 Limitations of the IRI methodology

The IRI does have limitations:

- It does not cover all policy dimensions that affect the business climate. Dimensions not included such as infrastructure and financial services have been covered extensively, and in depth, by other international organisations such as the World Bank and EBRD. Evaluation of SME policy is part of a separate process conducted in cooperation with the European Commission, in the framework of the European Charter for Small Enterprises.

- Measuring effective implementation of government policy can be difficult. The IRI combines available quantitative data (e.g. number of ISO certificates) with qualitative data (e.g. private sector feedback through interviews), but the information provided can sometimes be limited and the evaluation will require judgment.

- Distinctions between scoring levels can be challenged, particularly for scores beyond a 3 which evaluate level of implementation.

- Not all of the indicators have the same weight or importance. To address this issue, a simple weighting system has been incorporated, but the assigned weights can always be questioned.¹³

- As countries are at different stages of development, all dimensions are not equally important for each country. Human capital might currently be more of a priority in Bulgaria and Romania, for example. Each country must interpret the scores based on its specific development context.

These limitations of the IRI methodology highlight the fact that measuring policy reform is not an exact science. However, by adopting a common comparative framework based on OECD good practices, and incorporating quantitative and qualitative data from a wide range of sources, the results still provide a much clearer picture of policy reform priorities in the SEE region than is available elsewhere.

¹³ The weighting system ranges from 3 (most important) to 1 (least important). For example, in the tax policy dimension the tax policy and legislation and tax administration sub-dimensions were given a weight of 3 while the compliance costs sub-dimension was given a weight of only 1.

Appendix 1.1

The SME Policy Index

Small and medium-sized enterprises (SMEs) make up a very high proportion of the company population in South East Europe. All SEE governments have introduced active measures to support SMEs, but the IRI does not include a specific chapter on SME policy. Instead, evaluation of SME policy is the object of a specific evaluation process built around the SME Policy Index. This index is an analytical tool elaborated by the Investment Compact for South East Europe in cooperation with the European Commission, the European Bank for Reconstruction and Development (EBRD) and the European Training Foundation (ETF).

In 2003 all the SEE countries endorsed the European Charter for Small Enterprises, the main policy framework for SME development elaborated by the European Union. In parallel, they actively promoted entrepreneurship and innovative SMEs through the Bologna Process, coordinated by the OECD. In this initial phase the OECD Investment Compact supported the European Charter's implementation process by providing an independent assessment of SME policies through the development of the Enterprise Policy Performance Assessment (EPPA).

At the end of 2005 the SEE countries launched a second phase (2006-08) of the European Charter process and agreed to adopt the SME Policy Index as a common tool to measure and communicate progress on the ten action lines of the European Charter for Small Enterprises. The index allows countries and entities to benchmark their progress relative to peers in the region. It provides direction on how to improve in respect to each dimension through good practice.

The SME Policy Index covers ten policy dimensions derived from the national and regional Charter reports:

1. Education and training for entrepreneurship;
2. Cheaper and faster start-up;
3. Better legislation and regulation;
4. Availability of skills;
5. Improving online access for tax filing and company registration;
6. Getting more out of the Single Market;
7. Taxation and financial matters;
8. Strengthening the technological capacity of small enterprises;
9. Successful e-business models and top class business support;
10. Developing stronger, more effective representation of small enterprises.

A final report on the SME Policy Index is expected to be completed by December 2006.



Chapter 2

Macroeconomic and Infrastructure Environment

Macroeconomic and Infrastructure Environment

2.1 Key factors determining the investment climate

Apart from endogenous factors such as natural resource endowment and domestic market size, the quality of a country's investment climate is largely determined by three interdependent factors:

- The macroeconomic and political environment;
- The physical and financial infrastructure;
- The policy framework.

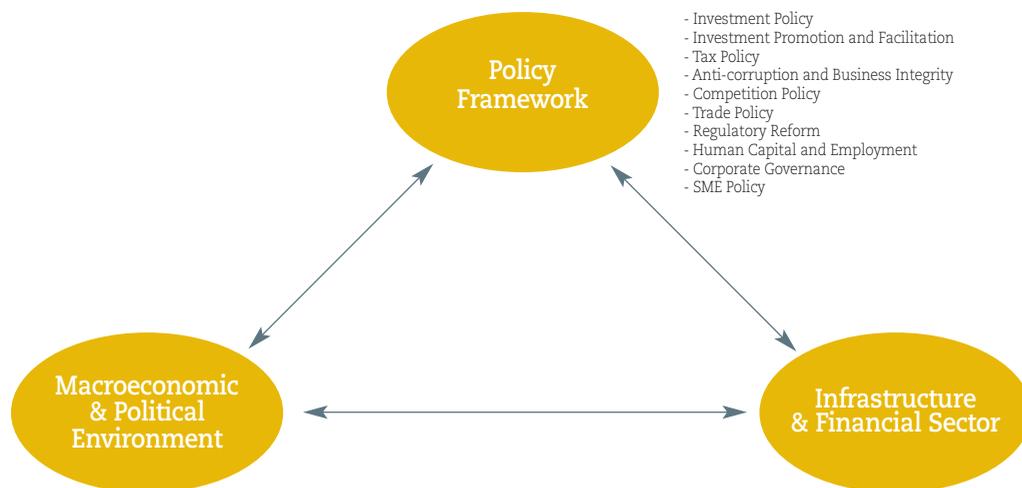
All three of these factors can be directly influenced by government action (see Figure 2.1).

The macroeconomic and political environment

and infrastructure consistently rank high in investor surveys of the most important criteria used to make investment decisions. Both are pre-requirements for potential investors. Government policy is critical, of course, as it defines the rules of the game for doing business in a country.

Before analysing, as we do in Part II of this report, the Investment Reform Index (IRI) results, which focus mainly on policy reform and implementation, it is worthwhile to briefly assess the other two factors influencing the investment climate: the macroeconomic and political environment and infrastructure.

FIGURE 2.1 – FACTORS INFLUENCING THE INVESTMENT CLIMATE



Source: OECD Investment Compact.

2.2 The macroeconomic and political environment

South East Europe has a long history of political instability. More recently, the wars of the 1990s left a deep scar on the region. However, in the last four years significant progress has been made towards achieving greater political stability. Peaceful and fair elections have taken place at both country and regional level. Regional treaties on sensitive economic issues such as trade and energy have been signed. And two of the region's most burning issues – Montenegro and Kosovo – have been solved or are in the process of being solved by political means. Montenegro has become an independent country through a popular referendum; peaceful negotiations are underway to determine the final status of Kosovo.

On the economic front, the SEE countries have largely implemented the economic stabilisation programmes successfully. The region is currently experiencing sustained economic growth within a relatively stable macroeconomic framework. The average GDP growth rate in SEE was 4.8% in 2005; Albania and Moldova had the highest rates at 5.9% and 7.1%, respectively. In 2006 the average is expected to reach 5.2%¹⁴ despite rising energy costs (see Table 2.1).

TABLE 2.1
REAL GDP GROWTH RATE (%) IN SEE COUNTRIES

Country	2004	2005	2006 (forecast)
Albania	5.9	5.9	5.8
Bosnia and Herzegovina	5.1	5.5	6.0
Bulgaria	5.7	5.5	6.0
Croatia	3.8	4.3	4.6
FYR Macedonia	4.1	3.5	3.5
Moldova	7.3	7.1	5.0
Montenegro	3.7	4.1	4.5
Romania	8.3	4.1	5.5
Serbia	9.3	5.1	5.0
SEE average	5.7	4.8	5.2

Source: ICEG, Economist Intelligence Unit, Central Bank of Montenegro/ Agenda of Economic Reforms of Montenegro 2002-2007, Serbian Ministry of International Economic Relations (www.mier.sr.gov.yu) / Serbia Memorandum on the Budget and on Economic and Fiscal Policy for 2006.

¹⁴ This average is based on figures which are forecasts.

¹⁵ International Centre for Economic Growth (ICEG), Economist Intelligence Unit, Central Bank of Montenegro/Agenda of Economic Reforms of Montenegro 2002-2007, Memorandum on the Budget and on Economic and Fiscal Policy of Serbia for 2006. Figures for Bosnia and Herzegovina and Serbia are the retail price index. Average weighted by GDP.

¹⁶ ICEG, Excludes Moldova; average weighted by GDP.

¹⁷ ICEG, Economist Intelligence Unit, Central Bank of Montenegro/Agenda of Economic Reforms of Montenegro 2002-2007, Serbian Ministry of International Economic Relations (www.mier.sr.gov.yu), Serbia Statistical Office.

Inflation in SEE was largely kept under control in 2005: the average consumer price index was 5.2%¹⁵ in a context of high energy prices. Inflation is expected to decline further in 2006 in Montenegro, Romania and Serbia, but to rise further in Moldova.

Most SEE countries have followed a balanced budget policy. The average fiscal balance in SEE in 2005 was -0.7% of GDP.¹⁶ Only Albania and Croatia had significant deficits at -5.5% and -4.2% of GDP, respectively.

However, economic growth and stability has not translated directly into employment. Unemployment is particularly high in countries born out of the disintegration of the former Yugoslavia: more than one third of the workforce in Bosnia and Herzegovina and FYR Macedonia and around one fifth of that in Montenegro and Serbia are unemployed (see Table 2.2).¹⁷

TABLE 2.2
UNEMPLOYMENT RATE (%) IN SEE COUNTRIES

Country	2004	2005	2006 (forecast)
Albania	14.4	14.3	14.0
Bosnia and Herzegovina	40.5	41.5	42.5
Bulgaria	12.0	10.1	8.5
Croatia	13.8	13.0	12.5
FYR Macedonia	37.2	36.5	36.0
Moldova	8.0	8.8	n/a
Montenegro	22.6	18.9	15
Romania	7.1	5.8	5.6
Serbia	18.5	20.8	n/a
SEE average	21.6	21.2	20.8

Source: ICEG, Economist Intelligence Unit, Central Bank of Montenegro/ Agenda of Economic Reforms of Montenegro 2002-2007, Montenegro Governmental Programme for 2006, Serbian Ministry of International Economic Relations (www.mier.sr.gov.yu), Serbia Statistical Office.

Every SEE country continues to suffer from significant trade imbalances, underscoring that the region's export competitiveness is still weak.¹⁸

Nevertheless, the overall trend for the region's economic and political environment is positive. This is best exemplified by international credit ratings that show an improving risk profile and economic outlook for SEE. Bulgaria, Croatia, FYR Macedonia and Romania are now regularly included in major surveys that monitor corporate investment decisions (see Table 2.3).

Any risk of persistent political instability and/or disruptive economic crisis, such as experienced by the region in the 1990s, has been significantly reduced.

2.3 Infrastructure environment

The quality and accessibility of infrastructure in SEE have not shown the same level of improvement as the macroeconomic and political environment. Endowments of physical infrastructure are still relatively weak; lack of competitiveness in related sectors, such as water and energy has led to consistently high prices and low overall quality. Energy and water infrastructure is largely characterised by high distribution losses and a large number of outages. In 2003 average electric power transmission and distribution losses (as a percentage of output) were 24.7% in SEE, compared to the CEE average of 7.7%.¹⁹

In general, communication costs are still high in SEE and internet penetration rates are low compared to peers in CEE (according to the 2005 EBRD Transition Report, SEE average in 2005 is 41.38% compared to 70.5% in Poland). This can again be attributed largely to a relatively weak telecommunications infrastructure and limited competition between telecommunications providers.

However, the infrastructure sector is undergoing a process of restructuring through the establishment of sector regulators, unbinding of the former integrated state monopolies, privatisation of state conglomerates and opening of domestic markets to competition. Initiatives have been launched to establish regional networks, particularly in the energy, transport and telecommunications sectors, and to integrate the region with European networks.

Physical infrastructure is therefore becoming less of a constraint for private direct investors.

2.4 Financial sector

Moreover, the financial sector in SEE has undergone a process of extensive restructuring. In all SEE countries the banking sector is currently dominated by privately owned banks. The supply of financial products has significantly increased, as has the supervisory role of the central banks.

TABLE 2.3
AVAILABLE CREDIT RATINGS OF SEE COUNTRIES IN 2006

Country	Fitch ICBA	Moody's	Standard & Poor's
Albania	n/a	n/a	n/a
Bosnia and Herzegovina	n/a	B3 (n/a)	n/a
Bulgaria	BBB- (Stable)	Baa3 (Stable)	BBB (Positive)
Croatia	BBB- (Stable)	Baa3 (Stable)	BBB (Stable)
FYR Macedonia	BB (Positive)	n/a	BBB- (Stable)
Moldova	B- (Stable)	Caa1 (Stable)	n/a
Romania	BBB (Stable)	Ba1 (Positive)	BBB- (Positive)
Serbia and Montenegro	BB- (Stable)	n/a	BB- (Serbia) (Stable) BB (Montenegro) (Positive)

Source: Fitch ICBA, Moody's, Standard & Poor's.

¹⁸ See Chapter 8. Trade Policy.

¹⁹ World Bank's World Development Indicators, World Bank Enterprise Surveys, Southeast Europe Investment Guide 2006.

In the last two years there has been a very significant credit expansion in most SEE countries, particularly for consumer loans and mortgages. However, access to credit, above all by smaller enterprises, is still difficult and costly. The average interest spread in the SEE is 60% higher than in CEE and twice as high as in the euro area (see Table 2.4). Alternative sources of financing, such as the bond and capital markets are still in the early stages of development.

TABLE 2.4
INTEREST SPREADS (%) IN SEE COUNTRIES
IN 2005

Country	Deposit rate	Lending rate	Spread
Albania	5.09	13.08	7.99
Bosnia and Herzegovina	3.56	9.61	6.05
Bulgaria	3.04	7.78	4.83
Croatia	1.71	11.19	9.48
FYR Macedonia	6.60	12.17	5.57
Moldova	13.22	19.26	6.05
Montenegro	n/a	n/a	n/a
Romania*	6.91	12.66	5.75
Serbia**	3.48	14.60	11.12
SEE average	5.24	12.55	7.10
CEE average	4.18	7.13	4.18

Source: IMF/IFS (International Financial Statistics), National Bank of Romania, Serbia National Bank.

* Excluding November and December 2005.

** Excluding December 2005.

In conclusion, although infrastructure and financial services in SEE have not improved as much as the economic and political environment, the investment climate has attracted investors. One of the best indications is the trend of FDI inflows.

FDI inflows have grown rapidly. They were more than twice as high in 2005 as in 2002. Nevertheless, actual FDI inflows remain well below the region's potential, particularly in the Western Balkan countries.²⁰ This becomes particularly apparent when they are compared to FDI inflows in CEE. On a per capita basis, only Croatia comes close to CEE in this regard. Furthermore, the FDI regional split in SEE is deepening. In 2005 Bulgaria, Croatia, Romania

TABLE 2.5
FDI NET INFLOWS (EUR MILLION)

Country	2002	2003	2004	2005
Albania	151	158	269	209
Bosnia and Herzegovina	282	338	489	240
Bulgaria	980	1,851	2,727	1,789
Croatia	1,195	1,788	989	1,328
FYR Macedonia	83	84	126	80
Moldova	140	69	124	181
Montenegro	76*	44*	53*	384*
Romania	1,212	1,946	5,183	5,197
Serbia	504	1,204	777	1,196
Total SEE-9	4,623	7,482	10,737	10,604
Total CEC-5	22,665	8,710	19,718	22,446

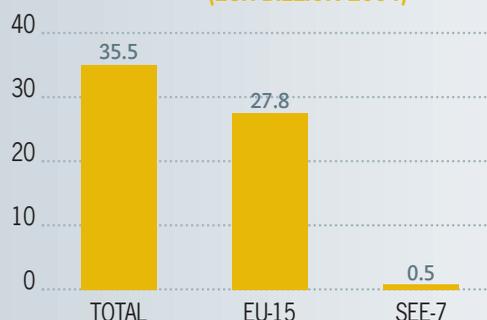
Source: Vienna Institute for International Economic Studies (WIIW), 2006.

* Central Bank of Montenegro, 2006.

and Serbia attracted almost 90% of net FDI inflows (see Table 2.5).

Most of this FDI originates in the EU-15 countries. Only a very small portion of FDI in SEE is intra-regional. Along with the low volume of intra-regional trade, this indicates the limited extent of economic integration in the region (see Figure 2.2).

FIGURE 2.2 – INWARD FDI STOCK BY HOME REGIONS
(EUR BILLION 2004)



Source: Vienna Institute for International Economic Studies (WIIW), 2006 (SEE-7 excludes Albania and Moldova).

Data on export performance and input costs indicate that SEE, particularly the Western Balkan countries, may have an underlying competitiveness issue. In view of the intense

²⁰ An IMF study has estimated (applying a gravity model) that the gap between potential and actual FDI on total 2003 FDI stock in the Western Balkan countries ranged from 50% in Serbia and Montenegro to 82% in Bosnia and Herzegovina (D. Demekas, B. Horvath, E. Ribakova and Wu Yi, FDI in South East Europe, How and How Much Can Policies Help?, IMF Working Paper, 2005).

competition to attract FDI, SEE risks being squeezed between the Central and Eastern European countries, which are increasingly active in higher-value, more capital and technology intensive sectors, and low-cost, labour-intensive producers in, for example Asia and North Africa.

These factors add weight to the role of government policies and economic reform implementation as key determinants of the

investment climate in SEE. To what extent can governments improve their competitive positioning through targeted policies? What success has there been in designing and implementing policies to date? These are some of the questions addressed by the IRI, as reported in the following chapters.



Appendix 2.1

Key Indicators of SEE Countries

	Land Area (sq km)	Population in 2005 in million ¹	Nominal GDP per capita in € ²	GDP per capita, USD at PPP in 2005 ³	Status with EU
Albania	27,398	3.1	2,184	5,318	SAA signed ⁵
Bosnia and Herzegovina	51,129	4.0	1,882	7,630	SAA under negotiation
Bulgaria	110,550	7.8	2,705	8,794	Accession on 1 Jan. '07
Croatia	56,414	4.5	6,741	13,169	SAA signed - candidate country status
FYR Macedonia	24,856	2.0	2,271	7,146	SAA signed - candidate country status
Moldova	33,371	4.3	690	1,908	European neighbourhood policy ⁶
Montenegro	13,812	0.65	2,494 ⁴	n/a	SAA under negotiation
Romania	230,340	22.3	3,436	9,208	Accession on 1 Jan. '07
Serbia	88,361	7.5		n/a	SAA under negotiation

Source: CIA Factbook.

¹ Population for Albania and Bulgaria from 2004.

² Source: EBRD Transition Report update May 2006, Estimates. Currency exchange rate 0.8 (in 2005) from the OECD Economic Outlook 2006.

³ Source: WDI: Data are in current international dollars: An international dollar has the same purchasing power over GDP as the U.S. dollar has in the United States.

⁴ Data refers to Serbia and Montenegro.

⁵ SAA: Stabilisation and Association Agreement.

⁶ European Neighbourhood Policy: Privileged relationship of the European Union with neighbours of the South (Mediterranean countries) and the East (Ukraine, Moldova). It builds on a mutual commitment to shared values and objectives.

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Part 2



Investment Reform Index: Policy Findings

The following chapters are structured by IRI dimensions. Each chapter includes:

- An assessment framework based on sub-dimensions and indicators;
- An evaluation of where each of the nine countries covered in this report stands along these sub-dimensions and indicators;
- A summary of actions to consider at the regional level;
- A summary of IRI scores for each country by sub-dimension and the average score for the overall dimensions.



Chapter 3

Investment Policy

Investment policy is one of the most advanced dimensions of policy reform in South East Europe. Every country has created a liberal regime to attract foreign investment, and provides equal treatment of foreign and domestic investors (national treatment), guarantees against expropriation and free transfer of funds. Exceptions to national treatment have been significantly reduced.

The main issue left to address in this area concerns property rights: outdated land registers and titles, restitution of nationalised property, and in some cases, the right to purchase land. Enforcement of intellectual property rights must also be strengthened.

Investment Policy

3.1 Introduction

Foreign direct investment (FDI) is now a fundamental driver of the international economic system and a catalyst for development. Global FDI flows should reach EUR 1 trillion in 2006²¹, with half of this amount going to emerging markets. The benefits of FDI are now well-documented (OECD, 2002; Aaron, 1999; Agenor, 2001; Bayoumi, Coe and Helpman, 1997; Blomström, 1996; Blomström and Kokko, 1996 and 2001). They include technology transfer, skill development, and increased employment, tax revenues, exports and capital investment.

However, the benefits of FDI are not automatic. Neither are they spread evenly between countries and regions. Government policies that ensure a fair and stable macroeconomic and regulatory environment (with the right human and institutional capabilities) are instrumental in transforming FDI into economic and social impacts.

Government policy therefore has a dual role: attracting FDI, and ensuring that it is transformed into growth and employment while simultaneously respecting regulatory standards.

3.2 Assessment framework

Investment policy encompasses government regulations and laws that govern private investment, including transparency, property protection and non-discrimination.

To create a sound investment framework that is favourable to foreign investment, governments should make sure that the essential investment policy principles are in place. These are:

- *Non-discrimination*, based on national treatment and most-favoured-nation treatment (MFN);
- *Protection of property* and contractual rights, ensured through promotion protection of physical property (including land) and intellectual property rights, contract enforcement, and timely and adequate compensation for expropriation (see Figure 3.1).

3.3 Non-discrimination

Non-discrimination in investment policy requires that all investors, foreign or domestic, be given the same treatment. Core principles of non-discrimination are:

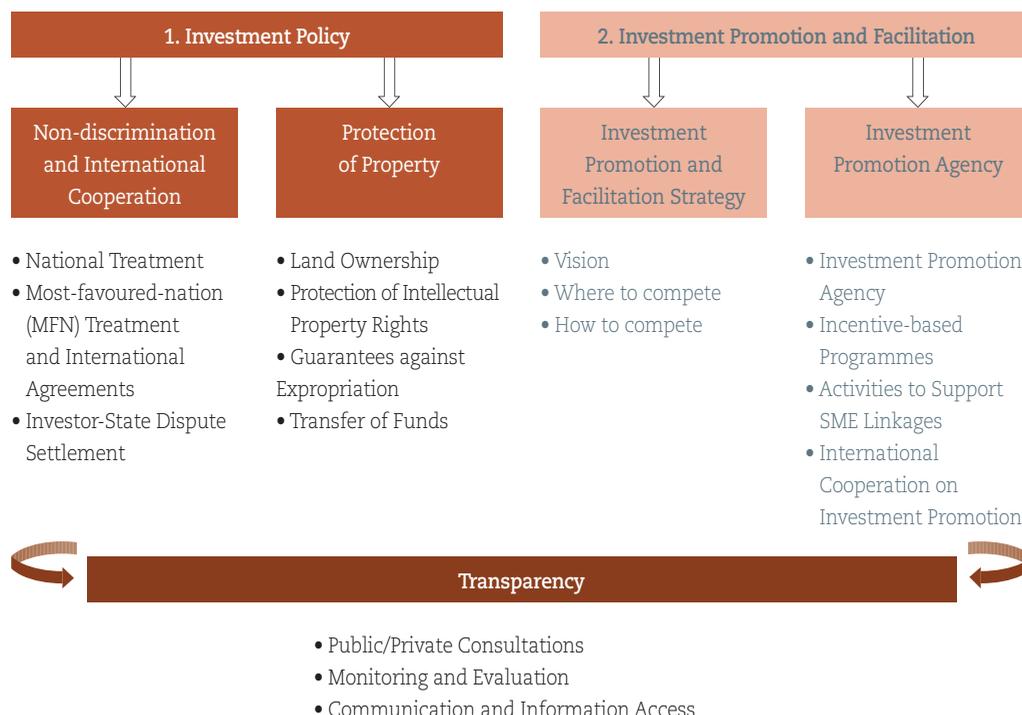
- *National treatment*, which is the commitment of a country to accord to foreign investors, and to foreign controlled enterprises in its territory, treatment no less favourable than that accorded in like situations to domestic enterprises. Measures which qualify as exceptions from national treatment can include restrictions during the pre-establishment²² and post-establishment phases.²³
- *Most-favoured-nation treatment* enshrined in international investment agreements, which ensures that an investor or investment from one country is treated by the host country 'no less favourably' with respect to a given subject

²¹ 'Global FDI set to surge past USD 1trn in 2006, despite fears of backlash'; Economist Intelligence Unit (press release), 2006.

²² Limitations on non-resident investors imposed at the time of entry or establishment (e.g. prohibitions on foreign investment in certain sectors; prohibitions on foreign acquisitions; ceilings on foreign equity shares; authorisation procedures).

²³ Limitations on the activities of already established foreign-controlled companies (e.g. authorisation or licensing requirements; limitations on acquisitions or expansion of activities; ceilings on foreign ownership; higher or special taxes; or discrimination in access to public procurement).

FIGURE 3.1 – INVESTMENT POLICY ASSESSMENT FRAMEWORK



Source: OECD Investment Compact.

matter than an investor or investment from any third country.

3.3.1 National treatment

All countries in the region have made important progress in creating liberal regimes which are favourable to foreign investment. National treatment that guarantees equal treatment of foreign and domestic investors is incorporated in domestic legislation (i.e. constitutions, foreign investment laws or similar legislation regulating foreign investment regime) (see Table 3.1).

Progress with respect to national treatment has been reinforced by regional initiatives such as the OECD Investment Compact's 2003 review of national treatment in SEE countries,²⁴ which provided a full assessment of the investment-

related legal framework and regulations faced by foreign investors, including an analysis of the most significant exceptions to national treatment. It also formulated country-specific and regional recommendations.²⁵

This review identified a number of exceptions to national treatment in SEE countries which have since been partly addressed. Based on a number of interviews conducted with the private sector as part of the IRI process, implementation of the national treatment principle is generally respected in SEE countries. Of course, many exceptions to national treatment still exist. They involve sectoral limitations in the energy, maritime and air transport, telecommunications, armaments, fisheries and agriculture sectors, etc. Moreover, some SEE countries apply

²⁴ See 'The National Treatment of International Investment in South East European Countries: Measures Providing Exceptions', OECD Investment Compact for South East Europe, 2003. This review reflects the political commitment of SEE countries expressed in the 2002 Ministerial Declaration on 'Attracting Investment to South East Europe: Common Principles and Best Practices' and reinforced by the 2003 Ministerial Declaration 'Pushing Ahead with Reforms: Removing Obstacles to FDI in South East Europe'.

²⁵ The most frequent type of exceptions were related to equity and discriminatory measures concerned with establishment and/or expansion in various industries and services, such as banking, insurance, telecommunications, maritime and fisheries; measures concerned with approval and licensing/screening procedures; real estate and land ownership; public order and security considerations.

reciprocity conditions in specific cases, such as acquisition of real estate assets and land (e.g. Croatia, FYR Macedonia, Serbia).

The IRI assessment shows that in some countries, such as Bulgaria and Romania²⁶, exceptions from national treatment have been progressively eliminated (e.g. in Romania an exception exists in the air transport sector). In others, such as Croatia, they are still extensive and need to be further reduced.

Some *de facto* discrimination remains in SEE countries. For example, in Croatia foreign investors report difficulties in completing transactions in the tourism and construction

sectors despite the incorporation of national treatment in the legislation.

Concerning national treatment of foreign investment in SEE, the real issue continues to be administrative barriers to investment (e.g. licensing and approval procedures, permits).²⁷ While these barriers affect both domestic and foreign investors, they have greater impact on foreign investors due to asymmetries in information, language and culture. Reducing licensing, approval and special registration procedures for investment to the level necessary for normal company law registration would be desirable.

TABLE 3.1
NATIONAL TREATMENT IN THE SEE COUNTRIES

Country	National treatment	Foreign investment-related legal framework	Examples of sectoral exceptions from national treatment
Albania	✓	Law on Foreign Investments (1993)	Broadcasting, health and legal services
Bosnia and Herzegovina	✓	Law on the Policy of Foreign Direct Investment (1998 and subsequent amendment from 2003)	Armaments and media, where foreign control is limited to 49%
Bulgaria	✓	Constitution and the Investment Promotion Act (and its amendments from 1997; 1998; 1999; 2002; 2005)	–
Croatia	✓	Law on Commercial Companies (1995); the amendments of the Law on Commercial Companies from 2003; the Investment Promotion Act (2000 and subsequent amendments from 2002)	Energy, telecommunications, air, rail and maritime transport, agriculture, securities trading
FYR Macedonia	✓	Constitution and Law on Trading Companies (2004)	Defense and interior areas
Moldova	✓	Law on Investment in Entrepreneurship (2004)	Armaments, health, land ownership*
Montenegro	✓	Law on Foreign Investment (2000)	Armaments, national parks and border areas, where foreign control is limited to 49%; insurance, banking
Romania	✓	Government Emergency Ordinance on Direct Investment Stimulation (2997) amended by Law No. 241/1998; Law on Promotion of Direct Investment (2001); Government Ordinance No. 59/2003	Air transport
Serbia	✓	Law on Foreign Investments (2002)	Armaments, insurance, banking, free zones

Source: OECD Investment Compact.

* The issue of foreign investors' access to land is dealt with separately below, under the section on Protection of Property.

²⁶ In 2005 Romania adhered to the OECD Declaration on International Investment and Multinational Enterprises.

²⁷ Analysis of administrative barriers to foreign investment was not included in the 2006 edition of the Investment Reform Index. Yet a number of investors highlighted administrative barriers as an important factor slowing down FDI transactions. A thorough assessment of the administrative barriers to foreign investment will be part of the 2007 edition of the Investment Reform Index.

3.3.2 MFN treatment and international investment agreements

3.3.2.1 MFN treatment

MFN treatment is incorporated in international investment agreements (e.g. bilateral investment treaties) concluded by the SEE countries with their main investment partners in SEE, the EU-25, OECD countries, and some Asian, Latin American and African countries.²⁸ International investment agreements generally include provisions for investment promotion, protection and treatment, free transfer of funds, measures concerned with paying prompt and adequate compensation for expropriation and losses, dispute settlement, entry into force and termination.

While some SEE countries (e.g. Bulgaria, Croatia and Romania) have concluded bilateral investment treaties (BITs) with almost all their SEE, EU-25 and OECD investment partners, others (e.g. FYR Macedonia, Moldova) need to further extend their network of bilateral investment treaties, especially with EU and OECD countries. At the same time, the intra-regional network of BITs is almost complete (Bosnia and Herzegovina and Moldova lack two treaties, as shown in Table 3.2).

3.3.2.2 Investor-state dispute settlement

The instruments available to resolve disputes are a key component of international investment agreements. In the framework of these agreements, governments commit to provide investors with the possibility to settle investment disputes through international arbitration,

carried out through ad hoc or institutional instruments (e.g. international conventions) which guarantee the impartiality of the process and increase the protection of investors.

With the exception of Moldova, Montenegro and Serbia, all SEE countries have signed and ratified institutional instruments such as the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (1958) and the Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID) (1965). These three countries have signed and ratified the New York Convention but still need to ratify the ICSID. Domestic arbitration laws generally follow the United Nations Commission on International Trade Law (UNCITRAL) law model; arbitration courts have been established within Chambers of Commerce. There is no evidence of serious problems arising in the enforcement of international arbitral awards by local courts.

3.3.3 IRI results for non-discrimination

The non-discrimination and international cooperation sub-dimension was assessed by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the target countries following the process described in the Chapter 1 of this report. This resulted in the scores in Table 3.3, describing the current situation in each of the nine target countries covered by the IRI.

TABLE 3.2
INTRA-REGIONAL BILATERAL INVESTMENT TREATIES

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Romania	Serbia and Montenegro
Albania	-	-	✓	✓	✓	✓	✓	✓
Bosnia and Herzegovina	-	-	-	✓	✓	✓	✓	✓
Bulgaria	✓	-	-	✓	✓	✓	✓	✓
Croatia	✓	✓	✓	-	✓	✓	✓	✓
FYR Macedonia	✓	✓	✓	✓	-	-	✓	✓
Moldova	✓	✓	✓	✓	-	-	✓	-
Romania	✓	✓	✓	✓	✓	✓	-	✓
Serbia and Montenegro	✓	✓	✓	✓	✓	-	✓	-

Source: UNCTAD BITs database, 2005.

²⁸ The number of bilateral investment treaties (BITs) varies in SEE as follows: Macedonia, 30; Moldova, 33; Albania, 35; Bosnia and Herzegovina, 36; Serbia and Montenegro, 41 (as of February 2006); Croatia, 53; Bulgaria, 56; Romania, 83.

TABLE 3.3
IRI SCORES FOR NON-DISCRIMINATION AND INTERNATIONAL COOPERATION²⁹

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
4	4	4.50	4.25	4	3.75	4	4.50	4

Source: OECD Investment Compact.

All SEE countries score at least a 4 on non-discrimination and international cooperation except Moldova which is just below due to a discriminatory treatment of foreign investors in some areas (e.g. access to agricultural land) and the lack of ratification of standard international investor-state dispute settlement instruments.

3.4 Protection of property

A sound system for protecting property and investment includes the following elements (OECD, 2006a):

- Protection and promotion of physical property, particularly land and real estate ownership;
- Protection and promotion of intellectual property rights in the form of patents, trademarks, copyrights, industrial design, etc. for all types of products;
- Free transfer of funds related to the investment;
- Timely, adequate and effective compensation for expropriation.

3.4.1 Land ownership

Land ownership plays an important role in determining the quality of the business environment. It also influences a country's attractiveness to foreign investors. This is one of the most important aspects that investors take into account when they decide whether to make new investments or maintain existing ones.

There is no discrimination concerning foreign ownership of land in SEE, except in the case of Moldova, where foreign investors – even locally incorporated – do not have the right to buy agricultural land. Acquisition of land by direct

purchase or long-term lease is generally possible in most SEE countries through local incorporation of non-resident foreign individuals and of legal persons undertaking business activities.

In some countries access to land is subject to a specific regime. For example, in Serbia urban construction land³⁰ is still state-owned, which implies that foreign and domestic investors may acquire the right to use the land for a fee but cannot own it. This could prevent the development of a transparent market for urban construction land. The Serbian Government has initiated a process to amend the relevant legislation in order to change the land regime. To buy state-owned non-agricultural land in Albania, the value of the investment should be at least three times that of the land.³¹

The IRI assessment highlights several other issues related to land ownership that affect both domestic and foreign investors. One important issue concerns outdated land registers and titles, which produce uncertainty about the acquisition of land.

Another aspect is restitution of nationalised property from the state to its original owners. In some countries the restitution process has not yet been completed, hampering the establishment of property titles. For example, in Montenegro restitution has not yet been resolved. The Montenegrin Parliament adopted a Restitution Act in June 2002, but it is being challenged before the Constitutional Court in a case brought by the government itself.

²⁹ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

³⁰ Urban construction land is land for construction purposes. This land is still owned by the Republic of Serbia. Construction land falling into the category of public construction land (roads, infrastructure, public facilities) is and will remain state property. The remaining construction land (non-public construction land) is available for all forms of ownership.

³¹ According to the Albanian Law on Trading of Non-agricultural Land No. 7980 date 27/7/1995, the value (selling price) of land owned by the state is defined by the Council of Ministers through a special decree. In the case of land rental, the price is defined in the rental contract.

3.4.2 Protection of intellectual property rights

Enforcement of intellectual property rights (IPR) encourages investment in research and development, innovation and technology transfer. Adequate mechanisms to protect IPR include:

- An appropriate legal and institutional framework, in line with international standards;
- Solid enforcement of IPR legislation through controls, seizures of pirated and counterfeited goods, sanctions, advocacy campaigns and court protection.

According to IPR reviews by bodies including the International Intellectual Property Alliance and the European Commission, most SEE countries currently have a legal framework (as well as the institutions and agencies) for IPR protection, but enforcement remains weak across the region.

Bulgaria, Croatia and Romania are more advanced in aligning the IPR legal framework³² with international standards (e.g. WTO's Trade-related Aspects of Intellectual Property Rights Agreement, TRIPS³³) and setting up the institutional framework (e.g. intellectual property/patent/copyright offices). In Bulgaria and Romania only limited amendments to this legislation are still necessary. Law enforcement in these countries needs to be reinforced through specific measures such as border control and seizures of pirated and counterfeited goods; sector-specific measures (e.g. music and software) to combat piracy; training of IPR officials, customs officials, judges, prosecutors and police; dismantling of street sales networks; and systematic public awareness campaigns (EC, 2005a, 2005 b; IIPA, 2006a, 2006b). Croatia has upgraded its institutional framework (e.g. the staff of the State Intellectual Property Office was increased from 15 to approximately 100 persons in 2005), but the legislation (e.g. on pharmaceutical products, biotechnological inventions) needs to be amended (EC, 2005c). Intra-agency coordination (e.g. between the patent office and the central health regulatory agency), training of IPR officials, customs officials,

judges and prosecutors, and more expedient criminal procedures remain high priorities.

Other SEE countries, including Albania, FYR Macedonia, Moldova, Montenegro and Serbia, need to continue developing their IPR legislation in order to meet international standards (EC, 2005d, 2005e, 2004, 2005f; IIPA, 2005a, 2004, 2006c). In addition, these countries will need to strengthen the IPR institutional capacity and ensure strong law enforcement. For example:

- Moldova needs to streamline its legal framework (e.g. amend the criminal code to apply to copyright and neighbouring rights violations) to comply with its international obligations resulting from WTO membership and implement criminal convictions and stronger border control.
- Montenegro needs to further develop its IPR legislation (e.g. pass and implement amendments to its criminal code); together with Serbia, it needs to take swift action to intensify inspections, strengthen border controls, train judges and prosecutors for more expeditious treatment of court cases, and dismantle street sales networks.
- In Albania there is limited administrative capacity within the Ministry of Culture and Youth, which is in charge of drafting the IPR policy (staff of five in the legal department). A copyright office has not yet been established. Lack of specialised courts and qualified judges further impedes proper enforcement of IPR protection.
- FYR Macedonia faces similar problems regarding institutional capacity for IPR protection, including the State Office of Industrial Property and the courts. Although the customs administration has taken some actions *ex officio* and upon complaints by right holders against violations of industrial property rights in 2006, law enforcement should involve more deterrent sanctions and higher fines to punish piracy and counterfeiting, stronger border controls, and (as in the other countries) training of inspectors, prosecutors, judges, police officers and customs officials.

³² Legislation on intellectual property, patents, trademarks, copyrights, industrial design, production and trade of optical discs and matrixes, new plant varieties and animal breeds, etc.

³³ Albania, Bulgaria, Croatia, FYR Macedonia, Moldova and Romania are WTO members.

Bosnia and Herzegovina lags behind its SEE neighbours in both legal and institutional framework and enforcement. Its legislation needs to be substantially upgraded to meet international standards (e.g. Bosnia and Herzegovina is not a signatory of TRIPS). Despite a generally adequate copyright law and the creation of an Intellectual Property Institute in 2004, the high level of piracy, especially of motion pictures, music³⁴ and software programmes, means that Bosnia and Herzegovina is one of the regional distributors of such pirated products which impact negatively on the competitiveness of companies distributing in the region (IIPA, 2006d). IPR enforcement should be given high government priority through a proactive IPR protection strategy; proper functioning of the Intellectual Property Institute; increased investigations, concerted efforts by and coordination of police, customs administration, prosecutors and courts; and training on IPR enforcement issues.

3.4.3 Transfer of funds

Free transfer of investment-related capital is a key requirement for an open investment regime. This principle, embedded in investment legislation, guarantees transfers of profits, dividends, interest and other funds derived from foreign investment, and the repatriation of capital in case of disinvestment.

Overall, the SEE countries guarantee free transfer of funds through investment-related legislation which largely complies with international standards. There are generally no significant limitations on the free transfer of profits in SEE after payment of local tax obligations (apart from some administrative delays).

3.4.4 Guarantees against expropriation

As part of property rights protection, governments need to ensure timely, effective and adequate compensation for expropriation of property in cases of public interest. In accordance with the 1992 World Bank Guidelines, 'a state may not expropriate or otherwise take in whole or in part a foreign investment in its territory, or take measures which have similar effects, except where this is done in accordance with the applicable legal procedures, in pursuance in good faith of a public purpose without discrimination on the basis of nationality and against the payment of appropriate compensation' (OECD, 2006a).

All SEE countries guarantee protection against expropriation and nationalisation in their constitution or in investment-related legislation. As in most OECD countries, expropriation is possible only in defined circumstances, i.e. public interest (which can apply to construction of infrastructure, power stations, water supply systems, defense buildings, etc.). Where expropriation takes place in pursuance of a public interest, fair and adequate compensation is guaranteed in all SEE countries. Compensation is normally based on the market value of the investment and includes interest at commercial market rates from the date of expropriation. Payment of compensation without delay is guaranteed under law. In addition, expropriation is subject to judicial review. All SEE countries provide for dispute settlement instruments (e.g. domestic and international) in cases of unfair compensation through judicial review and arbitration under bilateral investment treaties. No problematic expropriation cases have been reported in the region in 2005-06.

³⁴ According to data estimates provided by the International Intellectual Property Alliance, in Bosnia and Herzegovina the level of music piracy was 95% in 2005 and the level of motion picture piracy was 90% in 2004, one of highest levels in the SEE region.

TABLE 3.4

IRI SCORES FOR PROTECTION OF PROPERTY³⁵

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
3.50	3.25	3.75	3.50	3.50	3.25	3.50	3.75	3.50

Source: OECD Investment Compact.

3.4.5 IRI results for protection of property

The evaluation of the protection of property sub-dimension has resulted in the scores in Table 3.4, describing the current situation in each of the nine target countries.

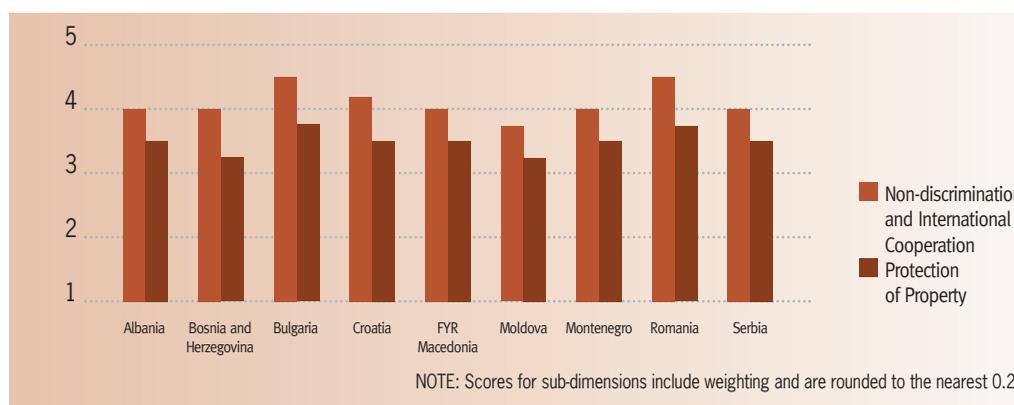
While all the countries score at least 3 or above, Bosnia and Herzegovina and Moldova score only just above 3 due to weak enforcement of IPR in Bosnia and Herzegovina and restrictions in ownership of agricultural land in Moldova.

3.5 Key actions to consider at the regional level

1. Actively enforce intellectual property rights with adequate financial and human resources. Enforcement of IPR should be incorporated in the new regional free trade agreement, to be signed by SEE countries by the end of 2006.
2. Review and update land cadastres in the region, and liberalise acquisition of land for investors in some countries (in Moldova, Serbia).

IRI SCORES FOR INVESTMENT POLICY

FIGURE 3.2 – INVESTMENT POLICY: SCORES BY SUB-DIMENSION



Source: OECD Investment Compact.

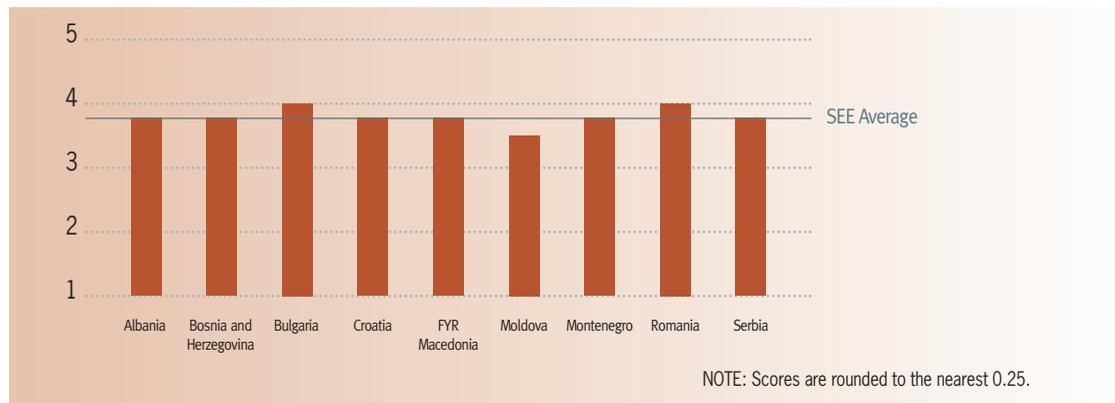
³⁵ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

Non-discrimination and international cooperation

- All SEE countries score at least a 4 on non-discrimination and international cooperation except Moldova which is just below due to a discriminatory treatment of foreign investors in some areas (e.g. access to agricultural land) and the lack of ratification of standard international investor-state dispute settlement instruments.

Protection of property

- While all the countries score at least 3 or above, Bosnia and Herzegovina and Moldova score only just above 3 due to weak enforcement of IPR in Bosnia and Herzegovina and restrictions in ownership of agricultural land in Moldova.

FIGURE 3.3 – OVERALL SCORES FOR INVESTMENT POLICY

Source: OECD Investment Compact.

- High scores for investment policy, with an average of 3.75.
- Little variation among SEE countries.

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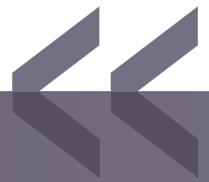
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United Nations Commission on International Trade Law (UNCITRAL) (www.uncitral.org)
World Intellectual Property Organization (WIPO) (www.wipo.int)
World Trade Organization (WTO) (www.wto.org)





Chapter 4

Investment Promotion and Facilitation

Many countries have improved their business environment but the region as a whole still suffers from a poor image. Developing marketing skills and learning how to promote the region as an attractive destination for foreign investment will be a key priority in the years ahead.

Investment Promotion and Facilitation

4.1 Introduction

In the face of ruthless global competition from countries providing similar opportunities to investors, governments can package their offers to investors to gain a competitive edge. Information and support services can be provided by host governments to reduce investors' uncertainty. This can involve pro-active guidance on how to proceed with administrative steps and licenses (see Figure 4.1).

The SEE region as a whole still suffers from a perception of risk. Pro-active and coordinated investment promotion at regional level can help improve its image for foreign investors, and sell a market potential of 56 million consumers.

4.2 Assessment framework

The assessment framework includes several main components:

- A *pro-active investment promotion and facilitation*

strategy consistent with competitiveness, innovation and export strategies;

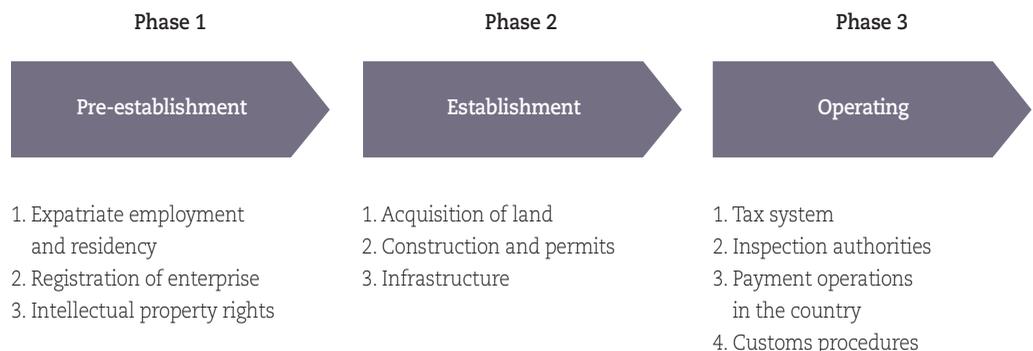
- An *investment promotion agency* to implement this strategy, including with incentive-based programmes and programmes that facilitate linkages between foreign investment and local businesses (see Figure 4.2).

4.3 Investment promotion and facilitation strategy

An investment promotion and facilitation (IPF) strategy should have three main elements:

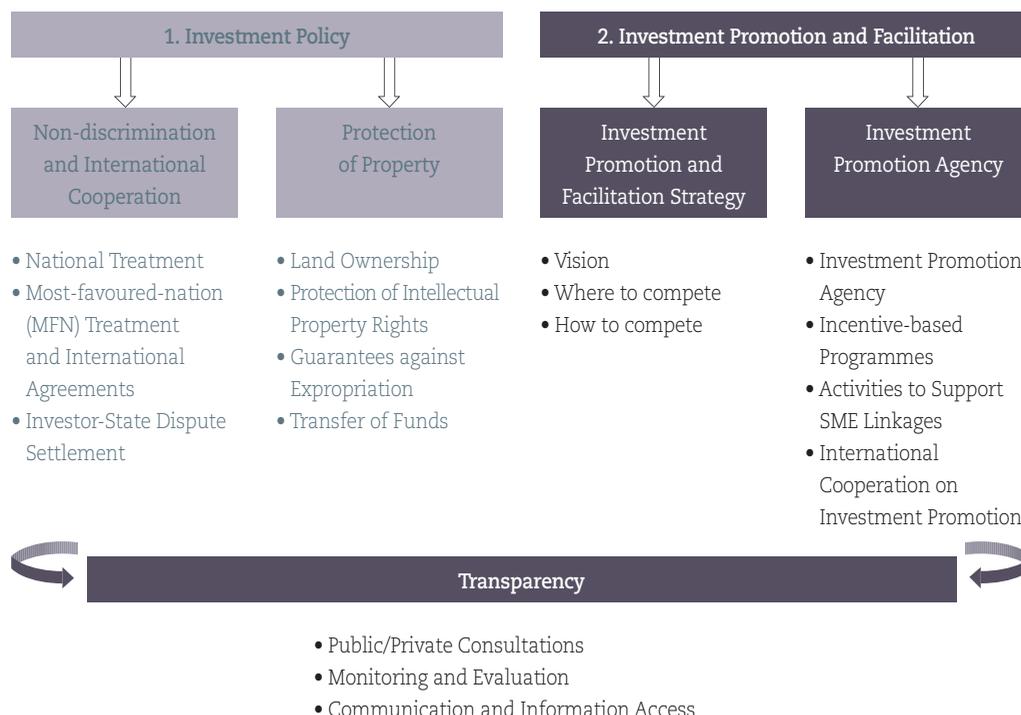
- A clear strategic vision for the country;
- A precise definition of 'where to compete', including sector and geographic focus, customer type and measures to improve business environment;
- A roadmap specifying 'how to compete' with the right skills, sector-specific removal of barriers, linkage programmes and marketing/sales campaigns (see Figure 4.3).

FIGURE 4.1 – GOVERNMENT SUPPORT FOR THE ESTABLISHMENT OF GREENFIELD INVESTMENT



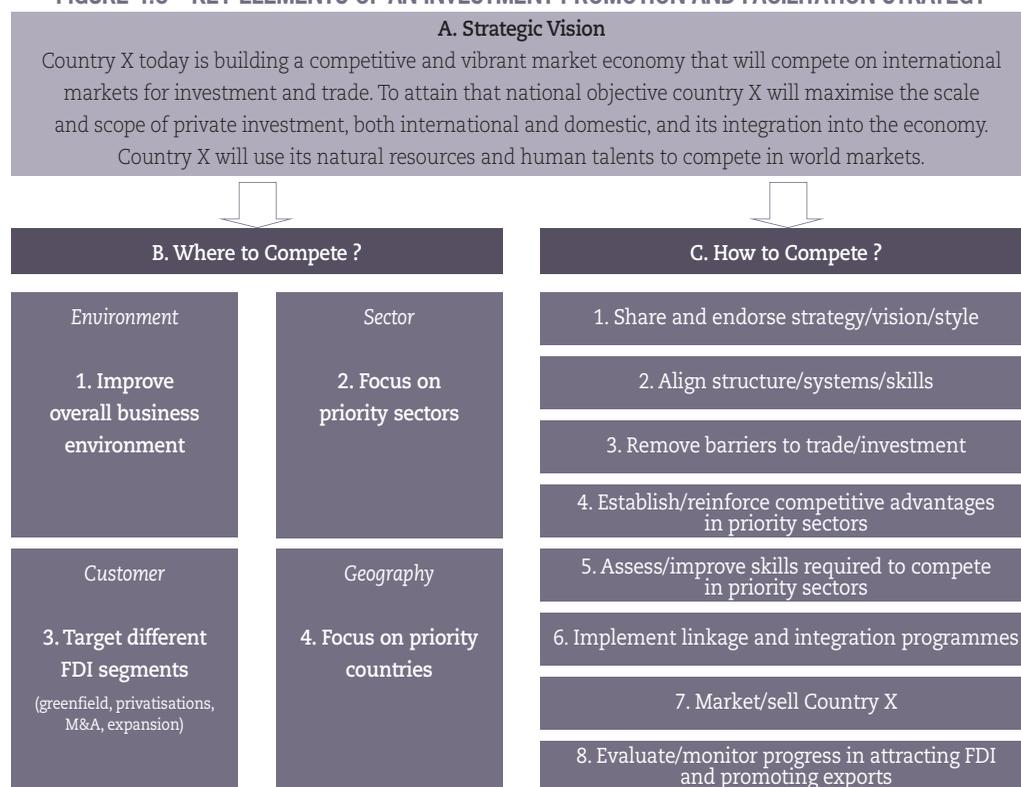
Source: Foreign Investment Advisory Service (FIAS); OECD Investment Compact.

FIGURE 4.2 – INVESTMENT PROMOTION AND FACILITATION ASSESSMENT FRAMEWORK



Source: OECD Investment Compact.

FIGURE 4.3 – KEY ELEMENTS OF AN INVESTMENT PROMOTION AND FACILITATION STRATEGY



Source: OECD Investment Compact.

Only a few SEE countries have succeeded in defining effective investment promotion strategies.

Bulgaria and Serbia have come closest. Bulgaria adopted a National Strategy for Investment Promotion for 2005-10, developed in line with the major priorities of its National Development Plan for 2007-13. It defines a strategic vision for investment promotion, provides for measures to improve the overall business environment and strategic sectors (e.g. ICT, telecommunications, energy, transport infrastructure, water supply) and evaluates the country's investment environment and competitive positioning. In addition, it includes objectives aimed at improving workforce skills and quality and specifies marketing and sales mechanisms.

Similarly, in 2006 Serbia passed a Strategy for Encouraging and Developing Foreign Investment. It includes a strategic economic and investment development vision, defines measures for removing the main obstacles to investment, identifies Serbia's competitive advantages, focuses on several sectors (e.g. agribusiness and food processing industry, public utilities, tourism, the chemical industry, wood, ICT), presents the country's overall positioning and provides for measures to enhance educational/business linkages. The strategy is accompanied by an action plan to remove administrative barriers to foreign investment in 2006 and an international marketing strategy.

Croatia and Romania have IPF strategies that

BOX 4.1

CHECKLIST: HOW TO MARKET A COUNTRY

The design of a comprehensive marketing and selling campaign follows several steps:

- Use professional surveys of investor perceptions of the country as the basis for an image-building and promotion programme;
- Develop an international image-building programme aimed at the foreign investment community and international business media;
- Where possible, include the existing foreign investor/importer community in all promotional activities;
- Use senior political figures and government officials, existing foreign investors/importers, and the overseas expatriate community as 'ambassadors';
- Focus on selected target sectors, i.e. those sectors where the country can offer competitive advantage and where key competitive messages have been developed;
- Within these sectors, identify key investing companies and the decision-makers within those companies;
- Implement an investment generation campaign aimed at key executives in potential investing companies and based on an appreciation of investors' investment/import priorities and on competitive advantages;
- Organise and conduct well-planned country visits by potential investors/importers, ensuring provision of all relevant information and advice necessary to assess the country's attractiveness as an investment location.

The investment promotion agency may also envisage keeping international and domestic media regularly informed through:

- Promotional events (e.g. lists of events such as investment forums and trade shows, within the country and outside it, could be circulated);
- Public relations and press releases concerning all new investment deals;
- Advertising and publicity material (e.g. a full range of general, sectoral and website material, such as brochures, newsletters, investment guides and types of presentations);
- Investor award schemes to promote annual awards to investors and exporters (e.g. largest investment/trade deal, largest employment creator, largest exporter) in order to highlight the benefits of new investment.

Source: OECD Investment Compact.

are still incomplete. Croatia passed an Investment Promotion Strategy in 2002, but it has not been implemented and is now outdated. The government plans to launch a new strategy by the end of 2006. Romania's Strategy for Investment Promotion for 2005-08 contains some 'where to compete' aspects (e.g. priority countries) but does not identify priority sectors and lacks customer segmentation. More emphasis needs to be put on identifying priority sectors for attracting foreign investment and on specifying 'how to compete', including priorities for sector-specific removal of barriers and the creation of stronger links between foreign investment and SMEs, in line with the country's industrial and export promotion strategies.

Montenegro adopted an Investment Promotion and Facilitation Strategy in July 2006. Moldova is finalising its investment promotion strategy, with the assistance of the OECD Investment Compact. In all the other SEE countries plans to adopt IPF strategies exist but have not materialised.

The investment promotion and facilitation strategy sub-dimension was assessed by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the target countries following the process described in the Chapter 1 of this report. This resulted in the scores in Table 4.1, describing the current situation in each of the nine target countries covered by the IRI.

Outside Bulgaria and Serbia which score 4 and 3.50, respectively, no other SEE country has yet implemented an effective investment promotion and facilitation strategy.

4.4 Investment promotion agency

An investment promotion agency (IPA) is the executive arm of the investment promotion strategy. It acts as:

- A demand generator, through image building, marketing and sales;
- An investment facilitator, by helping to remove sector-specific barriers to investment (e.g. aftercare services in regard to licenses, procedures, certification, specific taxes, work and residency permits, company registration, building permits, utility connections).

The IPA should also have a policy advocacy role vis-à-vis the investor community and its government counterparts.

Staff must have specific skills and knowledge concerning strategic business issues, legal affairs and industry sectors. They must also have language and sales skills, including presentation skills.

From an organisational point of view, a non-political and non-governmental IPA ensures better stability and continuity in the institutional structure and implementation of programmes, as it is less affected by periodic changes in government and less restricted by formal procedures that apply within ministries. Hence, the IPA should be a separate body that reports to a Board of Directors appointed by the Government to oversee the development and implementation of the IPF strategy. The board should be chaired by a private sector appointee and include key ministries (e.g. Economy, Foreign Affairs, Finance, Justice, Regional Development) and domestic and international private companies.

TABLE 4.1
IRI SCORES FOR INVESTMENT PROMOTION AND FACILITATION STRATEGY³⁶

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.50	2	4	2.50	2	2.50	3	2.50	3.50

Source: OECD Investment Compact.

³⁶The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

TABLE 4.2
OVERVIEW OF SEE INVESTMENT PROMOTION AGENCIES

Investment Promotion Agency	Coordination	Budget in 2005 (EUR)	Staff (2005/2006)
AlbInvest, Albania	Ministry of Economy	343,954*	31
Foreign Investment Promotion Agency of Bosnia and Herzegovina	Council of Ministers	742,739	15
InvestBulgaria Agency	Ministry of Economy	767,000*	35
Trade and Investment Promotion Agency of Croatia	Vice Prime Minister's Cabinet	n/a	25
Agency for Foreign Investments of the Republic of Macedonia	Ministry of Economy	80,000	10
Moldovan Export Promotion Organisation	n/a	n/a	n/a
Montenegrin Investment Promotion Agency	Prime Minister's Cabinet	180,000	5
Romanian Agency for Foreign Investments	Vice Prime Minister's Cabinet	520,000	31**
Serbia Investment and Export Promotion Agency	Deputy Prime Minister's Cabinet	592,300	30

Source: OECD Investment Compact.

* 2006 data.

** Staff included in the organisational chart. Currently, approximately half of the posts are occupied due to a restructuring process.

IPAs' level of development varies across South East Europe (see Table 4.2).

Bulgaria and Serbia have the most advanced IPAs. InvestBulgaria is customer driven, has a strong set of skills for both demand generation and investment facilitation, and acts as a one-stop-shop for investors. It also plays a strong advocacy role. It has offices in Brussels, Los Angeles and Barcelona. However, more efforts could be targeted at supporting linkages between foreign investors and local businesses, and at extending assistance to medium-sized investors.

The Serbia Investment and Export Promotion Agency has made progress in image building in 2006. Investment promotion activities include distribution of attractive brochures and guides, expert advice, and servicing of investors. However, cooperation with other ministries and with government agencies should be reinforced by giving the agency an active role in implementing the investment promotion strategy and policy advice. More emphasis should be placed on assistance to investors in solving specific problems.

In Croatia, after a number of false starts, the Trade and Investment Promotion Agency became fully operational at the end of 2005,

creating a national coordinating body for investment promotion which until then had been undertaken by local authorities.

IPAs in Albania³⁷, Bosnia and Herzegovina, FYR Macedonia, Montenegro and Romania still need to consolidate their investment promotion and facilitation activities, especially through concrete on-the-ground services for potential and existing investors (e.g. to facilitate licensing and administrative procedures for greenfield investment). These IPAs' administrative capacity and policy advice role should be strengthened, including links with other governmental bodies and private sector organisations.

In Moldova the investment promotion agency is undergoing a restructuring process, as part of the process of defining a new investment promotion strategy.

4.4.1 Incentive-based programmes

Incentives can be effective if they are based on clear policy objectives (e.g. employment in disadvantaged areas³⁸) and have undergone a thorough assessment of their relevance, appropriateness and economic benefits against budgetary costs, including long-term impacts on domestic allocative efficiency (OECD, 2003). They must also be consistent with state aid rules³⁹

³⁷ Albania recently restructured its IPA. The new Albanian Agency for Business and Investments (AlbInvest) is operational and has responsibilities in the areas of investment and export promotion and support for SMEs.

³⁸ Tax incentives are dealt with separately in the Chapter 5. Tax Policy.

³⁹ EU *acquis communautaire* on state aid, including Articles 87 and 88 of the EC Treaty. See also the Chapter 7. Competition Policy. (section on state aid control programmes).

BOX 4.2

CASE STUDY ON A SUCCESSFUL INVESTMENT PROMOTION AGENCY: CZECHINVEST

A well-funded, independent investment promotion agency which has the main responsibility for implementing investment strategy – operating with full political support and in close cooperation with public and private sector representatives – can have a significant impact on a country's attractiveness to FDI.

CzechInvest was established in 1992 by the Ministry of Industry and Trade of the Czech Republic. It is a government agency whose task is to attract FDI in manufacturing and services. CzechInvest received full political support starting in 1998, when the Czech Government adopted a pro-active investment strategy. In 2004 it merged with the Agency for Development of Industry. The agency currently also provides assistance to SMEs and handles access to EU structural funds.

In the field of investment promotion CzechInvest provides information to investors on the business climate, the investment environment and investment opportunities. It has been also responsible for implementing various programmes. These include incentive-based programmes, the industrial zone development programme, the supplier development programme and the National Strategy for Cluster Development.

CzechInvest's success is illustrated by the fact that it has been involved in 605 investment projects worth over EUR 12 billion representing about one fourth of total FDI inflow to the Czech Republic.

The success of this agency is due to several factors:

- It acts as a one-stop-shop for foreign investors and is the sole body authorised to submit applications for incentives;
- Each client is assigned a Project Manager, who concentrates on the individual investor;
- There is a clear-cut, standardised and formalised approach to foreign investors, corresponding to the different phases of the investment project;
- CzechInvest handles contacts fully with authorities at the national and local level;
- It has a pro-active strategy to lobby for important changes in the business environment;
- Aftercare services are provided, as well as a forum for foreign investors already present in the Czech Republic, so that they can communicate with the state administration and with Czech companies;
- There is an extensive domestic and international network of offices and a comprehensive network of regional partners;
- Services are provided free of charge.

Source: www.czechinvest.org.

and the principles of national treatment. Too often the short-term need to attract investment generates incentive structures which are inconsistent and costly in the medium term. In all cases, incentives should be used parsimoniously and cannot replace sound and well-defined investment policy measures that create an attractive business environment.

Bulgaria has simplified its incentive-based programmes to attract foreign investment. Investors receive specific treatment corresponding to three classes of investment defined in the Investment Promotion Act (2005). InvestBulgaria is in charge of implementing this programme. Tax incentives are granted for job creation in disadvantaged areas.

In the past, Croatia and Romania have introduced a plethora of incentive schemes. These were often poorly coordinated and not properly assessed. Initiatives have been taken to streamline them and align them with state aid rules:

- Croatian legislation provides for tax incentives, incentives for research and development, job creation and training, incentives for business operations in free zones, etc. A new investment promotion law under preparation will provide a range of incentives targeting export-oriented production, high value-added products and job creation, especially in underdeveloped areas, in line with EC and domestic state aid rules.
- In Romania the current Law on Promotion of Direct Investment (2001) provides for incentives in the form of customs duty exemptions for goods and equipment imported as part of investment; a deduction of 20% of the value of the new investments; use of accelerated depreciation of fixed assets (except buildings); and the possibility of exemption/reduction from/on the payment of the land tax for up to three years. These incentives are granted to businesses that make significant investments.⁴⁰ However, a new investment promotion law being prepared will replace the existing law and ensure full compatibility with state aid rules. Other tax incentives are granted for regional development and development in free zones and industrial parks.

In June 2006 Serbia adopted a programme which provides financial incentives for investments in manufacturing, internationally marketable services and R&D. This programme will be implemented by the Serbia Investment and Export Promotion Agency.

The other SEE countries also provide a range of incentives under various legislation, but there is a need to reconcile the different schemes and ensure consistency with the EU *acquis communautaire* on state aid and the international obligations.

4.4.2 Programmes to support linkages between FDI and local businesses

Programmes to support linkages between FDI and local businesses can have spill-over effects, including transfers of technology and know-how, and can contribute to the development of SMEs. The Czech Republic and Ireland have been active supporters of linkage programmes. However, linkage programmes also require significant resources and ongoing investment, such that governments should carefully consider whether resources might be better spent on 'core' investment promotion activities and on activities to ensure a well-functioning market, which is ultimately the surest way to promote linkages.

Bulgaria, and to some extent Romania, have developed linkage and cluster development programmes. In Bulgaria current clusters include wood processing, ceramics and textiles.

Croatia, FYR Macedonia and Serbia have made efforts to provide SME linkage and cluster development support, but implementation is at a very early stage. Croatia adopted an Incentives Programme for Small and Medium Entrepreneurship in 2004. It includes the development of a strategic partnership to support linkages between Croatian SMEs and foreign companies. In FYR Macedonia, financial and technical support for the establishment of clusters (an 'ABC cluster' and a 'home cluster') is envisaged in 2006. Similarly, a pilot project on cluster development launched in Serbia in 2006 aims to improve innovation and technology development, enhance enterprises' capacity to enter foreign markets, establish strategic partnerships and linkages, attract FDI, and implement a new economic development policy in line with EU standards.

All other SEE countries have adopted and implemented SME development policies. However, there is no evidence of direct linkage support by governments.

⁴⁰ Investment with a value exceeding the equivalent of USD 1 million (approximately EUR 797,216).

BOX 4.3

CASE STUDY ON ACTIVITIES TO SUPPORT LINKAGES BETWEEN FDI AND SMES: CZECHINVEST'S SUPPLIER DEVELOPMENT PROGRAMME

Companies with foreign participation may have a positive impact on the economic performance of the host country. Their role is of special importance in economies in transition. One of the channels through which domestic enterprises can benefit from inflows of FDI (in terms of restructuring and raising the levels of productivity and competitiveness) is their links to companies with foreign participation. Contacts with foreign-owned companies may be hindered by market failures (e.g. lack of information), financial weakness, low quality, lack of experience, or local companies' lack of familiarity with certain managerial and marketing solutions. In these cases, economic policy measures enabling local companies to become suppliers of foreign-owned companies may be justified.

The Czech Supplier Development Programme draws on the experience of Ireland, Sweden and the United Kingdom. The first project was launched in 2000 by CzechInvest, the Czech investment promotion agency, and financed through the EU PHARE programme. Its main aim was to enable a group of Czech SMEs (with a maximum of 25% foreign capital) to supply large, foreign owned companies in the electro-technical and electronics sector. Out of 200 Czech companies, 45 were chosen on the basis of predetermined assessment criteria. Eleven multinational companies looking for local supplies participated in this programme.

The programme had several phases:

- Identification of the business weaknesses and strengths of SMEs, based on the European Quality Model assessment and other methodology;
- Elaboration of a six-month action plan based on the company evaluation;
- Selection of relevant companies;
- Linking selected SMEs with multinational corporations (MNCs).

By the end of the programme (July 2002), the majority of selected companies had become suppliers of MNC affiliates in the Czech Republic and had experienced a substantial increase (on average 10%) in earnings between 2000 and 2001. The share of local input in the sector had risen by 21% in 2004, according to KPMG estimates.

Following the success of this pilot programme, the EU provided additional financing to expand the programme to other sectors considered strategic by CzechInvest. The programme's second phase was launched in January 2003 and lasted until October 2004; 50 firms were involved from the following selected sectors: production of components for automotive and aircraft industries, equipment, biotechnology and pharmaceuticals/health care.

Key success factors of the Czech supplier programme were:

- Concentration of efforts and financing on a relatively small number of companies and on selected sectors;
- Active participation by Czech affiliates of MNCs, which were looking for local suppliers;
- Customised financial, human and managerial support for the most 'capable' Czech SMEs, and intensive training for the most competitive ones.

Source: Interviews with experts from CzechInvest; www.czechinvest.org.

TABLE 4.3
IRI SCORES FOR INVESTMENT PROMOTION AGENCY AND PROGRAMMES⁴¹

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
3	2.75	3.75	3.25	3	2.50	3	3.25	3.50

Source: OECD Investment Compact.

4.4.3 IRI results for investment promotion agency and programmes

The evaluation of the investment promotion agency and programmes sub-dimension has resulted in the scores in Table 4.3, describing the current situation in each of the nine target countries.

Bulgaria and Serbia have the most advanced IPAs and programmes in the region (IRI scores of 3.75 and 3.50, respectively). The IPAs in other SEE countries are at the early stages of operation. In Bosnia and Herzegovina and Moldova the IPAs are currently going through a restructuring process limiting their operational capacity.

4.5 Transparency of investment policy and of investment promotion and facilitation framework

To better tailor investment policy measures, determine the orientation of strategic investment promotion and ensure a transparent investment environment, it is important to have well-established, regular and effective consultations between public authorities and private sector organisations. Monitoring and evaluation of policy regulations, and easy access to information, are also important in this regard.

Where major investment policy measures have been passed, SEE countries have generally made efforts to establish consultation channels with key actors from the public and private sectors through consultative bodies. Consultations are pursued more systematically in some countries (e.g. Bulgaria, Romania and Serbia) than in others; in some countries consultations may take place on an ad hoc basis and may not always involve all stakeholders.

Concerning monitoring and evaluation, some countries (e.g. Bulgaria and Romania) have regularly prepared analyses and recommendations on foreign direct investment and have reviewed administrative obstacles to foreign investment. Serbia has incorporated mandatory monitoring and evaluation mechanisms in its investment promotion strategy; reports will be issued on a regular basis.

While Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Moldova and Montenegro follow the same trend, more emphasis should be placed on establishing regular mechanisms for monitoring and evaluating the investment policy environment and including such mechanisms in investment promotion strategies.

Overall, information on investment policy regulations and investment opportunities in SEE countries is largely available in written (e.g. brochures, leaflets) and electronic (e.g. website) form, in both English and local languages. In some countries (e.g. Bulgaria and Serbia) information on the investment policy legal framework, investment opportunities and priority sectors is easily accessible, regularly updated and available in other languages (e.g. Italian, Spanish and Japanese in Bulgaria). Other countries need to focus more on updating the information available in English and in local languages, streamlining communications and avoiding information dissemination through dispersed sources.

⁴¹ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

TABLE 4.4

IRI SCORES FOR TRANSPARENCY⁴²

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.75	2.75	3.75	3	3	2.75	3	3.50	3.75

Source: OECD Investment Compact.

4.5.1 IRI results for transparency

The evaluation of the transparency sub-dimension has resulted in the scores in Table 4.4, describing the current situation in each of the nine target countries.

As with the other two sub-dimensions reviewed in this chapter, Bulgaria and Serbia are ahead of their peers in transparency, being closely followed by Romania.

4.6 Key actions to consider at the regional level

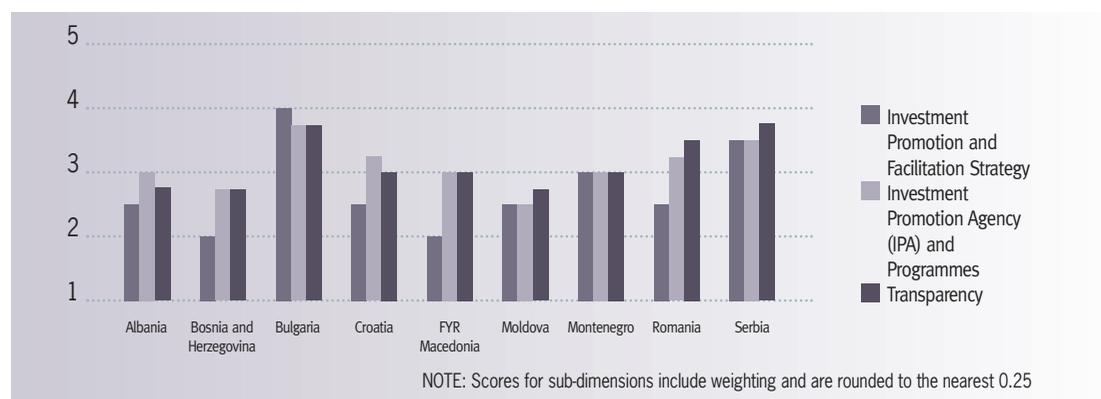
1. Adopt investment promotion strategies that include a clear strategic vision for each country and the region and that specify where and how to compete for FDI in Albania, Bosnia and Herzegovina,

Croatia, FYR Macedonia, Moldova and Romania.

2. Strengthen the capacity of investment promotion agencies (IPAs) in the region, with a particular focus on industry expertise and sales and marketing skills.
3. Follow the Czech example of creating linkages between FDI and local businesses in all SEE countries.
4. Assess investment incentives schemes in all SEE countries, thoroughly and periodically, in order to determine the costs incurred and whether they meet their objectives.

IRI SCORES FOR INVESTMENT PROMOTION AND FACILITATION

FIGURE 4.4 – INVESTMENT PROMOTION AND FACILITATION: SCORES BY SUB-DIMENSION



Source: OECD Investment Compact.

⁴²The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

Investment promotion and facilitation strategy

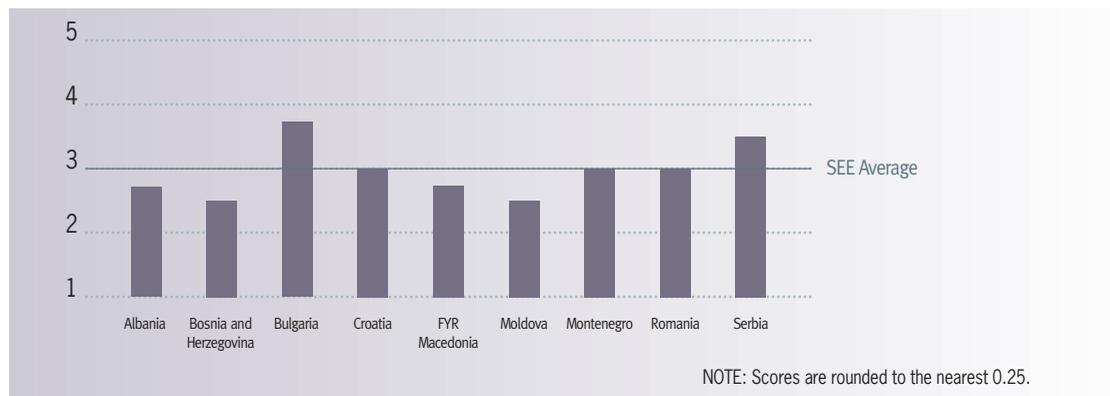
- Outside Bulgaria and Serbia which score 4 and 3.50, respectively, no other SEE country has yet implemented an effective investment promotion and facilitation strategy.

Investment promotion agency and programmes

- Bulgaria and Serbia have the most advanced IPAs in the region (IRI scores of 3.75 and 3.50, respectively). The IPAs in other SEE countries are at the early stages of operation. In Bosnia and Herzegovina and Moldova the IPAs are currently going through a restructuring process limiting their operational capacity.

Transparency of investment policy and investment promotion and facilitation framework

- As with the other two sub-dimensions reviewed in this chapter, Bulgaria and Serbia are ahead of their peers in transparency, being closely followed by Romania.

FIGURE 4.5 – OVERALL SCORES FOR INVESTMENT PROMOTION AND FACILITATION

Source: OECD Investment Compact.

- Investment promotion is lower than investment policy, with an average score of 3.
- Bulgaria and Serbia are ahead their peers in the region in defining and implementing IPF strategies that focus both on demand generation and support services for greenfield investment.

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– (2006) *Follow-up to the 2004 Investment Policy Review of Romania: Progress Report by the Romanian Authorities*, DAF/INV/RD, Paris.
– (2006) *Policy Framework for Investment*, Paris.

Selected websites:

SEE countries:

- Investment Promotion Agency of Bulgaria (InvestBulgaria) (www.investbg.government.bg)
- Trade and Investment Promotion Agency of Croatia (www.apiu.hr)
- Agency for Foreign Investments of the Republic of Macedonia (www.macinvest.org.mk)
- Montenegrin Investment Promotion Agency (www.mipa.cg.yu)
- Romanian Agency for Foreign Investments (www.arisinvest.ro)
- Serbia Investment and Export Promotion Agency (www.siepa.sr.gov.yu)

International bodies:

- Multilateral Investment Guarantee Agency (MIGA) (www.miga.org)
- World Association of Investment Promotion Agencies (WAIPA) (www.waipa.org)



Chapter 5

Tax Policy

Countries in South East Europe have put in place attractive tax policy and legislative frameworks with low corporate tax rates ranging from 9 to 20%. Overall, the region has implemented generous depreciation regimes; most countries allow companies to carry losses forward, in line with international standards. Furthermore, they have developed extensive tax treaty networks, which continue to expand.

However, tax administration in the region remains very weak. Revenue agencies continue to operate with insufficient budgets and staff. Most tax inspection authorities reportedly conduct too many tax inspections. Appeals procedures are lengthy and burdensome and VAT reimbursements often take well over 90 days.

Tax Policy

5.1 Introduction

Governments taxing their citizens face two competing objectives. First and foremost, taxation is required to finance essential public goods and services. However, governments interested in encouraging economic growth, in particular through investment, must ensure that the burden does not have a negative impact on the investment decisions of both foreign and domestic companies.

Taxpayers, and especially firms, face the same dilemma – they are recipients of public services and goods such as a sound education system, security and a stable macroeconomic environment. At the same time, they are interested in maximising after-tax profitability in order to effectively compete in an increasingly globalised world.

Although earlier studies failed to find a substantial link between taxation and the decisions and profitability of domestic and international investors,⁴³ more recent studies have started to find that taxation is indeed becoming more important to firms.⁴⁴ This change can in large part be attributed to reductions in other barriers to FDI which are primary to the function of firms. As these obstacles are surmounted, more focus is placed on the second competing objective stated above: minimising the burden of taxation.

Furthermore, the movement towards globalisation has resulted in firms producing for an international market instead of concentrating on domestic ones. And, over the past decades, the world has seen a boom in free trade areas and customs unions, allowing firms to supply many different markets from a single location unobstructed by various barriers to trade. These two factors have served to increase the mobility of firms. All things being equal, firms (especially those geared towards exports) will seek a location which minimises their tax burden.

5.2 Assessment framework

To maintain this balance between providing fundamental public goods and services and minimising the tax burden, governments should first implement sound tax policy, with legislation in line with international and OECD standards. The next important step is to make sure that policy and legislation are consistently and transparently implemented through a competent tax administration. As the costs associated with adhering to taxation requirements can also act to increase the effective tax burden (e.g. by requiring small firms to hire accountants), these compliance costs need to be minimised as much as possible. Finally, governments need to ensure that tax policies in all areas are implemented transparently, predictably and consistently, and that they are not subject to discretionary or arbitrary interpretation by individual officials.

⁴³ See *Corporate Tax Incentives for Foreign Direct Investment* (OECD, 2001), chapter 4, for a review of earlier studies of the impact of corporate taxation on direct investment. The difference between these findings and later findings can largely be attributed to modelling difficulties, as well as the relative importance of the first objective mentioned above. Firms, both through their concentration on catering primarily to the domestic market in which they are situated (see, among others, J. Mintz and R. Tsiopoulos, *Corporate Income Tax and Foreign Direct Investment in Central and Eastern Europe*, Foreign Investment Advisory Service (FIAS), 1992, and I. Trela and J. Whalley, 'Taxes, Outward Orientation and Growth Performance in Korea,' in *Tax Policy in Developing Countries* (World Bank), 1991) and their more immediate concerns about overcoming other barriers to FDI, placed less importance on taxation.

⁴⁴ See W.S. Clark, 'Tax Incentives for Foreign Direct Investment: Empirical Evidence on Effects and Alternative Policy Options,' *Canadian Tax Journal*, Vol. 48 (2000), p. 1139.

To achieve this goal, they should make use of routine consultations with stakeholders, proper mechanisms for monitoring and evaluation, and appropriate communications and information access on all issues related to taxation policy (see Figure 5.1).

5.3 Tax policy and legislation

Assessment of taxation policy and legislation is based on six main components:

- Statutory corporate tax rate;
- Tax incentive scheme;
- Tax treaty network;
- Transfer pricing;
- Depreciation allowances;
- Loss carry forward.

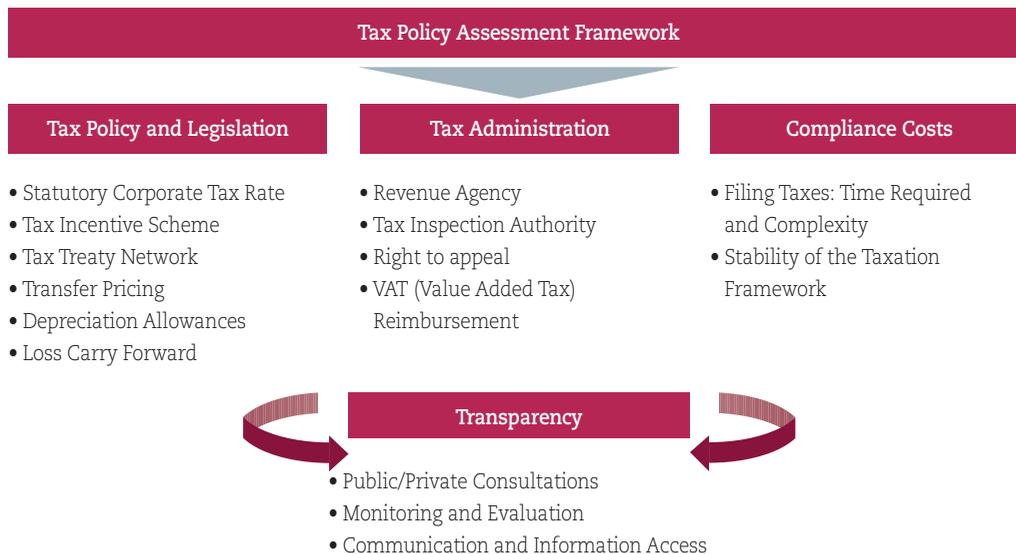
5.3.1 Statutory corporate tax rate

According to a survey conducted by the Ruding Committee, 57% of managers of multinational firms always considered the corporate tax rate as an important factor for determining where

to invest.⁴⁵ Several recent studies have also found a relationship between FDI inflows and the corporate tax rate.⁴⁶ This will come as good news to SEE countries: the region has some of the world's lowest statutory corporate tax rates, ranging from 9% in Montenegro to 20% in Croatia (see Figure 5.2).

The exception is the Federation of Bosnia and Herzegovina.⁴⁷ While the corporate tax rate in the Republika Srpska is the same as that in Serbia (10%), in the Federation it is 30%. There are encouraging signs, however, that Bosnia and Herzegovina plans to implement a uniform 15% corporate tax rate throughout the country.

FIGURE 5.1 – TAX POLICY ASSESSMENT FRAMEWORK



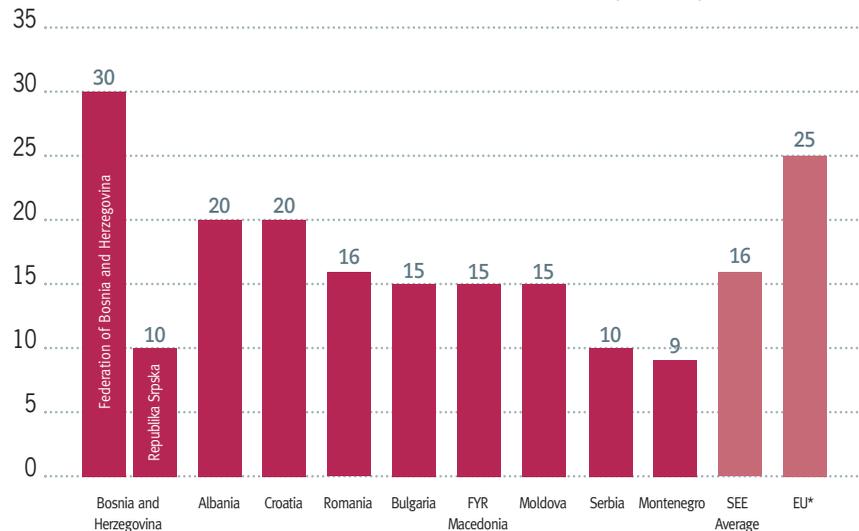
Source: OECD Investment Compact.

⁴⁵ Report of the Committee of Independent Experts on Company Taxation, European Commission, 1992, p. 115.

⁴⁶ See H. Grubert and J. Mutti, "Do Taxes Influence Where US Corporations Invest?", *National Tax Journal*, Vol. 53, No. 4, p. 825; *Corporate Tax Incentives for Foreign Direct Investment*, OECD Tax Policy Studies, No. 4.

⁴⁷ Due to separate taxation systems in the two entities of Bosnia and Herzegovina, the Federation of Bosnia and Herzegovina and the Republika Srpska, each entity has been evaluated separately in the investment Reform Index assessment of taxation policy. The Brcko District, the third constituent government of Bosnia and Herzegovina, was not evaluated.

FIGURE 5.2 – CORPORATE TAX RATES (% 2006)



Source: Individual countries' corporate tax legislation;
*KPMG's Corporate Tax Rate Survey 2006.

BOX 5.1

TAXES ABOVE THE STATUTORY CORPORATE TAX RATE

Companies operating in most countries, including those in SEE, are subject not only to statutory corporate taxes but also to other, secondary taxes. The quantity and complexity of such taxes add to companies' compliance costs.

TABLE 5.1
TAXES COMPANIES PAY (2006)*

Country	Estimated Number of Taxes Paid by Companies	Examples
Albania	8	Vehicle tax: fixed fee ALL 18,000 (~ EUR 150) per truck; road tax: fixed fee ALL 15,000 (~ EUR 130) per truck
Bosnia and Herzegovina**	7	Municipal tax: fixed fee BAM 1,200 (~ EUR 580)
Bulgaria	8	Final/one-off tax on certain expenses: 20% of gross expenses
Croatia	6	Forest contribution: 0.07% of turnover
FYR Macedonia	7	Municipal tax: fixed fee MKD 6,000 (~ EUR 100)
Moldova	10	Land improvement tax: MDL 18 (~ EUR 1) per employee x 10% + MDL 13.50 (~ EUR 0.8) per quarter
Montenegro	6	Business license: 0.08% to 0.8% of property's book value
Romania	15	Firm tax: fixed amount per square metre of lighting panel
Serbia	5	Property transfer tax: 5% sale price

* Taxes included: VAT, social security payments, municipal taxes, property taxes, property transfer taxes, CIT taxes, etc.
This is the actual number of taxes, not the number of tax payments, which can be found under compliance costs in Section 5.5.1.
** Separate data for the two entities is not available.

While the impact of these taxes on countries' overall effective tax rates is likely to be small, numerous taxes can give investors the impression that the overall tax burden is higher than it actually is. Therefore, countries should calculate and communicate the overall tax burden, in order to demonstrate with full transparency that they are competitive in terms of corporate tax regimes.

Source: World Bank, Doing Business in 2007 (www.doingbusiness.org).

5.3.2 Tax incentive scheme

In many countries, including most of those in SEE, tax incentives (e.g. partial tax relief or tax holidays) are a key policy instrument for boosting investment. The effectiveness of such tax incentives has been hotly debated, and there are numerous arguments both supporting and denying the beneficial impact of tax incentives on foreign and domestic investors.⁴⁸ In general, however, policy makers are advised to commit to the EU Code of Conduct on Business Taxation and to ensure that all existing and future tax incentives adhere to the Code. This encourages countries to implement tax incentives that follow clear revenue and overall development goals, with properly defined implementation instructions which do not discriminate between foreign and domestic investors (see Box 5.2).

SEE countries are at different stages of implementing responsible tax incentive schemes. These stages of implementation broadly correspond to their stages of EU accession:

- Bulgaria, Croatia, FYR Macedonia and Romania have committed to the EU Code of Conduct on Business Taxation, which is required of all Member States to eliminate tax incentives which could create harmful tax competition within the EU. Bulgaria and Romania have completed a gap analysis to identify incentives that violate the Code. Croatia is currently conducting a gap analysis which it hopes to complete by the end of 2006.
- Although no other SEE country has committed to the EU Code, Moldova, Montenegro and Serbia have generally aligned their incentives with their overall development goals and with international norms. Implementation instructions continue to be unclear in Moldova and Serbia. In Moldova instructions for implementing the incentives are sometimes vague and require continual clarification by the tax authorities; in Serbia certain tax exemptions are granted to companies investing in areas of special interest, but the law still does not specify these areas precisely.

BOX 5.2

THE EU CODE OF CONDUCT ON BUSINESS TAXATION

The EU Code of Conduct on Business Taxation aims to eliminate tax incentives which could create harmful tax competition within the EU. The EU accession countries, candidate countries and potential candidate countries are expected to adopt the Code prior to EU accession.

The Code of Conduct requires the adhering country to roll back all current tax incentives which violate the Code, as well as ensure that no tax incentives introduced in the future will violate it. The following criteria have been established to identify harmful tax measures:

- An effective level of taxation which is significantly lower than the general level of taxation in the country concerned;
- Tax benefits reserved for non-residents;
- Tax incentives for activities which are isolated from the domestic economy and therefore have no impact on the national tax base;
- Granting of tax advantages even in the absence of any real economic activity;
- Lack of transparency.⁴⁹

Source: European Commission (1997) 'Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy'; Official Journal of the European Communities [98/C 2/01]; http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/index_en.htm.

⁴⁸ See, among others, the OECD Investment Compact commissioned study by Emerging Market Economics, Ltd. *Survey on the Role of Taxation in Foreign Investment (2002)*, which found that special tax incentives were not considered in determining investment locations in SEE and, in some instances, actually acted to discourage investment. However, other studies have shown that when other factors such as political and macroeconomic stability are constant, there is potential for tax incentives to positively affect the investment decisions of firms (see Wells, 2001).

⁴⁹ The EU Code of Conduct on Business Taxation also addresses the basis of profit determination in multi-national firms, which within the IRI Tax Policy assessment is dealt with under section 5.3.4.

- Albania, the Federation of Bosnia and Herzegovina and the Republika Srpska are each at different stages of repealing current tax incentives and revising new investment incentive laws to provide improved targeting of incentives and to align tax incentives with overall revenue policy goals. This will be especially welcome in the Federation of Bosnia and Herzegovina, where current incentive schemes overtly discriminate between foreign and domestic investors while instructions for incentive implementation are unclear and are not applied consistently – leaving room for discretionary behaviour by officials applying the tax incentives.

5.3.3 Tax treaty network

To avoid double taxation, international firms prefer to locate to countries which have implemented tax treaties with their home countries. Therefore, it is important to develop a comprehensive tax treaty network (see Table 5.2).

The countries with the most comprehensive tax treaty networks are Bulgaria, Croatia and Romania. Albania, Bosnia and Herzegovina,⁵⁰ FYR Macedonia and Moldova have enforced tax treaties with most of their largest investment partners and are currently negotiating treaties with numerous other countries.⁵¹ With respect to the independence of Montenegro, Serbia is the

legal successor of the state union. All tax treaties concluded under the state union are still applicable between Serbia and the treaty partners. Montenegro has stated that it will honour all tax treaties concluded under the state union.

5.3.4 Transfer pricing

‘Transfer pricing’ is the common term for attributing profits to the different entities that make up a corporate group. As these entities are often based in different countries and are mutually involved in producing a final product, how the resulting profit is shared determines each entity’s taxable income. In the absence of clear transfer pricing regulations, two problems are posed:

- A multinational enterprise might seek to allocate all of its profit to the entity within its corporate group with the lowest corporate tax burden, thus depriving the countries in which the other entities are located of their fair share of the tax revenue;
- The tax administrations in two or more different countries might claim significant portions of the taxable profit of a corporate group as taxable within their jurisdictions, likely exposing these companies to double taxation.

TABLE 5.2
TAX TREATY NETWORK IN SEE*

Country	Number of income and capital tax treaties in force	Number of income tax treaties in force	Big investor countries with no tax treaty**
Albania	20	2	Germany, United States, Austria
Bosnia and Herzegovina	19	2	Austria, Slovenia, Kuwait, Switzerland
Bulgaria	39	20	United States
Croatia	29	14	Luxembourg, United States
FYR Macedonia	29	3	Greece, United States, Austria
Moldova	29	8	Ireland, United Kingdom
Montenegro	32***	4***	Austria
Romania	55	22	None
Serbia	32***	4***	Austria, Greece, United States

Source: IBFD Tax Treaties Database (<http://online2.ibfd.org/treaty/>).

* Includes all treaties which will come into force as of 1 January 2007.

** The largest investor countries were determined using FDI stock by country of origin from the following FDI databases: *wiiv* and *LOCOMonitor*.

*** Double taxation treaties of Serbia and Montenegro.

⁵⁰ In Bosnia and Herzegovina, tax treaties are concluded at the state level.

⁵¹ FYR Macedonia is not currently negotiating any bilateral tax treaties; the most recent negotiation, with the United Kingdom, was concluded in the summer of 2006.

Transfer pricing is especially relevant in SEE because much of FDI is concentrated in export processing operations that result in a high volume of inter-company trade. To avoid the problems listed above, SEE countries should implement transfer pricing legislation based on the arm's length principle.⁵² They should also have clearly defined implementation regulations stating the methods allowed in determining transfer pricing and their order in line with the OECD Guidelines on Transfer Pricing, as well as specifying the documentation required to justify pricing valuations. Agents within the tax administration should be specialised in handling transfer pricing examinations.

Significant work is needed in all SEE countries to improve transfer pricing regulations. These countries have adopted legislation broadly establishing the arm's length principle, but this is as far as many of them have gone.

Bulgaria, Croatia and Romania have implemented legislation allowing both traditional transactional methods⁵³ and transactional profit methods⁵⁴ to determine transfer pricing, as well as instructions for implementation. However, their prescribed documentation requirements are either only applicable in certain cases or do not always precisely state exact documentation requirements.⁵⁵ Advance pricing agreements⁵⁶ are not allowed, and there are no specialised units dealing specifically with transfer pricing within the respective revenue agencies.

In general, there appears to be little supervision of how transfer prices are calculated in SEE

countries. With the possible exception of Albania,⁵⁷ no agents within these countries' tax administrations appear to be specialised in handling transfer pricing examinations. It also appears that no SEE country has yet established clear and compulsory requirements for documentation, and that enforcement of transfer pricing legislation is generally lacking.

5.3.5 Depreciation allowances

Depreciation makes it possible for businesses to deduct normal wear and tear on their equipment from taxable income. This is especially important in the case of large, capital-intensive companies. Where depreciation regimes are overly complex and/or methods and rates for calculating depreciation are restrictive, this can increase companies' effective tax rates, often significantly. Transition economies, in particular, are advised to create a depreciation regime that has relatively few asset categories and applies depreciation rates which accurately reflect the productive lives of the underlying assets. These countries are also encouraged to adopt accelerated depreciation for certain assets as well as the declining balance method of depreciation (see Box 5.3 and Table 5.3).⁵⁸

With the exception of the two entities of Bosnia and Herzegovina and FYR Macedonia, SEE countries have relatively simplified depreciation systems with no more than seven asset categories. The following differences can be highlighted:

- Only Moldova, Romania and Serbia allow firms to calculate depreciation using the

⁵² According to the arm's length principle, transactions between two related entities should be conducted as if the two entities were independent. Therefore, the prices charged should reflect market prices for the goods sold.

⁵³ Traditional transactional methods are the comparable uncontrolled price method; the resale price method; and the cost plus method. For a full description of these methods, refer to the OECD Guidelines on Transfer Pricing.

⁵⁴ Transactional profit methods are the profit split method and the transactional net margin method. For a full description of these methods, refer to the OECD Guidelines on Transfer Pricing.

⁵⁵ In the case of Romania, there are no special documentation requirements although Romanian tax authorities have indicated that there is an intention to implement such requirements.

⁵⁶ An advance pricing arrangement allows a taxpayer to establish with the tax authorities, in advance, the proper transfer pricing methodology.

⁵⁷ Albania has established a Commission for the Transfer of Prices at the General Taxation Directorate (GTD). However, the country's transfer pricing rules have been applied only very recently.

⁵⁸ Instead of spreading the cost of an asset evenly over its life, as in the case of the straight-line depreciation method (described in the following footnote), the declining balance depreciation method applies a constant rate of depreciation, resulting in depreciation charges declining each successive period. The declining balance method of depreciation is actually itself a form of accelerated depreciation, however, here we refer to accelerated depreciation as allowing the capital costs of targeted investment to be written off at a faster rate than that applied under normal depreciation (i.e. above and beyond rates applied by the standard declining balance depreciation method).

BOX 5.3

TWO DEPRECIATION METHODS: DECLINING BALANCE AND ACCELERATED DEPRECIATION

Declining balance method of depreciation

The declining balance method of depreciation has numerous benefits over the straight-line method,⁵⁹ including (OECD, 2003):

- Allowing depreciable items within the same asset category to be depreciated on a pooling basis, so that the taxpayer is not required to keep separate depreciation accounts of each item;
- Allowing higher depreciation deductions in the first years of the asset's life, which is probably a more realistic representation of the lives of certain assets, especially short-lived ones;
- Providing a simplified method of dealing with differences between the value at which a taxpayer finally sells his/her depreciable asset and the value recorded on his/her depreciation schedule.

Accelerated depreciation

Accelerated depreciation, in the form of allowing the capital costs of targeted investment to be written off at a faster rate than that applied under normal depreciation rules, is a form of targeted tax incentive that is arguably preferable to other types of tax incentives. This is because accelerated depreciation does not cause added revenue losses but instead moves revenue offsets forward in time (OECD, 2003).

Source: Tax Policy Assessment and Design in Support of Direct Investment: A Study of Countries in South East Europe, OECD, 2003.

TABLE 5.3
SEE DEPRECIATION REGIMES

Country	Declining balance method allowed?	Accelerated depreciation allowed?	Number of asset categories
Albania	Yes	No	4*
Bosnia and Herzegovina			
Federation of Bosnia and Herzegovina	n/a**	No	n/a**
Republika Srpska	n/a**	No	n/a**
Bulgaria	No	Yes	7
Croatia	No	Yes	5
FYR Macedonia	Yes	Yes	13
Moldova	Yes	Yes	5
Montenegro	Yes	No	5
Romania	Yes	Yes	6
Serbia	Yes	Yes	5

Source: OECD Investment Compact; Individual countries' corporate income tax laws and regulations.

* Albania has five asset categories, but one is reserved for state-owned enterprises.

** In both entities of Bosnia and Herzegovina, the corporate tax legislation does not provide clear guidelines concerning depreciation, relying instead on numerous decrees and by-laws to clarify application.

declining balance method for some asset categories, and at the same time allow accelerated depreciation;

- Bulgaria and Croatia allow only the straight-line basis of depreciation, but they provide

generous accelerated depreciation deductions;

- Albania and Montenegro allow firms to calculate depreciation using the declining balance method for certain asset categories, but they do not allow accelerated depreciation

⁵⁹ The straight-line method of depreciation allows for equal annual deductions of an asset's value over its lifetime.

for qualifying capital at rates significantly higher than true economic depreciation.

measures at least in line with the international norm of five to seven years (see Figure 5.3).

Both entities in Bosnia and Herzegovina and FYR Macedonia need to simplify their depreciation rules. Although FYR Macedonia allows both accelerated depreciation and the declining balance method of depreciation, it should reduce the number of asset categories to five or six.⁶⁰ Currently, however, FYR Macedonia is revising its depreciation regime. The Federation of Bosnia and Herzegovina and the Republika Srpska continue to implement complex depreciation rules, relying on various government decrees and by-laws to clarify their application. However, new corporate income tax laws have been drafted in the entities and are awaiting adoption. Once adopted, they will harmonise entity laws and improve the depreciation regimes.

Serbia has the most flexible provisions in SEE for carrying losses forward (up to ten years). The Federation of Bosnia and Herzegovina, Bulgaria, Croatia, Montenegro and Romania allow losses to be deducted from taxable profits in the five subsequent years. Albania, FYR Macedonia and Moldova allow losses to be carried forward only for three years. The Republika Srpska does not allow losses to be carried forward at all.⁶¹

5.3.6 Loss carry forward

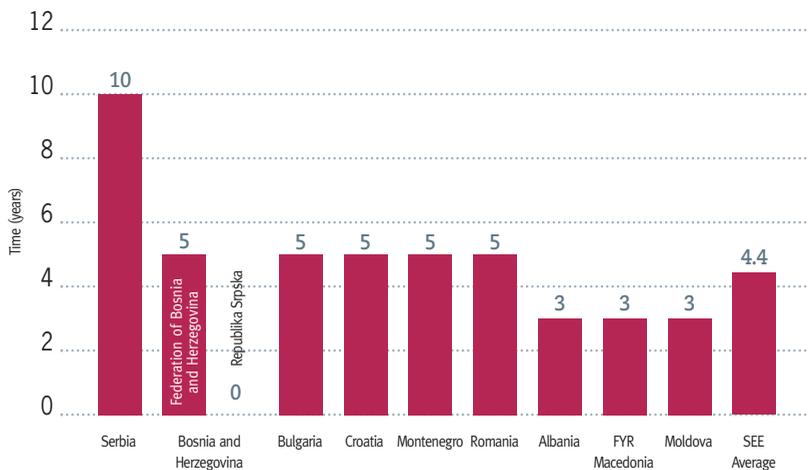
Another important aspect of countries' corporate tax regimes is the provision for loss relief. Firms involved in significant new investment often do not make a profit during their first years of operation. This is especially true in the capital-intensive manufacturing sector. It is critical to allow such firms to carry losses forward by implementing loss relief

5.3.7 IRI results for tax policy and legislation

The tax policy and legislation sub-dimension was assessed by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the target countries following the process described in the Chapter 1 of this report. This resulted in the scores in Table 5.4, describing the current situation in each of the nine target countries covered by the IRI.

Most countries have put into place tax policies and legislation that are in line with international standards, and have scores of 3 or above. In Bosnia and Herzegovina, the two entities score

FIGURE 5.3 – SEE LOSS RELIEF



Source: Individual countries' corporate tax legislation.

⁶⁰ Tanzi and Zee (2002) consider that most developing countries should only have three or four asset categories.

⁶¹ The draft Profit Tax Law will allow losses to be carried forward over the five subsequent years, effectively aligning loss provisions with those in the Federation of Bosnia and Herzegovina.

TABLE 5.4
IRI SCORES FOR TAX POLICY AND LEGISLATION⁶²

Albania	Bosnia and Herzegovina Federation of Bosnia and Herzegovina	Republika Srpska	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.75	2	2.50	3.50	3.75	3.25	3.25	3.50	4	4

Source: OECD Investment Compact.

the lowest due to restrictive depreciation regimes, limited tax treaty networks, and in the case of the Federation the highest corporate tax rate in the region (30%). Transfer pricing regulations remain an issue across SEE countries.

5.4 Tax administration

A sound tax policy and clearly drafted tax legislation are not enough. Governments must also ensure consistent and transparent implementation of tax policy and legislation through effective administration. Evaluation of the tax administration involves four main components:

- Revenue agency;
- Tax inspection authority;
- Right to appeal;
- VAT reimbursement.

5.4.1 Revenue agency

Central to tax administration is an autonomous or semi-autonomous revenue agency responsible for all direct tax collection activities, including social security charges. Such an agency must be well-staffed and have appropriate resources and training programmes. It should also have a clear strategy for improving tax collection through voluntary contributions, improving the productivity of the tax administration and cooperating with other institutions (see Figure 5.4 for a breakdown of revenue collected as % of GDP).

- Bulgaria, Croatia and Romania have established the strongest revenue agencies in the region. Each agency is responsible for collecting all direct taxes and social security contributions.

Both the Bulgarian National Revenue Agency and the Romanian National Agency for Fiscal Administration have adopted an operational strategy; Croatia is in the process of drafting a strategy to improve tax collection. Training of tax officials has been established in all three countries, although the EC monitoring and progress reports have recently indicated that administrative capacity in the tax administrations of each country has room for further improvement.

- Albania, Republika Srpska, FYR Macedonia, Montenegro and Serbia have all set up autonomous (or semi-autonomous) agencies responsible for collecting direct taxes and social security contributions. Each of these countries has adopted a tax administration strategy.⁶³ However, training of tax administration officials is generally only provided on an ad hoc basis. The EC progress reports have indicated that each SEE country's tax administration capacity needs to be improved.
- In Moldova direct collection of taxes and social security contributions has still not been consolidated under one authority. Training has only taken place on auditing and anti-corruption issues. However, these programmes seem relatively well-developed and well-organised, with a number of partner organisations and donors.

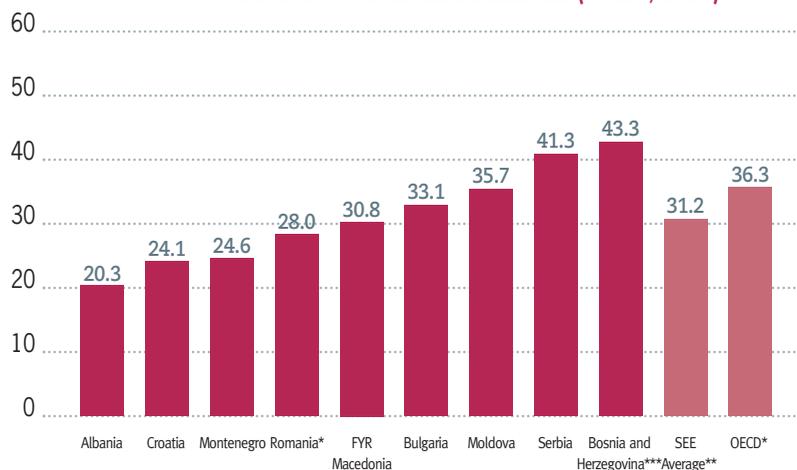
5.4.2 Tax inspection authority

One of the biggest complaints by companies investing in transition economies is that there is excessive interference and discretionary behaviour by tax inspectors. To limit such behaviour and encourage maximum productivity, the tax administration should consolidate all tax

⁶² The indicators of the Sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

⁶³ Montenegro does not have a specific strategy, but improvement of the tax administration and actions to achieve this are part of the Economic Reform Agenda.

FIGURE 5.4 – REVENUE COLLECTED (% GDP, 2004)



Source: EIU Country Profiles; individual countries' Ministries of Finance websites; OECD Revenue Statistics Database. *2003 data. ** SEE average is unweighted. *** Separate data for the two entities of Bosnia and Herzegovina not available.

inspection functions into one authority, governed by an audit strategy based on risk analysis. Moreover, audit actions per taxpayer should be limited to one per year except under exceptional circumstances (see Table 5.5).

- In Albania, Montenegro and Serbia responsibilities for tax inspections have been consolidated under the respective tax administrations. No systematic audit strategies based on risk analysis have been applied, although in Albania the tax administration is currently working with PricewaterhouseCoopers to create procedural manuals on audit case selection and temporary automated systems have been put in place to better target audits. In Serbia audit strategies based on risk analysis have been developed for controls related to the value added tax.
- In Bulgaria and FYR Macedonia responsibility for tax inspections is under the revenue agency. Audit strategies based on risk analysis have been developed and implemented.
- In Croatia the Financial Police (responsible for administering the payment of budget income and fees) was previously under the authority of the tax administration. It has recently been placed under the authority of the Ministry of Finance, reporting to the Minister, while the tax administration has its own auditors.

- Tax inspection authorities in Moldova and Romania have still not been consolidated under one authority. Different agencies responsible for taxpayer audits have overlapping responsibilities, although the number of audits per year and the average duration of audits in each country are among the lowest in SEE. Romania recently introduced risk analysis for VAT with plans to introduce a more comprehensive system soon.

**TABLE 5.5
TAX INSPECTIONS**

Country	Number of audits per year	Average duration of audit*
Albania	6.86	7.51
Bosnia and Herzegovina	1.98**	9.91**
Bulgaria	4.67	8.86
Croatia	0.74	17.47
FYR Macedonia	2.01	13.26
Moldova	2.23	4.07
Montenegro	6.24***	2.14***
Romania	1.47	4.99
Serbia	3.16	10.00

Source: Business Environment and Enterprise Performance Survey (BEEPS) 2005;

* The average duration of audits was calculated using data only from those firms which had inspections.

** Separate data for the two entities is not available.

*** The sample for Montenegro is extremely small; results should be interpreted with caution.

BOX 5.4**CASE STUDY ON RISK ANALYSIS: HUNGARY**

Where financial resources are limited and there is a relatively high level of tax avoidance, it is important for a country's tax inspection authority to establish an efficient strategy to improve its enforcement capacity. The objective of this strategy is to identify cases where the risk of fraud is high, based on information obtained from different sources. These cases would then be selected for detailed investigation and audit. Hungary's tax inspection authority uses such a strategy. The legal background is the 2003 XCII. Law, which states that in addition to obligatory controls, the head of the authority publishes annual control guidance. This document lists the characteristics of companies which present the highest risk of fraud to be examined in more detail in the coming financial year. Sources of information are the statistics office and the tax authority's own database.

With limited financial resources, the tax inspection authority is able to target and concentrate on cases where the risk of fraud is greatest. The chance of identifying actual tax evasion is higher than if companies had been selected at random.

Source: Jit B.S. Gill, *The Nuts and Bolts of Revenue Administration Reform*, World Bank, 2003.

5.4.3 Right to appeal

Complex and unclear tax regulations that leave room for discretionary behaviour by tax officials (together with pressure by the central tax administration to fill tax revenue quotas, and a high incidence of tax fraud) create an environment that encourages disputes between taxpayers and the administration. Therefore, the right to appeal is of special importance to investors. Private entities should be provided with an efficient and rapid tax appeals system, with low barriers for entering an appeal, administered by well-trained civil servants.

- In Albania, the two entities of Bosnia and Herzegovina, Moldova, Montenegro, Romania and Serbia independent or semi-independent appeals procedures have been established. There are generally high barriers to entering an appeal, and the appeals process is usually considered inefficient and slow.
- Bulgaria and FYR Macedonia do not require taxpayers to pay a disputed tax before appealing (although in FYR Macedonia the company disputing the tax must provide justification that paying it would entail serious financial harm). Appeals procedures in both countries have generally been characterised as slow and burdensome.
- Croatia has recently undertaken a significant reform of its court system. Independent appeals

procedures have been established, and the number of cases has been reduced from a backlog of 1.1 million in 2001 to 300,000 in 2005. According to the Ministry of Finance, there is currently no backlog of tax appeal cases. Relatively high barriers to entering an appeal still exist, including payment of 100% of the tax before the appeal can be filed (except in the case of personal income tax).

5.4.4 VAT reimbursement

Firms paying the value added tax are sometimes eligible for a refund. This is especially applicable to firms that produce for export. The refund often

TABLE 5.6
VAT REIMBURSEMENT DEADLINES (Number of Days)

Country	Deadline Non-exporter	Deadline Exporter
Albania*	30	30
Bosnia and Herzegovina ⁶⁴	60	30
Bulgaria	45	45
Croatia	30	30
FYR Macedonia	30	30
Moldova	45	45
Montenegro	60	30
Romania**	45	45
Serbia	45	15

Source: OECD Investment Compact; Individual countries' VAT laws;
*www.anih.com.al;
** PricewaterhouseCoopers Business Guide to Romania, 2005
(www.pwcglobal.com/ro/eng/main/home/pwc_bguide_2005.pdf).

⁶⁴ VAT legislation and administration is conducted at the state level with the state-level VAT law and the state-level Indirect Taxation Administration.

represents a large portion of the working capital available to a firm; delayed reimbursements can significantly strain company finances. However, VAT (value added tax) reimbursement continues to be a problem in the region. While all SEE countries have laws explicitly stating that VAT is to be reimbursed to non-exporters within a maximum of 60 days (and more rapidly for exporters), in practice this rarely occurs (see Table 5.6).

Albania is the most notorious example. While the legal time period is 30 days, anecdotal evidence suggests that the actual reimbursement time is much longer due to a combination of inconsistent regulations, discretionary behaviour by tax officials and lack of a proper VAT reimbursement allocation in the state budget. Several companies have brought VAT reimbursement cases to court. Large exporters are heavily penalised by the current system.

At the other end of the spectrum, Bulgaria, Croatia, FYR Macedonia and Moldova have laws stating that VAT is to be reimbursed between 30 and 45 days; Montenegro recently shortened its reimbursement period to 60 days for non-exporters and 30 days for exporters.⁶⁵ All four countries have implemented a mechanism for systematic monitoring of reimbursements. Official data in Bulgaria and Moldova show that their deadlines are generally respected.⁶⁶ No data were provided on whether the official deadline

is respected in Croatia, FYR Macedonia or Montenegro.⁶⁷

Few other SEE countries appear to have implemented a mechanism to monitor VAT reimbursement.

5.4.5 IRI results for tax administration

The evaluation of tax administration sub-dimension has resulted in the scores in Table 5.7, describing the current situation in each of the nine target countries.

Only Bulgaria, Croatia and Romania score above 3 for the tax administration sub-dimension. The average score is lower than for the tax policy and legislation sub-dimension due to a high level of tax inspections and the weak capacity of the revenue collection agencies.

5.5 Compliance costs

The assessment of compliance costs is based on two main components:

- Filing taxes: time required and complexity;
- Stability of the taxation framework.

5.5.1 Filing taxes: time required and complexity

As noted by Max Baucus, a United States Senator, 'Tax complexity itself is a kind of tax.' Governments therefore need to reduce the complexity of filing taxes. They also need to

TABLE 5.7
IRI SCORES FOR TAX ADMINISTRATION⁶⁸

Albania	Bosnia and Herzegovina Federation of Bosnia and Herzegovina	Republika Srpska	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.75	2.75	3	3.50	3.25	3	2.50	3	3.25	2.75

Source: OECD Investment Compact.

⁶⁵ The changes came into effect on 1 January 2006. The previous reimbursement period was 90 days for non-exporters and 60 days for exporters.

⁶⁶ According to interviews with the Bulgarian National Revenue Agency, in 2005 4.2% of total refund requests were not processed on time and the average time for reimbursement was 56 days. According to the Moldovan Ministry of Finance, out of a total of 739 VAT refund requests, 683 were processed within 45 days in the first half of 2005.

⁶⁷ However, the following data was provided: according to the Croatian tax administration, 56% of VAT is reimbursed. According to the FYR Macedonian tax administration, average reimbursement time is estimated to be between 30 and 60 days by the Government, although only 26.07% of VAT receipts have been refunded in 2006. According to the Montenegrin tax administration, 96% of total requested VAT reimbursements were completed between 1 April 2003 and 28 February 2006.

⁶⁸ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

ensure that the time it takes to comply with tax requirements and the number of tax payments are both minimised, possibly through the introduction of an online tax filing system.

The average time it takes to comply with tax requirements in SEE countries is 230 hours, according to the World Bank *Doing Business in 2007* report. Bulgaria tops the charts, with businesses spending an estimated 616 hours per year on filing taxes. The number of tax payments made by companies in SEE countries is also extremely high. Firms must make 54 different tax payments each year, considerably above the OECD average of 15. These compliance costs represent an additional burden on SMEs; a recent survey found, for example, that in Moldova most individual entrepreneurs need to hire a full-time accountant (Pro Era Grup, 2005).

To increase the efficiency of tax filing, Bulgaria, Croatia, FYR Macedonia, Montenegro and Romania have implemented online tax filing for at least certain taxes or taxpayers. Bulgaria has the most comprehensive online tax filing system: personal and corporate income taxes, as well as VAT and social security and health system contributions, can be paid online (see Table 5.8).

5.5.2 Stability of the tax framework

A stable regulatory environment is important to investors. This is particularly true with respect to a sensitive area such as tax. Frequent changes in primary and secondary tax legislation

represent a compliance cost for enterprises, which are required to relearn implementation procedures each time there is a change.

While SEE countries have made significant progress in aligning their tax legislation and administrations with international standards, this has often been at the expense of the stability of the tax system. However, the stability of the tax system appears to be improving even if it is not yet 'satisfactory' (see Figure 5.5). In general, SEE countries have primarily been introducing amendments to tax law and procedures within the annual budgetary process. Nevertheless, changes in the tax system are often introduced without appropriate compliance procedures. For example, FYR Macedonia recently introduced a new dividend tax with little advance notice apart from publication in the Official Gazette, and with no regulations for compliance.

5.5.3 IRI results for compliance costs

The evaluation of the compliance costs sub-dimension has resulted in the scores in Table 5.9, describing the current situation in each of the nine target countries.

Compliance costs in SEE are high overall, particularly in Albania, Bulgaria, Croatia, Moldova and Romania. Bulgaria is actively introducing online tax filing to reduce the time it takes to file taxes.

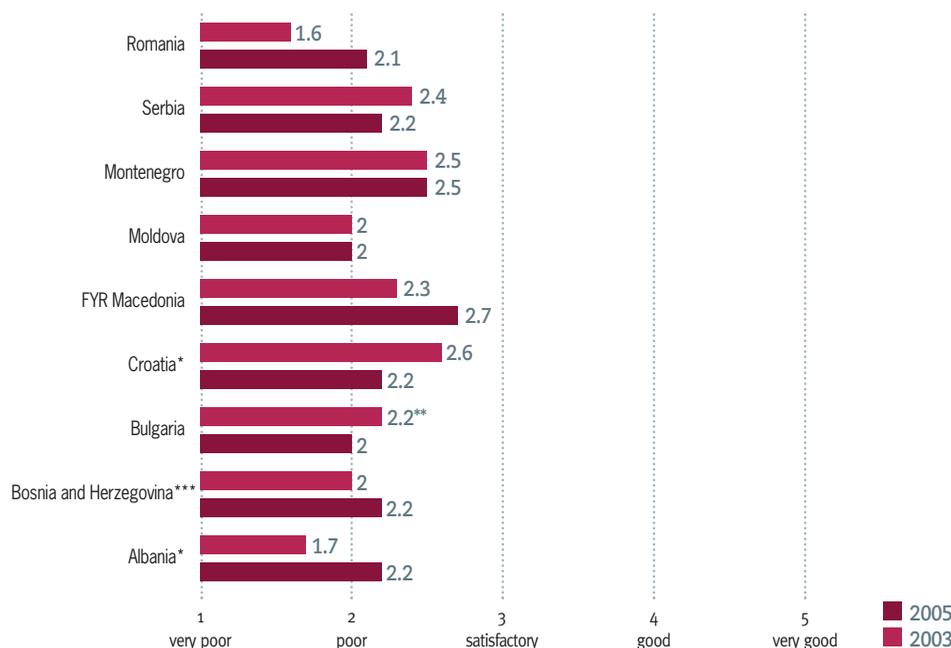
TABLE 5.8
COMPLIANCE COSTS

Country	Number of Payments	Time (Hours)
Albania	41	240
Bosnia and Herzegovina*	73	100
Bulgaria	27	616
Croatia	39	196
FYR Macedonia	54	96
Moldova	44	250
Montenegro	75	208
Romania	89	198
Serbia	41	168

Source: World Bank, *Doing Business in 2007* (www.doingbusiness.org).

* Separate data for the two entities is not available.

FIGURE 5.5 – STABILITY OF THE TAX SYSTEM



Source: 2005 Enterprise Policy Performance Assessments (EPPA).

*Measurement of both the stability and transparency of the tax system.

**2002 data.

*** Separate data for the two entities of Bosnia and Herzegovina not available.

TABLE 5.9

IRI SCORES FOR COMPLIANCE COSTS⁶⁹

Albania	Bosnia and Herzegovina Federation of Bosnia and Herzegovina	Republika Srpska	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.25	3	3	2.75	2.50	3.25	2	3.25	2.50	3.25

Source: OECD Investment Compact.

5.6 Transparency

The assessment of transparency is based on three main components:

- Public/private consultations;
- Monitoring and evaluation;
- Communication and information access.

5.6.1 Public/private consultations

To avoid bias and uneven access by more powerful interests, governments need to ensure that consultations with the private sector on tax

issues are routine and structured.

Bulgaria, Croatia and Romania have made the greatest progress in improving mechanisms for consultation with the private sector on taxation issues. In Bulgaria the National Tax Policy Council arranges regular consultations with the business sector. Comparable institutions in Croatia and Romania are the tax advisory committee within the tax administration and the Working Group for Business and Environment, respectively.

⁶⁹ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

In Albania a Business Advisory Council has been created. In the past this body met regularly to comment on pending legislative and procedural changes, including those related to taxation. It has made numerous comments and suggestions on the fiscal package, many of which have been incorporated into the final package. With the election of the new Government, it remains to be seen whether frequent consultations will continue.

In both entities of Bosnia and Herzegovina, FYR Macedonia, Moldova, Montenegro and Serbia the consultative process has been improved recently. In each of these countries, Chambers of Commerce and other stakeholders are allowed to comment on and debate pending legislation related to taxation. However, OECD Investment Compact interviews with the private sector in each country revealed that the private sector still considered the level of consultation to be insufficient.

5.6.2 Monitoring and evaluation

Governments also need to continually monitor and evaluate their tax regimes and provide feedback loops to improve policy based on those evaluations. This involves undertaking tax expenditure accounting.⁷⁰ Sunset clauses⁷¹ should be formally included in all tax incentive legislation, and effective tax rates should be systematically calculated, published and considered in tax policy elaboration.

Bulgaria has implemented the strongest tax policy monitoring and evaluation in the region. According to the Government, both tax expenditure accounting and the calculation of effective tax rates are routinely undertaken (the figures are not made public). Sunset clauses have been included in a limited amount of tax incentive legislation.

Albania, both entities of Bosnia and Herzegovina, FYR Macedonia, Moldova, Montenegro and Serbia have all – at some point – conducted tax expenditure accounting and/or calculated effective tax rates, although these are not undertaken systematically or published. They are

usually carried out as isolated cases with the aid of international organisations.

Croatia and Romania do not report on tax expenditures and have not calculated effective tax rates except in isolated cases. There are no sunset clauses in any of their tax incentive legislation.

5.6.3 Communication and information access

Effective public dissemination of information and procedural requirements for taxation policy are essential to ensure full compliance by taxpayers.

In Bulgaria, Croatia and Romania it is easy to obtain access to information on taxation policy. All relevant information can be found online and in English (in Bulgaria the information provided in English is more limited). Numerous pamphlets and handbooks exist to aid taxpayers. All three countries have set up tax information centres.

Albania and Montenegro have recently improved public access to information on taxation issues. Both countries have established hotlines to assist taxpayers, as well as set up taxpayer information centres. Online information is generally limited to tax laws; the availability of information in English could still be improved. A similar situation exists in both entities of Bosnia and Herzegovina, FYR Macedonia and Serbia, where taxpayer information is still somewhat limited.

5.6.4 IRI results for transparency

The evaluation of the transparency sub-dimension has resulted in the scores in Table 5.10, describing the current situation in each of the nine target countries.

Bulgaria has the highest transparency scores for tax policy within the SEE region, with good consultation mechanisms, relatively easy access to information and the basic tools for monitoring and evaluation. The other SEE countries follow very closely in consultation and

⁷⁰ Tax expenditure accounting determine the revenue lost due to tax incentives.

⁷¹ 'Sunset clauses' call for the expiry of the incentive to which they are attached (e.g. three years after implementation), in order to provide an opportunity for assessment to assess whether the incentive should be extended or not.

TABLE 5.10
IRI SCORES FOR TRANSPARENCY⁷²

Albania	Bosnia and Herzegovina Federation of Bosnia and Herzegovina	Republika Srpska	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
3	2	2	3.75	3.25	2.50	2.50	3.25	2.75	3

Source: OECD Investment Compact.

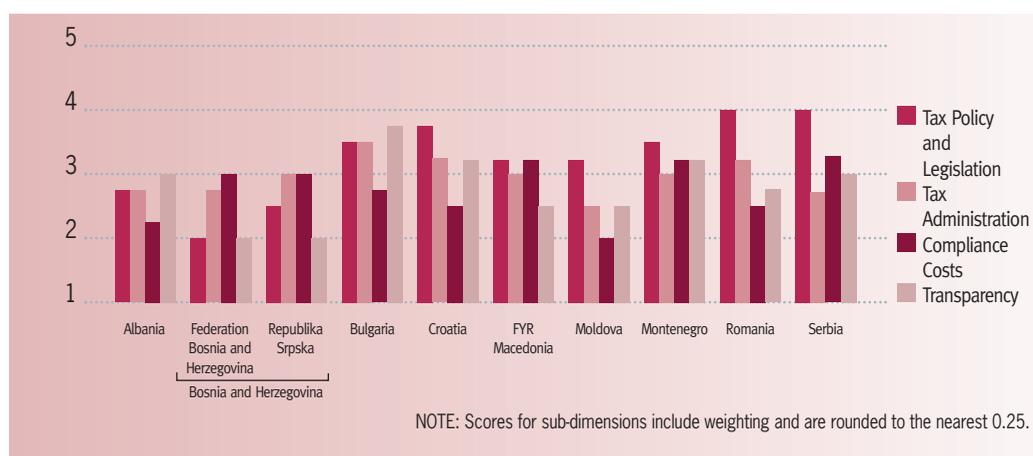
access to information, but are much weaker in monitoring and evaluation.

5.7 Key actions to consider at the regional level

1. Improve transfer pricing legislation by drafting clear and comprehensive implementation instructions, including documentation requirements, and ensure supervision and enforcement of these rules.
2. Improve tax administration capacity through more systematic training of tax officials, especially auditors.
3. Implement taxpayer audit strategies based on risk analysis.
4. Systematically monitor VAT reimbursements.
5. Calculate and communicate the overall tax burden.

IRI SCORES FOR TAX POLICY

FIGURE 5.6 – TAX POLICY: SCORES BY SUB-DIMENSION



Source: OECD Investment Compact.

⁷²The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

Tax policy and legislation

- Most countries have put into place tax policies and legislation that are in line with international standards, and have scores at 3 or above. In Bosnia and Herzegovina, the two entities score the lowest due to restrictive depreciation regimes, limited tax treaty networks, and in the case of the Federation the highest corporate tax rate in the region (30%). Transfer pricing regulations remain an issue across SEE countries.

Tax administration

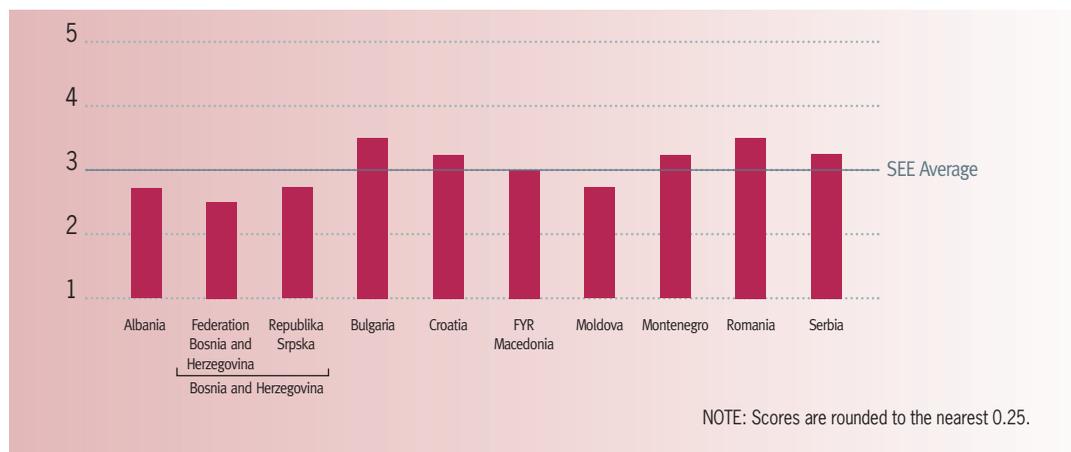
- Only Bulgaria, Croatia and Romania score above a 3 for the tax administration sub-dimension. The average score is lower than for the tax policy and legislation sub-dimension due to a high level of tax inspections and the weak capacity of the revenue collection agencies.

Compliance costs

- Compliance costs in SEE are high overall, particularly in Albania, Bulgaria, Croatia, Moldova and Romania. Bulgaria is actively introducing online tax filing to reduce the time it takes to file taxes.

Transparency

- Bulgaria has the highest transparency scores for tax policy within the SEE region with good consultation mechanisms, relatively easy access to information and the basic tools for monitoring and evaluation. The other SEE countries follow very closely in consultation and access to information but are much weaker in monitoring and evaluation.

FIGURE 5.7 – OVERALL SCORES FOR TAX POLICY

Source: OECD Investment Compact.

- Significant improvements have been made for tax policy and legislation, with attractive corporate tax rates.
- Weak tax administration lowers the overall score for tax policy to 3.

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Federation of Bosnia and Herzegovina (Federal Ministry of Finance): www.fmf.gov.ba

Bulgaria (Ministry of Finance): www.minfin.government.bg

Croatia (Ministry of Finance): www.mfin.hr

FYR Macedonia (Ministry of Finance): www.finance.gov.mk

Montenegro (Ministry of Finance): www.vlada.cg.yu/minfin

Romania (Ministry of Public Finance): www.mfinante.ro

Serbia (Ministry of Finance): www.mfin.sr.gov.yu

UNMIK/Kosovo (Ministry of Finance and Economy): www.mfe-ks.org

Tax administrations:

Albania (General Taxation Department): www.tatime.gov.al

Federation of Bosnia and Herzegovina (Taxation Office): www.fmf.gov.ba

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European Bank for Reconstruction and Development: www.ebrd.com

European Commission Taxation and Customs Union, Taxation:
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International Monetary Fund: www.imf.org

International Tax Dialogue: www.itdweb.org

Intra-European Organisations of Tax Administrations: www.iota-tax.org

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Chapter 6

Anti-Corruption and Business Integrity

Anti-corruption and business integrity is one of the weaker policy dimensions in South East Europe. While laws and institutions are in place to fight corruption, there is little evidence of enforcement. There are too few investigations, prosecutions and convictions on corruption charges. Corruption in tax and customs has been reduced by streamlining administrative processes but conflict of interest for civil servants and public procurement remain a problem. Increasing transparency through monitoring and public/private consultations would help clean up the system and improve the region's image.

Anti-Corruption and Business Integrity

6.1 Introduction

Corruption can be defined as ‘the misuse of entrusted power for private benefit.’⁷³ It is a major constraint on doing business in emerging countries. Empirical research confirms that high levels of corruption negatively affect capital inflows, investment rates and economic growth.⁷⁴

By all accounts, corruption is a serious problem in South East Europe (SEE). Perceived levels of corruption are high. Of 159 countries included in the Transparency International (TI) Corruption Perceptions Index (CPI) in 2005, SEE countries ranked between 55 and 126 (a rank of 1 indicates the country that is perceived as the least corrupt or ‘cleanest’) as shown in Table 6.1. Only Bulgaria and Croatia are ranked above the median

(Transparency International, 2005). The 2005 CPI score in SEE is approximately the same as that in 2003, with no notable improvement.

Perceived levels of corruption are higher in SEE than in Central and Eastern Europe. According to the EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS)⁷⁵ nearly 50% of firms surveyed in SEE countries in 2005 reported that corruption represented a problem in doing business, compared with roughly 32% of firms in the eight new European Union (EU) member countries (EU-8) (EBRD-World Bank, 2005) as shown in Figure 6.1 and Figure 6.2.⁷⁶

TABLE 6.1
TRANSPARENCY INTERNATIONAL CORRUPTION PERCEPTIONS INDEX RANKINGS, 2005

Country	TI 2005 CPI Country Rank	Countries with the Same Rank (most corrupt to least corrupt)
Albania	126	Niger, Russia, Sierra Leone
FYR Macedonia	103	Gambia, Swaziland, Yemen
Serbia and Montenegro	97	Algeria, Argentina, Madagascar, Malawi, Mozambique
Bosnia and Herzegovina, Moldova	88	Armenia, Benin, Gabon, India, Iran, Mali, Tanzania
Romania	85	Dominican Republic, Mongolia
Croatia	70	Burkina Faso, Egypt, Lesotho, Poland, Saudi Arabia, Syria
Bulgaria	55	Colombia, Fiji, Seychelles

Source: Transparency International.

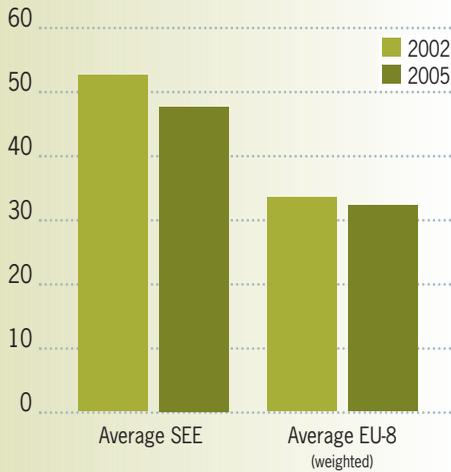
⁷³ Transparency International (www.transparency.org).

⁷⁴ For an overview of the existing literature, see Tanzi (1998) Graf Lambsdorff (1997) and Lanyi (2004).

⁷⁵ The Business Environment and Enterprise Performance Survey (BEEPS), developed jointly by the World Bank and the European Bank for Reconstruction and Development, is a survey of firms in transition countries that examines a wide range of interactions between firms and the state. Based on face-to-face interviews with firm managers and owners, BEEPS is designed to generate comparative measurements in such areas as corruption, state capture, lobbying, and the quality of the business environment, which can then be related to specific firm characteristics and firm performance. For more information on the survey, the BEEPS research project and related papers, see http://www.worldbank.org/wbi/governance/pubs_statecapture/.

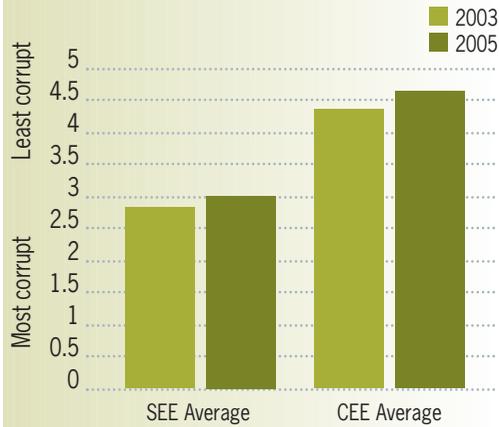
⁷⁶ The EU-8 countries are the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.

FIGURE 6.1 – PERCENTAGE OF FIRMS INDICATING CORRUPTION AS A PROBLEM IN DOING BUSINESS IN SEE AND THE EU-8



Source: EBRD/World Bank BEEPS.

FIGURE 6.2 – TRANSPARENCY INTERNATIONAL CORRUPTION PERCEPTIONS INDEX SCORES, SEE AND CEE⁷⁷

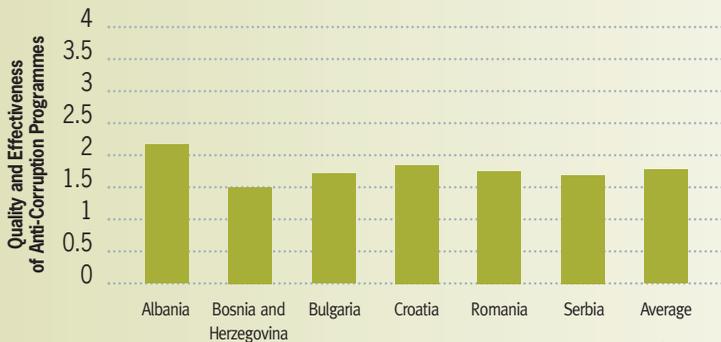


Source: Transparency International (2005).

Perceptions of corruption in SEE are reinforced by concrete feedback from investors. Focus group interviews carried out in 2004 for the Investment Compact's Enterprise Policy Performance

Assessments (EPPAs) revealed that small business owners were sceptical about the quality and effectiveness of government anti-corruption programmes (see Figure 6.3).

FIGURE 6.3 – EPPA 2004: QUALITY AND EFFECTIVENESS OF GOVERNMENT ANTI-CORRUPTION PROGRAMMES



Source: Investment Compact 2004 EPPA reports.

⁷⁷ Corruption is broadly defined by Transparency International as 'the misuse of public power for private benefit'. No distinction is made between administrative and political corruption, nor between petty and grand corruption.

Numerous business associations have addressed the issue of corruption in publications and in public statements. In 2006 the Business Advisory Council for South East Europe and the Regional Network of Foreign Investors Councils urged countries to increase their efforts to fight corruption, stating that: 'Corruption is an obstacle to doing business in SEE and undermines investment and economic growth. Governments should focus on implementing strong, comprehensive anti-corruption programmes.

Special emphasis should be placed on corruption in public procurement, tax administration and customs through the systematic application of the law and monitoring of results' (Business Advisory Council for South East Europe and the Regional Network of Foreign Investors, 2006).

SEE Governments recognise the negative social and economic effects of corruption and have made political commitments to intensify anti-corruption efforts. For example, the 2004

BOX 6.1

THE STABILITY PACT ANTI-CORRUPTION INITIATIVE (SPAI)

Mission Statement

The Stability Pact Anti-Corruption Initiative gives impetus to the fight against corruption in South Eastern Europe by building upon existing actions, through better coordination of all efforts, and by relying on high-level political commitment. Its objective is to assist and support the countries of the region to adopt efficient legislation, to establish effective institutions and to develop best practices in civil society for a joint sustained fight against corruption.

The SPAI Regional Secretariat Liaison Office (RSLO) is the executive body for SPAI. It serves as the focal point for regional anti-corruption cooperation in South Eastern Europe through the coordination, facilitation and dissemination of best practices and lessons learned.

Since 2000 the Stability Pact Anti-corruption Initiative (SPAI) has served as a forum for policy coordination and dialogue. It has adopted a multidisciplinary approach to anti-corruption, encouraging SEE countries to adopt international legal instruments, promote good governance, strengthen the rule of law, promote transparency and integrity in business operations, and develop an active civil society in the fight against corruption. Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Moldova, Montenegro, Romania and Serbia are members. Bulgaria and UNMIK/Kosovo have observer status.

Initially the SPAI secretariat was administered by the OECD and the Council of Europe. Since 2004 the Regional Secretariat Liaison Office (RSLO) in Sarajevo has assumed secretariat functions in order to increase regional ownership of the programme.

In 2005 SEE Ministers adopted the Declaration on Ten Joint Measures to Curb Corruption in South Eastern Europe. Each year SPAI countries report on progress in implementing the measures outlined in the declaration.

RSLO activities include:

- Fostering regional cooperation among institutions involved in the fight against corruption;
- Promoting the adoption of international anti-corruption standards;
- Developing training programmes for law enforcement professionals and public officials;
- Facilitating expert networking in government, civil society and the media.

Source: www.stabilitypact.org/anticorruption.

Investment Compact Ministerial Declaration states that ‘Ministers recognise that corruption is a major obstacle to the growth of the private sector. They support the existing anti-corruption initiatives in South East Europe, including the Stability Pact Anti-Corruption Initiative (SPAI) (see Box 6.1) and the recent Bucharest Declaration within the framework of South-East European Cooperation Process (SEECP)’ (Investment Compact for South East Europe, 2004). Through SPAI, SEE countries have committed to adopt international anti-corruption instruments, strengthen national legislation, promote integrity in business operations and promote an active civil society. SPAI helps countries to adopt international standards and promotes regional cooperation in the fight against corruption.

To a large extent, the anti-corruption and business integrity framework described in the next section is structured around political commitments made through Stability Pact Initiatives such as the Investment Compact and SPAI.

6.2 Assessment framework

The anti-corruption and business integrity framework is organised around four key elements (see Figure 6.4):

- An anti-corruption strategy and action plan;
- An anti-corruption legal framework and adoption of international conventions;

- Promotion of good governance and public administration;
- Policy transparency, monitoring, oversight and communication.

This framework does not attempt to evaluate all areas of corruption that can affect society as a whole. Rather, the focus is on areas which most directly affect the business environment and investments.

6.3 Anti-corruption strategy

Corruption is a complex phenomenon whose underlying causes differ from one country to another. There is no single recipe for an effective anti-corruption strategy. To fight corruption successfully, governments need to understand its extent and nature before they can define appropriate reforms involving public institutions, legislation, public sector management and civil society. To this end, it is important that governments have comprehensive anti-corruption strategies and action plans.

Anti-corruption strategies and action plans are useful tools to identify necessary measures, plan reforms and allocate resources. However, a strategy alone will not necessarily lead to the desired results. Without the political will and ownership to ensure implementation and policy effectiveness, anti-corruption programmes are of little value. For this reason, the IRI evaluation criteria include the

FIGURE 6.4 – ANTI-CORRUPTION AND BUSINESS INTEGRITY ASSESSMENT FRAMEWORK



Source: OECD Investment Compact.

level of implementation of respective anti-corruption strategies. Another shortcoming of national anti-corruption strategies is that they often do not address local, decentralised corruption issues. Governments should also take action to reduce corruption at the local and regional level in addition to the national level.

With the exception of Albania and Bosnia and Herzegovina,⁷⁸ all of the SEE countries have adopted comprehensive anti-corruption strategies, often with donor assistance and technical support from initiatives such as the Council of Europe's Programme against Corruption and Organised Crime Implementation of Anti-Corruption Plans in South-eastern Europe (CoE PACO IMPACT).⁷⁹ Bulgaria, FYR Macedonia, Moldova, Montenegro and Romania have adopted action plans to implement anti-corruption strategies. In Bosnia and Herzegovina⁸⁰, Croatia and Serbia action plans are either in the process of being drafted or have been drafted and are awaiting adoption. In Albania the newly elected Government has decided to change the anti-corruption programme. According to the Government, a working group has been established to develop the anti-corruption strategy as part of the National Strategy for Development and Integration. In Bosnia and Herzegovina the draft strategy still awaits adoption.

Implementation varies in those countries which have adopted action plans. Based on the Progress Report for the Implementation of the 2005 Action Plan for Moldova, the Government reports that the majority of items planned for 2005 were implemented. Closer inspection reveals that many actions are vaguely defined; it is unclear to what extent they were successfully accomplished. In FYR Macedonia the State Commission for the Prevention of Corruption elaborated a national anti-corruption programme and an action plan, but this programme was never officially adopted or endorsed by the Government.⁸¹ Since the most

recent implementation progress report made available by the Government is from June 2004, it is difficult to assess the extent to which the programme has been realised to date. The action plan in Montenegro was only adopted in August 2006, so it is too soon to evaluate implementation.

In Bulgaria all ministries have accomplished at least 50% of actions foreseen for 2004-05, with more than half of the listed bodies accomplishing more than 70% of the tasks assigned for the period (Government of Bulgaria, 2006). There is a new strategy for 2006-08, but it is too soon to evaluate progress in its implementation.

Romania has adopted an Action Plan to Implement the National Anti-Corruption Strategy for 2005-07. Half of the 52 actions had been accomplished by early 2006, according to Romanian officials. An independent audit of the former anti-corruption strategy was conducted, and the results were incorporated into the updated strategy for 2005-07.

Of course, implementation of annual action plans does not necessarily translate instantly into reduced levels of corruption. However, some of these actions are important prerequisites for reduced corruption levels. For example, Bulgaria has adopted a Code of Conduct for the public administration and developed specific codes of conduct for certain sectors (e.g. a Code of Conduct for officials of the Ministry of Interior). The customs administration has also undergone major reform, including restructuring of the customs intelligence and investigation directorate. A new module on customs ethics and counteracting corruption is now included in mandatory training of all newly appointed customs officers.

In Romania several codes of conduct have been developed, the legislative framework has been amended, and sector-specific anti-corruption strategies have been developed in sensitive areas

⁷⁸ Although Bosnia and Herzegovina does not have a comprehensive anti-corruption strategy, a chapter in the *Mid-Term Development Strategy* (or 'Poverty Reduction Strategy Paper') addresses anti-corruption.

⁷⁹ PACO IMPACT is financed by the Swedish International Development and Co-operation Agency (SIDA).

⁸⁰ During a mission to Sarajevo, experts at the Office of the High Representative (OHR) informed the *Investment Compact* that the action plan is included in the draft anti-corruption strategy awaiting adoption in Bosnia and Herzegovina.

⁸¹ While there is no legal obligation for the Government to adopt the plan, such endorsement would show its commitment to implementing the programme.

such as customs. The process of assigning precise actions and responsibilities is in itself a signal to the investor community that a government is taking charge of the fight against corruption. Greater emphasis should be put on implementing existing strategies and communicating progress to the investor community and public at large.

6.3.1 IRI results for anti-corruption strategy

The Anti-corruption Strategy and Action Plan sub-dimension were assessed by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the target countries following the process described in the Chapter 1 of this report. This resulted in the scores in Table 6.2, describing the current situation in each of the nine target countries covered by the IRI.

With a score of 4, Bulgaria and Romania are the only two countries in SEE that have a clear anti-corruption strategy and action plan with some evidence of implementation.

6.4 Anti-corruption legal framework and adoption of international conventions

An anti-corruption strategy needs to be supported by an appropriate legal landscape, including:

- Adoption of key international conventions;
- Appropriate criminal legislation in the field of corruption, with enforcement of these laws.

6.4.1 Ratification of relevant international conventions

The SEE countries have signed the main international conventions on corruption. All of them have signed the key Council of Europe (CoE) conventions.⁸² All countries except Moldova and Montenegro have signed the United Nations Convention against Corruption; four countries have already ratified it (see Table 6.3).

It should also be noted that Bulgaria is a signatory to the OECD Anti-Bribery Convention, which addresses the criminalisation of bribery of foreign public officials.

TABLE 6.2
IRI SCORES FOR ANTI-CORRUPTION STRATEGY AND ACTION PLAN⁸²

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
1.50	1.50	4	2	3	3.50	3	4	2

Source: OECD Investment Compact.

TABLE 6.3
ADOPTION OF RELEVANT INTERNATIONAL CONVENTIONS IN SEE

Country	CoE Civil Law Convention		CoE Criminal Law Convention		CoE Convention on Laundering, Search, Seizure		UN Convention against Corruption	
	Signed	Ratified	Signed	Ratified	Signed	Ratified	Signed	Ratified
Albania	Y	Y	Y	Y	Y	Y	Y	Y
Bosnia and Herzegovina	Y	Y	Y	Y	Y	N	Y	N
Bulgaria	Y	Y	Y	Y	Y	Y	Y	N
Croatia	Y	Y	Y	Y	Y	Y	Y	Y
FYR Macedonia	Y	Y	Y	Y	Y	Y	Y	N
Moldova	Y	Y	Y	Y	Y	Y	N	N
Montenegro	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Romania	Y	Y	Y	Y	Y	Y	Y	Y
Serbia	Y	N	Y	Y	Y	Y	Y	Y

Source: Council of Europe, United Nations, governments of SEE countries.

⁸² The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

⁸³ The CoE Civil Law Convention must still be ratified by Serbia. Due to the recent independence of Montenegro, there has not been sufficient time for it to sign and ratify the international conventions mentioned in this section. Therefore, Montenegro's performance has not been evaluated in this area.

6.4.2 Criminalisation of corruption: elements of offence

Consistent with these international conventions, SEE countries have taken steps to strengthen their legislation. They have amended their criminal codes to bring them into line with international standards, adopting laws that criminalise active and passive bribery, money laundering and trading in influence. Bosnia-Herzegovina, Bulgaria, Croatia and Romania all have criminal legislation addressing the elements of offence analysed.⁸⁴ Further amendments are needed in countries, including Albania, FYR Macedonia, Moldova, Montenegro and Serbia. Of the elements of offence analysed in this report, the main issue that most countries must still address is the full establishment of criminal liability for legal persons (i.e. corporations) as required by the CoE and UN conventions.

Although the main elements of legislation are largely in place, enforcement needs to be improved. For example, in 2005 the Group of States against Corruption (GRECO) reported that in Albania during the previous three years no money laundering cases had been prosecuted (GRECO, 2005a). The European Commission (EC) found that the same was true in Bulgaria (EC, 2005a).

In other countries there are signs of an upward trend in prosecutions and convictions. In 2006 the EC reported that in Romania there had been an increase in investigations, indictments and convictions between October 2005 and May 2006 (EC, 2006a).

6.4.3 IRI results for anti-corruption legal framework and adoption of international conventions

The evaluation of the anti-corruption legal framework and adoption of international conventions sub-dimension has resulted in the scores in Table 6.4, describing the current situation in each of the nine target countries.

Romania, Croatia and Bulgaria have the highest scores because they have both signed the main international conventions on corruption and adopted appropriate criminal legislation with mechanisms of enforcement. Serbia, Moldova, FYR Macedonia and Montenegro still have incomplete legislation on criminalisation of corruption, namely no criminal liability of legal persons.

6.5 Promotion of good governance and reliable public administration⁸⁶

Good governance is said to exist when a government is capable of effectively implementing policies and providing services that are responsive to the needs of citizens. Corruption in public administration is often the result of poor governance practices.

Good governance and public administration reform needs to address at least the following four areas:

- The development of a conflict of interest policy for civil servants;
- Anti-corruption measures in public procurement;
- Anti-corruption measures in the customs administration;

TABLE 6.4

IRI SCORES FOR ANTI-CORRUPTION LEGAL FRAMEWORK AND ADOPTION OF INTERNATIONAL CONVENTIONS⁸⁵

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
3.50	3.25	3.75	4	3	3	2.50	4.50	3

Source: OECD Investment Compact.

⁸⁴ The criminal offences considered in this section include: active bribery, passive bribery, trading in influence, money laundering, and the establishment of criminal liability of legal persons for these offences. International conventions include numerous other offences and anti-corruption measures which are not addressed in this assessment.

⁸⁵ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

⁸⁶ The 2006 evaluation of anti-corruption measures in public procurement, customs and tax administration in the SEE countries is mainly based on perceptions data from EBRD/World Bank BEEPS. Data for Serbia and Montenegro have been disaggregated, allowing for separate evaluations of the two countries. However, the BEEPS sample for Montenegro was very small (less than 20 firms) and results should be interpreted accordingly.

- Anti-corruption measures in the tax administration.

6.5.1 Conflict of interest policy for civil servants

A key element of good governance is the concept of the rule of law, under which the public administration is required to perform its duties according to legal guidelines in a predictable, impartial manner in accordance with the public interest. If conflicts are not properly managed, there is a serious risk that public employees will make decisions based on their own private interests and will abuse their power.

There is no single way to incorporate conflict of interest provisions into the regulatory framework. While some SEE countries have specific conflict of interest laws, Bulgaria, FYR Macedonia, Moldova and Romania have chosen to address conflict of interest in other legislation and regulations, e.g. civil service laws, anti-corruption laws and codes of ethics. Conflict of interest laws are currently under preparation in FYR Macedonia and Moldova. Even in countries that have adopted conflict of interest laws, conflict of interest rules are often defined in several different places.

It is beyond the scope of this study to present a detailed analysis of conflict of interest policy in all branches of government. Nevertheless, it is possible to carry out a basic assessment of the laws and regulations applying to civil servants.

The OECD Guidelines for Managing Conflict of Interest in the Public Sector (OECD, 2003) ask four main questions:

- Is the definition of conflict of interest in line with that recommended in the OECD Guidelines?
- Are civil servants required to make decisions without regard to their personal interest?
- Must civil servants declare all relevant private interests that potentially conflict with official duty when they take office?
- Are civil servants subsequently required to notify the appropriate body when any changes lead to an emergent conflict of interest situation?

Based on the OECD Guidelines, it is clear that in several cases SEE countries' conflict of interest policies and definitions need to be refined in order to be effective. Definitions of conflict of interest are often confused. For instance, Montenegro's Law on Conflict of Interests 2004 states that there is a conflict of interest 'when a public official gives priority to a private interest over a public interest so as to gain material benefit or privilege for himself or persons connected to him.'

In fact, this is the definition of abuse of office or corruption rather than of conflict of interest. Article 49 of the Law on Civil Servants and State Employees (2004) states that civil servants may not perform actions that could cause a conflict between public duties and their private interest. However, in this case a conflict of interest is not defined, nor is a private interest.

Conflict of interest, according to the OECD Guidelines, is 'a conflict between the public duties and private interests of a public official, in which the public official has private-capacity interests which could improperly influence the performance of their official duties and responsibilities' (OECD, 2003).

The OECD Guidelines also state that private interest should not be limited to financial or pecuniary interests, or interests that generate direct personal benefit to the public official. Conflict of interest can include private capacity activity, personal affiliations, and associations and family interests if those interests could improperly influence the official's performance of duties (i.e. disinterested decision-making/impartiality).

In Romania conflict of interest is defined in anti-corruption legislation, but the definition of private interest is restricted to financial interests. The Government of Romania is in the process of enlarging the definition of private interests.

Similar issues of definition emerge with respect to the conflict of interest policies of other SEE countries. Definitions that are opaque or subject

to wide interpretation make it more difficult to enforce conflict of interest provisions properly. SEE countries need to ensure that conflict of interest policies are clear, coherent and in line with OECD standards before enforcement can be truly effective. FYR Macedonia and Moldova are in the process of revising their conflict of interest policies.

6.5.2 Public procurement

Public procurement is an area that is particularly susceptible to corruption. The goal of modern public procurement systems is to deliver efficiency and 'value for money' in the use of public funds whilst adhering to public procurement legislation based on the fundamental principles of transparency, non-discrimination, mutual recognition and proportionality. Nevertheless, it is easy to see how public officials might be tempted to use their authority or influence to further their personal interests, namely by soliciting or accepting bribes.

OECD experience shows that transparency is an important prerequisite for ensuring integrity in government procurement. Transparency typically includes (OECD, 2005a; SIGMA, 1997):

- Development of a clear set of pre-tender documents laying down the procurement rules and all conditions necessary for the preparation of tenders which are fully accessible to bidders;
- Widespread use of open competition procedures, under which contracting entities publicise contract opportunities; non-open tender procedures should only be allowed in exceptional circumstances;
- Announcements clearly explaining selection and award criteria;
- Public disclosure of the name of the selected bidder, as well as the names and bids of all firms that submitted bids following selection;
- Availability of a complaints review and remedies mechanism which provides a possibility for a dissatisfied tender to lodge a complaint or request damages at an independent review body.

Ensuring integrity in procurement involves more than just transparent procedures. Participants in the OECD Global Forum on 'Governance – Fighting Corruption and Promoting Integrity in Public Procurement' in 2004 identified the following additional tools to promote integrity and fight corruption in public procurement (results summarised in OECD, 2005a):

- New technologies such as e-procurement;
- Provision and promotion of needed skills and training for procurement personnel;
- Mapping of risk areas at all stages of the procurement process;
- Accounting, auditing and reporting;
- Sanctioning of misconduct and corruption through such tools as disbarment or 'blacklisting'.

In the context of EU accession, SEE countries need to adopt procurement legislation aligned with the EC Directives and the fundamental principles of the European Treaty such as transparency, equal treatment, free competition, mutual recognition and proportionality (see Table 6.5).

SEE countries have made good progress in adopting legislation that approximates the requirements of the *acquis communautaire*. They still need to adopt changes in order to be fully aligned with the EC Directives.

The main problem in SEE countries has been the difficulty of creating strong institutions to ensure implementation. Agencies and departments in

TABLE 6.5
PUBLIC PROCUREMENT LAWS
AND YEARS OF ADOPTION

Country	Year of Public Procurement Law
Albania	2003
Bosnia and Herzegovina	2004
Bulgaria	2004
Croatia	2001
FYR Macedonia	2004
Moldova	1997
Montenegro	2001
Romania	2002
Serbia	2002

Source: Support for Improvement in Governance and Management (SIGMA).

all countries are weak and poorly funded and lack the resources they need. In some cases public procurement agencies have not even been established. For example, a Law on Public Procurement was adopted by Bosnia and Herzegovina in 2004. The law calls for the creation of a Public Procurement Agency within three months of its entry into force. As of September 2006, however, this agency had not begun to operate. As the agency is meant to define implementation regulations and guidelines and to ensure proper implementation of the Public Procurement Law, it is difficult to see how this law can be enforced.

Weak institutions and poor implementation of legislation have contributed to the continued perception by the private sector that there is a high level of corruption in government procurement.

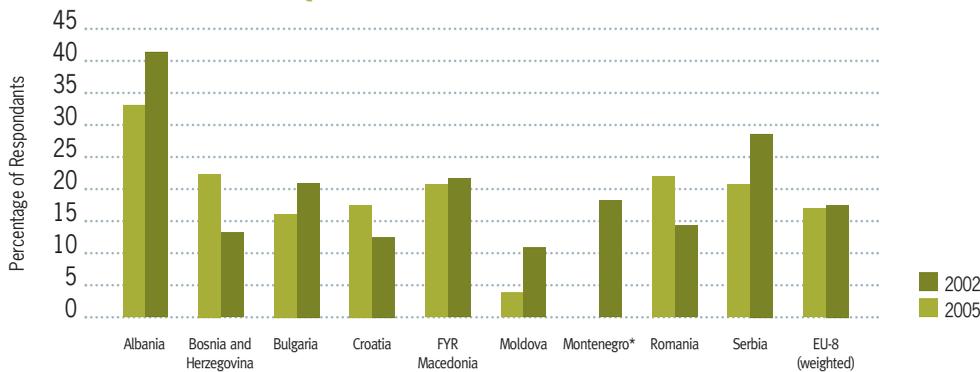
On average, 20% of BEEPS firms surveyed in SEE countries responded that in 2005 bribery was

frequently practiced in obtaining government contracts (see Figure 6.5).

More troubling than the actual level of perceived corruption in public procurement is the trend over time. In Albania, Bulgaria, FYR Macedonia, Moldova and Serbia perceptions worsened from 2002 to 2005. Despite improvements in the public procurement legislation, in many countries integrity in public procurement does not seem to be improving.

There is significant variation among countries. In Albania over 40% of firms indicated that bribery was frequent in public procurement in 2005. In Bulgaria, FYR Macedonia, Montenegro* and Serbia between 20 and 30% indicated that this was the case. In Bosnia and Herzegovina, Croatia, Moldova and Romania between 10 and 20% of respondents said that bribery was frequent in obtaining government contracts (EBRD/World Bank, 2005).

FIGURE 6.5 – PERCENTAGE OF FIRMS IN EACH COUNTRY RESPONDING THAT BRIBERY IS FREQUENT IN OBTAINING GOVERNMENT CONTRACTS



Source: EBRD/World Bank.
 * The BEEPS sample used for Montenegro in 2005 was very small; results should be interpreted with caution. 2002 data for Montenegro not available.

6.5.3 Tax administration

The introduction of a number of reforms in the tax policy area has reduced opportunities for corruption in tax administration. These reforms include simpler, flat corporate income taxes; the adoption of new tax codes; and the limitation of the discretionary power of tax officials.

Countries have also made an effort to improve tax administration. Bulgaria, Croatia and FYR Macedonia have adopted codes of conduct for tax officials. In Bulgaria the code was distributed to all employees and widely publicised. A hotline was set up to report corruption in tax administration. Bulgaria, Croatia, Moldova and Romania have implemented some form of online tax filing. Most countries have consolidated tax inspection functions into one authority to reduce the frequency of tax inspections.⁸⁷

Improvement in tax administration is reflected in private sector perceptions that SEE countries have made significant progress in reducing corruption in tax administration in the past several years, even if their performance is still poor compared with that of the EU-8 countries. The percentage of SEE firms indicating that

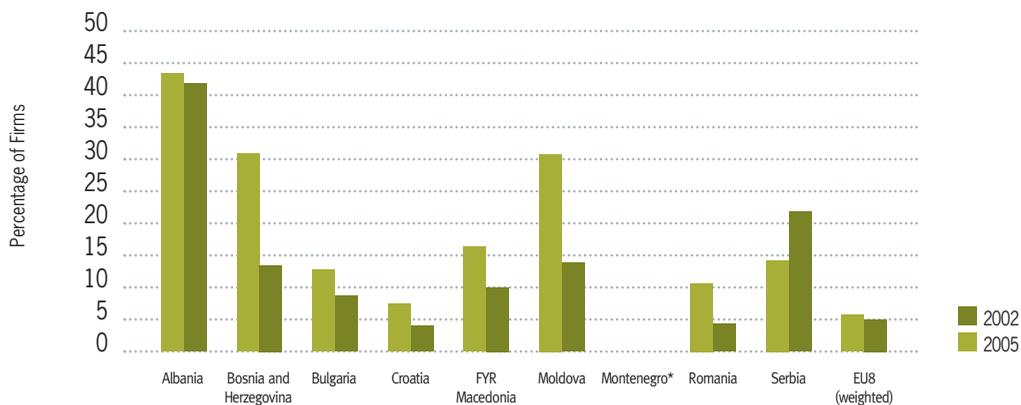
bribery was frequent in tax administration decreased in nearly all countries between 2002 and 2005 (see Figure 6.6). Again, results vary across countries. In Croatia and Romania less than 5% of firms said that bribery was frequent in dealings with taxes and tax collection in 2005, compared with over 40% in Albania (EBRD/World Bank, 2005).

Despite a marked improvement in perceptions of corruption in tax administration, much remains to be done to reduce opportunities and incentives for corruption in tax administration. Investment Compact interviews with associations of foreign investors highlighted that foreign investors were subject to an unusually high number of tax inspections. Multiple secondary and local taxes add complexity to tax administration and are likely to increase opportunities for corruption. Lingering problems with VAT reimbursements in SEE countries also create opportunities for corruption (Anderson and Gray, 2006).

6.5.4 Customs administration

Corruption in customs administration stems from the discretion that customs officers have

FIGURE 6.6 – PERCENTAGE OF FIRMS RESPONDING THAT BRIBERY IS FREQUENT IN TAX COLLECTION AND ADMINISTRATION



Source: EBRD/World Bank.

* The BEEPS sample used for Montenegro in 2005 was very small; results should be interpreted with caution. 2002 data for Montenegro not available.

⁸⁷ For further details, see Chapter 5. Tax Policy.

with respect to acceptance of invoices, classification of goods and inspections. Complex, slow and inefficient customs administrations that lack clear rules and procedures (coupled with high customs duties) create an environment that favours corruption.

According to the World Customs Organization (WCO) the leading international authority in this area, and the revised Arusha Declaration, members should adopt and implement effective integrity programmes for customs addressing the following elements (WCO, 2003):

- A regulatory framework (e.g. simplified laws, regulations and procedures and moderate customs duties);
- Transparency (e.g. law, regulations, procedures and administrative guidelines should be clear and publicly available);
- Automation;
- Reform and modernisation;
- Audit and investigation;
- A code of conduct;
- Human resource management (e.g. adequate pay for officers, merit-based recruitment and promotion practices, rotation of staff and training);
- A relationship with the private sector.

SEE countries have streamlined areas of customs administration through participation in the Trade and Transport Facilitation in Southeast Europe (TTFSE) programme. This programme, sponsored by the World Bank, the United States and the EU, has produced positive results, with entry and clearance times showing a downward trend at nearly all border crossings (Anderson and Gray, 2006).⁸⁸

Another positive development has been the increased use of automation, which reduces discretion on the part of customs officers and speeds up customs procedures. Bulgaria uses the Bulgarian Integrated Customs Information System (BICIS). Albania, FYR Macedonia and Moldova operate ASYCUDA.⁸⁹

As recommended by the WCO, codes of ethics or behaviour for customs officers have been adopted in Bulgaria, Albania, FYR Macedonia and Romania. Croatia and Montenegro have drafted codes; Moldova plans to develop one.

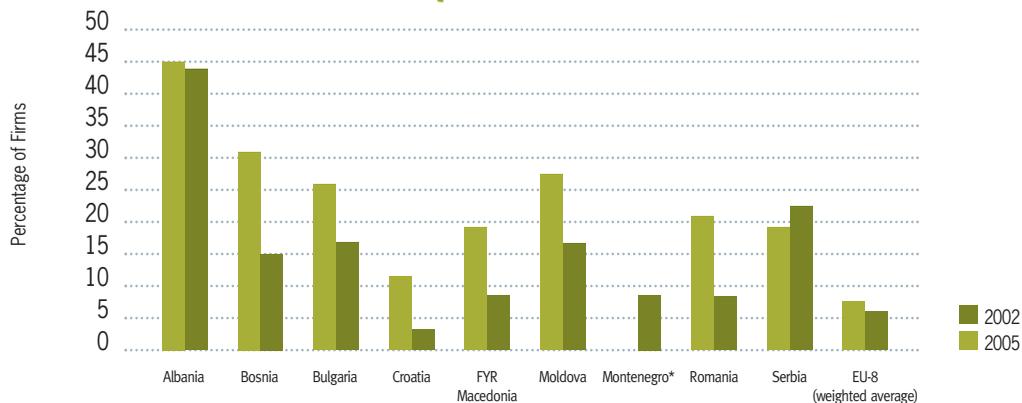
Overall, it appears that customs reforms have resulted in cleaner customs administrations. Some of the most impressive progress in the region has been made in this area (see Figure 6.7). In Albania, Bulgaria, Croatia, FYR Macedonia, Moldova and Romania perceived corruption levels in customs administration have declined over the past several years (EBRD/World Bank, 2005). Changes are particularly significant in Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Moldova and Romania.

Nevertheless, as with tax administration, customs administration has room for improvement. Corruption in customs is still high compared with that in the recent EU accession countries. As will be discussed Chapter 8 of this Report on Trade Policy, import/export requirements remain burdensome, total import/export times remain high and numerous documents are required, all generating opportunities for corruption. Furthermore, corruption in customs administration is still very common in Albania and Serbia.

⁸⁸ For more detailed information on clearance times, see Figure 8.9 in the Chapter 8. Trade Policy.

⁸⁹ ASYCUDA is a computerised customs management system developed by UNCTAD which covers most foreign trade procedures. The system handles manifests and customs declarations, accounting procedures, and transit and suspense procedures (www.asycuda.org).

FIGURE 6.7 – PERCENTAGE OF FIRMS RESPONDING THAT BRIBERY IS FREQUENT IN CUSTOMS ADMINISTRATION



Source: EBRD/World Bank.

* The BEEPS sample used for Montenegro in 2005 was very small; results should be interpreted with caution. 2002 data for Montenegro not available.

6.5.5 IRI results for promotion of good governance and reliable public administration

The evaluation of the promotion of good governance and public administration sub-dimension has resulted in the scores in Table 6.6, describing the current situation in each of the nine target countries.

Croatia and Romania receive highest scores for the promotion of good governance and public administration mainly due to significant improvements in tax and customs administration. However, public procurement and conflict of interest remain an area of concern for all SEE countries. With a score of only 1.75, Albania shows the highest gap between legislation in place and perceived levels of corruption.

6.6 Transparency

Evaluation of anti-corruption policy transparency is based on the following components:

- Public/private consultation on anti-corruption policy;
- Monitoring and evaluation of policy and impact;
- Functioning of oversight bodies, such as supreme audit institutions and ombudsmen.

6.6.1 Public/private consultation

OECD experience shows that partnering with private sector organisations can greatly increase the quality of policies and improve implementation.

Mechanisms for public/private consultation on anti-corruption policy are still in the early stages of development in SEE. It appears that the private

TABLE 6.6

IRI SCORES FOR PROMOTION OF GOOD GOVERNANCE AND RELIABLE PUBLIC ADMINISTRATION⁹⁰

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
1.75	3	3	4.25	3.50	3.25	3.50	4	2.50

Source: OECD Investment Compact.

⁹⁰ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

sector has been consulted in several countries on an ad hoc basis. For example, several countries have consulted with the private sector while drafting anti-corruption strategies and action plans. However, few countries have institutionalised a system ensuring regular public/private consultation. Several countries report that they plan to develop procedures for consultation with the private sector on anti-corruption policy.

Bulgaria and Romania are more advanced than other SEE countries in this area. According to Bulgarian officials, active consultations with the private sector are envisioned in the new strategy through public discussions and round tables with NGOs and business representatives, to be held four times per year. Regional councils for preventing and counteracting corruption have been established in 24 regions, and board members include private sector representatives. In Romania monthly meetings are held with the private sector through the OECD Romania Anticorruption Pilot Project.

6.6.2 Monitoring and evaluation

Effective implementation of anti-corruption policy, like all other policy areas, requires regular monitoring and evaluation by governments.

Some SEE countries, including Bulgaria, FYR Macedonia, Moldova and Romania, have clearly addressed the task of monitoring the implementation of anti-corruption strategies. In some cases monitoring bodies have been created, as in Moldova. In other cases, the agency or commission responsible for anti-corruption matters is responsible for monitoring implementation, as in FYR Macedonia.

In Croatia and Montenegro specific bodies will be created to monitor implementation of anti-corruption strategies. In Albania the Anti-Corruption Monitoring Group, which used to report regularly on implementation of the former anti-corruption strategy and action plan, no longer exists. According to the Government, policy monitoring mechanisms consist of the Prime Minister reporting to Parliament periodically.

In Bosnia and Herzegovina no body is responsible for monitoring anti-corruption policy.⁹¹

While some countries are monitoring implementation of strategies and action plans, governments need to develop more tools to evaluate policy impact and study the development of corruption trends in various areas over time. These findings should then be used to update and modify anti-corruption policy.

6.6.3 Oversight bodies

All SEE countries have adopted legislation creating supreme audit institutions and ombudsmen. The supreme audit institutions and offices of the ombudsman are staffed and currently operational in all countries except Serbia.

Although the activities of oversight bodies like supreme audit institutions and ombudsmen can increase the transparency of the functioning of an anti-corruption policy, their legal tasks do not, in principle, focus on anti-corruption.

6.6.4 Communications and information

SEE countries have not yet implemented large public awareness campaigns on corruption. Some countries have carried out small projects aimed at raising awareness. In FYR Macedonia leaflets with anti-corruption messages were distributed to the wider public. In Bulgaria the government foresees an anti-corruption education programme for radio and television. In Romania public awareness is included in the 2005-07 plan; Croatia plans to include public awareness in the 2006-08 programme.

6.6.5 IRI results for transparency

The evaluation of the transparency sub-dimension has resulted in the scores in Table 6.7, describing the current situation in each of the nine target countries.

Bulgaria, Romania and Moldova score higher than their peers primarily because of better public/private consultations. Five out of the nine SEE countries score below 3 due to limited public/private consultations, monitoring and evaluation and communication.

⁹¹ It should be noted that the Unit for Economic Policy Planning and Implementation of Bosnia and Herzegovina's Medium-Term Strategy (EPPU) monitors implementation of anti-corruption measures in the Mid-Term Development Strategy.

TABLE 6.7
IRI SCORES FOR TRANSPARENCY⁹²

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.25	2.25	4	2.75	3	3.75	2.50	4	2.25

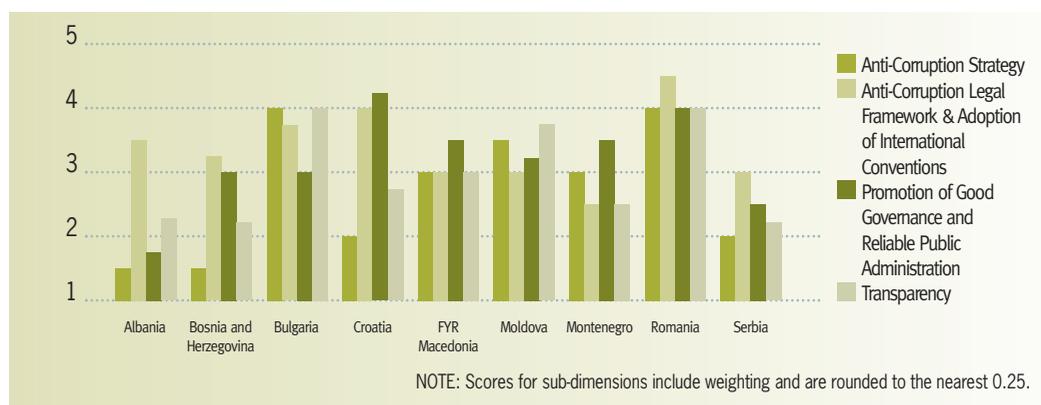
Source: OECD Investment Compact.

6.7 Key actions to consider at the regional level

1. Strengthen further legislative frameworks to ensure consistency with international standards and conventions.
2. Increase numbers of investigations, prosecutions and convictions resulting in strong, dissuasive sanctions.
3. Ensure that policies in SEE countries are in line with the OECD Guidelines for Managing Conflict of Interest in the Public Sector and that appropriate resources are allocated for implementation.
4. Strengthen public procurement institutions through regular training of public officials and monitoring of procurement cases.
5. Implement and regularly monitor anti-corruption policy, focusing on the evaluation of the effectiveness of policies in place and on the use of risk assessment techniques to identify future priorities.
6. Institutionalise regular, sustainable consultation mechanisms, with representatives of businesses for policy development, implementation and monitoring in all countries.

IRI SCORES FOR ANTI-CORRUPTION AND BUSINESS INTEGRITY

FIGURE 6.8 – ANTI-CORRUPTION AND BUSINESS INTEGRITY: SCORES BY SUB-DIMENSION



Source: OECD Investment Compact.

⁹² The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

Anti-corruption strategy

- With a score of 4, Bulgaria and Romania are the only two countries in SEE that have a clear anti-corruption strategy and action plan with some evidence of implementation.

Anti-corruption legal framework and adoption of international conventions

- Romania, Croatia and Bulgaria have the highest scores because they have both signed the main international conventions on corruption and adopted appropriate criminal legislation with mechanisms of enforcement. Montenegro, Serbia, Moldova and FYR Macedonia still have incomplete legislation on criminalisation of corruption, namely no criminal liability of legal persons.

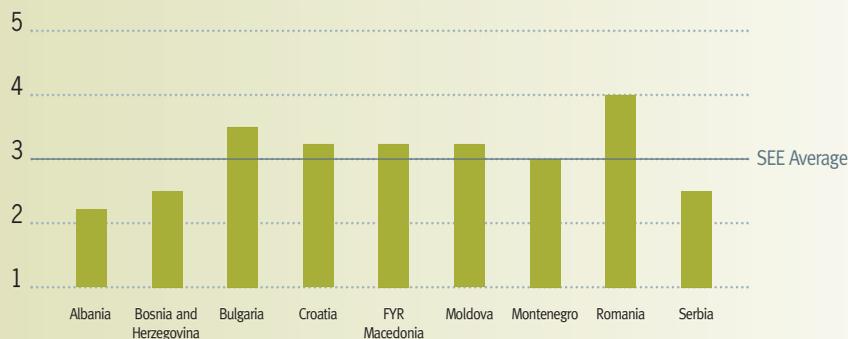
Promotion of good governance and public administration

- Croatia and Romania receive highest scores for the promotion of good governance and public administration mainly due to significant improvements in tax and customs administration. However, public procurement and conflict of interest remain an area of concern for all SEE countries. With a score of only 1.75, Albania shows the highest gap between legislation in place and perceived levels of corruption.

Transparency

- Bulgaria, Romania and Moldova score higher than their peers primarily because of better public/private consultations. Five out of the nine SEE countries score below 3 due to limited public/private consultations, monitoring and evaluation and communication.

FIGURE 6.9 – OVERALL SCORES FOR ANTI-CORRUPTION AND BUSINESS INTEGRITY



NOTE: Scores are rounded to the nearest 0.25.

Source: OECD Investment Compact.

- Bulgaria and Romania lead the SEE region in anti-corruption and business integrity.
- Albania, Bosnia and Herzegovina and Serbia score the lowest primarily due to areas for improvement for promotion of good governance and public administration.

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IMF International Monetary Fund: www.imf.org

IRIS: www.iris.umd.edu

Support for Improvement in Governance and Management (SIGMA): www.sigmaweb.org

Trade and Transport Facilitation in Southeast Europe: www.seerecon.org/ttfse/

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Chapter 7

Competition Policy

*Driven by the *acquis communautaire*, Romania and Bulgaria have pulled ahead of their peers in the design, implementation and enforcement of competition policy. Overall, competition policy in the region is still in early stage of development. Authorities across the region need to be strengthened by introducing more expertise and providing appropriate budgetary resources. Several competition authorities in the region are either still not independent (Moldova and Montenegro) or do not have sanctioning powers (Croatia, FYR Macedonia and Serbia).*

Competition Policy

7.1 Introduction

Competition policy⁹³ is one of the building blocks of a sound economic environment. When it is well-formulated and implemented, it creates a stable and transparent economic environment for investors and ensures that the interaction between economic operators is efficient and welfare-maximising.

Social, economic and legal frameworks in transition economies often differ from those established in more mature market economies. The state presence in the market is stronger, and access to the market by new competitors is more likely to be impaired by regulatory, legal, institutional and cultural factors. Transition economies typically have a relatively high degree of market concentration, significant state

ownership and weaker legal frameworks for competition, which combine to limit new investment and economic growth.

7.2 Assessment framework

The goal of competition policy is to encourage economic efficiency. Market competition safeguards consumers' interests and supports competitiveness. Competition policy aims to ensure that competition is not limited by the anti-competitive practices of firms or national authorities (restrictive agreements and concerted practices), to prevent firms from improperly exploiting their market power over weaker companies (abuse of dominant position) and to prevent state authorities from distorting competition (state aid) (see Figure 7.1).⁹⁴

FIGURE 7.1 – COMPETITION POLICY ASSESSMENT FRAMEWORK



Source: OECD Investment Compact.

⁹³ Scores for Competition Policy are not included in the 2006 edition of the IRI evaluation.

⁹⁴ Activities of the European Union – Summaries of legislation - Competition: introduction (<http://europa.eu.int/scadplus/leg/en/tvb/126055.htm>)

7.3 Competition strategy

A formal competition strategy for the South East European (SEE) countries should include:

- A legal framework (competition law and secondary legislation for implementation based on the EU *acquis communautaire* in the competition area);
- An institutional framework (independent competition authority);
- Enforcement;
- Policy advocacy.

SEE countries are at different stages of designing competition policy strategies, and the progress made by each country largely depends on its stage in the EU accession or stabilisation and association processes. Three countries have formal competition strategies: Bulgaria, Romania, and Croatia.

Bulgaria and Romania cover all the key components of the competition framework and have formalised competition strategies. However, the contents of their competition strategies differ, reflecting different stages of incorporation of the EU *acquis*. While Bulgaria places more emphasis on an 'action plan' to comply with EU standards – including law approximation and policy advocacy – Romania strongly emphasises a medium term approach to develop an enforcement record.

- The Bulgarian Commission for the Protection of Competition devised an Action Plan in 2005⁹⁵ which aims to improve national competition law and ensure full harmonisation with the EU *acquis*; to increase the amount of fines imposed; to improve policy advocacy; to prepare the Commission for the direct application of the *acquis*; and to ensure collaboration with the European Commission and the European Competition Network.
- The Romanian Competition Council has issued a "Strategy on a Pro-active Approach to the Competition Law Enforcement" (2005–06)⁹⁶ which provides a detailed plan for dealing with anti-competitive behaviour by firms. The strategy contains specific time-bound targets,

including conducting a survey of key industry sectors which are important for enhancing competition (2005); guidelines for a more proactive enforcement of competition rules (2005); and a leniency programme to improve the Council's ability to fight cartels (adopted in 2004).

Croatia recently formalised a competition strategy (March 2006) to address the existing deficiencies of the competition framework. The strategy focuses on: amendment of the Competition Act and of the Courts Act in order to empower the Agency to impose sanctions and remedy the deficiencies of the current court system; improvement of judicial review of the Competition Agency's decisions; application of the law in the area of liberal professions; cooperation with sectoral regulators; further alignment of the competition legislation with the EU *acquis* (e.g. block exemption regulation regarding transport agreements); improvement of policy advocacy actions.⁹⁷

In all other SEE countries, various government programmes refer to the adoption of various components of the competition framework (e.g. competition legislation, creation of the institutional framework). However, the programmes do not always cover all the components of a competition strategy and the competition strategies have not, in all cases, been separately formalised.

There are three levels of progress in this group of 'non-formalised competition strategies':

Albania, Bosnia and Herzegovina and FYR Macedonia:

- Albania provided for the design of a competition strategy in 2007–08 in the National Plan for Approximation of Legislation and Implementation of the Stabilisation and Association Agreement with the European Union. It has developed its legal framework (a new competition law adopted in 2003 and secondary legislation for implementation) and institutional framework (an independent competition

⁹⁵ Commission for the Protection of Competition (2005), *Information Bulletin*.

⁹⁶ Romanian Competition Council website: www.competition.ro.

⁹⁷ Croatian Competition Agency (2006), *Strategy Statement*.

- authority). It has also started to build up an enforcement record and policy advocacy.
- Bosnia and Herzegovina included basic provisions on competition in the EU Integration Strategy (2004), but lacks a competition strategy despite improvements to the legal framework and the creation of an independent competition body (the Competition Council).
 - FYR Macedonia integrated basic competition policy principles within the Government's Macroeconomic Programme, and the programmes of the Commission for the Protection of Competition and of the Ministry of Economy, respectively, and made some progress in the competition field through the development of a legal and institutional framework (including leniency provisions) in 2005.
- Montenegro and Serbia:
 - Montenegro included competition principles in the Government's Economic Reform Agenda 2002–07. Serbia has included them in its Trade Strategy. Both countries have adopted new competition laws in 2005, but the establishment of independent competition bodies to implement the laws and to define strategic priorities is still pending.
 - Moldova included the development of a competition strategy within the National Indicative Programme 2005–06. Although a basic legal framework was created, including the establishment of a competition agency, little progress has been made so far in implementing a coherent competition policy due to the lack of an independent competition body.

7.4 Competition legal framework

Assessment of the competition legal framework is based on two main components:

- **Competition law**, which:
 - covers restrictive agreements, dominance and merger control, and applies to both public and private undertakings.

- establishes law enforcers, i.e. independent competition bodies.⁹⁸
- provides for enforcement tools, including investigative and sanctioning powers.

- **Secondary legislation for implementation** encompassing, for example:

- application of the provisions of competition law to restrictive agreements, abuse of dominance and merger authorisation (including the definition of the relevant market; turnover calculation in the case of restrictive agreements, abuses of dominance and mergers; application of sanctions as well as remedies in the case of conditional approval of mergers).
- application of the competition law to minor infringements.
- block exemption regulations consistent with the *acquis* (e.g. those related to vertical agreements; agreements in the motor vehicle sector; technology transfer; horizontal cooperation agreements for specialisation and for research and development; insurance).
- application of competition law to the telecommunication sector.
- application of competition law to the transport sector (rail, road, inland waterway; maritime; air).
- organisation and functioning of the competition authority.

All SEE countries have made strides in developing the competition legal framework. To a large extent, SEE competition legislation follows EC standard language and principles. SEE competition laws cover all the basic subjects (restrictive agreements, abuse of dominance and merger control) with the exception of the competition law of Moldova, which does not clearly define merger control. All provide for setting up law enforcers, and most grant these bodies investigation and sanctioning powers (except Croatia, FYR Macedonia and Serbia). The laws also apply to both public and private undertakings and provide for the possibility of judicial appeal.

⁹⁸ The assessment of the institutional framework is performed separately under the section 7.5.1 Independent competition authorities.

The EC model is most recognisable in the competition laws of Bulgaria and Romania. Secondary legislation in these two countries includes regulations on block exemptions related to vertical agreements in the motor vehicle sector, specialisation, research and development, transport agreements, the insurance sector, *de minimis* regulations, merger regulations and other guidelines based on EC practice. However, some fine-tuning is still needed, particularly to the Bulgarian legislation. For example, amendments should include, among other things, the introduction of turnover-related fines and transposition of the newest EU *acquis* to prepare for participation in the European Competition Network. Priority should be given to measures to improve cartel investigations and dawn raids.

EC competition principles are also transposed in the competition laws of Albania and Croatia and in the newly adopted competition legislation of Bosnia and Herzegovina, FYR Macedonia, Montenegro and Serbia. Adoption of a full set of guidelines for implementation has not yet been completed in these countries, and streamlining of the legislation is still needed. For example:

- Croatia has adopted guidelines for implementation, including several block exemption regulations (in the fields of vertical agreements, horizontal agreements, technology transfer, motor vehicles and insurance), as well as regulations on the notification and assessment of mergers, the definition of relevant markets and agreements of minor importance, but it needs to fine-tune the legal provisions and ensure that the Competition Act applies to all sectors. The most important shortcoming to be addressed is the current ineffective mechanism for fining companies that are in breach of competition legislation, which should be remedied by giving the Competition Agency the power to impose fines.
- Albania, Montenegro and Serbia need to expand the scope of guidelines and adopt regulations on block exemptions for vertical and horizontal agreements and other guidelines. Amendments to Serbian legislation

are needed to grant powers to the independent competition agency; improve the threshold criteria for notification of concentrations; set clear procedural rules regarding the merger notifications; introduce a *de minimis* rule; and provide for leniency for whistle blowers in cartel cases. Similarly, the competition agency of FYR Macedonia should be granted powers to impose fines and Bosnia and Herzegovina should preferably apply a notification system for restrictive agreements at this very early stage of developing an enforcement record.

Moldova amended its competition law to redefine the attributes of the enforcement body. Guidelines for implementation are not in place, as an independent competition body has not yet been set up.

7.5 Institutional framework

7.5.1 Independent competition authorities

An independent competition authority is the main body for the implementation of the competition policy and law which operates with strong political support. This authority:

- should have a recognised advocacy and policy advice role, and its activities should prove to be effective in creating a level playing field for investment;
- should be well-funded and have strong economic and legal capacities in place to handle significant enforcement matters.

All SEE competition laws provide for the establishment of specialised competition bodies to implement the law. However, the current institutional framework in SEE shows various degrees of resource commitment and organisational independence from the government (see Table 7.1).

TABLE 7.1
COMPETITION AUTHORITIES IN THE SOUTH EAST EUROPEAN COUNTRIES*

	Legal status	Investigative powers	Direct sanctioning powers	Policy advocacy powers	Number of staff (2005)
Competition Authority of Albania	Independent administrative authority	yes	yes	yes	20
Competition Council of Bosnia and Herzegovina	Independent administrative authority	yes	yes	yes	14
Commission for the Protection of Competition of Bulgaria	Independent administrative authority	yes	yes	yes	77
Competition Authority of Croatia	Independent administrative authority	yes	–	yes	37
Commission for the Protection of Competition of Macedonia	Independent administrative authority	yes	–	yes	16
Competition Authority of Moldova**	Department within the Ministry of Economy	–	–	–	n/a
Competition Authority of Montenegro***	Department within the Ministry of Economy	yes	yes	yes	n/a
Competition Council of Romania	Independent administrative authority	yes	yes	yes	272
Commission for the Protection of Competition of Serbia****	Independent administrative authority	yes	–	yes	n/a

Source: OECD Investment Compact.

* This table shows whether certain elements (i.e. investigative, sanctioning and policy advocacy powers) are foreseen in the competition laws. For a detailed assessment as to their effectiveness, see the relevant sections below.

** In Moldova, the establishment of an independent competition authority is still pending. By law, the competition authority should have investigative, sanctioning and advocacy powers. Currently, the Ministry of Economy is in charge of the competition policy.

*** In Montenegro, the competition law entered into force only on 1 January 2006. The Ministry of Economy is currently in charge of the competition policy. There are plans to set up an independent competition authority.

**** In Serbia, the Commission for Protection of Competition is currently being established.

Only Bulgaria and Romania have independent competition agencies which are adequately staffed and funded, and which have expertise in both the competition and state aid fields and a record of implementation.

- The Bulgarian Commission for Protection of Competition is an independent specialised state body. Its board has seven members: a chairman, two deputy chairmen and four other members, who are directly elected by the Parliament of the Republic of Bulgaria for five years. The Commission's administrative capacity (legal and economic) has been steadily improving. Currently it has 77 staff (of which 70 are economists and lawyers). The state-allocated budget for 2005 (approximately EUR 773,000) has been increased by approximately EUR 988,000 collected from fees, fines, and penalty interest charges.⁹⁹ The staff has participated in training programmes organised by the European Commission and other international bodies.
- The Competition Council of Romania was set up in 1997 and is managed by a board made up of seven independent members (one of which is the president of the Council). Board

members are appointed by the President of Romania, upon a government proposal for a period of five years. The Council has 350 posts (in Bucharest and the 41 local branches) and recruitment is nearing completion (current staff is 272). The budget has increased by over 30% in 2005 compared to 2004 (a 36% increase on the 2005 budget is provided in 2006). Staff has participated in training programmes, study visits and internships (87 training activities in 2005 related to anti-trust) with the European Commission, Member States or other bodies including the OECD.

By contrast, the competition authorities of Albania, Bosnia and Herzegovina, Croatia and FYR Macedonia still need to strengthen their institutional capacity substantially through budget reinforcement, adequate staffing (including legal and economic expertise) and training of personnel:

- The Albanian Competition Authority consists of a Commission (the decision-making body) and a Secretariat (the executive body). The Commission has five members, appointed by the Assembly (parliament) every five years.

⁹⁹ International best practice suggests that fines and penalty payments should not flow directly into the competition agency's budget as this may create the (perceived) risk of improper incentives for the agency's decision makers.

The Competition Authority has a limited staff (of 20) and budget, as its activities are financed from the State budget and the CARDS 2002 programme "Support for Competition and State Aid". The budget allocated to the Competition Authority from the state budget for the year 2006 has decreased compared to the 2005 budget.

- The Competition Council of Bosnia and Herzegovina was set up in 2004 as a State-level authority and became operational in 2005. Offices for Competition have been also established in the Entities as investigative bodies. The two Entity offices (in Banja Luka and Mostar) are operated pursuant to the single legislation at the state level. They conduct investigations on behalf of the Competition Council. The Competition Council managing board has six members, three of whom are appointed by the Council of Ministers of Bosnia and Herzegovina, two by the Federation of Bosnia and Herzegovina and one by the Republika Srpska. However, the Competition Council has only 14 staff and its budget remains limited, corresponding to its restricted initial operations.
- The Croatian Competition Agency has been operational since 1997. The board has five members, of whom one is the president of the Agency. Members are appointed for a five-year term of office (and may be re-appointed) by the Croatian Parliament upon government proposal. There are 37 staff, of whom 17 are experts working on anti-trust and merger issues. Administrative capacity has improved. The Agency benefited from training programmes in 2004 and 2005, including for administrators and judges (in cooperation with the Judicial Academy and the European Commission). A budget increase is planned as follows: 39% in 2006 on the 2005 budget, and 37% in 2007 on the 2006 budget.
- The Commission for Protection of Competition of FYR Macedonia has been operational since 2005. Its five board members are elected by the Parliament. The total number of staff is 16 (13 professional and 3 administrative). The budget necessary for the Commission's work is provided from the budget of FYR Macedonia, which remains limited.

Serbia is the process of creating an independent competition authority (board members were appointed very recently). Moldova and Montenegro do not yet have independent competition agencies, as law enforcement in these countries is being entrusted to competition departments under Ministries of Economy with insufficient resources.

7.5.2 State aid control programmes

State aid control tries to prevent and correct restrictions on competition that are created by governments through granting public aid to firms. EC competition law does not permit aid granted by a government or by government resources in any form if it distorts competition by favouring some firms or products, and if it has an effect on trade between Member States.

The assessment provides an overview of the state aid control programmes in SEE by looking at several specific elements:

- well-funded and well-structured state aid control policies, including legislation and institutions, which conform to EC practice;
- sound implementation of state aid provisions, demonstrated by a record of enforcement;
- a full inventory of state aid and effective monitoring and reporting, in particular monitoring in sensitive sectors and in special economic zones.

The approach to state aid control in SEE generally follows the EC model. State aid control frameworks are in place in most SEE countries (except Bosnia and Herzegovina and Moldova). Both development of the legal and institutional framework and the enforcement record in the state aid area are more advanced in Bulgaria and Romania (EC, 2005a, b):

- In Bulgaria the Commission for Protection of Competition is responsible for state aid control. The State Aid Act (SAA) of 2002 and the regulations for its implementation are in line with the main principles of the EU state aid *acquis* (including Articles 87 and 88 of the EC Treaty). The State Aid Department of the Ministry of Finance is in charge of aid

monitoring and reporting. The Commission for Protection of Competition resolves cases about state aid either *ex officio* or when these cases are referred to it. The State Aid Department of the Ministry of Finance is in charge of aid monitoring and reporting. The state aid enforcement record has grown considerably, with 89 decisions in state aid cases in 2005 (on regional aid, horizontal aid, employment and training aid, environmental aid, rescue and restructuring aid). There has been an alignment of fiscal aid and deferrals to state aid rules but strict monitoring and follow-up to decisions is still to be ensured.

- In Romania the Competition Council is in charge of developing and implementing the state aid policy. A State Aid Strategy for 2006 is under preparation. It will be guided by horizontal objectives such as support for research and development, innovation, environment and energy saving, SME and regional development, job creation and training. The State Aid Law No. 143/1999 (republished) and its implementing rules are in line with EC standards and a case record has been established, with (in 2005) 31 binding opinions, 20 points of view, 163 clarifications and 5 negative state aid decisions. In addition, 14 state aid monitoring reports were sent to the European Commission. Special attention is paid to the state aid to the steel industry, particularly to the monitoring of the National Steel Restructuring Strategy. A state aid report showing the aids granted between 2002 and 2004 has also been published. Nevertheless, efforts need to be continued to ensure a stringent *ex ante* control of state aid schemes in line with EC standards.

In other SEE countries, the degree of development of a state aid legal and institutional framework varies. Monitoring of state aid, including fiscal incentives, also needs further improvements. Establishment of a comprehensive inventory and ensuring stringent *ex ante* notification of aid measures are issues that need to be addressed by all countries. Furthermore:

- Croatia has adopted a state aid act and implementing regulations, and has now to ensure their systematic implementation;
- Albania has adopted state aid legislation, has set up state aid control structures and now has to establish a solid enforcement record;
- FYR Macedonia has set up monitoring structure, but it needs to adopt rules for horizontal aid measures and harmonise industrial policies with state aid rules;
- Montenegro and Serbia have set up the necessary structures to monitor the state aid, but need to establish a comprehensive aid inventory and reporting system for all aid measures in force.

Bosnia and Herzegovina is in the process of adopting the state aid legislation which will set the basis for state aid control.

BOX 7.1

CASE STUDY ON INSTITUTIONAL ARCHITECTURE IN THE COMPETITION FIELD IN HUNGARY

The Hungarian Competition Authority GVH (Gazdasági Versenyhivatal) was founded in 1991 based on the LXXXVI. 1990 Act on the prohibition of unfair and restrictive market practices. The architecture of this authority provides for a high level of independence from political influence. Its track record and advisory activities have contributed to its high reputation and to its public and political support.

GVH's key organisational features are:

- The authority is headed by a president, appointed for six years by the President of the Republic on the recommendation of the Prime Minister. The president has ministerial status. Two vice-presidents are appointed by the President of the Republic on the consent of the president and the Prime Minister;
- The authority's activities are independent of the government or of any public offices; its tasks may be assigned only through legislation. The president reports to the Parliament annually. These reports, publicly available, contain all the relevant information about its activities;
- The Competition Council (rather than the president of the authority) takes decisions on competition cases. The chairman of the Council is one of the vice-presidents; the chairman's assignment period of six years may be extended only once. The Council members are appointed by the President of the Republic on the recommendation of the president. This architecture ensures a strict separation of analysis (conducted by GVH) and decision-making (conducted by the Competition Council of the GVH);
- The president, deputies and members of the Council may be removed by the President of the Republic only if they a) commit a criminal offence, b) are permanently unable to fulfil their duties or c) are incompetent. They may not be executives or members of the supervisory boards of any enterprise; they cannot accept any other employment during their service. These rules ensure that the authority's key executives are free from political or economic influence;
- The GVH's budget is independent of ministerial budgets. It is established directly by the Parliament. In 2005 this budget was HUF 1,522 million (approximately EUR 5.8 million). On the basis of the newly amended act, the GVH is entitled to use for the development of competition culture five per cent as a maximum of the total amount of the fines collected in the previous year.
- In 2005, the authority employed 116 persons.
- GVH regularly co-operates with other Hungarian authorities, including the Hungarian Energy Office, the National Telecommunications Authority, the General Inspectorate for Consumer Protection and the National Privatisation Agency. It is a member of the European and International Competition Networks and co-operates with the competition offices of neighbouring countries, within the framework of CECI (Central European Competition Initiative). The GVH is the OECD's partner in the OECD-Hungary Regional Centre for Competition, a core project for competition capacity building in the region, which is generously supported by the GVH and the Hungarian Government.

GVH's institutional structure has proved to be effective in several ways:

- The rules for appointing and removing management have been sufficient to safeguard GVH from political interests. Rules about incompatibility ensure independence from economic interest groups;
- GVH's independent budget provides adequate resources and acts as another safeguard against government interference;
- To avoid bribery, the employees' salary of the GVH is expressly higher than that of the average officers working in the public administration;
- Strict separation of investigation and analysis from decision-making is another powerful tool for improving the authority's autonomy. The down side is that enforcement may be slowed in such an institutional setting. This issue has been addressed by focusing GVH's activities, and relying on courts and other authorities to address matters less relevant to competition policy (e.g. consumer protection);
- Regular surveys were conducted (by a research institute, TÁRKI) on public perceptions of competition policy. According to the 2004 survey, 90% of lawyers were aware of the most serious forms of anticompetitive behaviour; over 80% of corporate executives had knowledge of competition law and almost all of them knew about GVH.
- The State Audit Office conducts thorough inspections of GVH's activities twice a year, one during the planning of the budget, and another after closure of the budget year. In 2004 there was an overall financial audit conducted by the State Audit Office.

Source: Annual Report of the Hungarian Competition Office 2004 (available at <http://www.gvh.hu>); Hungary – Report on Competition Law and Institutions, January 2005 (OECD, DAF/COMP(2005)7); Wise, M. (2000), Review of Competition Law and Policy in Hungary, OECD Journal of Competition Law and Policy.

7.6 Competition law enforcement

Effective and efficient enforcement of competition law is the most important component of a well-designed competition policy (see Box 7.2). The enforcement capacity (including *ex officio* investigations and dawn raid techniques) and the case record in the competition area are measured by the scope and effectiveness of sanctions and remedies imposed in case of abuse of dominance, cartels and merger control.

Currently in SEE, there are three levels of enforcement of competition law:

- Bulgaria and Romania have a record of decisions and investigations on abuses of dominance, cartels and merger control and of significant sanctions imposed. For instance, Romania carried out 10 *ex officio* investigations and 12 dawn raids in 2005. It has also imposed increased fines. In seven cases fines were imposed for restrictive agreements. The 2005

total of nearly EUR 40 million is 33 times greater than the 2004 total.

- Croatia has developed a growing case record. However, the agency's effectiveness is hampered by an ineffective mechanism for the imposition of fines, which needs to be addressed.
- All other SEE countries have limited enforcement records due to the lack of adequate staffing and budget (e.g. Albania, Bosnia and Herzegovina, Montenegro), of independence (e.g. Moldova, Serbia) or of sanctioning power (e.g. FYR Macedonia).

As competition regimes develop, uncovering cartels becomes more important, leading to the need to introduce leniency programmes. Programmes have been adopted in Bulgaria and Romania whereby amnesty is offered to whistleblowers against hard-core cartels. Bosnia and Herzegovina and Macedonia have also enacted leniency provisions. Serbia has included the adoption of a leniency programme in the current revision of the competition legal framework.

BOX 7.2

CASE STUDY ON ENFORCEMENT OF COMPETITION LAW IN THE CZECH REPUBLIC

The Czech Anti-Monopoly Office became operational in 1991. In the period 1992-96 the Office functioned as the Ministry of Competition. It has since become the Office for the Protection of Competition ('the Office'). It is entirely independent in its decision-making processes.

The main elements that create conditions for competition law enforcement in the Czech Republic are:

- **Investigative powers:** The Office can choose from a wide array of investigative tools, including requests for information, oral hearings, dawn raids to secure incriminating evidence investigations on private premises and sealing of business premises;
- **Schedule:** The Office is not bound by any time limits within which it is to take the decision;
- **Fines:** The basic fine for all substantive violations is up to 10% of annual net turnover, or CZK 10 million (approximately EUR 0.3 million), whichever is greater. If the violator profited from the violation, the fine must be at least as great as the profit;
- **Appeals:** Parties may appeal the the Office's decision to the chairman, who makes a decision on the basis of a proposal by an advisory board, including outside experts. The next appeal level is the Regional Court in Brno, the home city of the Office. The decision of the court might further be reviewed by the Supreme Administrative Court, that may however review the courts' decision only for compliance with the law, and will not hear a full appeal on the merits;
- **Leniency programme:** A leniency programme to attack hard-core cartels was introduced in 2001. Parties who are willing to disclose information on cartels may be exempted from fines.
- **Negative clearance:** From 2001, parties could ask the Office's opinion about whether their conduct was against the law without facing punishment. (This procedure was discontinued following the Czech Republic's accession to the European Union.)

Refocusing on cartels resulted in a significant rise in the amount of imposed fines. Over the past 4 years, the amount of fines imposed by the authority has increased by 15 times.

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BOX 7.2

... CASE STUDY ON ENFORCEMENT OF COMPETITION LAW IN THE CZECH REPUBLIC (cont.)

Some notable cases:

- **Cartels:** In 2001 six fuel distributors were investigated for concerted setting of fuel prices. It was established that even though the fuel price level had fallen during the year, the distributors had maintained unreasonably high prices. The reason was assumed to be cooperation by the parties involved. The Office carried out a dawn raid at the undertakings' central location and recovered decisive proof in the form of e-mails and other electronic documents. The Office prohibited this anti-competitive behaviour and imposed a record fine of CZK 313 million (approximately EUR 9.2 million). Following appeals, in 2004 the chairman of the Office confirmed the first instance decision.
- **Abuse of dominance:** In 2002 the Office received a number of complaints about preferential tariff programmes offered to important business customers by the incumbent fixed-line telecom company, Český Telcom. These programmes, intended to discourage key customers from changing operators, included fidelity rebates for long-term contracts and commitments to pay for a minimum amount of calls even if this amount was not made. The Office determined that in regard to ongoing liberalisation of the telecommunications sector, these arrangements were particularly detrimental to emerging competition. It prohibited these abusive practices and imposed a fine of CZK 81.7 million (EUR 2.7 million). Following an appeal, the chairman of the Office upheld these decisions in January 2004.
- **Merger control:** In 2002 the Office prohibited the merger of two major soft drink producers (Karlovarské minerální vody a.s. and Poděbradka s.r.o.), as it would have led to substantial distortions in relevant markets. The parties concerned appealed to the Supreme Court. It was suspected that they had implemented the concentration in practice while the appeal was pending in 2003. The authority carried out a dawn raid, and sufficient evidence was recovered to establish that the acquiring company had already taken control of the shares of the other company and exercised control over it. In March 2004 the Office fined the undertaking CZK 10 million (approximately EUR 0.3 million) for continuing with the acquisition before the final decision was issued. It ordered measures to remedy the situation prior to the acquisition. Independently of these proceedings, in April 2004 the Supreme Court confirmed the the Office's decision to prohibit the concentration.

Source: Annual Report on Competition Policy Developments in Czech Republic, OECD, 2003; Annual Report of the Office for the Protection of Competition 2003 (available at <http://www.compet.cz/English/TAL.htm>); Regulatory Reform in the Czech Republic: The Role of Competition Policy in Regulatory Reform, OECD, 2001.

7.7 Competition policy advocacy

Competition policy advocacy, which includes mandatory mechanisms of consultation on legislative and regulatory procedures and public awareness campaigns, is as important as law enforcement in creating a competition culture

and promoting competition principles among government bodies, private sector groups and the general public. Complementary to policy advocacy is access to information on competition policy and law, including decisions on competition cases and annual reports.

Progress on implementing effective competition advocacy measures has been uneven in the SEE region.

Consistent with their competition policy strategies, Bulgaria and Romania have formal mechanisms for policy advocacy, including *ex ante* consultations on draft legislation, opinions on draft legislation and effective public awareness campaigns. For example:

- In 2005 the Bulgarian Commission for the Protection of Competition made nine recommendations concerning draft legislation (e.g. related to telecommunications-, energy- and post-related legislation and the concessions act), organised public awareness campaigns involving the media and concluded a cooperation agreement with the Bulgarian International Business Association in 2005.
- The Romanian Competition Council issued 19 binding opinions and 12 viewpoints and intervened in 16 cases¹⁰⁰ in order to change legal acts with potential implications for competition in 2005. It set up a specialised unit that employs regulatory impact analysis techniques to assess draft legislation. It has also signed cooperation agreements with regulatory authorities and other agencies. As part of the awareness raising activities, the Competition Council has organised seminars for judges, local public authorities and the business community and published various documents on policy advocacy issues (e.g. White Paper on Free Competition in Romania, Road Map for Competition Advocacy, Action Plan for Competition Advocacy in Romania).

Croatia has been also developing policy advocacy actions. The Croatian Competition Agency is involved in *ex ante* consultations on draft legislation with potential implications for competition. It also issues opinions on laws and regulations that have already been adopted (e.g. 17 opinions in 2004). However, there is no clear and well-defined mechanism in place for consultation and impact assessment.

Policy advocacy is less developed in other SEE countries:

- In Albania and FYR Macedonia mechanisms for consultation are established by law, but these countries still need a pro-active approach to issuing opinions on draft legislation as well as stronger public awareness campaigns;
- Bosnia and Herzegovina, Serbia, and Montenegro are still at the early stage of adopting a horizontal approach to the promotion of competition policy in the fields of market liberalisation, privatisation, restructuring, screening of draft legislation, improved public procurement practices and strengthening of the rule of law. This is partly due to the fact that independent competition authorities are still to be set up in both Serbia and Montenegro, while the competition authority of Bosnia and Herzegovina needs to strengthen its role by designing and implementing pro-active advocacy programmes and public awareness campaigns.

In Moldova the absence of an independent competition body has resulted in the lack of any activities that promote competition policy among government bodies, businesses and the general public.

Access to information on competition policy and law

Effective public dissemination of information and competition decisions with full reasoning through written and electronic media (in official languages and, ideally, in another commonly known language) creates the conditions for a competition culture, a better basis for competition policy advocacy and a better understanding of competition policy's role in promoting an open business environment.

In Bulgaria, Croatia and Romania, access to information is easy, as it is ensured through publication of the legal framework, annual reports and decisions in written format and on the competition authorities' websites both in English and the local languages, permanent contact with media and the establishment of special green lines and databases dedicated to competition issues.

¹⁰⁰ Competition Council of Romania (2006), 2005 Annual Report.

Although Albania, Bosnia and Herzegovina and FYR Macedonia provide information on their competition legal framework in local languages and in English and publish annual reports, the information is not regularly updated, hampering the visibility and impact of the competition authorities' activities. A similar situation exists in Moldova, Montenegro and Serbia where information on the role of competition policy and law remains very limited.

7.8 Key actions to consider at the regional level

1. Set up independent competition authorities in Moldova and Montenegro.
2. Give the independent competition authorities sanctioning powers in Croatia, FYR Macedonia and Serbia.
3. Strengthen the administrative capacity of the competition authorities through budget reinforcement and increased staffing with legal and economic expertise, in order to develop an enforcement record and policy advocacy actions, in Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia and Serbia.
4. Apply sanctions strong enough to deter hard-core cartels in Bulgaria.
5. Strengthen the enforcement record in Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Moldova, Montenegro and Serbia.

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Selected websites:

SEE countries:

- Competition Authority of Albania (www.caa.gov.al)
- Competition Council of Bosnia and Herzegovina (www.bihkonk.gov.ba)
- Commission for Protection of Competition of Bulgaria (www.cpc.bg)
- Competition Authority of Croatia (www.crocompet.hr)
- Competition Council of Romania (www.competition.ro)

International bodies:

- European Commission, DG Competition (www.europa.eu.int/comm/competition)
- International Competition Network (www.internationalcompetitionnetwork.org)



Chapter 8

Trade Policy

Countries in the region are well integrated into the global system of trade agreements. All countries are WTO members, except Bosnia and Herzegovina, Montenegro and Serbia. Almost all countries benefit from nearly unrestricted access to the EU market through Autonomous Trade Measures, the Stabilisation and Association Agreements and Europe Agreements. At the regional level, a bilateral network of Free Trade Agreements (FTAs) is in place. The main obstacles to trade in the region are its high non-tariff barriers, in particular technical, sanitary and phytosanitary standards, as well as burdensome customs procedures.

Trade Policy

8.1 Introduction

8.1.1 Why is trade a key issue?

Trade is an important vehicle for generating national growth and prosperity. It is of particular importance as it provides local enterprises with access to world markets and knowledge. Increased trade also provides consumers with a wider choice of goods at competitive prices.

There is a positive relationship between trade and investment which also drives growth and employment. This interaction is due to three factors:

1. A liberal trade regime stimulates investment because it allows for specialisation and larger-scale production which are of the greatest importance in small countries.
2. Today Foreign Direct Investment (FDI) is often motivated more by productivity enhancing opportunities than by the need to access local

markets, which explains why multinationals delocalise the labour intensive part of their production chain to transition economies or developing countries (one third of world trade is intra-firm trade). Local businesses in transition economies may benefit from this development, in that some functions of the value chain may be contracted out to domestic suppliers.

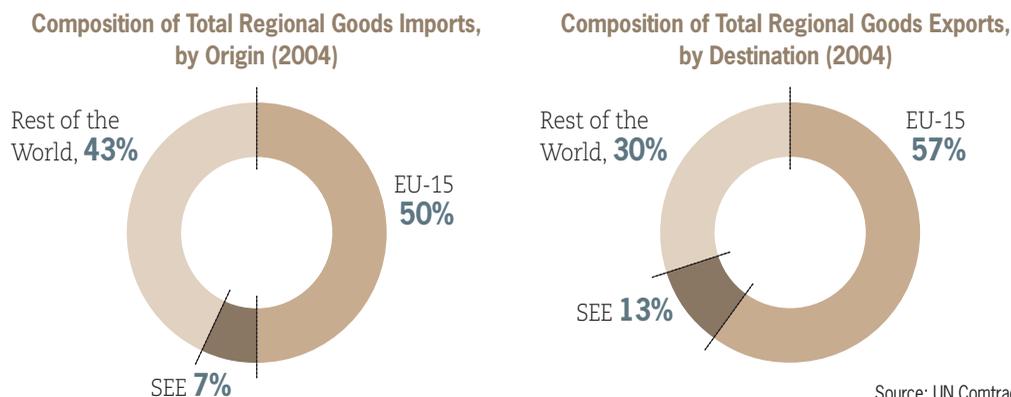
3. Trade can interact with FDI to increase the competitiveness of domestic enterprises' exports through knowledge and technology transfer.

8.1.2 A snapshot of the current trade situation in SEE

Strong dependence on the European Union

SEE trade flows are strongly oriented towards the European Union (EU). Trade in goods¹⁰¹ with the EU (primarily the pre-enlargement EU-15) accounts for approximately 50% of the region's imports and 57% of its exports (see Figure 8.1). Intra-regional trade plays only a limited role.

FIGURE 8.1 – ORIGIN AND DESTINATION OF TOTAL REGIONAL SEE IMPORTS/EXPORTS IN 2004



Source: UN Comtrade.

¹⁰¹ The focus of this chapter is on trade in goods.

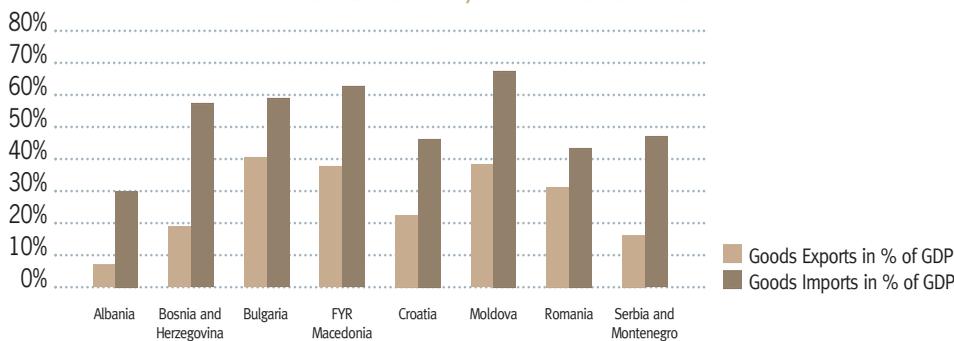
Trade deficits are high due to a low propensity to export

All of the SEE countries are running sizeable trade deficits, reaching over 50% of GDP in the case of Bosnia and Herzegovina. Most countries' large import shares contrast with a very low propensity to export which can be explained by a lack of competitiveness in several areas (e.g. meeting technical requirements, certification, branding, experience in selling to foreign markets). In particular, the region runs a large trade deficit with the EU, despite unrestricted access to the EU market granted through the European Association Agreements and Autonomous Trade Measures.¹⁰² While the share of EU-15 goods imports from SEE8 countries in total (ignoring intra-EU trade) increased only slightly from 1.5 to 2.1% between 2000 and 2004, the five Central Eastern European Accession countries (the Czech Republic, Hungary, Poland, Slovakia, Slovenia) could increase their share from 7.6 to almost 10%. Given that Romania accounts for more than half of EU-15 imports from the region, it becomes evident that countries like Albania, FYR Macedonia or Moldova are completely marginalised (see Figure 8.2).

Scope for agriculture and sophisticated manufactured goods

The structure of merchandise exports shows that most countries specialise in low value added industrial supplies and consumer goods (e.g. garments, shoes), while very few specialise in sophisticated manufactured products¹⁰³, putting the SEE countries in direct competition with low cost suppliers in, for example, Asia and North Africa (see Figure 8.3). In addition, protectionist policies force SEE farmers to concentrate their production on the same range of agricultural products. Free trade would encourage specialisation. Thus SEE countries may in the short run benefit from increased market access in areas such as agriculture. In the longer run FDI and trade may, as explained above, be instrumental in shifting the export structure towards products where SEE countries have or may have a comparative advantage, including those which involve the use of more highly-skilled labour.

FIGURE 8.2 – EXPORT/IMPORT SHARE OF GDP

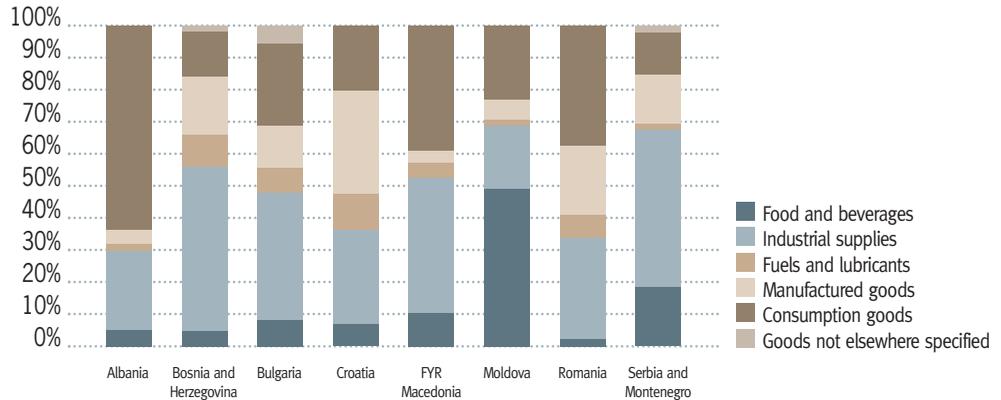


Source: UN Comtrade, 2004.

¹⁰² All Western Balkan countries benefit from preferential access to EU market through Autonomous Trade Measures (ATMs) which were adopted by the EC in 2000. Under this arrangement, about 95% of exports from the Western Balkans can be imported into the EU free of duties and quantitative restrictions.

¹⁰³ The category manufactured goods includes transport equipment and capital goods.

FIGURE 8.3 – STRUCTURE OF MERCHANDISE EXPORTS



Source: UN Comtrade.

8.1.3 Key policy issues

Despite unrestricted access to the EU market, the region's export performance has been relatively poor, with the exception of Bulgaria, Romania, and to a certain extent Serbia.

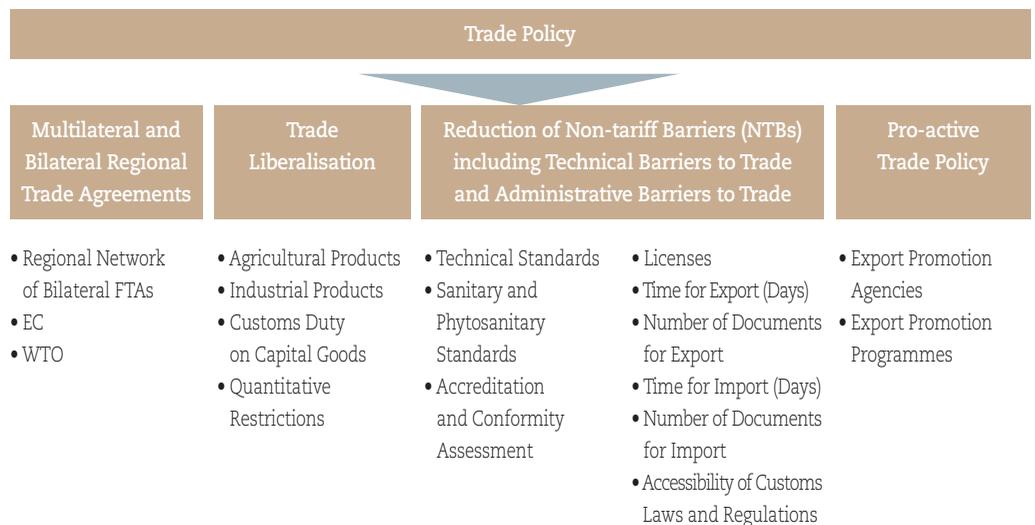
How does the trade regime and in particular non-tariff barriers (NTBs) influence export performance? How can SEE countries devise and implement an effective trade policy, enabling them to bring trade deficits under control over the medium term? What are the priorities for action? These are the main questions answered in the following sections.

8.2 Assessment framework

An effective trade policy incorporates four basic elements listed below and described in detail in the following sections (see Figure 8.4):

- Multilateral and bilateral regional trade agreements;
- Trade liberalisation;
- Reduction of non-tariff barriers (NTBs) including technical barriers to trade and administrative barriers to trade;
- Pro-active trade policy.

FIGURE 8.4 – TRADE POLICY ASSESSMENT FRAMEWORK



Source: OECD Investment Compact.

8.3 Multilateral and regional bilateral trade agreements

SEE countries have achieved a high level of external integration into the world's system of trade agreements (see Table 8.1).

All of the SEE countries are World Trade Organization (WTO) members, with the exception of Bosnia and Herzegovina, Montenegro and Serbia which are in the process of negotiations.

The European Union has three levels of trade agreements for SEE countries:¹⁰⁴

- 1) Autonomous Trade Measures (ATMs): All Western Balkan countries have preferential access to the EU market through ATMs. About 95% of exports from the Western Balkans can be imported into the EC free of duties and quantitative restrictions under this arrangement.
- 2) Stabilisation and Association Agreements (SAAs): A series of agreements with individual Balkan countries, aimed at creating a free trade area and encouraging reforms designed to achieve the adoption of EU standards. They are regarded as the first step towards applying for EU membership.
- 3) Europe Agreements (EAs): Europe Agreements are bilateral association agreements creating free trade areas and establishing additional forms of political and economic cooperation that have been concluded between the European Communities and their Member

States on the one hand and each of the following countries of Central and Eastern Europe: Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Romania, Slovakia, Slovenia and Poland. Europe Agreements recognise that the ultimate objective of the associated countries is to accede to the European Union.

At the European Union level, almost all SEE countries benefit from nearly complete unrestricted access through the ATMs (offered to the Western Balkan Countries in the year 2000), the SAAs (Albania, Croatia, FYR Macedonia) and Europe Agreements (Bulgaria and Romania). The only exception is Moldova, which is currently excluded from the ATMs, but benefits from conditional access to the EU market under the Generalised System of Preferences (GSP).¹⁰⁵

TABLE 8.1
TRADE REGIMES

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
WTO	Member	Negotiations	Member	Member	Member	Member	Negotiations	Member	Negotiations
EC Association Agreement (EA, SAA)	✓		✓	✓	✓			✓	
Preferential Access to European Union Market (ATM)	✓	✓	✓	✓	✓		✓	✓	✓
SEE FTA	✓	✓	✓	✓	✓	✓	✓	✓	✓
Other relevant FTA*		✓	✓	✓	✓	✓	✓	✓	✓
Pre-accession			✓					✓	

Source: OECD Investment Compact.

* European Free Trade Association (EFTA), Israel, Russia, Turkey.

¹⁰⁴ See website of the European Union: <http://europa.eu>.

¹⁰⁵ As far as trade is concerned, Moldova benefits from unilateral preferential access to the Community market through the new Generalised System of Preferences (GSP+) with a special incentive for good governance.

BOX 8.1

CASE STUDY ON TRADE OPENNESS: ESTONIA

Before becoming a member of the European Union and therefore adopting the Common External Tariff, Estonia had one of the most liberal trade regimes in the world. Until 1998, it applied duties only on imports of furs (16%), sea scooters, small vessels and snow scooters (10%). Following the adoption of the Law on Customs Tariff of 1997, the Government passed a decree abolishing all customs duties from June 1998. Imports were not restricted by any quantitative restriction.

Estonia's macroeconomic performance is impressive. Real GDP continues to grow at a rate of 6 to 8% per year, domestic credit growth is rapid, the budget balance has been in surplus for several years, public debt is at a record low of about 5% of GDP, and inflation is relatively contained at about 4%. Due to strong export growth the current account deficit declined from 13% in 2004 to 11% in 2005. It is financed through FDI inflows, borrowing by banks from foreign parents and increasing EU funding. The currency board with the EU, however, requires sustained fiscal discipline to help correct external imbalances.

Source: WTO (1999); EBRD (2006).

At the regional level, much has been done since 2001 to eliminate trade barriers under the auspices of the Stability Pact for South Eastern Europe.

A bilateral Free Trade Agreement (FTA) network is in place.¹⁰⁶ The network is well established and has begun to have an impact on trade patterns. A limited number of trade disputes, involving Bosnia and Herzegovina, Croatia, Montenegro and Serbia, have not reduced support for further regional trade integration.

Under the current network of bilateral FTAs, 80% of bilateral imports have been liberalised, on average. Customs duties on industrial goods are scheduled to be progressively abolished, but only 40% of all agricultural products are covered by the FTAs. The pace of trade liberalisation is also highly differentiated among countries. Croatia and FYR Macedonia lead the regional trade liberalisation process which should be completed at the latest by 1 January 2008 (Messierlin and Miroudot, 2004).

At a wider regional level, several SEE countries have also entered into bilateral free trade agreements with EFTA and Turkey. Bulgaria and Romania have also signed bilateral trade agreements with Israel.

SEE countries' main objective now is to transform the bilateral agreements into a single FTA. The single FTA will be pursued through simultaneous enlargement and amendment of the Central European Free Trade Agreement (CEFTA). The agreement will include new areas such as intellectual property (IP), government procurement and trade in services. It will also have a strengthened dispute settlement mechanism. By standardising policies, objectives and definitions, and broadening its scope to areas such as IP, the new regional FTA (RFTA) will be more efficient and effective in enhancing the overall trade and investment climate in the SEE region. Following a meeting of SEE prime ministers and senior representatives in Bucharest on 6 April 2006, the objective is now to sign a regional trade agreement by the end of 2006.

The Trade Working Group of the Stability Pact for South Eastern Europe significantly contributes to the process of trade liberalisation and facilitation of trade in the SEE region and between the region and the rest of the world. The main value of the Trade Working Group lies in its capacity to coordinate, facilitate and review the countries' efforts to expand trade in the region in line with the MoU signed. It provides an important forum for dialogue both between the countries of the region themselves

¹⁰⁶ In June 2001, seven SEE countries signed a Memorandum of Understanding on Trade Liberalisation and Facilitation (the MoU). In the MoU they committed themselves to conclude before the end of 2002 a network of 21 bilateral free trade agreements between themselves and to set up a procedure to identify and eliminate non-tariff barriers to trade. To date, there are 31 agreements in force.

and between these countries and supporting countries and organisations.

8.3.1 IRI results for multilateral and regional bilateral trade agreements

The multilateral and regional trade agreements sub-dimension was assessed by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the target countries following the process described in the Chapter 1 of this report. This resulted in the scores in Table 8.2, describing the current situation in each of the nine target countries covered by the IRI.

Bulgaria, Croatia, FYR Macedonia and Romania scored at the highest level having established an extensive network of multilateral and bilateral trade agreements. Bosnia and Herzegovina, Montenegro and Serbia score below 4 primarily because they are not yet member of the WTO.

8.4 Trade liberalisation

Most SEE countries have reached a high level of trade liberalisation. Applied most-favoured-nation

(MFN) tariffs for agricultural and industrial goods are adjusted according to international standards by most SEE countries (see Figure 8.5).

As illustrated in Figure 8.5, Bulgaria and Romania still apply relatively high tariffs, especially on agricultural products, but these tariffs will need to be lowered to enable EU accession.

Quantitative restrictions on exports and imports have been eliminated in all the SEE countries except in the case of products posing health, safety or security risks.

The trade regime applied to capital goods is particularly significant for countries that are largely dependent on imports of capital goods. To lower fixed investment costs, capital goods imports should be exempted from customs duties and other barriers.

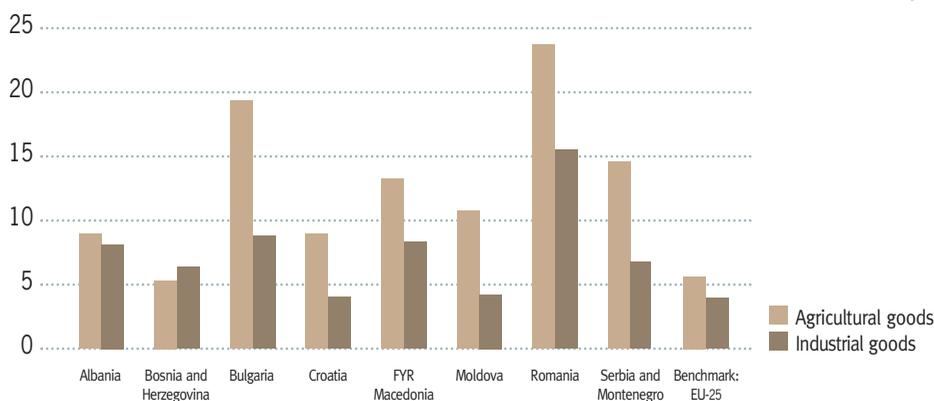
In fact, imports of capital goods are not treated in a homogeneous and coherent way in SEE countries. In general, customs duties on capital goods are low (1 to 10%), but no country offers

TABLE 8.2
IRI SCORES FOR MULTILATERAL AND REGIONAL TRADE AGREEMENTS¹⁰⁷

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
4.25	3.50	5	5	5	4	3.75	5	3.75

Source: OECD Investment Compact.

FIGURE 8.5 – AVERAGE APPLIED MFN TARIFF FOR INDUSTRIAL AND AGRICULTURAL PRODUCTS (%)¹⁰⁸



Source: UNCTAD Trains.

¹⁰⁷ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

¹⁰⁸ Data are for 2005, except Albania (2002), Bosnia and Herzegovina, and Moldova (both 2001).

TABLE 8.3
CUSTOMS DUTY ON CAPITAL GOODS

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
Customs Duty ¹⁰⁹	0-10%	0-15%	0-24%	5-14%	0-21%	0-15%	0-15%	5-25% ¹¹⁰	0-15% ¹¹¹
Exemption based on Europe Agreement, SAA	✓ ¹¹²		✓	✓ ¹¹³	✓ ¹¹⁴			✓	
FDI exemption		✓		✓ ¹¹⁵	✓		✓		✓
Exemption based on initial capital investment						✓			

Source: OECD Investment Compact.

total exemption from customs duties. Albania comes closest to zero exemption with customs duties ranging from 0 to 10% and a 2% rate that applies to most tariff lines (see Table 8.3).

The conditions for a zero rate regime generally depend on two factors:¹¹⁶

- The capital good originates from a country which is covered by an FTA with SEE countries or from the EU for the countries which have signed an Association Agreement with the EU (Europe Agreement, SAA).
- The capital good is part of the initial capital investment or is part of a foreign direct investment operation (e.g. in Bosnia and Herzegovina, Moldova, Montenegro and Serbia).¹¹⁷

Exemptions from customs duties also apply to capital goods imported into free trade zones, as in the case of Albania, Bosnia and Herzegovina, Bulgaria, FYR Macedonia, Moldova, Montenegro and Serbia.

While these special regimes soften the negative impact of customs duties on imports of capital goods, they also introduce discriminations among companies and among suppliers. Moreover, different regimes applied to specific situations allow room for discretionary behaviour by customs officials, which can lead to corruption.

8.4.1 IRI results for trade liberalisation

The evaluation of the trade liberalisation sub-dimension has resulted in the scores in Table 8.4, describing the current situation in each of the nine target countries.

TABLE 8.4
IRI SCORES FOR TRADE LIBERALISATION¹¹⁸

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
4.25	4	3.25	4.75	3.50	4.25	3.50	2.25	3.50

Source: OECD Investment Compact.

¹⁰⁹ Not weighted range of the applied tariff which includes the minimum to the maximum tariff.

¹¹⁰ One tariff line is at 42%.

¹¹¹ One tariff line is at 20%.

¹¹² With very few exceptions listed in Annex I of Albania's SAA with the EU.

¹¹³ According to Croatia's SAA with the EU, customs duties on imports into Croatia of goods originating in the Community shall be abolished upon the entry into force of the SAA. Customs duties for capital goods listed in Annex I of the Agreement were abolished on 1 January 2004. However, customs duties on some other capital goods listed in Annex II of the Agreement will be progressively reduced and eliminated by 1 January 2007.

¹¹⁴ With exceptions covered in the Annex I and II of the FYR Macedonia's SAA with the EU.

¹¹⁵ When equipment is imported as part of an investment, customs duties do not apply to goods under HS 84, 85, 86, 87, 88, 89, and 90.

¹¹⁶ Except in the case of Albania.

¹¹⁷ Motor vehicles are generally excluded.

¹¹⁸ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

SEE countries on average perform well in terms of trade liberalisation. Bulgaria and Romania have lower scores than the average because of higher import tariffs, especially on agricultural products. But those tariffs will have to be lowered at the time of EU accession.

8.5 Non-tariff barriers

The greatest barrier to achieving the full potential of free trade in SEE is high non-tariff barriers, including complex product regulations and standards, rules on certificates of origin and burdensome customs procedures.

Addressing non-tariff barriers requires implementation of an action plan, with active participation by a number of government agencies, private sector associations and individual companies and a high level of international and regional cooperation. It includes the introduction of a vast number of legislative and regulatory measures and the establishment of new institutions (e.g. technical laboratories, certification and inspection bodies).

The activities involved in simply upgrading domestic technical and quality standards in line with EU or international norms give a good indication of the complexity of the task SEE countries face.

The first step is to design, implement and coordinate the respective legal framework and institutional infrastructure, including:

- Adopting international (mainly European) standards and securing participation in the relevant EU and international standard-setting organisations.
- Strengthening institutional capacity in the fields of metrology, standardisation, testing and quality management.
- Establishing authoritative bodies (accreditation agencies), that give formal recognition that conformity assessment bodies (testing and calibration laboratories, inspection and certification bodies) are competent to carry out specific conformity assessment task (EC, 2005a).

The second step is to make sure that an increasing number of companies operate according to EU and international standards and that they acquire relevant technical and management certification. This involves upgrading the technical and management skills of the company and very often, considerable investment in technology equipment and human resources.

Ultimately, it is the number of companies operating according to EU and/or international standards and the number of quality certificates obtained that really matter.¹¹⁹

For SEE countries, failure to adopt EU standards at the company level means a high risk of being marginalised in the global supply chain. SEE companies can apply for certification abroad, but this option is largely reserved for larger or foreign-owned companies.

Equally, complex and costly customs procedures for imports and exports penalise companies working with international partners. This reduces the value of one of the main competitive factors of the SEE region, which is its proximity to the EU market.

All SEE countries are committed to reducing non tariff barriers and have launched specific programmes, often supported by international donors and in particular by the European Commission and the World Bank. As would be expected, Bulgaria and Romania are at a more advanced stage of implementation than the other SEE countries.

8.5.1 Technical barriers to trade

8.5.1.1 Technical standards

SEE countries face tough challenges throughout the process of adopting and implementing technical standards. In a limited period of time they need to make the transition from regimes of obsolete mandatory standards developed under the socialist command economy to new sets of voluntary EU and international standards.

¹¹⁹ The IFC has an initiative, supported by a number of donors called PEP-SE which assists SMEs to meet technical standards and to attain certification.

The position of individual countries during the process varies considerably and is to a large extent determined by their position in the EU accession process. The following section will briefly review the progress achieved so far by SEE countries in relation to the process described in section 8.5 above.

Membership in/affiliation to European and international standards organisations

The main technical standards organisations at European level are the European Committee for Standardization (CEN), the European Committee for Electrotechnical Standardization (CENELEC) and the European Telecommunications Standards Institute (ETSI). At the global level, the International Organization of Standardization (ISO) is the largest developer of international standards. As of June 2006, CEN had 11,815 European standards and approved documents. ISO's total portfolio contained 15,649 international standards as at the end of 2005. ISO and CEN are coordinating their work and approximately one third of CEN approved standards are identical to ISO standards (ANSI, 2005).

A first indication of the relative position of SEE countries with respect to technical standards is given by the type of membership or affiliation of their national standardisation bodies, as indicated in Table 8.5.

Transposition of European and international standards

The next step concerns the extent to which EU/international standards have been transposed into domestic legislation and regulations. Unfortunately, comparable data concerning this process are not available for all the SEE countries. However, it appears that the two pre-accession countries (Bulgaria and Romania) have largely completed their transposition of EU standards and have made some progress in adopting international standards.

For instance, at the end of 2005 Romania had adopted 98% of the CEN standards and 99% of the CENELEC standards, but only 19% of the ISO standards. Bulgaria amended its laws on standardisation in 1999 and adopted a law on technical requirements in 2005 (EC, 2005b). At the end of 2005 more than 90% of EU standards (CEN, CENELEC, ETSI) had been adopted.

According to the EC Progress Reports, by mid-2005 Albania and Croatia had each adopted approximately 57% of CEN and CENELEC standards (EC, 2005c, d), while Bosnia and Herzegovina had adopted approximately one third of EU standards.

The FYR Macedonia, Moldova, Montenegro and Serbia are at the very beginning of the process. Up to the end of 2005, Serbia and Montenegro

TABLE 8.5
MEMBERSHIP IN STANDARDS ORGANISATIONS

	European Committee for Standardization (CEN)	European Committee for Electrotechnical Standardization (CENELEC)	International Organization for Standardization (ISO)
Forms of participation	Members/Affiliates/ Partners ¹²⁰	Members/ Affiliates	Member bodies/ Correspondent Members
Albania	Affiliate	Affiliate	Correspondent Member
Bosnia and Herzegovina	Partner	Affiliate	Member
Bulgaria	Affiliate	Affiliate	Member
Croatia	Affiliate	Affiliate	Member
FYR Macedonia	Affiliate	Affiliate	Member
Moldova	n/a	n/a	Correspondent Member
Romania	Member	Member	Member
Serbia and Montenegro	Partner	Affiliate	Member

Sources: CEN, CENELEC, ISO.

¹²⁰ Members: The national standard bodies of the Union, EFTA, some Eastern and Central European countries are the national members of CEN. Affiliates: National standard bodies of Central and Eastern European countries which can in principle become full national members of CEN. Partner Standardisation Bodies are national standard bodies which are a member of ISO, but are unlikely to become CEN members or CEN Affiliates for political or geographical reasons.

had not dealt with the adoption of international standards (EC, 2005e), but relied almost entirely on the old Yugoslav standards (JUS) of which only 2.4% were in conformity with CEN standards and only 0.1% in conformity with those of CENELEC. The European standards adaptation process is expected to start in Serbia in 2006, with the entry into force of the new Law on Standardisation. Following independence, Montenegro is expected to launch the same process in early 2007.

Despite its status as an EU candidate country as of the end of October 2005, FYR Macedonia has only transposed five European standards (EN) and it is still relying on JUS national standards. However, a work programme for the adoption of EN standards, including a database of harmonised standards, has been prepared (EC, 2005f). Moldova has adopted only 42 European and 292 International (ISO/CEI) standards so far, but it has launched a national programme for drafting technical regulations harmonised with international and EU standards.

National standardisation bodies

The relative position of the SEE countries is not very different regarding the establishment of national standardisation bodies.

According to the 2005 EC Monitoring Reports, the infrastructure of national standardisation bodies in Bulgaria and Romania is well in place.

In Croatia most of the institutional framework is in place. Two new public institutions were created in early 2005: the Croatian Standards Institute, as the national standards body and the Croatian Accreditation Agency, as the national accreditation service. Albania introduced a first law on standardisation in 1999. It subsequently established the General Directorate of Standardisation within the Ministry of Economy, which during a first stage administered both standardisation and certification. However, there are plans to split the two functions by 2007 to avoid potential conflict of interest (EC, 2005c).

In July 2004 Bosnia and Herzegovina adopted a new law on Standardisation including the

establishment at state level of three independent bodies: the Institutes for Standards, Metrology and Intellectual Property. However, the institutes are not yet fully operational and tasks related to standards and metrology continue to be performed by the previous body (BASMP) (EC, 2005g).

FYR Macedonia, Moldova, Montenegro and Serbia have established national standardisation bodies which are currently being restructured and upgraded.

8.5.1.2 Sanitary and phytosanitary standards

The adoption of measures related to sanitary and phytosanitary standards is regulated by a WTO agreement that encourages WTO members to base their regulations on international standards developed by the Codex Alimentarius Commission (food safety), the International Office of Epizootics (animal health) and the International Plant Protection Convention. Furthermore, the EU *acquis communautaire* provides detailed rules regarding food safety, veterinary and phytosanitary standards.

Agricultural products and foodstuffs represent an important part of SEE countries' GDP and exports. Rapid adoption of European or international standards in agriculture would greatly enhance SEE export opportunities and allow deeper integration into the global production chains of the food processing industry. However, adoption of EU/international standards in the sanitary and phytosanitary areas is proceeding at a slower pace than in the area of technical regulations and standards. Progress is also highly differentiated among countries.

Bulgaria and Romania are the most advanced countries, although adoption of European standards has not been completed in some areas. For example, Bulgaria transposed most of the EU *acquis* in the areas of food safety and phytosanitary issues (EC, 2005b), but only 10% of companies are EU certified in the food sector. As of mid-2005, only one fifth of meat processing and one tenth of milk processing companies fulfil European phytosanitary standards. The transposition of the EU *acquis* in the area of food safety has largely

been completed in Romania but the transposition of veterinary and phytosanitary standards has been slower (EC, 2005h, 2006a).

Croatia, Montenegro and Serbia have adopted sectoral measures in line with EU standards, focussed mainly on the veterinary sector. However, further action is needed with respect to implementation of legislation in this area, especially regarding administrative capacities. Serbia has made progress in aligning its legislative framework with the EU *acquis* and Montenegro has partially implemented sanitary and phytosanitary standards through the Veterinary Law and is currently preparing a draft law on food safety.

FYR Macedonia has begun the process of aligning its food safety, veterinary and phytosanitary legislation with EU standards, and has introduced framework laws in these areas. Implementing legislation, however, is still in preparation. The veterinary and phytosanitary services lack institutional and infrastructure capacity. (EC, 2005f)

Albanian and Moldovan standards and institutions in the food safety, veterinary and phytosanitary areas are far from meeting European requirements. However, Moldova has largely harmonised its food law with international standards and with EC Directives. The Moldovan Government has adopted a plan to modernise standards by 2008 with an emphasis on the agro-business sector. Albania passed a first law on veterinary services in 2004, but further efforts are still needed in order to align its legislation with the EU veterinary and phytosanitary *acquis*. The same situation applies to fishery and other relevant sectors for the Albanian economy (EC, 2005c).

Bosnia and Herzegovina has made only limited progress in adopting legislation in line with EU standards. The phytosanitary and sanitary agency is not operational, but there has been progress in the veterinary sector (EC, 2005g).

8.5.1.3 Accreditation and conformity assessment
As mentioned in section 8.5, the ultimate outcome of the process of introducing European

and international standards will be determined by the number of companies that adopt these standards and obtain the relevant certification. This in turn will require a well-established and well-functioning conformity assessment system (testing and calibration laboratories, inspection and certification bodies).

Once again, the main issue for most countries is a weak institutional framework. National accreditation bodies in most countries are not yet full members of international accreditation organisations such as the European Cooperation for Accreditation (EA) and the International Laboratory Accreditation Cooperation (ILAC) as shown in Table 8.6. Testing and calibration laboratories and inspection and certification bodies often lack adequate technical and human resources, hampering the conformity assessment process and forcing companies to rely on foreign laboratories.

Another important issue is a lack of technical skills and financial resources at the company level required to meet related technical and managerial requirements for obtaining the relevant certification.

Again Bulgaria and Romania are the most advanced countries in this regard, followed by Croatia. A functioning certification system is in place, but limitations exist, including administrative capacity issues. For example, the administrative capacity of the Romanian accreditation body RENAR should be enhanced (EC, 2005h). According to the latest Monitoring Report of the EC, progress has been made recently in this area. Staff was recruited and training took place. Certification obtained in Bulgaria, Croatia and Romania is recognised by European trading partners on the basis of their membership in the European Cooperation for Accreditation.

Serbia and Montenegro have recently made some progress with respect to conformity assessment. There is an increasing number of certifying laboratories and testing agencies. However, foreign product certification is not yet recognised in Montenegro. Serbia only recently recognised

TABLE 8.6

MEMBERSHIP IN INTERNATIONAL ACCREDITATION ORGANISATIONS

	European Cooperation for Accreditation (EA)	International Laboratory Accreditation Cooperation (ILAC)
Forms of participation	Members/Associate/Cooperation ¹²¹	Member/Associate/Affiliate ¹²²
Albania	Associate	Affiliate
Bosnia and Herzegovina	Cooperation	Associate
Bulgaria	Member	–
Croatia	Member	–
FYR Macedonia	Cooperation	–
Moldova	Cooperation	Affiliate
Romania	Member	Member
Serbia and Montenegro	Associate	–

Source: EA, ILAC.

foreign certification of food products. Yet exporters can obtain certification by domestic organisations. In addition, a growing number of companies are obtaining EU or international certificates.

The process of obtaining internationally recognised certification appears to be easier in Moldova. The Body for Quality Systems Certification (QSCB) provides certification for Moldovan and international standards (TÜV Germany, Romania, Russia and Ukraine). International product certificates can be accepted on a case-by-case basis and may also be validated.

Lack of internationally recognised certification is a significant barrier to exports in Albania, Bosnia and Herzegovina, and FYR Macedonia. These countries' institutional structures are particularly weak. Exporters have their products certified by foreign laboratories. For example, FYR Macedonia does not have a functioning

certification system and laboratory facilities are unable to meet industry's demand (EC, 2005f). However, foreign certificates are accepted. In Bosnia and Herzegovina it is almost impossible to export animal products to most markets because of an inefficient veterinary system and lack of an accepted certification system. Only four companies in Bosnia and Herzegovina have CE certification.¹²³ Albania has established an Accreditation Directorate under the Ministry of Economy and has recently increased its staffing. The main bottleneck is the poor conditions of the laboratories.

Figure 8.6 shows the different stages of certification in SEE countries using the ISO 9001 certificate for quality management systems.¹²⁴ Raw data weighted by population figures make the figures comparable. Although the EU-15 average is still far ahead, three countries (Bulgaria, Croatia and Romania) in the SEE region have advanced much further than their neighbours.

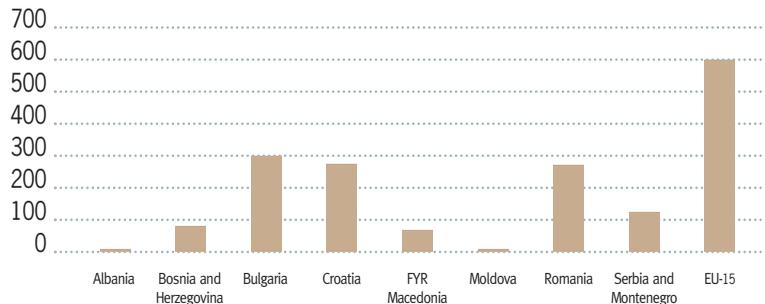
¹²¹ Members: Nationally recognised accreditation bodies in a country (economy) being a member state of the European Economic Area, EFTA or a candidate country for membership in EU or EFTA. Associate: Nationally recognised accreditation bodies in a European country (economy) not being a member state of EU, EFTA or not a candidate country for membership in EU or EFTA. For these two types of membership, they need to prove that they are operational and comply with requirements set out in relevant European Standards and EA application documents. Cooperation: 16 non-European accreditation bodies have signed a contract of cooperation with EA.

¹²² Members: Accreditation bodies that meet the requirements for Associates and have also been accepted as signatories to the ILAC Mutual Recognition Arrangement. Associates: Accreditation bodies that are not yet signatories to the ILAC Arrangement. Affiliates: Accreditation bodies that are currently operating, being developed or intended to be developed for testing laboratories, calibration laboratories, inspection bodies [...].

¹²³ The CE conformity marking on a product symbolises the conformity of this product with EC requirements (European Directives). It indicates that the product can be legally sold within the EU market and EFTA.

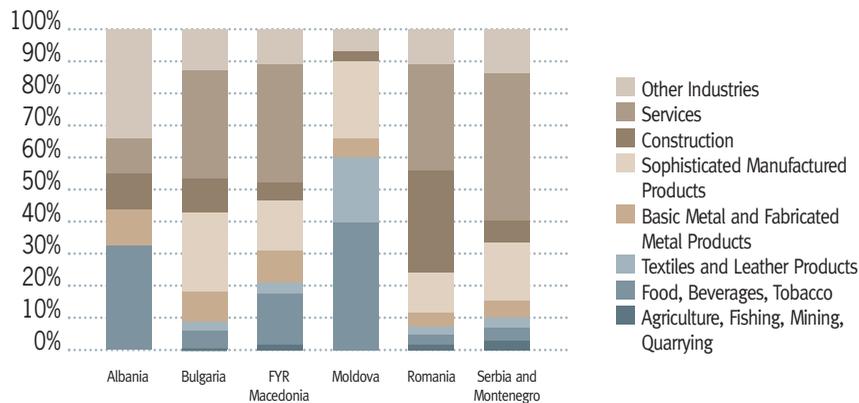
¹²⁴ Data on certificates for technical standards are not available. It may be assumed that quality management is correlated with certification in strictly technical areas because this is a condition for meeting high standards in production. According to the ISO Survey 2005, page 6, growth in 9001 quality management certificates in India and China 'is no doubt partly linked to their increasing participation in global supply chains, in export trade and in business process outsourcing'. The data are population weighted because it is impossible to determine the total share of firms that are certified. One firm may have more than one valid ISO 9001 certificate and certificates are not only issued to firms, but also to other organisations.

FIGURE 8.6 – NUMBER OF VALID ISO 9001 CERTIFICATES PER MILLION PEOPLE, DECEMBER 2005



Source: ISO.

FIGURE 8.7 – SECTORAL BREAKDOWN OF VALID ISO 9001 CERTIFICATES IN SIX SEE COUNTRIES, DECEMBER 2005



Source: ISO.

The distribution of valid ISO 9001 certificates across sectors is also relevant. Figure 8.7 shows that services and food sectors alone absorb a large share of total certificates in many countries, while relatively few valid certificates exist in other sectors. Sophisticated manufactured products (a category comprising machinery and equipment, electrical and optical equipment, and transport equipment) have a significant share of above 20% only in Bulgaria and Moldova. But since total certificates in Moldova are negligible

as shown in Figure 8.6, only Bulgaria has achieved substantial progress in this area. Despite data limitations, these facts help to understand why export performance in the area of high value-added manufacturing in most SEE countries has been disappointing.

8.5.1.4 IRI results for technical barriers to trade

The evaluation of the technical barriers to trade sub-dimension has resulted in the scores in Table 8.7, describing the current situation in each of the nine target countries.

TABLE 8.7

IRI SCORES FOR TECHNICAL BARRIERS TO TRADE¹²⁵

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.25	1.75	4.25	3	1.75	2	2.25	4	2.25

Source: OECD Investment Compact.

¹²⁵ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

Bulgaria and Romania are the most advanced countries in terms of introducing technical, sanitary and phytosanitary standards and also in accreditation and conformity assessment. Countries such as Bosnia and Herzegovina, FYR Macedonia and Moldova have an overall weak institutional framework and slower transposition and implementation of European/international standards. In general, most SEE countries scored lower in sanitary and phytosanitary standards than in technical standards and accreditation and conformity assessment.

8.5.2 Administrative barriers to trade

In addition to more technical NTBs, there are also administrative barriers which hamper trade including a large number of licenses and number of documents required in order to import and export. Estimates of the costs associated with border procedures, trade and transaction costs

(TTCs), range from 1 to 15%. An OECD study found that reducing TTCs on trade in goods by only 1% could result in an average increase in GDP of 0.47% for non-OECD countries (OECD, 2003). Most customs administrations in SEE countries are improving their infrastructure to facilitate transparency and effectiveness. However, in most cases there are still long waiting periods to export and import. To help investors comply with the most recent customs requirements and avoid unnecessary problems and longer waiting times at customs, the accessibility of customs laws and regulations is an important information tool.

The majority of SEE countries have abolished general import and export licenses. Licenses are only applied to products which might pose a health, safety or security risk.

BOX 8.2

CASE STUDY ON CUSTOMS ADMINISTRATION IN LATVIA

Following independence, Latvia introduced new customs legislation and procedures modeled on the Community Customs Code. At the same time, Latvia also implemented the World Customs Organization's Kyoto Convention. Among others, the following features of the Latvian customs administration contributed to simpler and more efficient customs procedures, in the interest of trade expansion:

Advance lodgement and processing of data: An electronic declaration can be lodged prior to the arrival of goods. If the information complies with customs requirements, the goods are cleared and can be released shortly after their physical arrival.

Risk assessment and audit-based controls: These tools allow customs to reduce the number of physical inspections of imported goods. A risk profiling database allows identification of shipments for which the risk of customs fraud is higher. A system of authorised traders is in place; these traders enjoy faster procedures thanks to the use of audit-based controls rather than physical inspections of goods.

Consultative and feedback mechanisms: The Customs Consultative Board meets with trade representatives monthly. The customs administration also consults traders before modifying customs legislation, procedures and practices. Following amendment of the Administration Law, these consultations are now mandatory and traders have the right to propose items for discussion to be added to the agenda.

Two-tiered appeal procedures: Appeals against customs decisions are heard at a first level by the Customs director. Appeals against this decision can be filed in an administrative court.

Source: OECD (2004).

Croatia's import licensing regime is particularly liberal (automatic import licenses for arms, drugs, waste and other products). However, mandatory quality controls are performed on a list of 55 commonly traded goods (e.g. foodstuffs, textiles, electronic equipment), which significantly slows down customs procedures.

Montenegro and Serbia are currently undergoing adjustments to their licensing regimes. Montenegro has a system of import licenses for iron and steel products. These licenses are automatic and do not pose a restriction. There are licenses for products affecting human and animal health, plants and intellectual property rights. However, an elaborated version of the new Control List for exports, imports and transit is being developed.¹²⁶ Serbia no longer has import licences. It applies import and export licenses only in the case of products that pose safety, health or security risks.

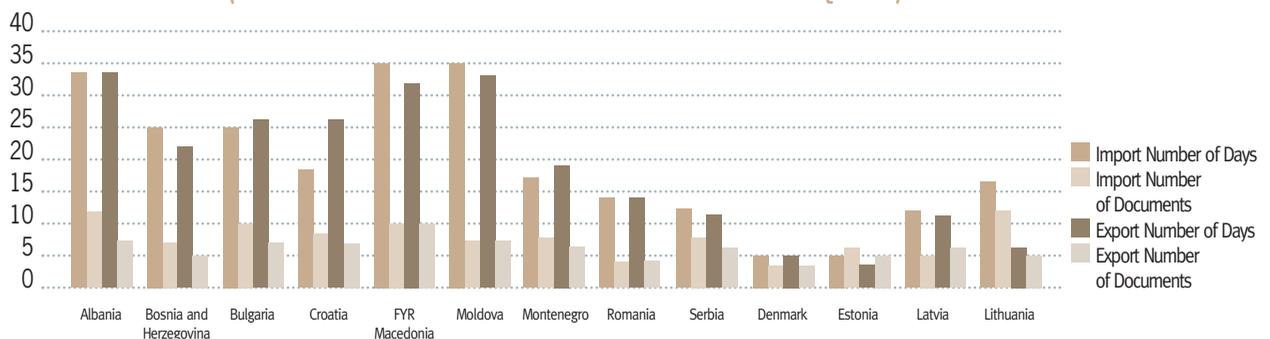
In general, import-export administrative procedures are still burdensome in most SEE countries. Nevertheless, procedures improved significantly in Croatia, Romania and Serbia between 2005 and 2006. The time needed to import and export, as well as the number of documents required is still high in some SEE countries. For example, in Albania 34 days and 12 documents are required for importing according to the World Bank *Doing Business in 2007* report. The report takes into

account the entire process, including document processing, packing of the goods, customs clearance and goods' departure from the port of exit. Figure 8.8 presents cross-country data. According to the figure, administrative barriers in Romania and Serbia are relatively low.

In the last two years there has been considerable improvement in customs administrations across the SEE countries. These changes are not fully captured by the *Doing Business in 2007* indicators shown in Figure 8.8. However, the time needed solely to clear imports and exports through customs is relatively low in most SEE countries, especially when compared with other countries in the region as shown in Figure 8.9.

Information on customs laws and regulations such as tariffs, goods classification and customs procedures, is generally accessible and available in the local language on websites and in Official Gazettes, but this is less true in Bosnia and Herzegovina, Moldova and Montenegro. Bulgaria and Romania each have customs websites and provide a functioning English version of some pages. Croatia and FYR Macedonia provide only very limited information in English on their customs websites. Serbia does not have a functioning customs website in English. Albania recently introduced a customs website with some information in English.

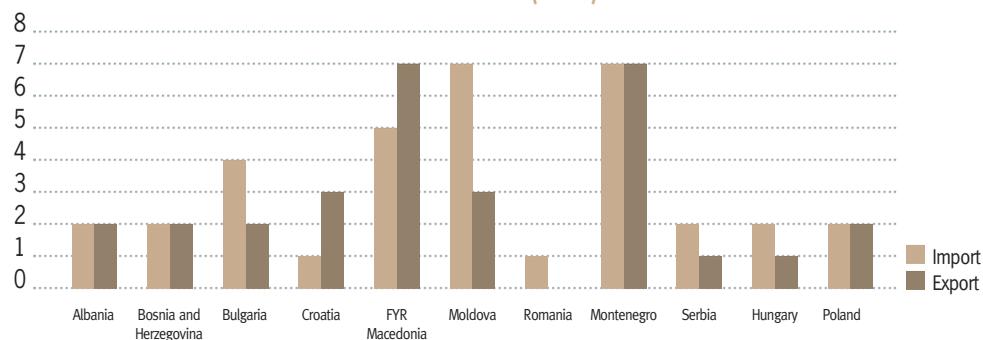
**FIGURE 8.8 – IMPORT/EXPORT ADMINISTRATIVE PROCEDURES
(LENGTH OF PROCEDURE AND NUMBER OF DOCUMENTS REQUIRED) IN 2006**



Source: *Doing Business in 2007* Report, World Bank (2006).

¹²⁶ According to the Montenegrin government, this is supposed to be introduced in 2006.

FIGURE 8.9 – AVERAGE TIME FOR CUSTOMS CLEARANCE AND TECHNICAL CONTROL FOR IMPORTS AND EXPORTS (DAYS) IN 2006



Source: Doing Business in 2007, World Bank (2006).

Although much progress has been made in integrating SEE countries at the regional and European levels, a number of obstacles remain. These are partly linked to the different pace of the SEE countries in the EU integration process and in completing multilateral trade negotiations. The impact of these obstacles on expansion of trade and investment in sensitive sectors can be significant, as illustrated in the Box 8.3.

8.5.2.1 IRI results for administrative barriers to trade

The evaluation of the administrative barriers to trade sub-dimension has resulted in the scores in Table 8.8, describing the current situation in each of the nine target countries.

Romania and Serbia have the lowest administrative barriers to trade. Albania, FYR Macedonia and Moldova require a relatively high number of days and documents for import and export operations.

TABLE 8.8

IRI SCORES FOR ADMINISTRATIVE BARRIERS TO TRADE¹²⁷

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.50	3	3	3	2.25	2.50	3.25	4.25	4

Source: OECD Investment Compact.

¹²⁷ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

BOX 8.3

RULES OF ORIGIN, TRADE AND INVESTMENT

All SEE countries benefit from preferential access (exemption or reduction of customs duties) to the Community market. To ensure that exporters from third countries do not unduly benefit from this preferential treatment by simply shipping their goods to the EC through an SEE country, preferential treatment is granted only to goods that originate in SEE countries.

The Rules of Origin attached to the unilateral (ATM, GSP) or bilateral (Europe Agreement, Stabilisation and Association Agreement) trade concessions granted by the EC include the criteria that goods must meet in order to be considered to originate in a country that benefits from trade concessions. Establishing the origin of products completely produced (“wholly obtained”) in one country is relatively straightforward; however, things become more complicated when a product is obtained through processing raw materials and semi-processed products from different countries. In this case, the product will be considered to originate in the country where the last substantial processing took place. One way to define what constitutes a sufficient “substantial processing” is the change of tariff line. Thus, wheat originating in country A can be transformed into bread in country B. As the tariff line for bread (HS1905) is different from the tariff line for wheat (HS 1001), the bread will be considered to originate in country B. However, rules of origin are generally more complicated, and strict criteria for what constitutes “substantial processing” are defined for each product.

Countries with identical rules of origin can decide to cumulate origin. In this case, products do not have to undergo sufficient transformation to be considered as originating in the country of the last processing, as long as all inputs came from countries participating in the cumulation of origin. Under the pan-European cumulation system currently in force between the EC25, the EFTA countries, Bulgaria, Romania and Turkey, a product originating in one of these countries can be added to products originating in any other participating country without affecting the origin of the product. For example, a product produced in Slovakia from inputs originating in Poland and the Czech Republic will be considered to be of Slovak origin, even if the transformation undergone in Slovakia has been less than substantial (diagonal cumulation of origin).

The issue of cumulation of origin is of crucial importance for the SEE region. Under the autonomous trade measures (applicable to Bosnia and Herzegovina, Montenegro and Serbia), the Stabilisation and Association Agreements (with Albania, Croatia and FYR Macedonia) and the GSP (Moldova), origin can be cumulated only with the EC (bilateral cumulation), and not with the other SEE countries (diagonal cumulation). This can create obstacles to intra-regional trade and investment when the EC rules of origin pose important requirements in terms of what constitutes “substantial processing”.

An example can clarify this concept. Under the general origin rule for clothing, the working or processing carried out on non-originating materials that confer originating status is “manufacture from yarn”. If Bosnia and Herzegovina wishes to export handkerchiefs to the EC under the preferential customs treatment, it should make sure that the processing of the yarn into fabric and of the fabric into handkerchiefs both take place in Bosnia and Herzegovina. If Bosnia and Herzegovina imports fabric from Serbia and uses this fabric to make handkerchiefs, these products will not be considered as originating in Bosnia and Herzegovina, and will be subject to quantitative restrictions and customs duties when exported to the EC. If diagonal cumulation of origin was permitted under the ATMs, instead the Serbian-Bosnian handkerchiefs could be exported to the EC under the preferential tariff treatment.

Diagonal cumulation of origin between SEE countries would allow these countries to maximise the trade and investment gains of the regional network of free trade agreements and of the preferential access to the Community market, as all the production phases of a good could take place anywhere in the SEE region where competitive advantages are higher. This would be beneficial for industries in which economies of scale are particularly important, or where the production chain is segmented into a multitude of steps, not all of which would be considered sufficient to change product’s origin. On the other hand, administering the cumulation of rules of origin requires the customs administrations to have adequate administrative capacities.

The European Council of Thessaloniki recognised the importance of allowing diagonal cumulation of origin and asked the Commission to ‘prepare the extension of the pan-European diagonal cumulation of origin to the countries of the region in a manner consistent with all relevant community policies and dependent on their administrative capacity’.

Source: OECD Investment Compact.

8.6 Pro-active trade policy

Many SEE countries have export promotion programmes carried out by specialised agencies and Chambers of Commerce and maintain a network of commercial offices in key export markets. These measures are targeted mainly at SMEs. At the same time governments can indirectly hamper exports by delaying VAT rebate for exporters (this issue is dealt with in greater detail in this tax policy section) and through inappropriate macroeconomic policies which result in currency misalignment.

Most SEE countries have established export promotion agencies, but in most of them there is a lack of well-defined export promotion strategies implemented through coordinated and adequately funded export promotion programmes.

Often some export promotion functions are carried out by SME promotion agencies. This is the case in Bulgaria and Romania, which operate relatively well-structured export promotion programmes. Montenegro recently established an export promotion department within the SME development agency; its operational and financial plan has been adopted.

Croatia, Moldova and Serbia have established export promotion departments under their FDI promotion agencies, while Albania has recently grouped the functions of SME development, export promotion and FDI promotion under one single agency. Bosnia and Herzegovina has a department within the Ministry for Foreign Trade and Economic Relations dealing with export promotion. In addition, the Chambers of Commerce which were traditionally in charge of this area still play an important role, organising trade missions and participation in fairs abroad. This is particularly the case in FYR Macedonia where there is no export promotion agency and

export promotion services are available from the Economic Chamber of Macedonia.

Typical export promotion programmes include provision of information about new business requirements related to potential EU accession, assistance to industrial development, facilitation of access to financing, participation by SMEs in international programmes, the search for business partners, protection of intellectual property, information about markets, foreign trade regimes, participation in international fairs, organisation of trade missions, training of management and staff, and information about the implementation of international standards and related certification. The activities of most export promotion agencies also include promoting linkages with other agencies, ministries and partner organisations.

No SEE country has yet developed a network of specialised commercial offices in other countries. Instead these countries rely on their diplomatic representations.

An overview of export promotion agencies in SEE and their activities is given in Table 8.9.

All SEE countries have VAT rebate mechanisms for exporters in place but there are differences in actual implementation of reimbursement. In Bulgaria, FYR Macedonia, Romania and Serbia reimbursement takes around 30 to 45 days, although in some cases this timeframe cannot be met. In Albania and Moldova reimbursement takes much longer, e.g. in Moldova it can take up to six months.

8.6.1 IRI results for pro-active trade policy

The evaluation of the pro-active trade policy sub-dimension has resulted in the scores in Table 8.10, describing the current situation in each of the nine target countries.

TABLE 8.9
EXPORT PROMOTION AGENCIES IN SEE COUNTRIES

	Organisational Structure	Export Linkage Promotion*	Information/ Consulting Services	Training Offered
Albania				
Agency for Business and Investments (AlbInvest)	Merged functions: SME + Investment + Export Promotion	✓	✓	✓
Bosnia and Herzegovina				
	Department within the Ministry for Foreign Trade and Economic Relations		✓	
Bulgaria				
SME Promotion Agency	Merged functions: SME + Export Promotion	✓	✓	✓
Croatia				
Trade and Investment Promotion Agency	Merged functions: Investment + Export Promotion	✓	✓	✓
FYR Macedonia				
Economic Chamber of Macedonia	Chamber of Commerce**	✓	✓	✓
Moldova				
Moldovan Export Promotion Agency	Independent government agency	✓	✓	✓
Montenegro				
	Department within the Directorate for SME Development	✓	✓	
Romania				
National Agency for SMEs	Merged functions: SME + Export Promotion	✓	✓	✓
Serbia				
Investment and Export Promotion Agency	Merged functions: Investment + Export Promotion	✓	✓	✓

Source: OECD Investment Compact.

* Export linkage promotion refers to the promotion of contacts with other agencies, ministries and partner organisations.

** Export promotion is conducted by the Chamber of Commerce. No export promotion agency exists.

TABLE 8.10
IRI SCORES FOR PRO-ACTIVE TRADE POLICY¹²⁸

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
3.25	2.25	4	3	2.75	3.25	3	4.25	3.50

Source: OECD Investment Compact.

Bulgaria and Romania have established a sound pro-active trade policy. Bosnia and Herzegovina lacks effective export promotion programmes, and FYR Macedonia has no export promotion agency in place.

8.7 Key actions to consider at the regional level

1. Strengthen domestic institutions/ organisations in order to implement technical, sanitary and phytosanitary standards in line with EU/international requirements. Achieve further progress in establishing a well-functioning conformity assessment system.

2. Monitor implementation of technical, sanitary and phytosanitary standards to help identify areas for action and accelerate implementation.

3. Provide further assistance to companies, especially SMEs, in order to apply for certification and to implement EU/international standards.

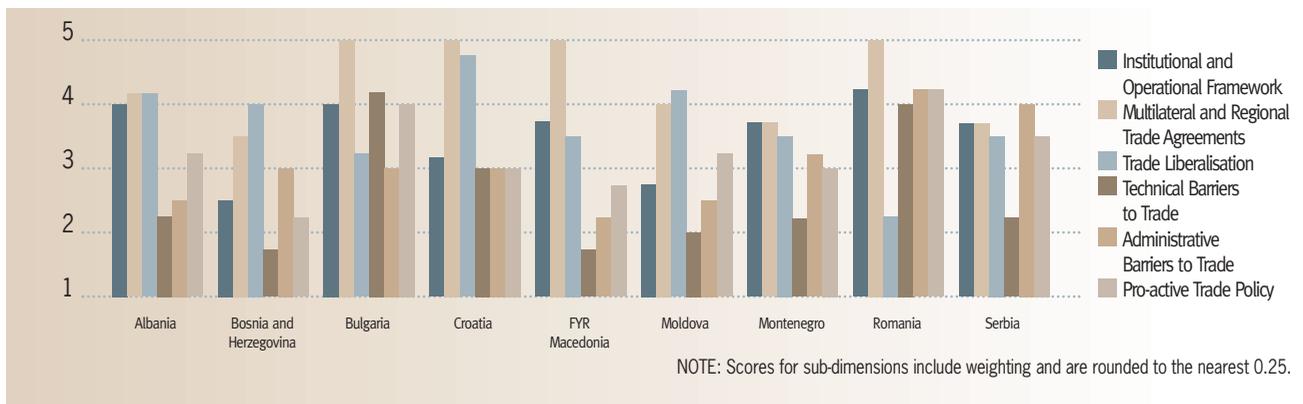
4. Further improve customs administration in terms of transparency and efficiency, for example by introducing a hotline for companies to report any irregularities.

¹²⁸ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

5. Further reduce tariff barriers on imports of capital goods.
6. Implement rapid and transparent VAT reimbursement for exporters.
7. Introduce export promotion programmes to integrate domestic companies into the international supply chain.
8. Pursue the regional SEE Free Trade Agreement to make possible a common economic space.

IRI SCORES FOR TRADE POLICY

FIGURE 8.10 – TRADE POLICY: SCORES BY SUB-DIMENSION



Source: OECD Investment Compact.

Multilateral and regional bilateral trade agreements

- Bulgaria, Croatia, FYR Macedonia and Romania scored at the highest level having established an extensive network of multilateral and bilateral trade agreements. Bosnia and Herzegovina, Montenegro and Serbia score below 4 primarily because they are not yet member of the WTO.

Trade liberalisation

- SEE countries on average perform well in terms of trade liberalisation. Bulgaria and Romania have lower scores than the average because of higher import tariffs, especially on agricultural products. But those tariffs will have to be lowered at the time of EU accession.

Technical barriers to trade

- Bulgaria and Romania are the most advanced countries in terms of introducing technical, sanitary and phytosanitary standards and also in accreditation and conformity assessment. Countries such as Bosnia and Herzegovina, FYR Macedonia and Moldova have an overall weak institutional framework and slower transposition and implementation of European/international standards. In general, most SEE countries scored lower in sanitary and phytosanitary standards than in technical standards and accreditation and conformity assessment.

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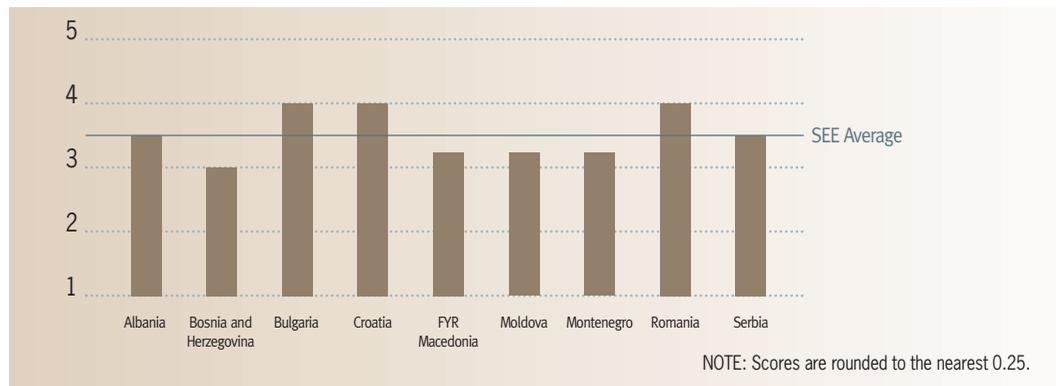
Administrative barriers to trade

- Romania and Serbia have the lowest administrative barriers to trade. Albania, FYR Macedonia and Moldova require a relatively high number of days and documents for import and export operations.

Pro-active trade policy

- Bulgaria and Romania have established a sound pro-active trade policy. Bosnia and Herzegovina lacks effective export promotion programmes, and FYR Macedonia has no export promotion agency in place.

FIGURE 8.11 – OVERALL SCORES FOR TRADE POLICY



Source: OECD Investment Compact.

- Along with investment policy, trade policy is one of the strongest policy dimensions in SEE, with an average of 3.50.
- A more active focus on NTBs - in particular technical barriers to trade - would help make trade policy the strongest policy dimension in the region.

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- Albanian Investment Promotion Agency (www.anih.com.al)
- Albanian Ministry of Economy (www.minek.gov.al)
- Albanian Ministry of Foreign Affairs (www.mfa.gov.al)
- Bosnia and Herzegovina Indirect Taxation Authority (<http://www.uino.gov.ba>)
- Bosnia and Herzegovina Foreign Investment Promotion Agency (www.fipa.gov.ba)
- Bosnia and Herzegovina Ministry of Foreign Trade and Economic Relations (www.mvteo.gov.ba)
- Bulgaria Customs Agency (www.customs.bg)
- Bulgaria Ministry of Economy and Energy (www.mi.government.bg)
- Bulgaria Small and Medium Enterprises Promotion Agency (www.sme.government.bg)
- Croatia Customs Directorate (www.carina.hr)
- Croatia Ministry of Economy, Labour and Entrepreneurship (www.mingorp.hr)
- Croatia Ministry of Finance (www.mfin.hr)

FYR Macedonia Customs Administration (www.customs.gov.mk)
FYR Macedonia Ministry of Economy (www.economy.gov.mk)
FYR Macedonia Ministry of Finance (www.finance.gov.mk)
Macedonian Economic Chamber (www.mchamber.org.mk)
Moldova Customs Service (www.customs.md)
Moldovan Export Promotion Organization (www.mida.md, www.mepo.net)
Moldova Ministry of Foreign Affairs and European Integration (www.mfa.md)
Montenegrin Investment Promotion Agency (www.mipa.cg.yu)
Montenegro Ministry of International Economic Relations (www.vlada.cg.yu/eng/minevrint)
Romania Foreign Trade Department (www.dce.gov.ro)
Romania Ministry of Economy and Trade (www.minind.ro)
Romania National Agency for SMEs and Cooperatives (<http://en.animmc.ro>)
Romania National Customs Authority (www.customs.ro)
Romanian Standards Association (www.asro.ro)
Romanian Trade Promotion Center (www.traderom.ro)
Serbian Investment and Export Promotion Agency (www.siepa.sr.gov.yu)
Serbia Ministry of International Economic Relations (www.mier.sr.gov.yu)
Serbia Ministry of Finance, Customs Administration (www.fcs.yu)
Serbia Ministry of Trade, Tourism and Services (www.minttu.sr.gov.yu)

International bodies:

BSI group (BSI) (www.bsi-global.com)
Codex Alimentarius (www.codexalimentarius.net/web/index_en.jsp)
European Bank for Reconstruction and Development (EBRD) (www.ebrd.org)
European Committee for Electrotechnical Standardization (www.cenelec.org)
European Committee for Standardization (www.cenorm.be)
European Cooperation for Accreditation (EA) (www.european-accreditation.org)
European Union (EU) (<http://europa.eu>)
International Finance Corporation (IFC) (www.ifc.org)
International Laboratory Accreditation Cooperation (ILAC) (www.ilac.org)
International Organization for Standardization (ISO) (www.iso.org)
International Phytosanitary Portal (IPP) (www.ippc.int)
Southeast European Times (SETimes) (www.setimes.com)
Stability Pact for South Eastern Europe (www.stabilitypact.org)
United Nations Commodity Trade Statistics Database (UN Comtrade)
(<http://unstats.un.org/unsd/comtrade/default.aspx>)
United Nations Conference on Trade and Development (UNCTAD) (www.unctad.org)
United Nations Conference on Trade and Development Trade Analysis and Information System
(UNCTAD Trains) (www.unctad.org/trains/body.htm)
World Bank (www.worldbank.org)
World Integrated Trade Solution (WITS) (www.wits.worldbank.org)
World Trade Organization (WTO) (www.wto.org)



Chapter 9

Regulatory Reform

*Regulatory reform is clearly one of the region's biggest challenges. True enough, countries have designed and implemented regulatory reform strategies and established regulatory bodies. But some of these bodies are understaffed and many lack the power to challenge draft laws. Regulatory Impact Analysis (RIA) is still in its infancy and rarely used to improve legislation. This is a key problem because many countries require extensive and rapid adoption of EU regulations to comply with the *acquis communautaire*.*

Regulatory Reform

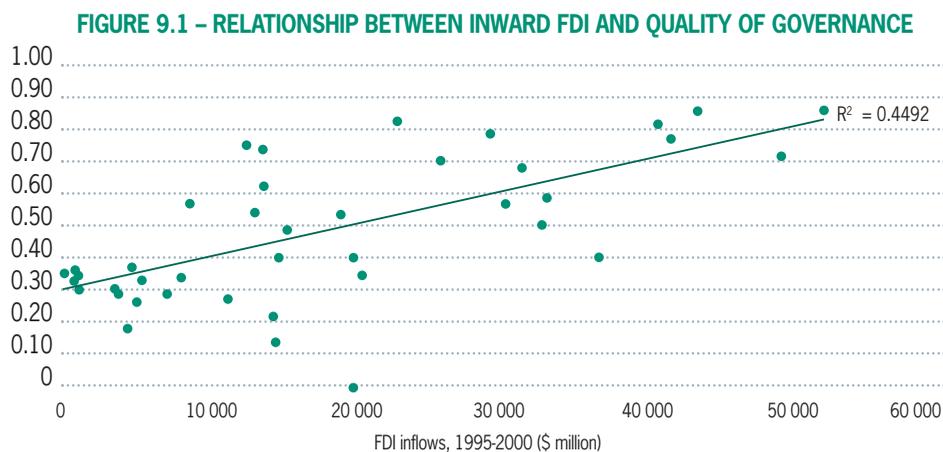
9.1 Introduction

Research suggests that there are positive links between high-quality regulation and Foreign Direct Investment (FDI) inflows (see Figure 9.1).

Lower regulatory burdens for citizens and governments promote sustainable economic development. High-quality regulation also provides governments with policy instruments to achieve social and environmental goals, better aligning public and private interests in markets. Regulatory policies that enhance competition and reduce regulatory costs can boost efficiency, bring down prices and stimulate innovation.

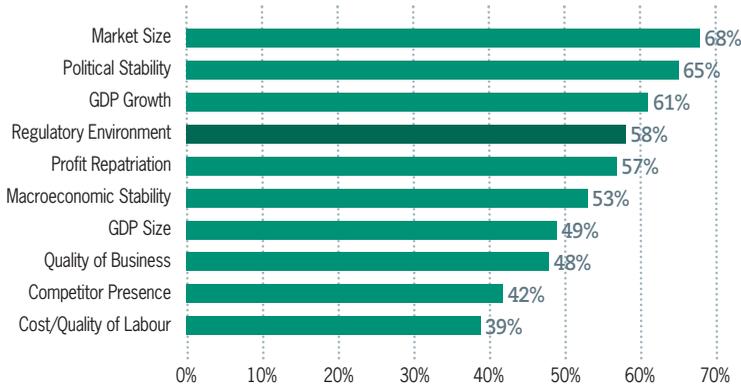
Reform that reduces business burdens and increases the transparency of regulatory regimes supports entrepreneurship, market entry and economic growth, which in turn attract foreign and domestic investors.

According to a survey by the management consultancy A.T. Kearney, the quality of the regulatory environment is a more important determinant of FDI in South East Europe (SEE) than other criteria commonly cited, such as macroeconomic stability, Gross Domestic Product (GDP) or cost of labour (see Figure 9.2).



Source: OECD (2002).

FIGURE 9.2 – TOP DETERMINANTS OF FDI IN SEE COUNTRIES



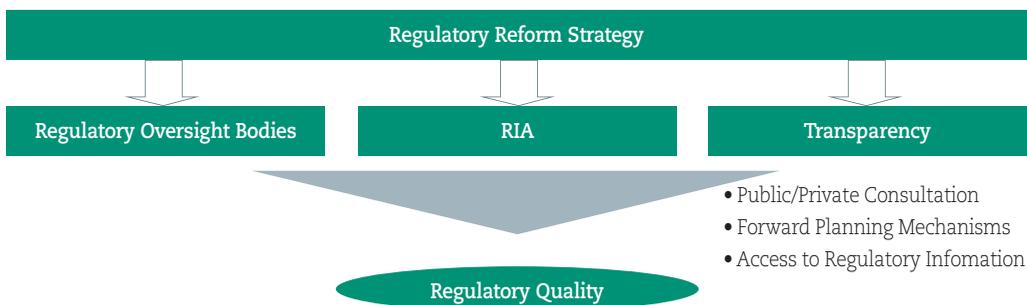
Source: FDI Confidence Index, A.T. Kearney.

9.2 Assessment framework

There is no single model with fixed stages of regulatory reform. Designing and implementing a broad regulatory reform programme is a complex task. It involves actions on several fronts (legislative, institutional and organisational) over a number of years, covers a wide spectrum of administrative functions and affects a considerable number of economic sectors. Policy co-ordination plays a considerable role, as does

political commitment. An effective way to deliver high-quality regulation, particularly in transition countries, is to structure government intervention based on a multi-year regulatory reform strategy that encompasses the institutional framework and tools for regulatory assessment, as well as a process for transparency,¹²⁹ all of which need to be implemented and ultimately to deliver results (see Figure 9.3).

FIGURE 9.3 – REGULATORY REFORM ASSESSMENT FRAMEWORK



Source: OECD Investment Compact.

¹²⁹ Includes public-private consultation, forward planning mechanisms and access to information on regulatory requirements.

9.3 Regulatory reform strategy

An effective regulatory reform strategy should include:

- a broad, multi-year policy agenda explicitly aimed at continuously improving the quality of the regulatory environment, with evidence that targets are implemented;
- an institutional framework designed according to good practice;
- Regulatory Impact Analysis (RIA), if not yet formally and systematically in place;
- mechanisms to ensure transparency (public-private consultation, forward planning mechanisms, access to information on regulatory requirements).

Of course, the different components of the regulatory reform strategy need to be implemented and enforced if they are to achieve results.

SEE countries are at different stages of designing, adopting and implementing their regulatory reform strategies.

Bulgaria, Romania, and Serbia have formalised strategies covering all the key components of the framework described above, and there is solid evidence of implementation in these countries. In Romania the *Business Environment Unit* drives regulatory reform, RIA and regulatory transparency. To perform these functions Bulgaria set up the *Ministry of State Administration and Administrative Reform*, and Serbia the *Council for Regulatory Reform*.

In Romania the *Business Environment Unit* works on the basis of an overall strategy and annual action plans, implemented with the support of a working group drawn from the public and private sectors. Specific efforts have been undertaken in the areas of business registration, tax and customs administration and site inspections.

Bulgaria and Serbia have each passed an array of laws, and have adopted and implemented a range of strategies to improve regulatory quality and the business climate. In Bulgaria examples include the *Bullstat Act* (to simplify company registration), the *White Book of Public Administration*, and the *Strategy for Modernisation of the Administration*. Serbia has reformed its public administration

through the *Strategy of Public Administration Reform*. It has adopted laws to increase transparency and it recently adopted a strategy to reduce administrative barriers.

Bulgaria, Romania, and Serbia have implemented large parts of their strategies. Romania and Bulgaria have, for example, established 'one-stop-shops'; Serbia has introduced 'silent approval' of many administrative approval processes.

In the remaining SEE countries, not all components of the regulatory reform strategy are in place. These countries can be considered according to the extent to which a national regulatory reform strategy has been elaborated and the key components of a regulatory reform strategy implemented.

Strategies have been formalised and partially implemented in Croatia, Moldova and Montenegro, but these strategies are narrower in scope than those described in the first group of countries above. They cannot fully be considered as broad policy agendas explicitly aimed at continuously improving the quality of the regulatory environment. All three countries have established oversight bodies: the *Task Force for Administrative Barriers Reduction* (Croatia), the *State Commission for Regulating Entrepreneurial Activity* (Moldova) and the *Governmental Commission for Economic Freedom* (Montenegro). Formal RIA already exists in Moldova. Specific reference to RIA is missing in the Montenegrin strategy. Croatia's strategy does not put enough emphasis on transparency.

- In Croatia the regulatory reform strategy is part of the *National Programme for the Integration of Croatia in the European Union (EU), 2006*. One part of this programme focuses on developing an efficient state administration system. It has included development of e-government and a further decrease in the number of ministries. An RIA filter is being gradually introduced with the assistance of the *Foreign Investment Advisory Service (FIAS)*.
- In February 2004 Moldova adopted a three-year programme to reform the regulatory framework of the enterprise sector. It established new rules for the creation of laws and regulations, including a legal requirement for their publication prior to adoption and consultation

with concerned stakeholders. Key components of this strategy have been implemented. For example, in 2005 'one-stop-shops' were put into operation with the support of the United States Agency for International Development (USAID). Furthermore, a new Law on Basic Principles Regulating Entrepreneurial Activity was enforced on August 11, 2006.

- In Montenegro there is a focus on the development of entrepreneurship by simplifying administrative procedures. This is part of the Economic Reform Agenda and includes by-laws for implementation. In addition, the Government has adopted a decision to establish a socio-economic Council and a Commission for Economic Freedom to promote dialogue with the private sector and thereby improve transparency. A Framework for Co-operation with the Non-Governmental Organisation (NGO) sector is also being set up.

Albania has developed a formal and broad strategy, but this strategy has not been implemented much yet. A regulatory reform action plan, adopted only in March 2006, is administered by the *Task Force for Administrative Barriers Reduction*. It focuses on four main pillars:

- development of the managerial system of regulatory reform;
- improvement of the existing legal framework through removal of administrative barriers for businesses;
- improvement of the quality of the new regulatory framework;
- systematic monitoring and evaluation of regulations.

The action plan includes the establishment of a regular system of public private consultation; however, the introduction of RIA is being deferred to a second phase of regulatory reform.

The other SEE countries do not have formalised regulatory reform strategies:

- There are only two, donor-driven programmes in Bosnia and Herzegovina. The regulatory guillotine in the Republika Srpska deals with business licences and inspection-related measures. Launched early this year, it was supposed to end in September 2006. The programme is funded by FIAS and USAID. Other donors are observing the programme, which is likely to expand following the general elections in autumn 2006. USAID is driving a second project, Streamlining Permits and Inspection Regimes Activity (SPIRA), concerned with reducing administrative barriers for small- and medium-sized enterprises (SMEs).
- The Government of the FYR Macedonia has not yet devised a formal regulatory reform strategy. A small number of programmes attempt to improve the sectoral regulatory framework (e.g. the Law on the Organisation of Government Bodies, which reduced the number of ministries). The World Bank programmes BERIS (Business Environment Reform and Institutional Strengthening) and FIAS will provide further guidance this year.

Both countries have defined oversight bodies: Bosnia and Herzegovina has established the *Task Force for Administrative Barriers Reduction*. In the FYR Macedonia the *Sector of Economic Reform* performs this role.

9.3.1 IRI results for regulatory reform policy and strategy

The regulatory reform policy and strategy sub-dimension was assessed by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the target countries following the process described in the Chapter 1 of this report. This resulted in the scores in Table 9.1, describing the current situation in each of the nine target countries.

TABLE 9.1
IRI SCORES FOR REGULATORY REFORM POLICY AND STRATEGY¹³⁰

Albania	Bosnia and Herzegovina Federation of Bosnia and Herzegovina	Republika Srpska	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
3	1.50	2	4	3	2	3	3	4	4

Source: OECD Investment Compact.

¹³⁰ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

Bulgaria, Romania, and Serbia have the most complete regulatory reform strategies and show a good level of implementation. Bosnia and Herzegovina and FYR Macedonia have introduced only a small number of programmes to improve regulatory quality and have not yet formalised broad regulatory reform strategies.

9.4 Regulatory oversight bodies

All strategies need an executive arm to ensure that targets are reached. In the world of regulatory reform these are the oversight bodies. Based on OECD experience, an effective oversight body should:

- be distinct from the entity preparing the draft legislation (i.e. it should be at arm's length), thereby providing an objective opinion;¹³¹
- be well-staffed and have a nucleus of highly qualified experts;
- not be entirely dependent on donor support;¹³²
- be located at the centre of government;¹³³
- have the following powers:

- *ex ante* appraisal (i.e. before legislation is drafted) and monitoring of regulations;
- consultation (other members of the administration seek advice from the oversight body);

BOX 9.1

BUSINESS REGISTRATION IN SEE

A key reform area in SEE's enterprise sector has been company registration. Only half a decade ago, starting up a business in the region entailed an exceedingly lengthy, costly and complicated process by OECD standards. Since then, there has been vast improvement in efficiency (e.g. through online registration) and in the time and procedures required for the approval of new companies.

Moldova, for example, can now boast a modern and efficient registration system. It effectively operates as a 'one-stop' system, incorporating various steps and approval of the company's name into one integrated electronic system in the State Registration Chamber, which connects various regional offices via a 'real-time' information network. The number of formal steps required in order to register has been reduced from 13 to two.

Croatia has simplified the registration of craftsmen through the establishment of the Central Register of Crafts in the Ministry of Economy, Labour and Entrepreneurship. Collection of data on registered craftsmen has been made more rapid and transparent. Electronically linked to the central register, 108 registration bodies have been established locally, which means that start-ups are relatively fast and efficient.

The table below shows the number of procedures, duration, and cost required to start a business in each SEE country.

	Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
Procedures (number)	11	12	9*	10	7*	2*	15	5*	10
Duration (days)	39	54	32	45	7	30	24	11	18
Cost (% GNI per capita)	22.4	37	7.9	12.2	7.4	13.3	6.6	4.4	10.2

* Have established one-stop-shop.

Source: European Commission (2005), World Bank (2006).

¹³¹ A second and broader opinion is important since sectoral drafters may have great difficulty being aware of the cumulative impact of a measure vis-à-vis the whole legal, budgetary, and economic framework.

¹³² Donor support is a short-term solution rather than a long-term strategy.

¹³³ That is, top and central body of the executive branch (e.g. Cabinet, Council of Ministers, government).

- advocacy (the oversight body proposes reforms to existing regulations);
- challenge (the oversight body can return a regulatory proposal put forward by a ministry or agency for further review and require that it be improved before it goes to Parliament).

All SEE countries have established arm's length oversight bodies. Nevertheless, several key issues remain:

- Serbia's oversight body, the Council for Regulatory Reform for the Economic System, stands out among those in SEE countries. It meets all the key criteria for a regulatory oversight body. Located at the centre of government, it employs 18 people.¹³⁴ It has powers of *ex ante* appraisal, consultation, advocacy, challenge and monitoring and has proven that it has the political leverage to stop low quality regulations being enacted.
- A second group of countries – Moldova, Montenegro and Romania – also have central governmental structures as oversight bodies. Although they are well-staffed and have most of the necessary powers, these oversight bodies do not have the power to systematically block the enactment of all poor quality legislation. To regulate entrepreneurial activity, Moldova has the State Commission for Regulating Entrepreneurial Activity and Montenegro has the Governmental Commission for Economic Freedom. Each of these oversight bodies employs around 20 people. Romania has the Business Environment Unit (BEU), which employs 45 people. The Moldovan State Commission has the power to block only minor, low-level legislation but has the necessary remaining powers. The Montenegrin and Romanian oversight bodies lack any power to block draft legislation. The Romanian BEU also lacks the power of *ex ante* appraisal.
- Bulgaria's Ministry for State Administration replaced the relatively powerless Council for State Administration and Administrative Reform in August 2005. This body employs 188

people, but lacks the power to seriously challenge the enactment of poor legislation or the power of *ex ante* appraisal.

- The FYR Macedonia is also a special case, in that it is located at the centre of government but is still supported by donors. The Sector for Economic Reform, operating under the office of the Vice Prime Minister, began with a staff of two and is currently expanding. This body is a component of the BERIS programme, supported by the World Bank. It has monitoring and advocacy powers.
- A final group of countries has donor supported oversight bodies, which are not at the centre of government, are understaffed and have only relatively limited powers. In Albania, Bosnia and Herzegovina and Croatia the oversight bodies are the Task Force for Administrative Barriers Reduction. They were initially established within the framework of FIAS led projects for the reduction of regulatory barriers to investment. In Albania and Croatia they have been set up under the relevant line ministries: the Ministry of Economy and Energy in Albania, and the Ministry of Economy, Entrepreneurship and Labour in Croatia. In Bosnia and Herzegovina, the Task Force for Administrative Barriers Reduction is located within the Ministry of Economy of the Republika Srpska. Given the high level of administrative decentralisation, there are also administrative reform units operating at entity level. In all three cases, the oversight bodies have relatively limited powers.

Table 9.2 gives an overview of the oversight bodies in each SEE country.

9.4.1 IRI results for regulatory oversight bodies

The evaluation of the regulatory oversight bodies (or equivalent) sub-dimension has resulted in the scores in Table 9.3, describing the current situation in each of the nine target countries.

¹³⁴ All staff-numbers and powers of the oversight bodies are based on information received in spring 2006 and may have changed slightly since.

TABLE 9.2
REGULATORY OVERSIGHT BODIES IN SEE

Country	Body in charge	Donor supported	Located at the centre of government	Ex ante approval	Monitoring	Consultation	Advocacy	Challenge
Serbia	Council for Regulatory Reform of the Economic System		✓	✓	✓	✓	✓	✓
Moldova	State Commission for Regulating Entrepreneurial Activity		✓	✓	✓	✓	✓	(✓)
Montenegro	Governmental Commission for Economic Freedom		✓	✓	✓	✓	✓	
Romania	Directorate for Monitoring and Improving the Business Environment		✓		✓	✓	✓	
Bulgaria	Ministry for State Administration				✓	✓	✓	
FYR Macedonia	Sector of Economic Reform	✓	✓		✓		✓	
Croatia	Task Force for Administrative Barriers Reduction	✓			✓		✓	
Bosnia and Herzegovina	Task Force for Administrative Barriers Reduction	✓					✓	
Albania	Task Force for Administrative Barriers Reduction	✓			✓			

Source: OECD Investment Compact (2006).

TABLE 9.3
IRI SCORES FOR REGULATORY OVERSIGHT BODIES OR EQUIVALENT¹³⁵

Albania	Bosnia and Herzegovina Federation of Bosnia and Herzegovina	Bosnia and Herzegovina Republika Srpska	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.50	1.50	2.50	3.50	2.50	2.50	3.50	3.50	3.50	4

Source: OECD Investment Compact.

The regulatory oversight body in Serbia is more advanced than those of its peers: it is well staffed, located at the centre of government and has all necessary powers including that of challenging draft legislation. The Serbian regulatory oversight body is closely followed by Bulgaria, Moldova, Montenegro and Romania. Albania, Bosnia and Herzegovina, Croatia and FYR Macedonia score below a 3 because their regulatory oversight bodies are not at the centre of government, are understaffed, and/or have relatively limited powers.

9.5 Regulatory Impact Analysis

Regulatory Impact Analysis (RIA) is a tool to evaluate the costs and benefits of new legislation. It involves systematically and consistently examining selected potential impacts arising from government action or non-action and

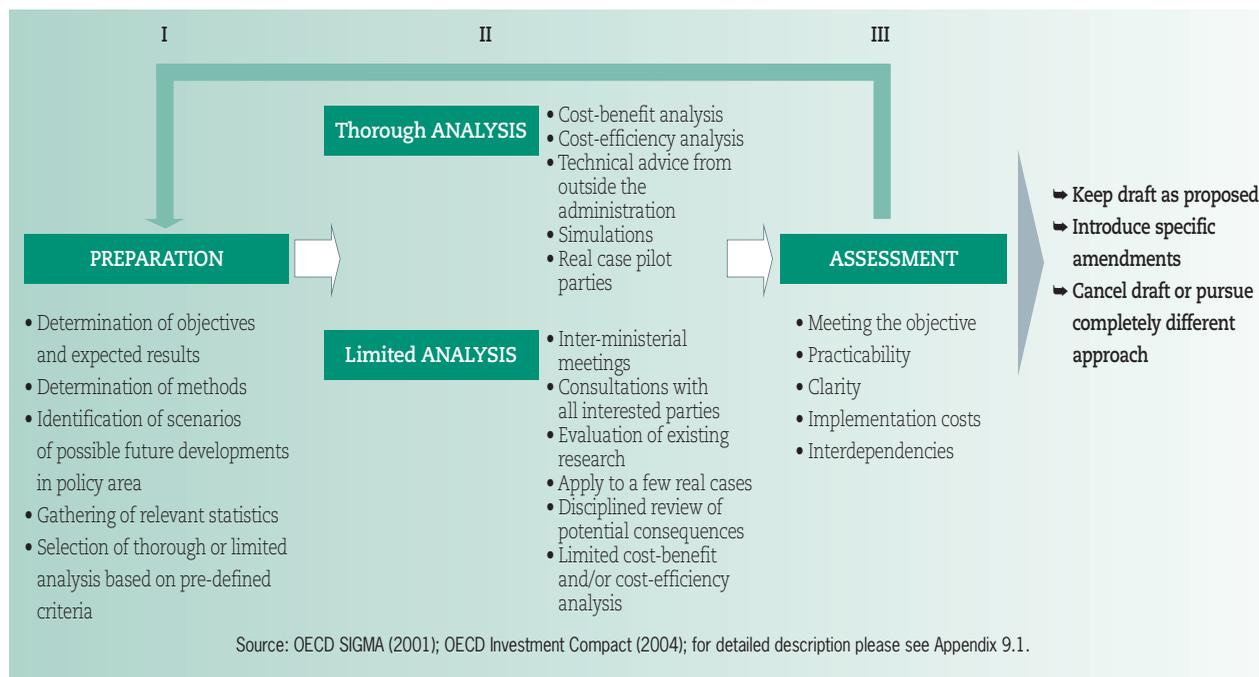
communicating this information to policy makers.

RIA should be used when legal instruments are drafted, to optimise the efficiency and effectiveness of the instrument in order to ensure that it will achieve the intended objectives at minimum cost, and with the smallest number of unintended negative consequences. The objective of RIA is thus two-fold:

- to improve the policy instruments themselves;
- to reduce the number of legal instruments by avoiding unnecessary legislation.

¹³⁵ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

FIGURE 9.4 – BEST PRACTICE: THE OECD-IC THREE-STEP RIA PROCESS



RIA should include the following key elements:

- formalisation;
- application to all new regulations;
- targeted efforts (i.e. decision whether thorough or limited RIA is necessary for new regulations, based on predefined criteria);
- RIA results used to improve draft legislation;
- political commitment (powerful, centralised oversight body).

Use of RIA is most advanced in Serbia, where it is applied to all draft regulations and has been formally introduced into the legislative system through the Rules of Procedure of the Government of Serbia. Through the introduction of RIA, an obligation has been established whereby all draft laws must first be submitted to the Council for Regulatory Reform of the Economic System. In 2005 the Council issued opinions on more than 80 regulations. It has successfully challenged regulations such as the Draft Law amending the Environment Protection Law or the Draft Law on Accounting and

Auditing. Serbia also demonstrates a strong political commitment to RIA. The Council is centralised and has all the necessary powers. Nevertheless, RIA in Serbia is still not targeted enough. There should be greater differentiation between legislation that requires thorough RIA and legislation for which limited RIA is sufficient. Serbia will also need to further involve and communicate with Parliamentarians about the RIA process to make it more transparent and effective.

For a second group of countries application of RIA is limited to certain types of new regulation. Again, efforts are not sufficiently targeted and there is not much evidence that RIA improves draft legislation. However, political commitment is strong, as the countries' oversight bodies are located at the centre of government and have most of the necessary powers.

- In 2003 Bulgaria introduced a pilot project on RIA, which was mandatory and formalised, through the Law on Reduction of Administrative

Regulation and Administrative Control of Economic Activity. Today, RIA is applied only when proposed legislation comes from the central administration. However, outsourced impact assessments have been prepared for some normative acts.

- Moldova uses RIA only for low-level legislation.
- Romania regularly uses RIA for SME policies (within the National Agency for SMEs and Co-operatives) and competition policies (within the Competition Council). It is in the process of adopting a new strategy focusing on the elaboration and adoption of normative acts, which will include RIA.

Use of RIA is less well-developed in the other SEE countries.

- In Albania RIA is not being applied. It was introduced in 2006 by The Task Force for Administrative Barriers Reduction as an exercise, and included in the action plan for the removal of administrative barriers. However, the pilot stage has not yet been launched.
- In the Republika Srpska (Bosnia and Herzegovina) FIAS is assisting the Government to establish a Council for Regulatory Reforms. This process will set up RIA mechanisms, and pilot areas for RIA have been determined (inspections, licensing). It is envisaged that RIA will be formalised and conducted later this year.

- Croatia has started a pilot project on RIA. The systematic use of RIA will begin in a second phase.
- In FYR Macedonia, RIA has also not been officially implemented. However, each ministry is to submit a memorandum to the Government for the act that it is adopting. The memorandum must contain alternative solutions, positive and negative comments and implications, reasons for the adoption of the act etc. These practices will be further developed during 2006 in order to comply with good-quality implementation of RIA.
- Montenegro is in the process of setting up an RIA programme, particularly with regard to harmonisation with European legislation. According to the Government's Rules of Procedure, assessments of the fiscal impact of each new law, and of its compatibility with European legislation is prepared, as key elements for determining the quality of a new regulation. However, full RIA only exists in the form of a pilot RIA programme.

9.5.1 IRI results for regulatory impact analysis

The evaluation of the regulatory impact analysis sub-dimension has resulted in the scores in Table 9.4, describing the current situation in each of the nine target countries.

BOX 9.2

THE REGULATORY GUILLOTINE

Some countries in transition face an enormous task in reviewing and updating the legacy of laws, rules and other instruments dating back decades. The administrative, legal and political costs of doing so are enormous. This is particularly the case in Moldova, with its USSR legacy. The regulatory guillotine provides a means of rapidly reviewing a large number of regulations and eliminating those that are no longer necessary, without the need for lengthy and costly legal action on each regulation. In 2005 Moldova adopted a guillotine to streamline 1,130 formal ministerial acts over a six-month period. Of these acts, 35% were amended and 12% were eliminated. In 2006 the guillotine is being used for laws. Bosnia and Herzegovina has made similar progress through implementing the Bulldozer initiative: the Republika Srpska completed the first phase of this programme in July 2006 and announced that it will be necessary to annul one third and modify half of its regulations to improve the business environment. Croatia and the Republic of Macedonia have announced plans to adopt a guillotine law in 2006.

Source: Jacobs and Associates (2006), OECD Investment Compact (2006).

TABLE 9.4

IRI SCORES FOR REGULATORY IMPACT ANALYSIS¹³⁶

Albania	Bosnia and Herzegovina Federation of Bosnia and Herzegovina	Republika Srpska	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
1.50	1	2	3	2	1.50	3	2.50	3	3.50

Source: OECD Investment Compact.

RIA is still in the early stage of development in SEE. When applied, it is rarely used to change draft legislation. Serbia has demonstrated more systematic application of RIA to draft legislation than its SEE counterparts.

9.6 Regulatory transparency

Improving regulatory transparency is a key element of sound regulatory policy. In intricate administrative and political situations, transparency often complements efficiency and accountability principles.

Transparency can address many causes of regulatory failure, such as regulatory capture and bias towards concentrated benefits; inadequate information in the public sector; rigidity; market uncertainty; inability to understand policy risk; and lack of accountability. Improving regulatory transparency can also encourage the development of better policy options and reduce arbitrariness and corruption.

Early and meaningful consultation with the private sector before a regulatory decision is taken is one of the most important ways to reassure businesses in a supportive legal environment.¹³⁷ Consultation processes should:

- include a formal consultation body;
- be a routine part of the decision-making process, rather than being carried out on an ad hoc basis;
- be carefully structured to avoid bias and uneven access by more powerful interests, such as very large businesses.

SEE governments have encouraged new public-private forums in their drive for improved

dialogue. In addition to joint institutions such as the FIAS Task Forces, new privately backed groups have actively engaged with the government. For example, the Business Advisory Council to the Stability Pact and the Business and Industry Advisory Committee (BIAC) to the OECD have provided policy advice. The Regional Network of Foreign Investors Councils, and individual councils, as well as employers' associations and Chambers of Commerce, have been set up in all SEE countries. However, communication and dialogue need to be further strengthened, as many companies (particularly small ones) still report that there is little or no meaningful dialogue with policy makers.

In Romania consultation with the private sector is a routine part of decision-making. It is carefully structured and driven by the Social Dialogue Commission. In 2002 the Government decided to make consultation with employers' organisations and NGOs mandatory for all proposed regulations that could have an impact on the business environment. In particular, a minimum period was established (ten days, as a rule) during which the authorities would withhold further actions, to give consulted parties an opportunity to comment and provide suggestions. A year later, the government extended the consultation requirements to all aspects of governmental decision-making with the enactment of the 'Sunshine Law'. This law establishes the framework for both institutional and regular meetings between government officials and the private sector.

Although they lack the routine and legal structure seen in Romania, four countries have established formal consultation bodies and/or formal consultation mechanisms:

¹³⁶ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

¹³⁷ Other tools to ensure regulatory transparency include forward planning mechanisms and access to information on regulatory requirements. The scores per country for these indicators can be found on the Investment Compact website: www.investmentcompact.org

- Bulgaria has created the Council for Economic Growth of the Bulgarian Council of Ministers and the Joint Consultative Council of the Ministry of Economy and Energy of, which focuses on involving stakeholders in consultations on draft normative acts. Bulgaria also has a Foreign Investor's Council, which is particularly good at regularly publishing White Books. However, Bulgaria does not yet have as clear a legal framework formalising consultations and integrating them into the policy making process as Romania.
- Similarly, Moldova and Montenegro have created bodies of experts from the private sector (Working Groups) that comment on draft laws prior to their adoption. Significant improvement is in sight in the case of Montenegro: a Commission for Economic Freedom has been established, as well as a Socio-Economic Council (with 38 representatives) and a Framework for Co-operation with the NGO sector.
- Serbia's Rules of Procedure of the Government prescribe mandatory public consultation on laws that significantly change the legal regime in a certain area, or are of particular interest to the public. In other cases, public consultation is not mandatory but can be performed if the proposer of the law considers this necessary. The programme of public consultation and the period during which it will be performed are determined by the competent governmental committee upon the proposal, so there is no separate consultation body.

The four remaining countries in SEE have only rudimentary consultation structures:

- Albania is in the process of establishing a regular consultation system through its regulatory reform programme. The private

sector reports that consultations on general issues have been quite effective, but that the structure for supporting technical consultations still requires significant improvement.

- In Bosnia and Herzegovina public/private consultations take place on an ad hoc basis when laws that the government considers highly important are being adopted. In most such cases, only the Chambers of Commerce and labour unions are consulted. Increasingly, NGOs approach the legislative branch with draft proposals, which are sometimes subject to parliamentary procedures. However, no formal mechanisms are in place yet.
- In Croatia consultations with the private sector mainly take place through the two main Chambers of Commerce (one for craftsmen and the SME sector, the other for large companies). These consultations take place on a fairly regular basis but are predominantly informal.
- The FYR Macedonia is in the process of setting up formal public/private consultations, although consultation is mandatory by law. Support will be provided through the World Bank programme BERIS.

9.6.1 IRI results for public/private consultation

The evaluation of the public/private consultation sub-dimension has resulted in the scores in Table 9.5, describing the current situation in each of the nine target countries.

With a score of 4, Romania is the country with most effective public-private consultation in regulatory reform: it is a formalised, routine part of decision-making, carefully structured and driven by a separate consultation body. Albania, Bosnia and Herzegovina, and the FYR Macedonia score below a 3 because public-private consultations take place mainly on an informal, ad hoc basis.

TABLE 9.5
IRI SCORES FOR PUBLIC/PRIVATE CONSULTATION¹³⁸

Albania	Bosnia and Herzegovina Federation of Bosnia and Herzegovina	Republika Srpska	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2	2	2	3.50	2.50	2	2.50	3	4	3

Source: OECD Investment Compact.

¹³⁸ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

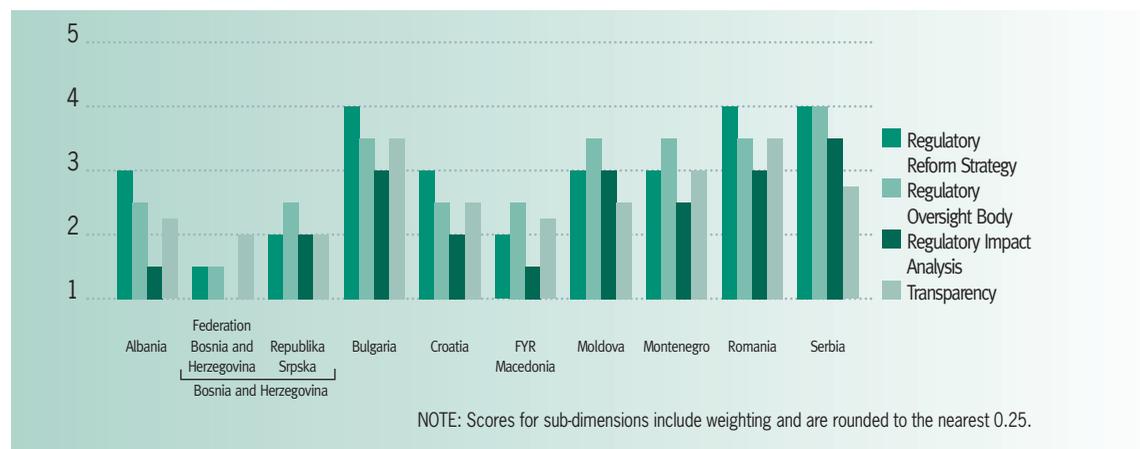
9.7 Key actions to consider at the regional level

1. Formalise and systematically apply Regulatory Impact Analysis (RIA) to draft regulations.
2. Increase inter-ministerial coordination on proposed regulations and involve and communicate with Parliamentarians
3. Increase regulatory transparency through formalised and routine public/private consultations on regulation management.
4. Create a complete register online, listing all regulations and formalities.

around the RIA process to make it more transparent and effective.

IRI SCORES FOR REGULATORY REFORM

FIGURE 9.5 – REGULATORY REFORM: SCORES BY SUB-DIMENSION



Source: OECD Investment Compact.

Regulatory reform strategy

- Bulgaria, Romania, and Serbia have the most complete regulatory reform strategies and show a good level of implementation. Bosnia and Herzegovina and FYR Macedonia have introduced only a small number of programmes to improve regulatory quality and have not yet formalised regulatory reform strategies.

Institutional framework

- The regulatory oversight body in Serbia is more advanced than those of its peers : it is well staffed, located at the centre of government and has all necessary powers including that of challenging draft legislation. The Serbian regulatory oversight body is closely followed by Bulgaria, Moldova, Montenegro and Romania. Albania, Bosnia and Herzegovina, Croatia and FYR Macedonia score below a 3 because their regulatory oversight bodies are not at the centre of government, are understaffed, and/or have relatively limited powers.



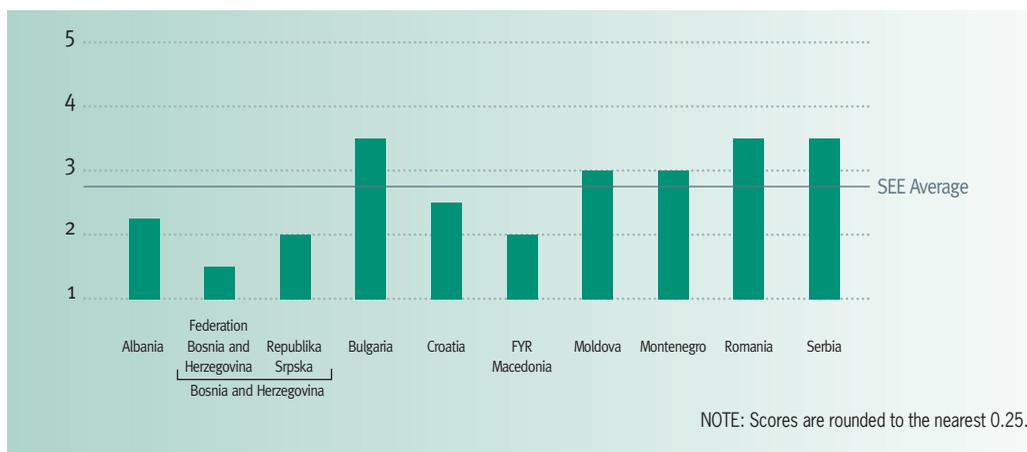
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Regulatory impact analysis

- RIA is still in the early stage of development in SEE. When applied, it is rarely used to change draft legislation. Serbia has demonstrated more systematic application of RIA to draft legislation than its SEE counterparts.

Regulatory transparency

- With a score of 4, Romania is the country with most effective public-private consultation in regulatory reform: it is a formalised, routine part of decision-making, carefully structured and driven by a separate consultation body. Albania, Bosnia and Herzegovina, and the FYR Macedonia score below a 3 because public-private consultations take place mainly on an informal, ad hoc basis.

FIGURE 9.6 – OVERALL SCORES FOR REGULATORY REFORM

Source: OECD Investment Compact.

- There is a high degree of variation among SEE countries concerning regulatory reform.
- Albania, Bosnia and Herzegovina and FYR Macedonia are the weakest primarily because RIA is not yet in place.

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Appendix 9.1

The OECD Investment Compact/ SIGMA Three-Step RIA Guidelines

I. Preparation

- Determination of specific objectives and expected results of the assessment;
- Determination of methods and techniques to be applied in the assessment;
- Sketching out of possible diverging future developments in the policy area (scenarios);
- For cost benefit or cost efficiency analysis: gather relevant statistics on the existing situation in the policy field;
- For simulation: develop theoretical cases, incidents and scenarios against which the draft law may be tested;
- For a test with real cases: such cases or a region will need to be selected where the draft will be applied on a pilot basis, in parallel with existing legislation;
- Select thorough or limited analysis, based on pre-defined criteria.

II. Analysis

RIAs can be limited or thorough in scope, depending on the importance of the policy instrument. The more important the policy instrument and the more impact it may be expected to have, the more sophisticated the RIA should be. An RIA for a less important policy instrument can be carried out by civil servants, even if they do not have in depth training in quantitative and qualitative assessment techniques. *Some limited RIA should be undertaken for all intended policy decisions (i.e. all laws and subordinate regulations)*

Limited analyses:

- inter ministerial meetings to discuss potential consequences;
- consultations with all interested parties;

- evaluation of existing research;
- testing of the legal instrument by applying it to a few real cases;
- a disciplined review of potential consequences, such as possible cost factors, where these costs may arise, and which possible unwanted side effects may occur;
- limited cost benefit and/or cost efficiency analysis.

A thorough RIA should be carried out for important new policies.

In addition to consultations, which should always take place, methods and techniques to carry out an analysis of a draft instrument are:

- cost benefit analysis;
- cost efficiency analysis;
- technical advice from outside the administration;
- simulations;
- testing of the instrument by applying it to real cases on a pilot basis.

III. Assessment of the Results of the Analysis

- Results of the analysis should be systematically documented and evaluated through a report on the assessment and recommendations.
- The recommendation of the RIA of the draft instrument might be:
 - to keep the draft instrument as proposed;
 - to introduce specific changes or amendments to the draft before submitting it to the Minister;
 - to cancel the draft, or to pursue a completely different approach.
- When any possible changes or amendments

have been introduced into the draft, it can then be submitted to the Minister of the lead ministry for approval. The report of the RIA and the recommendations should be submitted, together with the draft instrument itself. If particular recommendations have been rejected, this should be indicated and reasons given.

- Following approval by the Minister, who may initiate additional changes, the draft, with the report and recommendations, can be submitted to the Council of Ministers for decision.

III.1 Assessment Criteria

Depending on the time and resources available, the draft should be assessed against the following criteria in a more or less thorough manner:

a) Meeting the Objective

This criterion is geared to assess whether the draft instrument meets the objective which has been set to the greatest possible degree. For the analysis, it is necessary to explore the following questions:

- Could there be counterproductive side effects?
- Is it possible/easy to avoid compliance?
- Is misuse of the instrument possible?
- Are short term costs justified by long term benefits (e.g. preventive health measures or environmental provisions)?
- Is the distribution of benefits and costs justifiable and in line with the given objective?
- Is there a significant discrepancy between the segment of the population that pays the price, and the segment that receives the benefits?

b) Practicability

This criterion is used to assess whether the draft instrument can be effectively applied in the existing administrative structure. For the analysis, it is necessary to explore *inter alia* the following questions:

- Is the instrument sufficiently flexible to accommodate all possible cases but still provide enough guidance so that discretionary provisions cannot lead to arbitrary decisions?
- Are administrative requirements limited to the necessary degree? Is it probable that the costs of administering the instrument outweigh the benefits (e.g. fees for administrative services)?

- Are competencies for executing the instrument, including the requirement of co ordination, clearly defined?
- Is the transition from the old regulation to the new instrument clearly laid out and feasible?

c) Clarity

This criterion is geared to the assessment of another aspect of implementability, i.e. possible difficulties for the private sector in understanding the instrument correctly and complying with it in an appropriate way. For the analysis, it is necessary to explore the following questions:

- Is the language of the provision clear and understandable for the addressees?
- Are there any contradictions in the instrument?
- Are all definitions unambiguous?
- Are the tasks to be carried out by the addressees clearly listed, etc.?

d) Implementation Costs

This criterion is geared to the assessment of costs and possible savings directly linked to implementation of the instrument. For the analysis it is necessary to explore, as a first step, where the costs will be incurred (administration, industry, social groups) and then, for the respective groups, to explore the following questions:

- Are the incurred costs proportional to the intended objectives of the instrument?
- Are there possible savings which could offset, partially or fully, the costs incurred by the proposed instrument?
- Is the administrative work, including that asked of the addressee (e.g. statistics, application forms, credentials, controls), proportional to the expected benefits?
- the envisaged institutional set-up and the envisaged procedures efficient, or could costs be saved if they were organised differently?

e) Interdependencies

This criterion is geared to assess whether or not the new instrument creates conflicting interdependencies with other legislation which could lead to unwanted side effects, e.g. non targeted addressees benefiting from or suffering as a result of the new instrument. For the

analysis, it is necessary to explore the following questions:

- Is there existing legislation which covers the same or complementary target groups?
- Could there be an overlap with existing legislation which might hinder implementation of the new instrument?

- Could provisions in existing legislation hinder or be in opposition to the intended objectives of the new instrument?





Chapter 10

Human Capital

The key human capital issue in SEE is a shortage of skills relevant to businesses. While most countries have developed formal education strategies, implementation is slow and some of these are poorly adapted to the skills businesses are looking for. In particular, Vocational Education and Training (VET) and adult learning should be expanded and further shaped to labour market needs.

Education and training policies are improving, with more active public/private consultation, but monitoring and evaluation of the impact of education on the labour market must be greatly stepped up.

Human Capital

10.1 Introduction

People are the most important asset of any country. People drive economic growth, innovation and investment. The quality and flexibility of the labour force is one of the main factors that influence investment decisions by foreign investors.

South East Europe (SEE) had a tradition of excellence in education, particularly in science and mathematics. For example, Nikola Tesla (1856-1943), a Serbo-Croat scientist, invented the alternating electrical current and the three-phase system. Vladimir Prelog, (1906-1998, a Croat born in Sarajevo), won the 1975 Nobel Prize for his discoveries in organic chemistry. However, a decade of wars, combined with international isolation, has seriously weakened the education infrastructure and has contributed to the deterioration of a relatively sound education system of the ex-Yugoslav states. According to the Stability Pact this is most visible in Bosnia and Herzegovina, where 70% of the educational infrastructure was destroyed during the war (Stability Pact for South Eastern Europe, 2006). The need for infrastructure improvement in education is obvious across the region (OECD, 2003).

Human capital involves two different but interrelated components. The first is the quality of the labour supply and the extent to which that supply meets market demand (education policy). The second is the extent to which the market has easy and flexible access to labour supply at a comprehensive rate for investors while keeping

in mind the interest of employees (labour market policy). The IRI assessment in 2006 focuses on the first component, education policy.¹³⁹

Over the last 15 years, the SEE countries have faced three daunting tasks simultaneously: bringing labour policies and regulations into line with the needs of an open market economy, addressing human capital costs of economic transition and reforming education policy in order to respond to the new political environment and demand trends in the labour market. These challenges have had major political and budgetary implications.

As shown in Tables 10.1 and 10.2, SEE countries are currently experiencing an unfortunate mix of low spending on education and high unemployment.

TABLE 10.1
PUBLIC SPENDING ON EDUCATION

Public spending on education, total 2005
(% of GDP)

Albania	2.8
Bosnia and Herzegovina	NA
Bulgaria	3.6
Croatia	4.5
FYR Macedonia	3.5
Moldova	4.9
Montenegro	4.7 ¹⁴⁰
Romania	3.5
Serbia	NA
SEE average	3.8
OECD average	5.4
New EU-8 ¹⁴¹	5.5

Source: Data from World Bank Indicator 2006, includes spending on primary, secondary and tertiary levels of education.

¹³⁹ Assessment of labour market rigidities will be part of the next cycle of the IRI in 2007.

¹⁴⁰ According to the Government of Montenegro source and the Law on modification of the Budget Law for 2005.

¹⁴¹ Slovenia, Poland, Czech Republic, Hungary, Slovakia, Estonia, Latvia and Lithuania (Malta and Cyprus were not included).

Average public spending on education in SEE is 3.8% compared with an average of 5.5% for the new European Union (EU) 8 countries. The OECD average is 5.4% (see Table 10.1).

At the same time SEE has high rates of unemployment particularly in the Western Balkans. According to official statistics, unemployment reaches 36.5% in FYR Macedonia and 41.5% in Bosnia and Herzegovina.

Unemployment is not unrelated to another issue that has recently made newspaper headlines: migration. Migration from Albania, Bosnia and Herzegovina and Moldova has been particularly significant. Over 25 % of the 'active workforce' of these countries has migrated. The outflow consisted of skilled and unskilled workers, translating into a 'brain drain' with important implications concerning skill gaps and investors' ability to recruit and retain qualified staff. The 'brain drain' is not a recent phenomenon affecting the region; the years of war have also resulted in an enormous loss of human capital through migration.

Education spending, unemployment and migration are inter-related. Insufficient spending on targeted education policies contributes to higher unemployment and high unemployment encourages people to migrate to countries with more attractive job opportunities. High unemployment may also be due to rigidities in the labour market (see Box 10.1).

TABLE 10.2
UNEMPLOYMENT RATE
AND ACTIVE LABOUR FORCE

	Unemployment (%) 2005	Active labour force in % of total population 2004
Albania	14.3	43.4
Bosnia and Herzegovina	41.5	52.2
Bulgaria	10.1	40.6
Croatia	13	44.0
FYR Macedonia	36.5	42.3
Moldova	8.8	50.7
Montenegro	18.9	51.7 ¹⁴²
Romania	5.8	47.9
Serbia	20.8	n/a
New EU-10	8.97	47.3
OECD average	6.8	n/a

Source: ICEG, Economist Intelligence Unit, Central Bank of Montenegro/ Agenda of Economic Reforms of Montenegro 2002-2007, Montenegro Governmental Programme for 2006, Serbian Ministry of International Economic Relations (www.mier.sr.gov.yu), Serbia Statistical Office; World Development Indicators.

Moldova and Romania are the only two countries in SEE which record single digit unemployment figure and in Moldova much of it is due to the large emigration outflow. All the other SEE countries experience double digit unemployment figures, with particularly critical rates in the countries born out of the disintegration of former Yugoslavia. Outside Romania, however, unemployment remains a very important issue in the region. Actual unemployment is probably lower than the level indicated by the official figures, due to the presence of a large informal sector, but this is mainly a further indication that the labour market in the SEE countries does not operate efficiently.

¹⁴² According to data from the Montenegro Statistical Agency MONSTAT.

BOX 10.1**LABOUR MARKET RIGIDITIES IN SOUTH EAST EUROPE**

Although high unemployment in the SEE region can be attributed to a large spectrum of factors, one of the factors most often cited by investors is the strict labour market legislation and high non-wage taxes on labour (e.g. payroll taxes, social security contributions, etc.).

In general, however, SEE has relatively liberal employment legislation for permanent employment contracts, specifically:

- Redundancy is always allowed as a legitimate ground for dismissal in all SEE countries;
- No prior approval from a third party (e.g. a trade union) is required before firing an employee in all SEE countries (except Moldova).

Furthermore, firing costs in SEE are now lower than the OECD average. Severance pay for long-time employment in some countries is particularly low, especially in Romania and Bulgaria. The exception is Albania which is clearly above the SEE average of 5.3 months with almost 14 months of severance pay for dismissal of an employee with 20 years of continuous employment.

Fixed-term contracts in SEE, however, are generally restricted to specific situations such as seasonal work and replacement of temporarily absent permanent employees. Only Serbia and Bosnia and Herzegovina allow for fixed-term contracts in more general situations. In this area, especially, SEE countries lag significantly behind their CEE neighbours, where such contracts are allowed everywhere but Slovenia, although the legal duration of fixed-term contracts is higher in SEE – 43.5 months compared to 39 in CEE.¹⁴³

Source : World Bank Doing Business in 2007 (www.doingbusiness.org).

To what extent are education and labour market policies adapted to the needs of SEE? Are they having an impact? These are the questions addressed in the IRI evaluation that follows.

10.2 Assessment framework

The Investment Reform Index (IRI) Framework for assessing progress in Human Capital policy includes: Education Strategy, Education Quality, Vocational Training, Adult Learning, Civil Servant Training and Transparency in Education and Workforce Skills Development (see Figure 10.1).

10.3 Education and workforce skills development

10.3.1 Education strategy

The quality of education and its relevance to the workforce starts with having a good strategy, in line with the country's national economic growth

plan. This strategy should prioritise and co-ordinate government action, mobilise resources and respond to the demands of the private sector and of civil society. In particular, it should address any issues related to skill gaps between the labour force supply and market demand.

Skill gaps are generally an issue across SEE. Many SEE economies cannot absorb the high number of graduates in economics and law, yet these same countries are experiencing shortages in engineering and other technical fields. To complete a recent greenfield investment project in Bulgaria, a foreign investor had to hire a significant number of Turkish engineers. Foreign investors also report that there is a very limited supply of people with management or accounting skills in SEE countries.

¹⁴³ Averages exclude Albania and Poland.

FIGURE 10.1 – HUMAN CAPITAL ASSESSMENT STRUCTURE



Source: OECD Investment Compact.

Paradoxically, SEE is also starting to experience shortages of plumbers, electricians and construction engineers – traditionally one of the region’s strength. One reason, of course, is migration to more attractive opportunities in Western Europe.

Specific country examples of skill gaps are abundant. In 2003 FYR Macedonia still had 20 machinery schools packed with students, although 90% of companies in this sector had closed down (ETF, 2005). Employment Agency figures from Montenegro (2004) show a number of unfilled vacancies for engineers, doctors and medical staff. However, there is no sufficient enrolment in scientific and technological fields at university level to fill this demand (ETF, 2005). In Montenegro tourism development and service sector expansion have created a demand for new occupations such as management, marketing, bookkeeping and modern accounting, banking, finance, ICT and foreign languages. Educational establishments in Montenegro have not yet had the time or resources to adapt to these growth opportunities.

Finally, foreign investors report that many graduates coming out of universities in SEE have received very theoretical training and lack

practical/hands-on skills. According to data collected by Vocational Education Training Centres in FYR Macedonia, two-thirds of the companies surveyed were experiencing serious difficulties with the lack of practical training of new employees hired to practise specialised skills.

Foreign enterprises investing in the SEE region have an important role to play in skills development. Most international enterprises have considerable budgets for internal skills upgrading. For example, the Raiffeisen Bank, one of the main financial actors operating in the region, invested 3 million euros in 2003 and 15 million euros in 2004 in Albania to upgrade the bank and train the staff.¹⁴⁴ When presenting the plans to enter the Bosnia and Herzegovina market, Mobilkom, an Austrian mobile phone operator, put a strong emphasis on providing young experts with advanced training.¹⁴⁵

In evaluating education and workforce skills development strategies, countries can be categorised as follows:

- The country has a formalised and comprehensive strategy, with solid evidence of implementation.

¹⁴⁴ www.raiffeisen.ro; www.raiffeisen.hu.

¹⁴⁵ www.mobilkomaustria.com.

- The country has a formalised strategy, but it is incomplete and implementation is partial.
- A strategy has not yet been formalised, but some elements of the education and workforce skills development framework are in the early phases of implementation.
- There is no formalised strategy, and very little evidence of any policy implementation to improve education and workforce skills development.

Croatia is the only SEE country that has a formalised and comprehensive education strategy, with solid evidence of implementation.

This strategy incorporates lifelong learning in accordance with market needs, increases the use of information and communications technology and harmonises Croatia's higher education system with Western European education system. Vocational education has been adjusted

BOX 10.2

CASE STUDY ON EDUCATION STRATEGY: THE CZECH REPUBLIC

In 2001 the Ministry of Education of the Czech Republic published a White Paper on the National Programme for the Development of Education. This document formulated the intellectual basis, general goals and development programmes of the education system in the medium term. The two primary points of the strategy are decentralisation and increased accountability. The National Programme for the Development of Education focused on the following strategic guidelines:

- implementation of lifelong learning for all;
- adaptation of educational and study programmes to the needs of life in a knowledge society;
- support for the internal transformation and openness of educational institutions;
- monitoring and evaluation of the quality and effectiveness of education;
- transformation of the role and professional perspectives of educational staff and academics;
- transition from centralised administration to responsible participation in decision-making.

The Programme also sets out the requirement to gradually increase public expenditure on education so that it equals that in other developed countries and reaches 6% of GDP.

As of January 2003, sectoral administration was eliminated and schools were administered within the framework of general administration with authority distributed between the central government, 14 regions, and communities. The Ministry of Education retained responsibility for the development of the education system, educational standards, curricular documents, teachers' salaries, appointment of regional education directors, the school register, and organisation of pedagogical centres and detention homes for young people. Regions are responsible for upper secondary and special schools, basic art schools and out-of-school activities. Communities are responsible for compulsory schooling as well as nursery schools.

The Czech School Inspectorate is responsible for monitoring education results, management quality, financial efficiency and regulatory compliance at all levels except for higher education institutions. This control body is under the direct supervision of the Ministry of Education.

On PISA tests, Czech students performed well in comparison with the students in other observed countries, especially in the case of science and mathematics. In both areas their results were above the OECD average. The PISA results reflect another important factor: the Czech education system is basically a 'drill' system with much memorisation and testing, while there are fewer projects to develop students' problem-solving skills. To solve this problem, the State gave schools more freedom to choose their own teaching methods in 2004.

Source : National Programme for the Development of Education (White Paper).

to labour market requirements. Monitoring of implementation is carried out through Annual Development Plans.

Romania, FYR Macedonia, Moldova and Montenegro have formalised strategies, but these are still incomplete and implementation has been partial. Moldova has elaborated a comprehensive strategy and action plan for education that includes time-bound targets and a monitoring process. The annual education plan is adjusted to meet skill gaps through a Labour Market Report, which will undergo its third evaluation phase to identify new domains that need specific support in the fall of 2006. The Ministry of Education periodically issues a general education policy document entitled 'Conception Philosophy of Education in the Republic of Moldova'. According to the OECD Review of National Policies for Education, 'the review team considers that this is one of the best educational policy documents in the SEE region', (OECD, 2003).

FYR Macedonia adopted a comprehensive Strategy for 2001-10. The basic recommendations of the strategy include: greater private investment in education, better linkages with the labour market, more options in curricula and syllabi with involvement from business entities, local communities, parents, students and teachers, in-service teacher training. A further National Programme for the Development of Education in the FYR Macedonia for 2005-15 was also adopted. Montenegrin Ministry of Education has carried out a consultative process (involving the Ministry of Education and Science and other education staff, parents and students consulted at over 20 sites throughout Montenegro), around the system to determine reform priorities and broaden awareness and ownership of the reform initiatives contained in the strategy.

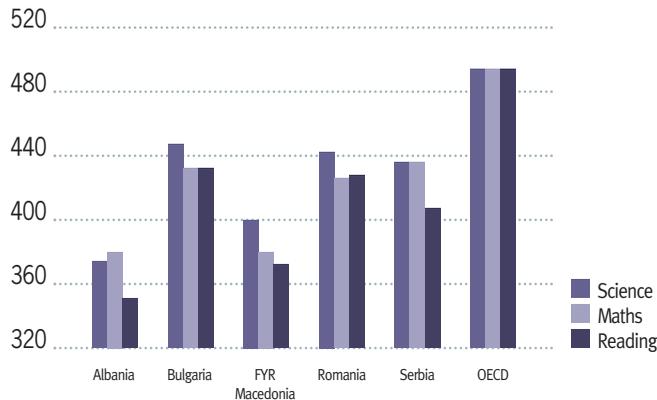
Although an education strategy has not yet been formalised in Bulgaria and Serbia, some elements of the education and workforce skills development framework have been implemented.

In Bulgaria the strategy awaits government approval and adoption by parliament. Serbia has made progress towards developing a formalised strategy. Decentralisation of primary and secondary education administration laws have been adopted, and several sectoral strategies are being elaborated (e.g. a policy and strategy for Vocational Education and Training (VET) and an Adult Education Strategy). Moreover, in Serbia a number of organisations, including NGOs, are involved in the discussion and development of an education strategy (for example the Education Forum, an NGO bringing together experts in various fields dedicated to the modernisation and reform of education, works closely with the Ministry of Education and Sport).

Albania adopted the National Education Strategy (2004-15) for pre-university education. The strategy for the pre-school education and a new strategy for the tertiary education are under preparation. A Draft Strategy for Development of Education was made in 2003, but was not adopted. Moreover the strategy was viewed by the OECD Review as too comprehensive for establishing clear priorities and lacked input from stakeholders other than government and its dependencies.

In Bosnia and Herzegovina education policy is decentralised at entity level and in the Federation of Bosnia and Herzegovina it is further decentralised at canton level. The politics of separation between the cantons make co-ordination difficult. A new education strategy at state level has been drafted, but it has not been adopted yet despite numerous consultations. According to the last OECD Review of National Policies for Education (OECD, 2003), Bosnia and Herzegovina suffers from dependency on donor funding, serious disruption of education for many children and young people, lack of adult education, despite high levels of unemployment, lack of co-ordination between education ministries and employment services. The IRI analysis for 2006 confirms this assessment.

FIGURE 10.2 – PISA SCORES IN SCIENCE, MATHS AND READING



Source: PISA 2000 and 2003 results.

10.3.2 Basic quality of education

Access to basic quality education is a human right and a minimum condition for development and growth. According to the OECD Programme for International Student Assessment (PISA)¹⁴⁶ scores, results in science, mathematics and

reading in SEE countries are still significantly below the OECD average, particularly in FYR Macedonia and Albania (see Figure 10.2).

UNDP data on Literacy and Enrolment indicates a high adults literacy rate but low levels of enrolment in primary, secondary and tertiary schools as shown in Table 10.3.

TABLE 10.3

DATA ON LITERACY AND ENROLMENT

Country	Adult literacy rate % ages 15 and above (2003)	Combined gross ratio enrolment ratio for primary, secondary and tertiary schools (%) 2002/2003
Albania	98.7	69
Bosnia and Herzegovina	94.6	67
Bulgaria	98.2	78
Croatia	98.1	75
FYR Macedonia	96.1	70
Moldova	96.2	62
Montenegro (2004)	97.5	73.9
Romania	97.3	72
Serbia (2002)	96.6	72.4
SEE Average	97	71
CEE-5 Average ¹⁴⁷	–	84
OECD Average	–	89

Source: UNDP Human Development Index in Human Development Report 2005.

Moldova, Bosnia and Herzegovina and Albania, in particular, have an enrolment that is below 70 per cent. The reasons for low rates of enrolment differ. Part of the explanation in Albania is high school fees relative to average household income.¹⁴⁸ In Moldova, there is a high dropout rate for children in poor families living in rural areas where transport is not readily available.¹⁴⁹

10.3.3 Vocational Education and Training (VET)

Vocational Education and Training (VET) is training targeted to a specific profession. Ideally VET programmes should be defined according to market need and help increase practical training while reducing skill gaps (see Box 10.3).

¹⁴⁶ PISA assesses three literacy domains: reading, science and mathematics on fifteen-year-olds. It assesses the ability to complete tasks relating to real life – depending on a broad understanding of key concepts rather than assessing possession of specific knowledge. The IRI analysis does not score education quality because the countries covered by PISA tests do not yet cover the whole SEE region. Croatia, Moldova and Bosnia and Herzegovina did not participate in PISA project, but Croatia shall participate in PISA in 2006 for the first time. Montenegro joined the PISA in 2004 and the scores shall be available in December 2006.

¹⁴⁷ CEE-5: Czech Republic, Hungary, Poland, Slovakia and Slovenia.

¹⁴⁸ World Bank Education Project 2006 for Albania for an 'Education Excellence and Equity Project'.

¹⁴⁹ World Bank Project Appraisal on a proposed credit and grant for the Republic of Moldova for a Quality Education in the rural areas of Moldova, 2006.

BOX 10.3

CASE STUDY ON VOCATIONAL TRAINING: AUSTRIA

Austria has a strong tradition in vocational training and education which is structured around the following institutions:

VET colleges provide double qualification: university entrance qualification and a VET diploma. Students who successfully complete the five-year college course in business management, technology, tourism acquire general and vocational qualifications for higher level occupations but also qualify for entry into higher education.

VET school courses of one to two year's duration combine general education with preparatory training and serve as a bridge to other training courses. Three- or four-year courses allow students to go straight into mainstream employment after their final examination.

Apprenticeships begin at the age of 15 and involve a three-year dual training course of company-based training supplemented by attendance at a part time school.

Fachhochschulen are university-level courses of applied science and technology. These are tailored to specific areas of professional activity.

The country is also pursuing the aim of reinforcing the European dimension of its VET system by:

- Continuing the process of introducing Europass which helps people make their skills and qualifications clearly and easily understood in Europe;
- Supporting the development of European qualifications framework;
- Concluding agreements with other countries on the equivalence of qualifications;
- Promoting the mobility of young people within the education and training system.

The success of Austria's VET is based on several factors:

- Combined general education with intensive theoretical and practical specialised training;
- Schools and colleges have the right to determine their own training priorities according to the needs of the local economy;
- Continuous cooperation with the business community to ensure that apprenticeship and training curricula keep abreast to the development of the labour market;
- Up to three foreign languages are compulsory depending on the type of school;
- Specific focus is given to entrepreneurship;
- Prerequisite of computer literacy is compulsory for all VET schools.

Results:

- The wide appeal of VET is one of the main reasons why Austria has traditionally one of the lowest rates of unemployment among those between 15-24 year old: 9.5 % in 2004 compared with 16.6% in the EU-15;
- More than 80% of young people in the tenth year of schooling opt for vocational training courses.

Source: Austrian Federal Ministry of Education, Science and Culture (www.bmbwk.gv.at).

Romania is the most advanced country regarding VET. Romania has adopted a Continuing Vocational Training Strategy in 2005 which reflects the country's economic priorities and specific labour needs. The implementation plan contains pre-defined success indicators and operational plans are made annually. The gross enrolment in vocational education rose from 71.4 % in 2000-01 to 76.4% in 2004-05. In particular, efforts are focused on 'Entrepreneurship Education': entrepreneurship courses were introduced in the compulsory curriculum and in the VET system after the completion of compulsory education. In order to promote Vocational Training, a web portal was launched on April 2006 containing all necessary information related to projects, programmes, and training. The Ministry also organised three regional seminars in May 2006 attended by representatives of the National Council for Adult Learning, the civil servants sector, unions, employers' associations and suppliers of vocational training. The purpose of these seminars was to organise a public debate with participants on the necessity, organisation and agendas of the training; debate with the participants on their relationship with the public institutions; update on several activities, public offices involved in training and international organisation cooperation plans.

Montenegro, FYR Macedonia and Bulgaria all have basic VET, but there are still areas for improvement. In Bulgaria the framework for cooperation between VET and the labour market is in place: the Unemployment Security and Employment Incentives Act (UEIPA, 1997) and the Vocational Education and Training Act (VETA, 1999) include initial and continuing training as well as retraining for the labour market. Concrete actions have been taken including Vocational Qualification Project for Upgrading of Vocational Standards and for the Development of a system of studying, identifying and monitoring of employer's and employee's needs for vocational training. However, VET is incorporated in the National Employment Action Plan which limits VET independence and resources. Although Montenegro and FYR Macedonia have

established VET, both countries are facing funding problems and implementation is slow. In FYR Macedonia various EU programs have been implemented in order to improve vocational education and a new law is currently being drafted. There are 72 schools offering VET programs for 60,000 students. Two thirds of these schools are currently undergoing a reform in their curricula and training programs. However the practical component of the VET curricula remains poor and VET schools graduates face difficulty finding work placement. Montenegro has several achievements in vocational training, namely: introducing legislation for VET specifying the particular needs and obligations of the sector, establishing a Council for Vocational Education and the Principle of Social Partnership between the VET centre and social partners, developing a system for monitoring and evaluation of success of new curricula in VET schools. Since 2004, trial implementation of 13 new curricula has started in 15 vocational schools for 9 work areas and groups of teacher trainers were established. However, the system is still too centralised and strict control from the Inspectorate prevents teachers from adopting modern teaching approaches and methodologies.

Serbia, Croatia and Albania are in the process of either creation or adoption of VET strategies. Serbian Policy and Strategy for Vocational Education and Training and Adult Education is in the process of adoption, however several experimental vocational programmes are producing positive effects on employment. The difficulty which Serbia is now facing is moving from concept to strategic implementation: appropriate methods to involve employers in VET still need to be developed, a broader deregulation of VET has to be implemented and joint responsibility by all stakeholders for the development and improvement of VET is needed.¹⁵⁰ Albania has finalised a Strategy on Vocational Education Training in 2006. One of the aims of the strategy is to increase the enrolment rate in VET up to 40 per cent within a four year period. The number of people trained in public vocational training centres has been doubled compared with 2000 and two new centres have

¹⁵⁰ Speech by Dejan Suvakov, European Agency for Reconstruction (EAR) Task Manager, 21/04/05.

been constructed in 2004 in the region of Elbasan and Fier. However, funding levels do not appear sufficient to meet the government's ambitious objectives and the absence of structured involvement of social partners representing the demand side in developing employment policies leads to the provision of inadequate management training. In Croatia a national Agency for Vocational training has been established in 2005 and a program of work was adopted. Preparatory activities have been conducted in cooperation with the European Training Foundation over the 2002-05 period. A process of reform in this area has started but many problems remain such as the lack of qualified teachers, low investment levels, the absence of nationally agreed occupational and qualification standards and the weakness of the links with the private sector.

Neither Bosnia and Herzegovina nor Moldova has yet defined a VET strategy.¹⁵¹ A number of important reform projects have been implemented regarding Vocational Training in Bosnia and Herzegovina. The Phare-VET Bridging Programme (2000–2001) was designed to link the first and the second VET Programmes and resulted in the adoption of a White Paper representing 'a commitment on what is politically, technically, organisationally feasible' (White Paper, 2001). The second Phare-VET Programme (2002–04) has taken the reform process further on from the agreed policy and strategy to implementation. In terms of legislation, there is no vocational education law at the State level, but 12 laws are currently in use in FBiH, one in RS and a separate law for District Brcko. Most curricula are however outdated due to unsatisfactory information base on employment and labour market needs and weak social partner contribution to vocational education reform.

The Law on Education adopted in 1995 sets out the basic structure of the present system of vocational education and training in Moldova. The implementation of polyvalent vocational schools and professional schools started in 1997 and a new law was drafted in 1999. There are no recent documents available regarding VET policy in Moldova. Although information is well developed

on the labor market, there is little evidence that it is used for developing a coordinated strategy to improve the efficiency of VET.

10.3.4 Adult learning

Adult learning refers to educational programmes directed to adults either to upgrade their skills or to re-train them for a new job.

As with VET, Romania has been very active in adult learning. Romania has established a National Centre for Adult Training operating as an independent authority. The centre runs numerous programmes and sector specific trainings, and works on the basis of a tripartite system: central public administration, union representatives and employers' associations. It also has a consultative role in elaborating and promoting all policies related to adult learning. In 2005, the Council has continued the national level process of authorising suppliers of adult learning: after legal framework modification, the Council has authorised 1,254 suppliers for 3,430 programmes, in 28 centres all over Romania.

Montenegro's Strategy for Adult Learning and Vocational Education in Montenegro for 2005 to 2015 has been prepared based on a solid collaboration between the Council for Adult Education, the Ministry of Labour and Social Welfare and the Ministry of Education and Science. One of the strategy's strong points is that it takes into consideration the number of employed and unemployed as well as sector specific labour force demand. In 2003, there were 3 institutions in Montenegro professionally engaged in adult education and 5,054 candidates went through different types of training in 2002.

Since 2004 Croatia has adopted a Strategy for Adult Education and Action Plan for implementation. The focus is on increasing opportunities for integrating adults in the education system, particularly those with less schooling in literacy, maths and vocational skills. According to the Ministry of Education and Sciences, there are a large number of institutions providing various programs for adult education but there are no uniform standards.

¹⁵¹ Bosnia and Herzegovina has participated in a CARDS VET project.

Bulgaria, FYR Macedonia and Serbia are in the process of adoption or drafting of Adult Education and Training Strategies. In Bulgaria, some programs such as the Life Long Learning and Vocational Education and Training project and the Vocational Qualification project deal with adult learning as well as vocational learning. The Ministry of Education and Science also provides training and retraining for adults in vocational schools and high schools which have nevertheless to be financed by the trainees. The Adult Learning development has been drafted in Serbia as part of the secondary VET Reform program. This document aims at creating a system of adult learning and training, including institutions and mechanisms for support and development. In FYR Macedonia a draft programme for Adult Education in the context of lifelong learning and a draft version of a Law for Adult Education are currently being prepared. The programme lists a certain number of recommendations that should be followed soon such as forming a Council for Adult education and community education centers, developing a system for the recognition of preceding education and a campaign for life long learning. Only one adult education unit is currently operating as part of the Faculty of Philosophy and it focuses on general education instead of a precise field of specialisation.

Albania, Bosnia and Herzegovina and Moldova do not yet have a specific programme for Adult Learning. In Albania, the 9 training centres offering short-term vocational courses for adults are operating in the absence of a national qualification frame. There is no recognised methodology for curriculum development and no centralised infrastructure in the Ministry of Social and Labour Affairs so that individual trainers are directly responsible for curriculum design and delivery. Finally, the real local needs of the market are poorly represented: professional curricula give more priority to academic knowledge than to the practical and technical skills needed in the labour market. In Bosnia and Herzegovina, pre-war institutions such as the Workers University, the in-training facilities offered by large companies or the Public Employment Service centres have not been

operating for a decade. There are today no adult education teachers or curricula, no legal basis and no financial capacity to restore the system. However, some management education is offered by the Chamber of commerce in transport and banking and the private sector is slowly developing education programs in foreign languages and IT.

10.3.5 Civil servant training

Training for Civil Servants is fundamental to maintaining integrity in the government and ensuring that it delivers on its promises to its constituents with the highest possible professionalism. Competent Civil Servants are also needed to keep up with the complex requirements of the EU integration process.

The average competence of Civil Servants in the region is still not up to standard. For instance, the Business Advisory Council, to the Stability Pact for South East Europe which groups representatives of the business community in SEE and OECD countries, highlights the need to upgrade Civil Servant skills in project management, communication, public outreach and international/European law. Emphasis should be put on specialised training of judges, in particular those in courts dealing with contracts and business law. The role of judges in adapting and applying newly adopted regulations is crucial for full implementation of reforms. Judges should also be trained regarding anti-corruption issues.

Croatia, Romania and Bulgaria have adopted comprehensive civil servant training with a particular stress on IT and foreign language skills.

Croatia adopted a programme for Civil Servant training in 2004 and now has a Centre of Education for Civil Servants. The Centre puts emphasis on training in languages and IT and has courses adapted to judges and law practitioners, tax and customs officers. Training is included in Pre-Accession Economic programme 2005-07 and in the National programme for Integration of Croatia with the EU 2005-07. A training strategy for European

integration matters was prepared and a considerable amount of training has been carried out by the Ministry of Foreign Affairs and European Integration. A general Strategy on Vocational Training and Professional Improvement of Civil Servants was adopted for the period 2005-09. A training strategy/policy aimed at local governments, including staff and appointed or elected officials is still missing (SIGMA, 2005).

Romania has had a National Agency for Public Servants since 1999 and a strategy for training Civil Servants 2005-09 is starting to be implemented. The National Administration Institute created in 2001 elaborated a development strategy for 2005-09. Several programs have taken place in 2005, new objectives have been set for 2006 and the department of continuous training is increasing and developing. The Action Plan on training of Civil Servants adopted for the 2004-07 is part of Romania's EU accession strategy.

Bulgaria formalised its Training Strategy for the Servants in the Administration in 2002 and most of its objectives and activities have been accomplished. The current Strategy for modernisation of state administration will remain in place till the end of 2006. Different programs have been designed and are implemented such as the administrative capacity operation program, the training program of English language literacy in 2006 and the PHARE twinning programs in many state institutions. The new strategy is awaiting adoption. Training responsibilities fall mainly on the Institute of Public Administration and European Integration (IPAEI), in whose catalogue for 2005, all levels of civil servants are targeted at central, regional, local and agency levels. According to the SIGMA assessment: 'training is developing well and represents an incentive for civil servants'. However, efforts are still necessary to ensure the quality of training required (SIGMA, 2005).

In Albania the Training Institute of Public Administration (TIPA) supports civil servant training. Each year approximately 2000 civil servants are trained by TIPA. Following a 2005-09

strategy designed and implemented by TIPA, a new training strategy was designed for 2006-2009. An annual training programme was established for 2006. The drafting process was carried out in close co-operation with stakeholders following a large feedback process. FYR Macedonia's Civil Servants Agency has adopted a strategy, however implementation is still lacking. Between 2002 and 2004, only 13 training programmes were carried out within the Civil Servants Agency. The implementation of the Strategy for EU training is done through biannual Operational Training Plans. The first Operational Plan for 2001-02 and the second for 2003-04 were fully implemented.

Serbia has adopted a Strategy for Public Administration Reform since 2004 and the institutional framework for Civil Servant Training (Personnel Management Service of the Government of Serbia) was established in 2006. The staff of this Service is currently being trained. The Strategy has established sound principles such as the establishment of objective and impartial criteria for the selection of public servants based on merits in the process of recruitment.

Montenegro's strategy for Civil Servants Training and state employees will be adopted by the end of 2007. Some training programmes are already implemented: computer skills improvement, languages, business communication.

Moldova has a Public Administration Academy which has a limited number of training programmes. A new action plan for improvement of capacities of civil servants was recently approved and a new strategy of Public Administration Reform should be soon adopted.

Bosnia and Herzegovina's Civil Servant Training remains supply-driven and largely dependant on donor funding. Training is not institutionalised. The Civil Service Agency currently offers only 22 training courses for over 6,700 Civil Servants at State level and a total of 41,000 Civil Servants paid out of the public budget (SIGMA, 2004).¹⁵²

¹⁵² Data made available to SIGMA for year 2004. Assessment available at <http://www.oecd.org/dataoecd/11/60/36480156.pdf>

10.3.6 IRI results for education and training of the workforce

The education and training of the workforce sub-dimension was assessed by government officials, local stakeholders and international staff of the OECD Investment Compact in each of the target countries following the process described in the Chapter 1 of this report. This resulted in the scores in Table 10.4, describing the current situation in each of the nine target countries.

Among the SEE countries Romania has the most comprehensive education strategy, well developed vocational training and adult learning programs as well as civil servant training. Serbia, Albania, Bosnia and Herzegovina do not have comprehensive formalised education strategies. VET and adult learning are less developed with the only exception of civil servant training in Albania and Serbia. Moldova has a formalised strategy but shows little or no evidence of developed VET, adult learning or civil servant training.

10.4 Transparency in education and workforce skills development

Monitoring and evaluation

To ensure transparency of education at all levels as well as workforce skills development, countries need to establish good monitoring and evaluation mechanisms, including regular internal and external evaluation exercises by specialised institutions. These should include reports on the strategy/action plan implementation as well as the impact of education reform on the labour market.

Monitoring and evaluation in Serbia, Montenegro and Croatia appears to be well designed and implemented.

Overall monitoring and evaluation in Serbia is assigned to the Institute for Education Quality and Evaluation. Labour force quality is monitored by the Statistical Office and the National Employment Service. Indicators for monitoring of labour market trends and evaluation of active labour market measures are defined in the National Employment Strategy and Draft National Action Plan for Employment.

In Montenegro the Employment Agency regularly monitors labour movement to help adapt workforce skills development training. The education system in Montenegro is monitored and evaluated by the State Institute for Education. In the Strategic Plan for the Implementation of the Education Reform 2005-09, systematic monitoring of the implementation of the reform has been established and key indicators set. The system is based on the cooperation and exchange between five main organisations responsible for carrying out the reform: the Ministry of Education and Science, the Bureau for Educational Services, the VET Centre, and the Centre for Textbooks, and the Examination Centre.

Croatia currently monitors the implementation of the development plan 2005-10, with a set of predefined indicators. The National Examination and Assessment Centre is operational since 2005 and there are plans to establish an Education Management System by 2008. The Development Plan contains evaluation and assessment of the implementation of the plan for all levels of education (primary, secondary, graduate and postgraduate), at both central and regional level. Several international donor programmes support monitoring and evaluation activities (EU CARDS and a World Bank loan). A Croatian National Educational Standard was introduced on

TABLE 10.4
IRI SCORES FOR EDUCATION AND TRAINING OF THE WORKFORCE¹⁵³

Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.50	1.75	3	3.50	3.25	2.50	3	4	2.75

Source: OECD Investment Compact.

¹⁵³ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

experimental basis for school year 2005-06. By 2008 a system of indicators will be introduced to enable monitoring and comparison of development of the educational system in Croatia with other EU educational systems.

In FYR Macedonia, the relevant agencies are involved in the monitoring and evaluation process, both external and internal evaluations exist. At elementary and secondary education level monitoring is done by the State Educational Inspectorate, an entity of the Ministry of Education. Other institutions such as the Pedagogical Institute and the National Examinations Centre are also involved. The Pedagogical Institute collaborates directly with schools and local authorities to define input and process quality indicators. Higher education monitoring is the responsibility of the Evaluation and Accreditation Authority.

Moldova, Romania and Bulgaria are at early stages of monitoring and evaluation. Bulgaria monitors and evaluates its education through the Centre for Evaluation and Control of the Quality of Education, but reports are not accessible to the public. The regional education inspectorates monitor education for primary and secondary schools, while the National Evaluation and Accreditation Agency focuses on higher education and scientific organisations. Monitoring in Moldova is primarily conducted by the Accreditation Department of the Ministry of Education Youth and Sport. The draft Strategy Framework 'Education for all' contains several monitoring and evaluation indicators for the following areas: early childhood care and education, access to high quality basic education, non-formal education, and public expenditures for each education level. There are several monitoring institutions in Romania, but evidence of implementation is lacking. The OECD Review of National Policies for Education (OECD, 2003) for Romania already emphasised the importance of assessment of the process of reform, of the development of forecasting tools in order to estimate the future flows of enrolment at different levels and the future qualifications required by the labour market; it also recommended that some basic indicators be

defined for evaluation at national, judet (county) and school level. Based on recent interviews with Romanian Government officials working in education not much progress has been made in these areas.

Albania has made plans for monitoring and evaluation through the Ministry of Education and Science. While there is currently no systematic evaluation and monitoring in Bosnia and Herzegovina, some of the institutions are in place and monitoring should follow within a short period, specifically concerning higher education.

Public/private consultation

Public/private consultation helps to ensure that training is of higher quality and more adapted to market needs.

Bulgaria is the best example of the region for public/private consultations. Private organisations and business associations actively collaborate with the Ministry of Education and Science and the Ministry of Labour and Social Policy. Many institutions have tripartite entities such as the National Council for Tripartite Cooperation in the Bulgarian Chamber of Commerce and Industry. Its members include representatives of the Ministry of Labour and Social Policy, Trade Unions and Employers' Association.

The involvement of the private sector in defining the education agenda in Montenegro is also important and in many cases required by law. The Chamber of Commerce and Trade Union, the Council of Professional Education, the Council for Adult Education as well as the Centre for Professional Education's Board of Director have all been actively consulted over the last few years. Extensive consultations were carried out prior to the elaboration of the education strategy in order to establish clear priorities for reform. Romania has several tripartite commissions and national bodies in charge of evaluation and monitoring. Croatia has conducted extensive public consultation in the framework of the elaboration of the Education Sector Development Plan including on line discussion sites.

In FYR Macedonia a National Entrepreneurship and Competitiveness Council was founded in 2003 and serves as a forum between the public and private sectors and the civil society for improving the country's competitiveness.

Moldova has established expert public/private committees, but none of these initiatives are legally formalised. Consultations with the private sector on education policy in Serbia and Albania are still sporadic. The Serbian Government has established a working group for preparation of the system of accreditation and certification for adult education and in Albania some public/private consultations were held during the preparation process of the pre-tertiary education strategy, VET and tertiary education strategy.

Bosnia and Herzegovina shows no evidence of systematic cooperation between private and public sector in the education area at state level. Only organisations such as parents' councils, teachers associations and student unions exist, however they rarely co-operate together.

10.4.1 IRI results for the transparency in education and workforce skills development

The evaluation of the transparency in education and workforce skills development sub-dimension has resulted in the scores in Table 10.5 describing the current situation in each of the nine target countries.

Bulgaria, Croatia and Montenegro are the best performers in SEE in terms of transparency in education and workforce development having introduced solid monitoring mechanisms and effective public/private consultation channels. Monitoring and evaluation in Albania and Bosnia and Herzegovina is sporadic and cooperation between public and private sectors is limited.

10.5 Key actions to consider at the regional level

1. Expand the implementation of adult learning and vocational training based on a careful assessment of market needs.
2. Further involve the private sector in vocational training and adult learning by providing tax relief or other forms of incentives.
3. Strengthen the overall curriculum of universities and colleges in SEE by establishing stronger links and exchange programmes with other internationally recognised universities.
4. Leverage technology, in particular broadband communication and CD-Roms, to help increase the accessibility of education to all segments of the population at a reasonable cost.
5. Conduct regular assessments of skill gaps and incorporate the results in medium and long-term education/training strategies.
6. Introduce strategies in adult learning in Albania, Bosnia and Herzegovina and Moldova and vocational training strategies in Bosnia and Herzegovina and Moldova.

TABLE 10.5
IRI SCORES FOR TRANSPARENCY IN EDUCATION AND WORKFORCE SKILLS DEVELOPMENT¹⁵⁴

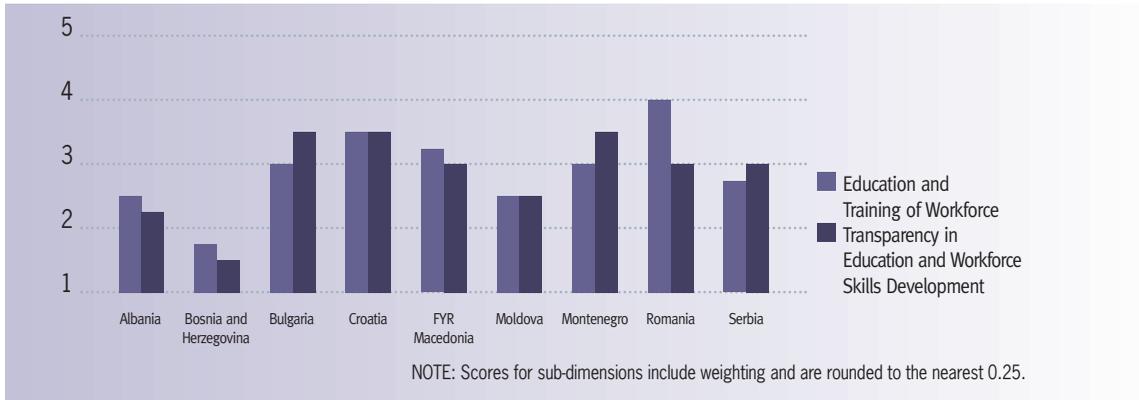
Albania	Bosnia and Herzegovina	Bulgaria	Croatia	FYR Macedonia	Moldova	Montenegro	Romania	Serbia
2.25	1.50	3.50	3.50	3	2.50	3.50	3	3

Source: OECD Investment Compact.

¹⁵⁴ The indicators of the sub-dimension are rated on a scale of 1 to 5 (weaker to stronger). The indicators and the sub-dimensions are weighted. The weighting system ranges from 1 (least important) to 3 (most important). For a detailed breakdown of sub-dimensions into indicators and scores please refer to: www.investmentcompact.org.

IRI SCORES FOR HUMAN CAPITAL

FIGURE 10.3 – HUMAN CAPITAL: SCORES BY SUB-DIMENSION



Source: OECD Investment Compact.

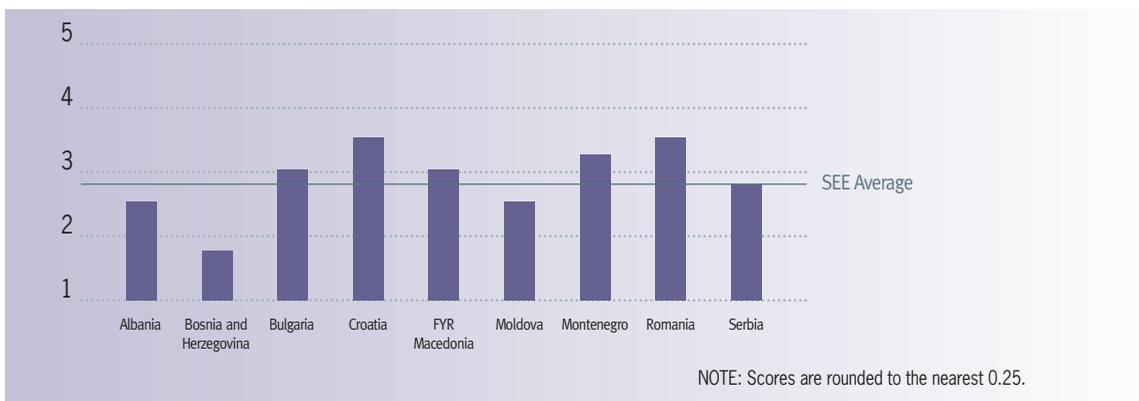
Education and workforce skills development

- Among the SEE countries Romania has the most comprehensive education strategy, well developed national training and adult learning programmes as well as civil servant training. Serbia, Albania, Bosnia and Herzegovina do not have comprehensive formalised education strategies. VET and adult learning are less developed with the exception only of civil servant training in Albania and Serbia. Moldova has a formalised strategy but shows little or no evidence of developed VET, adult learning or civil servant training.

Transparency in education and workforce skills development

- Bulgaria, Croatia and Montenegro are the best performers in SEE in terms of transparency in education and workforce development having introduced solid monitoring mechanisms and effective public/private consultation channels. Monitoring and evaluation in Albania and Bosnia and Herzegovina is sporadic and cooperation between public and private sectors is limited.

FIGURE 10.4 – OVERALL SCORES FOR HUMAN CAPITAL



Source: OECD Investment Compact.

- Croatia and Romania are the most advanced countries in SEE for human capital, in particular in the areas of education strategy, workforce skills and civil servant training.
- Overall, human capital is relatively weak compared to other dimensions and remains a top priority.

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Selected websites:

SEE countries:

ALBANIA

Training Institute of Public Administration: www.itap.gov.al

BULGARIA

Ministry of Labour and Social Policy: www.mlsp.government.bg

CROATIA

Ministry of Science Education and Sports: www.mzos.hr

Ministry of Foreign Affairs and European Integration: www.mvpei.hr

Ministry of Justice: www.pravosudje.hr

FYR MACEDONIA

National Strategy for Development of Education in the Republic of Macedonia: www.npro.edu.mk

Employment Service Agency of the Republic of Macedonia: <http://zvrn.gov.mk>

Agency for Civil Servants: www.ads.gov.mk

Macedonian Chambers of Commerce: www.sojuzkomori.org.mk

MONTENEGRO

Government of the Republic of Montenegro: www.gom.cg.yu

Statistical Office of the Government of Montenegro: www.monstat.cg.yu

Ministry of Education and Science: www.mpin.cg.yu

Centre for Professional Education: www.cso.cg.yu

Human Resources Management Authority: www.uzk.cg.yu

ROMANIA

Ministry of Education and Research: www.edu.ro

National Agency for Civil Servants: www.anfp-map.ro

Institute of National Administration: www.ina.gov.ro

SERBIA

Ministry of Education and Sports: www.mps.sr.gov.yu

Vocational Education and Training Reform Programme: www.vetserbia.edu.yu

European Commission: <http://europa.eu.int/comm/enlargement/>

Ministry of Public Administration and Local self Government: www.mpalsg.sr.gov.yu

International bodies:

Austrian Federal Ministry of Education, Science and Culture: www.bmbwk.gv.at

European Training Foundation (ETF): www.etf.eu.int

Mobilkom: www.mobilkomaustria.com

Organisation for Economic Co-operation and Development (OECD): www.oecd.org

Programme for International Student Assessment (PISA): www.pisa.oecd.org

Raiffeisen Bank: www.raiffeisen.ro and www.raiffeisen.hu

Support for Improvement in Governance and Management (SIGMA): www.sigmaweb.org

United Nations Development Programme (UNDP): <http://hdr.undp.org>

World Bank: <http://web.worldbank.org>



Annexes

Annex A

Country Priorities

Following the second round of country missions (April 2006) to discuss the self evaluations and preliminary IRI results with SEE governments, the Investment Compact and individual SEE Country Economic Teams agreed on six priorities for action between June 2006 and April 2007. Progress in fulfilment of these priorities will be measured in the 2007 edition of the IRI.

Albania

1. Tax Policy: Ensure that VAT reimbursement is systematically monitored and that VAT is reimbursed within 30 days, as stated in the law.
2. Tax Policy: Change the tax regulation stating that start-ups must pay taxes on estimated profits before beginning operations.
3. Investment Promotion: Create a new strategy for the National Business Agency, following the merger of the investment promotion and SME agencies.
4. Regulatory Reform: Implement the programme for regulatory governance to create the basis for RIA.
5. Anti-corruption and Facilitation: Develop and implement a new anti-corruption action plan with clear time bound targets and success indicators.
6. Human Capital: Finish drafting, adopt and implement the employment strategy, ensuring that it is in line with the principles of the European Employment Strategy.

Bosnia and Herzegovina

1. Tax Policy: Move towards greater harmonisation of corporate and personal tax regimes in the entities.
2. Investment Policy: Ensure proper functioning of the Intellectual Property Institute and

coordination of police, customs administration, prosecutors and courts to enforce intellectual property rights legislation.

3. Anti-corruption: Create and start operation of a Public Procurement Agency with the role of implementation of the Public Procurement Law.
4. Trade Policy: Upgrade domestic sanitary and phytosanitary standards to be in line with the EU standards; strengthen domestic laboratories and technical certification bodies.
5. Regulatory Reform: Introduce formalised and systematic Regulatory Impact Analysis at the state and entity level.
6. Human Capital: Introduce and implement strategies for adult learning and vocational training.

Bulgaria

1. Investment Promotion: Reinforce the cluster approach in investment promotion to further promote linkages between foreign investors and SMEs.
2. Tax Policy: Create an overarching tax strategy specifying the principles and economic goals of taxation, current and future tax rates, and improvement of the tax administration.
3. Anti-corruption: Create a coherent, comprehensive Conflict of Interest Policy and ensure that it is applied and monitored.
4. Competition Policy: Implement a deterrent sanctioning policy to limit hard-core anti-competitive behaviour (e.g. cartels).
5. Trade Policy: Streamline customs and administrative procedures to decrease the complexity and time required for imports and exports.
6. Regulatory Reform: Define and implement a comprehensive regulatory governance strategy

which includes a formal, systematic RIA programme.

Croatia

1. Competition Policy: Reinforce the Competition Authority by allowing it to issue fines.
2. Investment Promotion and Facilitation: Develop an Investment Promotion Strategy that is closely tied to the overall development strategy.
3. Tax: Closely monitor the activity of the newly established Financial Police in order to avoid overlapping responsibilities with tax administration auditors.
4. Regulatory Reform: Develop and implement a comprehensive RIA programme.
5. Anti-corruption: Develop an action plan for customs reform and put in place a system based on indicators to monitor implementation.
6. Human Capital: Adopt the new Law on Education with particular focus on adult education

FYR Macedonia

1. Investment Promotion and Facilitation: Adopt an investment promotion strategy that reflects government and private sector consensus on the country's investment promotion activities.
2. Regulatory Reform: Create a comprehensive regulatory reform policy and strategy incorporating a RIA programme which systematically evaluates new legislation.
3. Tax Policy: Ensure that VAT reimbursement is systematically monitored and that VAT is reimbursed within 30 days, as stated in the law.
4. Competition Policy: Strengthen the competition authority powers to impose sanctions.
5. Human Capital: Reduce the wage wedge, which is one of the highest in the region.
6. Human Capital: Develop and implement a comprehensive workforce skills development strategy.

Moldova

1. Competition Policy: Set up an independent National Competition Protection Authority with adequate budget and staff to carry out investigations and impose remedies and sanctions.
2. Investment Promotion and Facilitation: Define

and implement a comprehensive investment promotion strategy.

3. Tax Policy: Implement a Code of Ethics for tax inspectors and a monitoring system to ensure regulations are enforced.
4. Anti-corruption: Design and implement a law on conflict of interest, including an effective monitoring instrument.
5. Trade: Streamline customs and administrative procedures to decrease the complexity and time required for imports and exports.
6. Human Capital: Develop a comprehensive strategy to improve adult and vocational education.

Montenegro

1. Investment Promotion and Facilitation: Define and adopt an investment promotion strategy that reflects government and private sector consensus on sector priorities.
2. Competition Policy: Adopt a competition strategy that includes appointing an independent competition authority with power to investigate anti-competition behaviour and impose sanctions.
3. Anti-corruption: Adopt the new draft law on public procurement and enforce effective implementation timetable.
4. Regulatory Reform: Define and implement a long-term regulatory reform strategy and implement a RIA programme for all newly adopted legislation.
5. Tax Policy: Ensure Tax Administration Inspectors are based on clear monitoring indicators (e.g. filing of returns) instead of discretionary behaviour encouraged by needing to meet budget estimates.
6. Trade: Streamline customs and administrative procedures to decrease the complexity and time required for imports and exports.

Romania

1. Investment Promotion and Facilitation: Elaborate a comprehensive Investment promotion Strategy that includes priority sectors and concrete programs to tie foreign investment to local investment (SMEs). This IP Strategy should also be clearly linked to the industrial and export promotion strategies.
2. Investment Promotion and Facilitation:

Strengthen the investment Promotion Agency with additional staff and budget (aim to double budget from EUR 500,000 to EUR 1 million and increase staff to 40 from 19). The agency should intensify promotion to potential foreign investors through country/specific missions and offer clear and well packaged on the ground services for potential and existing investors.

3. Tax Policy: Implement transparent and consistent standards for tax inspectors to conduct investigations and impose sanctions, and monitor the results with pre-defined indicators to reduce discretionary power.
4. Regulatory Reform: Introduce Regulatory Impact Analysis for all newly adopted legislation.
5. Anti-corruption: Introduce a system with indicators to monitor implementation of the public procurement law. This system can then be used as basis to monitor other areas of anti-corruption (such as customs reform, professionalism of civil service).
6. Human Capital: Adapt the education strategy (including vocational training and adult learning) to reflect the specific needs of the labour market over the next ten years.

Serbia

1. Competition Policy: Establish a Competition Authority to enforce the law by carrying out investigations and imposing remedies and sanctions.
2. Investment Policy: Allow foreign and local investors to own all types of land (e.g. urban construction land).
3. Anti-corruption: Apply the law on public procurement and introduce a system to monitor implementation.
4. Trade Policy: Streamline customs and administrative procedures to decrease the complexity and time required for imports and exports.
5. Tax Policy: Enforce law to reimburse VAT within 30 days with effective monitoring and application of sanctions.
6. Human Capital: Develop specific strategies for adult and vocational education.

Annex B

Key Actions at Regional Level

Investment Policy

1. Actively enforce intellectual property rights with adequate financial and human resources. Enforcement of IPR should be incorporated in the new regional free trade agreement, to be signed by SEE countries by the end of 2006.
2. Review and update land cadastres in the region, and liberalise acquisition of land for investors in some countries (in Moldova, Serbia).

Investment Promotion and Facilitation

1. Adopt investment promotion strategies that include a clear strategic vision for each country and the region and that specify where and how to compete for FDI in Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Moldova and Romania.
2. Strengthen the capacity of investment promotion agencies (IPAs) in the region, with a particular focus on industry expertise and sales and marketing skills.
3. Follow the Czech example of creating linkages between FDI and local businesses in all SEE countries.
4. Assess investment incentives schemes in all SEE countries, thoroughly and periodically, in order to determine the costs incurred and whether they meet their objectives.

Tax Policy

1. Improve transfer pricing legislation by drafting clear and comprehensive implementation instructions, including documentation requirements, and ensure supervision and enforcement of these rules.
2. Improve tax administration capacity through more systematic training of tax officials, especially auditors.
3. Implement taxpayer audit strategies based on risk analysis.
4. Systematically monitor VAT reimbursements.
5. Calculate and communicate the overall tax burden.

Anti-corruption and Business Integrity

1. Strengthen further legislative frameworks to ensure consistency with international standards and conventions.
2. Increase numbers of investigations, prosecutions and convictions resulting in strong, dissuasive sanctions.
3. Ensure that policies in SEE countries are in line with the OECD Guidelines for Managing Conflict of Interest in the Public Sector and that appropriate resources are allocated for implementation.

4. Strengthen public procurement institutions through regular training of public officials and monitoring of procurement cases.
5. Implement and regularly monitor anti-corruption policy, focusing on the evaluation of the effectiveness of policies in place and on the use of risk assessment techniques to identify future priorities.
6. Institutionalise regular, sustainable consultation mechanisms, with representatives of businesses for policy development, implementation and monitoring in all countries.

Competition Policy

1. Set up independent competition authorities in Moldova and Montenegro.
 2. Give the independent competition authorities sanctioning powers in Croatia, FYR Macedonia and Serbia.
 3. Strengthen the administrative capacity of the competition authorities through budget reinforcement and increased staffing with legal and economic expertise, in order to develop an enforcement record and policy advocacy actions, in Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia and Serbia.
 4. Apply sanctions strong enough to deter hard-core cartels in Bulgaria.
 5. Strengthen the enforcement record in Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Moldova, Montenegro and Serbia.
2. Monitor implementation of technical, sanitary and phytosanitary standards to help identify areas for action and accelerate implementation.
 3. Provide further assistance to companies, especially SMEs, in order to apply for certification and to implement EU/international standards.
 4. Further improve customs administration in terms of transparency and efficiency, for example by introducing a hotline for companies to report any irregularities.
 5. Further reduce tariff barriers on imports of capital goods.
 6. Implement rapid and transparent VAT reimbursement for exporters.
 7. Introduce export promotion programmes to integrate domestic companies into the international supply chain.
 8. Pursue the regional SEE Free Trade Agreement to make possible a common economic space.

Regulatory Reform

1. Formalise and systematically apply Regulatory Impact Analysis (RIA) to draft regulations.
2. Increase inter-ministerial coordination on proposed regulations and involve and communicate with Parliamentarians around the RIA process to make it more transparent and effective.
3. Increase regulatory transparency through formalised and routine public/private consultations on regulation management.
4. Create a complete register online, listing all regulations and formalities.

Trade Policy

1. Strengthen domestic institutions/organisations in order to implement technical, sanitary and phytosanitary standards in line with EU/international requirements. Achieve further progress in establishing a well-functioning conformity assessment system.

Human Capital

1. Expand the implementation of adult learning and vocational training based on a careful assessment of market needs.
2. Further involve the private sector in vocational training and adult learning by providing tax relief or other forms of incentives.
3. Strengthen the overall curriculum of universities and colleges in SEE by establishing stronger links and exchange programmes with other internationally recognised universities.
4. Leverage technology, in particular broadband communication and CD-Roms, to help increase the accessibility of education to all segments of the population at a reasonable cost.
5. Conduct regular assessments of skill gaps and incorporate the results in medium and long-term education/training strategies.
6. Introduce strategies in adult learning in Albania, Bosnia and Herzegovina and Moldova and vocational training strategies in Bosnia and Herzegovina and Moldova.

Annex C

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