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HEADING TO “EUROPE”? STABILISATION AND ASSOCIATION AGREEMENT IN SERBIA (AND MONTENEGRO)

Likewise in the case of other Southeast European countries, one of the main political goals of Serbia and Montenegro is the accession to the European Union but certain recent political issues mean serious danger for the country's integration process and many questions must be answered in the future.

From the EU's point of view their interest and stated aim is to stabilise and develop the Southeast European region in a political and economical sense. In order to reach all these aims the EU, with the assistance of the Southeast European countries, created the Stabilisation and Association Process (SAP), covering Albania, Bosnia and Herzegovina, Croatia, the FYR of Macedonia, Serbia and Montenegro. Access has been given to the cooperating countries to the European Union's market, plus domestic reform programs are supported. The next step before applying for EU membership is the negotiation of the Stabilisation and Association Agreement (SAA). (To know more about the background and the aims of the SAA see SEE Monitor 2005/18, The EU-Albania Relations – The Present Engagement of the SAA.)

The main events that led Serbia and Montenegro on the track of EU accession are the following:

1997: Regional Approach. The EU Council of Ministers establishes political and economic conditionality for the development of bilateral relations.

1999: The EU proposes the new Stabilisation and Association Process (SAP) for five countries of South-Eastern Europe, including Serbia and Montenegro.

October 2000: fall of the Milosevic regime.

November 2000: "Framework Agreement FRY-EU for the provision of Assistance and Support by the EU to the FRY". Serbia and Montenegro benefits from Autonomous Trade Preferences from the EU.

June 2000: Feira European Council states that all the SAP countries are "potential candidates" for EU membership.

November 2000: at Zagreb Summit, the SAP is officially endorsed by the EU and the Western Balkan countries (including Serbia and Montenegro).

2001: First year of the new CARDS programme specifically designed for the SAP countries.

July 2001: start of the EU-FRY Consultative Task Force.

March 2002: signature of the Belgrade Agreement on a restructured State Union.

February 2003: entry into force of the Constitutional Charter.

June 2003: at Thessaloniki Summit, the SAP is confirmed as the EU policy for the Western Balkans. The EU perspective for these countries is confirmed.

July 2003: Enhanced Permanent Dialogue replaced the format of the Consultative Task Force.

June 2004: Council decision on the European Partnership for Serbia and Montenegro.

October 2004: Council conclusions on the twin-track approach

April 2005: the Commission adopts a Feasibility Report which concluded that Serbia and Montenegro is prepared to negotiate a Stabilisation and Association Agreement with the EU.

Source: http://europa.eu.int/comm/enlargement/serbia_montenegro/serbia_montenegro_key_events.htm

Besides the essential issues concerning the speed of the political, economic and judicial reforms of Serbia and Montenegro, recently there are three main questions that will greatly affect the pace and direction of the EU accession process:

- the cooperation with the International Criminal Tribunal in The Hague, the ICTY,
- the referendum in Montenegro on their potential independence,
- and the final status of Kosovo.

As we could see, the Commission adopted the Feasibility Report in April 2005, which meant that potentially the negotiations concerning the SAA may start. The main prerequisite is handing over war crimes indictee General Ratko Mladic to The Hague tribunal - the latest deadline for this is the 5th of April. Officials say that they are determined to arrest Mr Mladic. Whether or not politicians know where Mladic is staying, there might be a lack of political will to arrest a so called "hero" of the Serb nation. The country's political stability is fragile. The prime minister of Serbia, Vojislav Kostunica runs a fractious minority government, which has to rely on the votes of the Socialist Party of Serbia (previously led by Milosevic). The socialist party assists Kostunica, but expects no more "heros" to be sent to The Hague. Reforms and cooperation with the EU can also be threatened by the strongest party in the parliament, namely by the Serbian Radical Party, (nowadays trying to make a fortune from the death of Milosevics). Blocking the road to EU accession can be desired by the ultranationalists.

In May Montenegrins will vote about Montenegro's independence. If at least 55% of the electorate vote for independence and at least 50% of the electorate take part and vote valid, Montenegro will gain full independence (thus leaving Serbia without sea-port). A slim majority for independence is expected, but the outcome of the referendum is still uncertain. Taking into account the potential independence, the EU launched a twin-track approach for Serbia and Montenegro, and separate negotiations took place with Belgrade and Podgorica.

In February formal talks began on the final status of the province of Kosovo. Diplomats say Kosovo is likely to win independence later this year. The Serb nation considers Kosovo as a sacred place for their culture and religion, so as a result, loosing the province may cause political crises in Serbia and it can even mean potential danger for the Balkan's political stability (for example Bosnia-Herzegovina and its Serb entity, Republica Srpska).

To sum up, while the European Union started cooperating with one state (Serbia and Montenegro), it is probable that in the future negotiations may continue with two or three separate countries (Serbia, Montenegro, Kosovo).

CONCLUSIONS

EU politicians confirm the will to integrate Southeast European countries to the union, but on the other hand, the consideration of the "absorption capacity" is often mentioned. This is understandable, if we take into account that the EU has problems with "absorbing" even the New Member States. As a result the pace of the integration may be questionable, but the aim is obvious.

The main issues concerning Serbia's future and the negotiation with the EU are the questions of Montenegro and Kosovo, the cooperation with the ICTY, the implementation of legal, administrative and economic reforms. These topics are in the hands of Serbia and Montenegro. Hopefully the potential EU accession will be a powerful incentive for cooperation with the European Union.

REAL ESTATE MARKET OF BULGARIA

Since the late 1990s, international construction and real estate funds have shown increasing interests in Southeast European countries. They supposed that it would be difficult to realise substantial profits elsewhere because of the intense construction and strong competition. This made investors look to the east, where profit possibilities are still higher. Countries that offered the best conditions included prospective EU members like Romania and Bulgaria. The possible investment return was higher in these countries, compared to similar deals in Central and Western Europe. Some years ago there were periods when investment return in the UK was 3.6 % meanwhile it in Prague and Warsaw exceeded 7.5 % and even higher return was expected for the investments in Bulgaria.

Because of the expected more favourable market climate, various funds decided to relocate their activities to South-eastern Europe. A number of well-known Western companies started their business operation there. More companies were also becoming interested in specialised construction, such as holiday villages along Bulgaria's Black Sea coast.

After an all-time lowest record of real estate purchases in 1998 when the number of deals was only 65 179, the market was soaring, due to foreign investment and to the return of the Bulgarian temporary emigrants, who went abroad to work there during the economically hard times. In 2005, Bulgaria's growing real estate market experienced yet another record-breaking year of investment because about 250,000 old homes were sold and new finalised by the end of the year. It represented a 28 % increase compared to the total 196,000 flats sold in 2004. The investments in real estate transactions and property development in Bulgaria reached about 1 billion euro by the end of 2005. The FDI in the real estate sector represent about 25 % of all FDI inflows into the country by the end of 2005.

The increase in real estate prices slightly slowed down in 2005 but this 15 % growth rate was still the highest in Europe. Most of the analysis and expectations forecast that price growth in the residential sector will further slow down and it will be below 15 % in 2006.

In 2005, the new Bulgarian government announced a tax increase on real estates. The law on local taxes was amended by the parliament and the government also endorsed the necessary regulations. These changes took effect in January 1, 2006. The amendment increased the property tax valuations by 30 per cent in towns, by 25 per cent in smaller cities and by 20 per cent in small towns and villages. As a result of this, real estate taxes increased as well. The exact tax is determined through additional other factors. These include the type of construction, location within a building and infrastructure characteristics. Property taxes in bigger cities like Sofia Varna and Bourgas were increased by 30 %.

The IMF demanded an updating of the property valuations, which determine the amount of taxes. This request was justified by the increasing market prices of Bulgarian property. Real estate in bigger cities became 200 to 300 % more expensive between 2000 and 2004. Meanwhile, tax valuations were last updated in 1998.

The tax revision announcement led soon to large increase in the number of sold property, as well as to higher demand. The sale of real estate in Bulgaria was expected to double after the government approved the property tax evaluation. The number of transactions more than doubled by the end of 2005. During 2005, the number of sales surpassed the one for 2004 when a total of 4446 apartments were sold. The number of property donations also increased. The reason for such developments was also the expected tax increase and people preferred to

pass their property to relatives. The legal mortgages for the same period as well as the number of renting contracts also increased.

In 2005, a large number of hotels at the Black Sea coast have been offered for sale at the end of the summer season. Hotels were put up for sale because the owners could not recover the costs of their investment. That is, the owners of these hotels have found that their investments might not prove worthwhile. As a result, the real estate market was saturated.

The declining return on investment may discourage some of the potential large investors. Excessive constructions in some holiday resorts areas during the past two years also contributed to the worsening profitability. The summer season of 2005 proved how excessive construction, accompanied by noise and dirt, can compel holiday makers demanding high quality service to change their holiday destination. German tourists, who were traditional foreign visitors to Bulgaria, opted for tourist resorts in other countries. Another sign of an emerging crisis is the fact that the market has been recently flooded by offers for sales of hotels and other holiday properties, and there has not been a significant number of finalised deals. The offer exceeded the demand and the situation has worsened after the end of the summer season because newly built hotels appeared on the market. The offer consists mainly of small and medium size hotels in the Black Sea tourist resorts and the lower-altitude mountain areas. The main reasons why the owners want to sell their tourist facilities are wrong investment calculations, poor infrastructure and bad design.

This phenomenon could be predicted long ago because over the past two or three years, the development of tourism in Bulgaria has outpaced overall economic growth of the country, and especially the development of infrastructure. As regards infrastructure, there has been no improvement for 15 years. A tourism industry cannot exist without a working network of highways and a working economy.

There are already some hotels in Sofia that have been offered for sale. If the trend continues there will be soon more hotels which are offered on the real estate market. Fifty new buildings are under construction in Sofia at present. It is unlikely that there will be buyers for all of them. And the problem is again rooted in the poor quality of infrastructure.

However, there is a positive sentiment on another segment of the real-estate market. Sofia had 9 % more office space for rent at the end of 2005, compared to 2004, but rents will still be rising. High-quality office space for rent in Sofia increased by more than 20 000 sq m by the end of 2005 from 228 000 sq m at the end of June, 2005. This increase added to the 3.6 % increase between January and June, when new office buildings in the capital's suburbs started operations. Most of the office space that was offered to be rented in the second half of last year is also in the suburbs of Sofia.

The increasing supply of office space pushed the vacancy rate up in the second half of 2005 despite increasing demand. Vacancy rates rose by 1.5 percentage points to 13.6 % in the first half of 2005. The influx of foreign investors in Bulgaria and the expansion of those who already have businesses in the country have lifted demand for high quality office space. Thus the vacancy rates of office spaces of different qualities vary substantially.

Despite the higher offer, rents kept rising in the second half of 2005. The average monthly rents for different types of office space were 10 to 13.5 euro per sq m in the first half of 2005, with leases for some downtown offices reaching as high as 18 euro. Rents averaged 12 euro for a sq m at the end of 2004.

In spite of the declining profitability of investing in the real estate market there is still positive sentiment abroad towards Bulgaria's opportunities in the near future. The actual records of this

market are also positive. Bulgaria, together with Romania, holds significant potential in the commercial and holiday real estate sectors. These can be anyway the most promising sectors. In the case of holiday real estate sector Croatia will be the most important competitor.

By early 2006, the investment in property became less profitable than it used to be. Investment in Bulgarian property fails to bring the same returns. Other economic sectors take the lead in investment returns. Property prices increased on the average with 21.6 % between December 2004 and December 2005. There are various factors which resulted in this change in the market situation. The most important one is that the high construction rate remains constant. Construction works are highly focused on five major cities. Two thirds of the new constructions take place there. Bourgas remains the city with highest number of construction permits, followed by Sofia and Varna.

As far as the average real estate prices are concerned, these in Sofia are expected to stabilise due to the increasing supply. The first signals of such developments already became evident in several real estate market segments. Faster price increase is expected in smaller cities, because the real estate prices were undervalued for a long time. At the same time a migration from smaller to bigger cities is still continuing. As a result of it a number of small cities are becoming less populated.

The Bulgarian real estate market is in a period of uncertainty and volatile changes after the boom period of purchases, which started in 2003. The already quite saturated real estate market will have some further negative economic consequences. Property purchases may further slow down in the coming months, due to the rising interest rates of bank loans, as a consequence of the rise in basic rates of the Bulgarian National Bank.

ALBANIA SIGNED THE STABILISATION AND ASSOCIATION AGREEMENT

On 18 February, 2006 Albania signed the technical part of the Stabilization and Association Agreement (SAA) with the European Union. This is the first step towards the EU membership, which is aimed by the country for 2014. 2014 will be the year of the 25th anniversary of the demolition of the Berlin Wall, and the Albanian government think this year could be perfect for their accession. The European Commission President Jose Manuel Barroso called the signing of the SAA as a historical moment in the life of the country, because it is the start point of the integration into the European structure, but he emphasized that the real hard work just began. According to him, Albania has to do a lot, and make great performance to the further approach to the European Union. "This is a new historic page of our relations with the EU and it is a testament to the Albanians unshakable will to make their country part of the big European family," Minister Trashani said. Furthermore, it has to be emphasized that the signing is the outcome of a three-year long constructive cooperation between the EU and Albania.

After the collapse of the communist regime in 1991, the European Union has built an active relationship with Albania to support the institutional, political and economic reforms of the country. The overall objection of the EU is to increase the standard of living in Albania; in a country, which is till nowadays the poorest country in the region and in the whole continent too, and where (according to surveys) the half of the population lives on less than 2 dollars per a day, and about 17% on less than 1 dollar. Great evidence of the destitution of the country is that the majority of the population (about 60%) lives on agriculture, which represents about 25% of the GDP. This proportion is declining now thanks to the growing productivity of the non-tradable sector. The economy of Albania contracted in the early '90s, when the country attempted to shift from a tightly controlled state-run system to a market economy. In this period the unemployment rate stood at about 40%, but at the end of the decade it was closer to 20%. The country makes a difficult transition to a modern open-market economy, this process started in 1993.

The government began the fight against the organised crime and corruption, which are till now the biggest barriers of the foreign direct investment into Albania. It is especially important in Albania, where the level of the foreign direct investments is the lowest in the region from the year 1998, none the less that the foreign enterprises enjoy the same safety guarantees and the same legislation in Albania as the resident firms. Hence the reasons for non-existence of the foreign investors are unambiguously the political instability, the crime and the corruption in the country.

In 2004 the country showed a sound economic growth due to the improvement of the situation of the labour market and because the government supported the observance of the budget estimate.

One of the most important determinant of the market-oriented structural reforms of the country was the privatization of the one of the biggest Albanian banks, the "Savings Bank" in January 2004, because the loans of this bank played a great role in the stimulation of the private investments during the last year.

The driving force of the Albanian economic growth is the private sector, and the domestic demand because of the lack of the foreign demand and increasing real wages. Experts emphasize that Albania has to focus on the private sector in the future as well, and support the small and medium-sized enterprises (SMEs), and the privatization process of the

telecommunication and financial sector. It would be also important to improve the structure of the financial sector and to enhance the supervision in banking sector to give the financial actors a more central role in the economic development.

MAIN MACROECONOMIC INDICATORS OF ALBANIA

	2003	2004	2005*	2006*
GDP growth	5,7	5,9	6,0	6,0
Private consumption (%)	n. a.	n. a.	n. a.	n. a.
Public consumption (%)	n. a.	n. a.	n. a.	n. a.
Investments (GFCF, %)	n. a.	n. a.	n. a.	n. a.
Export (%)	13,5	23,5	12,0	15,0
Import (%)	0,5	8,0	10,0	10,0
Consumer price index (average, %)	2,4	2,9	2,2	2,8
Unemployment (%)	15,1	14,4	14,3	14,0
General government balance/GDP (%)	-4,9	-4,9	-4,6	-4,0
General government debt/GDP (%)	n. a.	55,0	54,0	53,0
Current account balance/GDP (%)	-7,1	-5,3	-5,1	-5,2
Trade balance/GDP (%)	-22,9	-20,7	-20,5	-20,0
Gross foreign debt/GDP (%)	24,3	22,0	20,5	20,0
Exchange rate (ALL/EUR)	137,5	127,6	125,5	126,0
Interest rate (end of year, %)	6,5	5,25	5,0	4,5

Source: ICEG EC Quarterly Forecast, 2005 fourth quarter - Albania

According to the figures, Albania shows a rapid growth but till now a lot of problems remained in the country. The negative attributes of the current economic situation of Albania are:

- Permanent and comprehensive destitution
- Scarce industrial production
- Too high role of the agriculture in the country's GDP
- Incremental unemployment rate

According to experts the factors that have negative impact on the development of the Albanian economy are the high unemployment rate and the lack of the confidence in the economic policy of the government.

According to the European Union, the key of the development is the enhancement of the public administration, especially:

- Training civil servants
- Notably in the management of public expenditures
- Drafting new laws in line with EU standards
- Reforming the judicial system to ensure a clear separation of powers,
- Training police officers, judges and magistrates.

Current contractual relationship between the European Union and Albania is based on the 1992 Trade, Commercial and Economic Co-operation Agreement, which was signed in May 1992 and

entered into force on 1 December 1992. It provides, in particular, for the harmonious development and diversification of trade between the EU and Albania, as well as for the development of commercial and economic co-operation between the parties.

Along with the other countries of the Western Balkans, Albania participates in the Stabilisation and Association Process (SAP). It benefits from autonomous trade preferences, national and regional financial assistance under CARDS programme.

Following the EU decision in June 2001 to proceed with SAA negotiations with Albania and the adoption by the European Council in October 2002 of the European Commission negotiating mandate, the negotiations for an SAA were officially opened on 31 January 2003 and started in February 2003.

The November 2005 Progress Report on Albania in the context of the Stabilisation and Association Process registered progress in a number of areas, but called for improved results in fighting against organised crime and corruption, enhanced media freedom, further electoral reform and swifter property restitution. The Commission's November 2005 Enlargement Strategy Paper found that Albania's reform progress paved the way for the conclusion of SAA negotiation. Finally, on 18 February, 2006 the SAA has been signed by the country.

Jose Manuel Barroso stressed that the benefits the country can absorb from the SAA could be the following:

- Improving the work conditions
- Higher standard of living
- The European Union will ease its visa system to some Albanian categories (researchers and students)

From 1991 the European Union granted EUR 1 billion to Albania and for the period of 2005-2006 a further EUR 90 million figure can be found in the plans. Analyst Andi Bushati summarized the situation clear, when he said: "Here it is important to bear in mind that the European integration of Albania is not only a question just of negotiation. It is first and foremost a question strictly related to country development. Therefore, the EU has given us a hand, but the country will be under closer scrutiny." And that is the significance of the Stabilization and Association Agreement: it is a big achievement in the economic history of the country. It is the end of a hard period, and the beginning of a new and perhaps even harder period, after which the country can achieve its chief target: to be an official member of the European Union in 2014.

TOURISM SECTOR IN BULGARIA

Bulgaria is planned to join the EU on January 1, 2007. Bulgaria's economy has grown at five-year average of 5%, driven considerably by private investment and private consumption. The corporate tax rate is at 15% level, while tax exemptions and investment incentives are granted to valuable investment projects. Bulgaria is the fourth-largest recipient of FDI in South-East Europe and the CIS, according to UNCTAD's World Investment Report 2005. FDI is driven by macroeconomic stability, EU accession and meaningful incentives measures. For the past three years, the tourism industry has also developed very rapidly in Bulgaria. But on behalf of the expected EU accession, the tighter monetary and fiscal policies would produce an economic slowdown for 2006.

ABOUT TOURISM

For the past three years, the tourism industry in Bulgaria has developed very rapidly, becoming a leading sector in terms of revenues. Preliminary figures showed that 2005 international tourism revenues (excluding transport) were about two billion euro, an increase of about 9% on the previous year. Furthermore, the provision of tourism services is directly related to the increasing demand for workforce and, indirectly, to the reduction of unemployment in a series of sectors. Bulgaria's travel and tourism sector is expected to grow 6.3 % in 2006 and by 4.3 % per annum, in real terms, between 2007 and 2016, a survey of World Travel and Tourism Council (WTTC) shows. According to the survey tourism in Bulgaria in 2006 will generate EUR 5523.5 million of economic activity. Bulgaria's travel and tourism economy (direct and indirect impact) in 2006 is expected to account for 16 % of GDP and 400 000 jobs (13.6 % of total employment).

International tourist arrivals in Bulgaria increased by 5% over the first eleven months of 2005. Europe is the major generator of tourism for Bulgaria and the share of the European Union (EU) in the total count has increased to 55% thanks to a higher than average 6% rise in arrivals from member countries, and more than 7% from new EU member markets. This year Black Sea coastal resorts expect a 12.1% increase in the number of German tourists. Sunny Beach will also experience increased interest from British tourists. According to estimates their number will rise by 50%. Tourism sector has already many tasks in the efforts for Bulgaria's adaptation to the EU demands. First of all Bulgaria's tourism sector will need additional state support, it means the authorities should lift the currently used state preferences.

One of the main problems for the tourism business is connected to the taxing policy. Currently, Bulgaria charges only seven per cent value added tax (VAT) on tourist services. However, in line with its commitments to the EU, the country will have to raise the rate to 20%, which is the uniform rate for all goods and services in Bulgaria. The introduction of the 20% VAT on tourist services in Bulgaria is a serious threat to the sector's further development, because this will increase prices by more than 13 per cent, which will discourage customers. About 80% of foreign visitors come to Bulgaria through foreign tour operators and their packages of hotel, food and other services currently include seven per cent VAT. If prices increase by 13 per cent next season, hotels will face quite serious problems. Their sales will slump or expenses will surge. In both cases, hotels may be forced to stop operating, as they will be unable to cover their costs and repay investment. This tax burden, according to experts, will make it hard for the country to counter the competitive pressure of other markets, such as Greece, Spain and Turkey.

Another serious problem the country's tourism sector faces is the heavy construction works along the country's Black Sea coast, which, many believe, has reduced the quality of a Bulgarian sun & beach holiday. But the peak months of August and September were adversely affected. But German and British tourists are more and more enticed by the country's marvellous beaches and their numbers will be expected double, compared to 2005.

In the recent year Bulgaria would be the most attractive real estate agent in the region, subsequently the price of the seaside resorts goes up permanently. According to the experts, the increase in the value of the houses will be 20-25% yearly. Currently an apartment is sold to 1100-1250 EUR/square metre price. Tourism as yet one factor to cause general rise in house prices in Sofia and that has led many UK residents to invest already in the still remarkably cheap property around the capital. (Source: Sofia News Agency)

INFRASTRUCTURE

The construction of the infrastructure should be very immediate task of Bulgaria because of the development of the economy, tourism and foreign investment. The EU Cohesion Fund is to invest in transport infrastructure in Bulgaria some EUR 2000 million, which group of projects will improve road traffic capacity and the compatibility of the national road network with the trans-European network. The airport in Varna, the largest city on Bulgaria's Black Sea coast, is set to come under growing pressure as international airlines have signed up to serve burgeoning tourist demand. Concern has risen about whether the airport will cope this summer. BAA reported that nearly five million passengers had travelled by air to and from Bulgaria in 2005. Varna Airport handled a total of 1.431 million passengers, a 12% increase compared to 2004. Foreign companies transported 52.3% of the passengers. "Growth in passenger numbers will surely continue in 2006 by at least the same pace as last year," BAA secretary-general Yovko Yotzev told a Bulgarian news agency. "This tendency is driven mainly by two factors: the growing lure of the tourism sector and Bulgaria's forthcoming accession to the European Union, hopefully next year," Yotzev said. The influx of low-cost carriers was also among the factors boosting the market by creating a new segment. In 2005, Hungary's Wizz Air and Slovak-based SkyEurope were the first low-cost carriers who launched flights to Bulgaria.

CONCLUSION

Till the EU accession Bulgaria has many tasks to do, for example with the threatening inflation and the widening current account deficit and needs the ability to meet challenges it prepares to adopt the euro. Furthermore Bulgaria must be prepared for a new shock with regard to employment and prices when it joins the EU, because many Bulgarian companies will be closed over failure to meet EU standards. Despite the difficulties, tourism is the one of the fastest growing economic sectors in Bulgaria.

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