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TABLE OF CONTENTS

WORLD BANK STRATEGY FOR 2005-2008 - ASSISTANCE FOR CROATIA

The World Bank is ready to loan to Croatia 1,5 billion dollars to assist the country to achieve reforms, which are essential to the EU membership. Until 2008 it lends 1 billion dollar in all, and if the transformation comes off according to plan, this amount will be completed with further 0,5 billion $. The objective is to enhance the country's competitiveness and the economy's achievement and help Croatia to harmonise its national laws to EU standards.

In Albert Martinez's opinion (the croation delegate of the World Bank) this is an important turn in the loan-policy of the financial institute as well, because till now they favour particularly single investment programmes, but in the future the main aim will be the transformation of the economic framework.

Croatia joined the World Bank and the International Development Association in 1993. Since then, the Bank has played an important role in providing financing, technical advice and knowledge transfer. Its assistance has focused on helping Croatia with the reconstruction after war, improving welfare and reviving the development in the country.

The basis of the World Bank's activities in Croatia is Country Assistance Strategy (CAS), sets forth in consultations with the Government, which works out the assistance of the Bank in a three-year period. The last period of 1999-2003 includes 3 standard types of project financing: loans, grants and analytical and advisory activities.

In Zagreb on 19th January 2005 the Government of the Republic of Croatia and the World Bank launched the new CAS for the period 2005-2008. This CAS focused on assisting the Government of Croatia in:

- improving macroeconomic sustainability through more efficient public spending, together with strengthened budget management;
- achieving sustainable private sector-led growth through enforcement of financial discipline and competitive conditions in the enterprise sector;
- ensuring broad participation in growth through transformation of the education system, improved targeting and delivery of health care and social benefits;
- facilitating sustainable natural resource management through strengthening of environmental management capacity, upgrading of wastewater and water supply infrastructure and improved energy efficiency.

The measure of the economic growth in Croatia was powerful in the last few years due to the accession of the large infrastructural investments and domestic consumption. By the statistic the real Gross Domestic Product for the third quarter of 2004 is by 3,6% higher than in the same period of the year 2003, and the annual GDP for the year 2003 showed an increase of 4,3%, as compared to the year 2002.

TABLE 1.
MAIN MACROECONOMIC INDICATORS IN CROATIA (2000-2004)

	2000	2001	2002	2003
GDP, market prices (kuna)	n.d.	165.639,4	176.428,8	189.883
GDP per capita, USD	n.d.	4.476,2	5.049,5	6.377,4
Annual growth rates (%), constant prices (1997)	n.d.	4,4	5,2	4,3
Exports – recalculated in USD, year t/year (t-1)	n.d.	105,3	105,1	125,7
Imports – recalculated in USD, year t/year (t-1)	n.d.	116	117,2	132,4
Personal consumption – total (kuna)	58.613	61.141	64.736	n.d.

Source: Central Bureau of Statistic – Republic of Croatia

In 2004 the monetary policy turned tighter, and it limited the consumption of the households and the public sector investments. The fact, that this year the GDP growth rates reached „just" approximately 3,8 percent shows that the way which assured the economic growth in Croatia is not sustainable in long-term. The economic recovery in the last years has been accompained by a growing external current account deficit, which has been financed primarily by a sharp rise in external debt.

But it is good news for Croatia that in the first ten months of 2004 the exports grew by 15,5%, while the imports showed a lower rate with 7% and the measure of the external debt fell last year as well.

Debt sustainability analysis shows that the deficit is not exceeding 3 percent of GDP in normal circumstances, and the ratio of public debt to GDP is not exceeding 60 percent, so these indicators are meeting the Maastricht criteria required for the European Monetary Union by now.

These data are essentially important for the country, which is standing before a great step. But they are not sufficient, they have to be stabilized for long-term, because Croatia have to focus on long-term. It has become an official candidate country of the EU since 2004, and now the main strategic objective of the Croatian Government is the successful accession to the EU, to enter as a dynamic and competitive economy. To achieve these objectives, the CAS program relies on fiscal adjustment to stabilize the debt-to-GDP rates and structural reforms to reduce the economic role of the state and promote private sector activity.

To become a successful member of the EU, Croatia will need to create conditions that will attract investment and induce growth. These conditions can be categorized as:

- macroeconomic and financial stability;
- stabil, progressive and predictable laws and institutions;
- efficient labor and financial markets;
- social and environmental sustainability;
- effective integration into the European infrastructure networks ensuring competitive cost and quality, and
- a dynamic business-oriented environment.

The key to Croatia's sustainable economic growth is the dominance of the private sector. There is a need to reduce public sector wage bill and subsidies. Principally the reducing and restructuring of public spending, perfection the business climate and reforms of the judicial system are needed to increase private sector investment and productivity.

The main objective of the CAS is to support the government's growth and reform strategy for successful EU accession. The strategy calls for a shift in the sources of growth from the public sector expenditures and consumption to private sector investments and efficiency. The greatest amount from the assistance of the World Bank (450 million USD) is intended to appropriate investments, the confirmation of the budget, and for finance the improvement of the efficiency of the public administration.

In addition, the CAS is proposed to assist Croatia in those efforts that have to be made in the next 4 years to meet EU accession requirements. This means that the CAS supports harmonization initiatives required by the acquis communautaire and enhances Croatia's ability to tackle with competitive pressures in the EU.

RECORD BUDGET REVENUES IN BULGARIA IN 2004 – AN ESTIMATED SURPLUS OF THE BUDGET AGAIN

In Bulgaria, the cash balance of the central government budget went on improving for the last months of 2004 in row. The consolidated budget revenues and expenditures in November amounted to BGN 1,326.4 mn and 1,323.7 mn, which were by 22.4 % and 14.5 % bigger amounts, respectively. The cash surplus in the eleven months to December amounted to BGN 1,478 mn, growing by 65 %, compared to the same period of 2003. The surplus makes up about 0.7 % of the GDP. The cash balance of the budget in the eleven months to December reached BGN 1,256.6 mn, running 71 % higher on a year earlier. It was a very important fact that the primary and domestic balance improved significantly. They amounted to BGN 1,926.3 and 1,748 mn vs. 1,430.7 and 1,269.8 mn respectively, relative to the same period of 2003.

The improving budget performance was mainly due to the robust growth in revenues, which last December ran at BGN 841.5 mn, or 32.92 % up on a year earlier. Since January 2004, budget revenues amounted to BGN 9,276 mn, reporting a year-on-year increase of 11.6 %. The revenues collected grew by 2.5 % on the 2004 budget projections.

On the revenue side, the budgetary improvement was resulted in by differently increasing revenues. Tax revenues grew most vigorously. They had a 12-month increase of 38.4 %. At the same time, non-tax revenues remained almost unchanged, growing by a bare 0.8 %. Of all items, it was revenues from VAT and the income tax that posted the highest growth of BGN 89.7 and 69.3 mn. However, it should be noted that the rise in income tax revenues was triggered by the alterations in the administration patterns of the tax item between the central budget and local governments. Indirect tax revenues increased, too. Revenues from excise duties grew by BGN 40.8 mn and from customs duties by BGN 9.4 mn due mostly to the robust increase in imports. At the same time, profit tax revenues declined by BGN 6.8 mn, or 13.9 %, as a result of the tax rate reduced in early 2004.

In spite of the robust growth in revenues the government pursued a rather cautious expenditure policy. For example, the central government expenditures in November amounted to BGN 770.4 mn, which was by only 2.4 % more than a year earlier. Capital expenditures and budget spending on maintenance reported the highest increase. Interest payments went up by BGN 6.6 mn (about 42.3 %) due mostly to the larger volumes of government securities placed on the domestic market as part of the debt restructuring exercise. At the same time, budgetary transfers declined by BGN 27.2 mn or 10.44 %.

In 2004, the public debt has further declined rapidly, due to the general government budget surplus, low interest rates, some use of the fiscal reserve and a strong exchange rate. General government debt is estimated to have closed 2004 equivalent to slightly below 40% of GDP. Rapid growth of the fiscal reserve due to privatisation successes is allowing the government to carry out buy-backs of its outstanding Brady debt. The general government debt is expected to fall to 32% of GDP at end-2005, in part reflecting the late January Brady debt retirement. This would mark a fall in general government debt of over 40% of GDP in six years, one of the fastest paces of sovereign debt reduction.

The last weeks of 2004 already marked the start of the election season in Bulgaria, as the government raised expenditure sharply. The election is to be held in June 2005. More fiscal loosening ahead of the elections can be expected in the coming months but it probably will not threaten the sustainability of the public finances of the country. It can be forecasted that the general government budget will close the year 2005 at a deficit of around 1% of GDP compared with an official 0.5% of GDP deficit target. While fiscal discipline will suffer somewhat due to the elections, policy direction is unlikely to change much under a future government given cross-party commitment to the currency board arrangement and EU accession

Concerning the future trends, fiscal expansion could exacerbate Bulgaria's sizeable current account deficit in 2005, which narrowed slightly in 2004 but remained a sizeable 7.7 % of GDP. Even a worthening ratio is well above the median current account deficit for all countries rated at the 'BBB' level and above those of other 'second wave' EU accession countries such as Croatia, Romania and Turkey.

While the large current account deficit highlights problems such as low domestic savings rates, there is little sign that it is unsustainable. Foreign direct investment covers a large share of the deficit, and while debt inflows have risen sharply in nominal terms, the country's external debt ratios continue to moderate. Capital flows to Bulgaria should remain underpinned by continued privatisation, policy discipline, and the country's accession to the EU expected in January 2007.

TABLE 2
BALANCE OF THE BUDGET (IN MILLIONS OF BGN)

Annual data					
	2000	2001	2002	2003	2004[1]
Consolidated budget revenues (accumulated)	11 062.0	11 837.4	12 523.3	14 072.0	15 800.0
Consolidated budget expenditures (accumulated)	11 330.7	12 096.6	12 732.7	14 071.1	14 544.4
Cash balance (accumulated)	-268.6	-259.1	-209.5	0.9	1 256.6
Internal government debt (annual average)	2.336,4	1.765,5	1.976,9	2.223,2	2.650,0
External government debt (annual average)	18.920,7	18.979,1	17.481,0	15.109,1	13.100,0

Monthly data of 2004						
	January	February	March	April	May	June
Consolidated budget revenues (accumulated)	1.126,0	2,110.62	3,636.80	5.097,6	6.375,55	7.646,90
Consolidated budget expenditures (accumulated)	1.152,7	2.260,16	3.408,40	4.568,7	5.665,80	6.769,30
Cash balance (accumulated)	-26,7	-149,55	228,40	528,9	709,75	877,60
Internal government debt	2.347,4	2.414,08	2.442,20	2.462,4	2.475,30	2.494,47
External government debt	14.588,1	14.577,39	14.729,40	14.874,3	14.712,30	14.704,32
	July	August	September	October	November	December
Consolidated budget revenues (accumulated)	8.996,50	10.311,38	11.622,09	12.978,15	14.304,55	15.800,0
Consolidated budget expenditures (accumulated)	8.019,80	9.119,70	10.322,35	11.502,85	12.826,55	14.544,6
Cash balance (accumulated)	976,70	1.191,68	1.299,74	1.475,30	1.478,00	1.256,6
Internal government debt	2.494,66	2.536,91	2.568,79	2.597,73	.	.
External government debt	13.595,2	13.531,8	13.485,4	13.329,7	.	.

Source: Ministry of Finance of Bulgaria Note: 1 estimations

MONTENEGRO – ECONOMIC POLICY FOCUSES ON PRIVATISATION

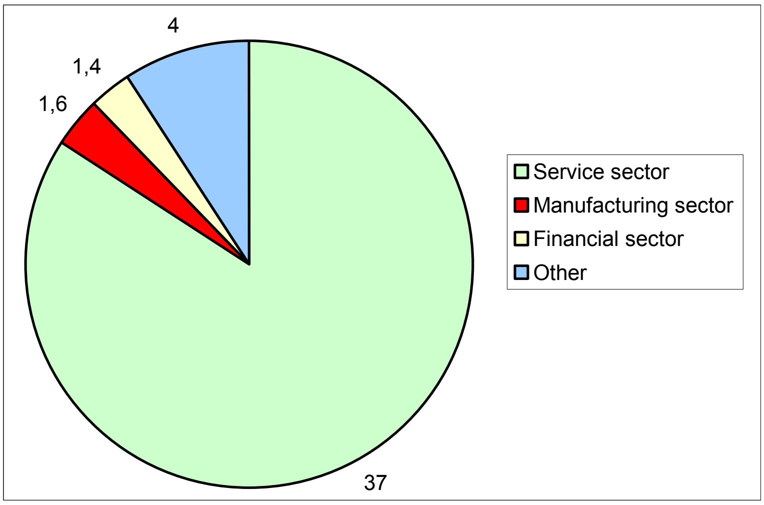
FDI INFLOW

FDI (Foreign Direct Investment) is considered to be a key instrument for increasing production, developing infrastructure and thus improving the standard of living. It is obvious that Montenegro would also like to have a share in these benefits, but in general we can state that Montenegro lags behind other countries - Bulgaria, Croatia and Romania – in the Southeast European region. This was the reason why the Montenegrin government had to make certain steps in 2004. For example foreign consultants were hired and an Agency for Investment Promotion was established.

According to a recent FIAS (Foreign Investment Advisory Service) report, Montenegro's main advantage is the good geographic location, the fast-paced economic reforms, the qualified but not so expensive workforce and last but not least the rapid privatization. On the other hand, Montenegro owns a small, low-revenue market, where the transition was relatively late. Other problems must be faced as well: structurally weak industries, macroeconomic instability, corruption and the deficiencies of the administrative system.

Montenegro's central bank reported USD 44 million net FDI inflow in the first nine months of 2004. This number represents 60 % increase in annual terms.

CHART 1.
NET FDI IN MONTENEGRO (JAN-SEP 2004, MILLION USD)



The Montenegrin government's aim is to gear up FDI inflow to 150 million euro in 2005 by privatization campaigns, greenfield investments and other development projects. The deal that is expected to generate most revenues is the sale of Telekom Montenegro (Telekom Crne Gore AD, TCG). The maximum price for TCG has been offered by Matáv – Hungary's leading telecom group. For TCG's 100 % stake Matáv offered 165 million euros, which means that the Montenegrin government's plan for 2005 will be overachieved.

TELEKOM MONTENEGRO'S ACQUISITION

The TCG Group consists of TCG and its three subsidiaries, Monet GSM, Montenegro Card and Internet CG. TCG - Montenegro's fixed-line operator - provides fixed-line services to around 191,000 customers. At the end of 2003 the 100 % owned Monet GSM is the country's second largest mobile operator with around 190,000 users and a 43 % market share. The 85 % owned Internet CG has over 70,000 dial-up users and a 90 % share of the market. TCG owns 51 % of Montenegro Card, a provider of public payphone services with a 60 % market share.

The deal with TCG is Matáv's second investment abroad after acquiring a controlling stake in Macedonian Maktel. The recent agreement with TCG is part of the Hungarian company's mid-term strategy and embodies further growth opportunities. Moreover, the acquisition might help Matáv to stop the decrease of revenues and the loss of fixed-line subscribers.

According to the agreement with TCG, Matáv will buy for 114 million euros 51,12 % of the shares from the Government of Montenegro and a further offer will be submitted for the minority stakeholders for the additional 48,88 % shares. The acquisition of TCG will temporarily increase the indebtedness of Matáv. The bid also included a plan to invest 67 million euros in TCG over the next five years.

CONCLUSIONS

It is indisputable that Montenegro's transition is proceeding and good results are demonstrated by the privatization of enterprises and banks, but certain problems must be faced. Experts emphasize that the administrative capacity to implement reforms is weak and the entrepreneurial culture needs further development. After the accomplishments of early transition, the government's new task is to formulate a medium-term plan, a clear strategy to achieve deeper institutional and structural reforms.

It seems that the Montenegrin government is trying to make efforts to attract sustained FDI inflows, including through large-scale privatization. Still urgent reforms are required in public sector administration and the judiciary system. All of these aim to boost private sector development and improve the investment climate. Attracting future FDI will be a challenge for Montenegro.

In 2005 the economic policy should find solution in two main topics: fighting inflation in order to keep it below 10 % and reducing the current payment deficit. Plans have been laid with the help of IMF to achieve these goals. Due to the fact that the share of the private sector is still only 45 % in Montenegro, experts advise to accelerate privatisation. The forthcoming privatisation of aluminium company Kombinat Aluminijuma Podgorica (KAP) will eventually put the largest part of Montenegro's economy in the hands of the private sector.

Macedonia – Status of European Integration One Year After Application

At the beginning of 2004, Branko Crvenkovski, Prime Minister of the Republic of Macedonia, announced that his country would apply for European Union membership at the end of February. According to the Macedonian government, the opposition agreed with the EU application. The country's European integration is their common and national interest, thus, this announcement seemed to be serious.

The Parliament of Macedonia agreed on formally applying for EU membership in February 2004. However, the official application date (26 February) was delayed due to Macedonian President Boris Trajkovski's tragic death in air crash. Almost one month later, on 22 March 2004, the Former Yugoslav Republic of Macedonia officially applied for EU membership.

With this application, the Former Yugoslav Republic of Macedonia (FYROM) - became independent at the beginning of '90s – can be the fourth candidate country in the Southeast European region after Bulgaria, Romania and Croatia. Bulgaria and Romania finished their pre-accession process at the end of 2004 and can be members in 2007[1], while Croatia applied for EU membership in early 2003. The EU welcomed Croatia's application, the European Commission's official statement on this issue was basically positive. According to the current roadmap, the accession negotiations with Croatia will start in March 2005.

Table 3.
Main Economic Figures of Macedonia (1998-2004)

	1998	1999	2000	2001	2002	2003*	2004**
GDP growth (%)	3,4	4,3	4,6	-4,5	0,9	3,2	4,0
Inflation rate (%)	0,8	-1,1	5,8	5,3	2,4	1,2	2,0
Unemployment rate (%)	34,5	32,4	32,2	30,9	31,9	36,7	35,0
General government balance (% of GDP)	-1,7	0	1,8	-7,2	-5,6	-1,6	-2,0
Current account balance (% of GDP)	-7,5	-0,8	-2,1	-6,8	-8,5	-6,0	-7,7
Net FDI (million euro)	105	30	191	498	82	83	120

Source: IMF, NBRM,
** Preliminary, ** Expectations*

Background

In contrast with Croatia's application that of Macedonia was not really welcomed by the EU. As a matter of fact, the Former Yugoslav Republic of Macedonia is now a much more "problematic" and less developed country than Croatia is. That is the reason why the application of Croatia was welcomed in 2003, while Javier Solana, the EU's security chief recommended to Macedonia that Skopje should not rush its application for European Union membership. His reason for his statement was that the EU would be too engaged with the accession of the 10 new member states. It is obvious that the EU will have enough problems after the accession of these states and will not have enough resources to manage the application of the Former Yugoslav Republic of Macedonia. Thus, Macedonia cannot expect an early answer from the EU[2]. On the other hand, Solana's statement – in

[1] This is the target date.

[2] The case of Croatia is a good example: the Western Balkan country applied for EU membership at the beginning of 2003, and the EU finished its official statement in one year.

our point of view - contains that the EU is still not prepared for the integration of the less developed Balkan countries like the Republic of Macedonia.

The relations between the EU and Macedonia started in 1996 when Macedonia became eligible for funding under the EU PHARE program. Three years later, the EU proposed a so-called Stabilization and Association process (SAp) for five Western Balkan countries. In 2000, the Stabilization and Association Agreement (SAA) was the result of the SAp which was signed and came into force in 2001. In that year, another Agreement was signed that was the so-called Ohrid Agreement. These two agreements helped Macedonia to the stabilization and founded a country with peace.

The application for EU membership was the next step in the European integration process of the Former Yugoslav Republic of Macedonia. However, the country faced a big problem at this stage. Greece, the southern neighbour of FYROM stated that it would veto Macedonia's entry into the EU if the country insists on being internationally recognised as the Republic of Macedonia. The row on the name flared again in late 2004 due to the fact that the United States announced that it had formally recognized the Republic of Macedonia as the name of Former Yugoslav Republic of Macedonia.

The reason for Greece's declaration is that they have fear of that the use of the Republic of Macedonia carries territorial claims on Greece's northern province of the same historic name (which is the birthplace of the Macedonian King Alexander the Great). That is why Athens announced that it might veto Macedonia's bid for EU membership.

The US' recognition was evaluated in three different ways in the three countries. Athens said that Washington's decision was "a diplomatic stab against Greece", and Bush was called as "the Godfather of Macedonia". In Macedonia, the decision was evaluated as a victory, while in the US the decision it was explained as the sign of support for Macedonia's government and rewards its commitments to democracy and war against terrorism. Probably, the solution could be that the two countries (Greece and Macedonia) will accept an agreed, mutually accepted name in the future.

In October 2004, the EC sent its questionnaire to Macedonia on which the Commission will base its opinion. This EU questionnaire includes around 4000 questions and covers a total of 3000 issues. When the questions have been answered, the questionnaire will be sent back to the EC which will prepare its opinion on the application of the Former Yugoslav Republic of Macedonia. According to officials in Skopje, the answers to the EU questionnaire will be sent back to Brussels on 14 February 2005. In our expectations, the opinion will be prepared in late 2005.

Undoubtedly, the case of Macedonia is a quite strong message to the other former Yugoslav states and Albania, which are making great efforts to implement reforms. The positive example of Macedonia (after that of Croatia) can be stimulating to these countries in the region.

Conclusion

In conclusion, it is obvious that the application for EU membership is a reasonable step from Macedonia because it may help the further stabilisation and the country's European integration. However, the application of Macedonia did not come in the right time because the EU faces its largest enlargement round when ten, mainly less-developed Central and Eastern European economies joined the Community. Thus, Macedonia could not expect an early reply to its application from the EU. Furthermore, the pre-accession negotiations of Bulgaria and Romania are completed and the first part of the roadmap of Croatia seems also be on track. So the Republic of Macedonia needs to be patient but its European integration rose onto a higher level by the application for EU membership.