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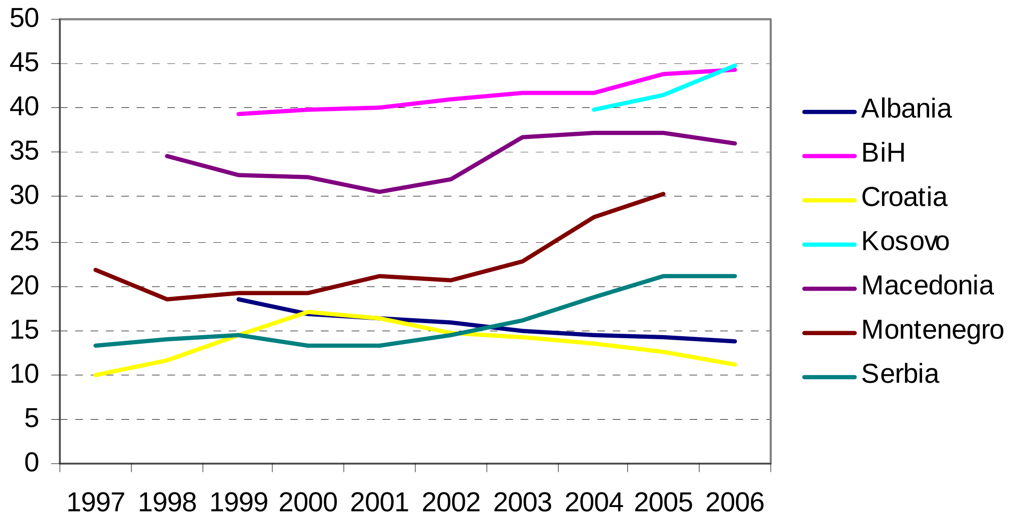
UNEMPLOYMENT IN THE WESTERN BALKANS – LATEST DEVELOPMENTS

Job creation remains a priority throughout the Western Balkans as in the majority of these countries fairly strong economic growth has been coupled with sluggish labour market performance since the transition period begun. However the evaluation of the exact labour market situation in the region and the comparison of the different countries' data are constrained by the limited availability and reliability of the relevant statistics.

Labour Force Surveys (LFS) (according to the ILO and EU standards) have been regularly conducted for a longer period only in Serbia, Croatia and Macedonia, while this methodology has been recently introduced in Kosovo, Montenegro and Bosnia[1]. Albania still does not conduct LFSs. As LFS provides more comprehensive and comparable data than the official statistics, its application is particularly important in the case of Western Balkan countries, as they are characterized by the presence of large informal economy and ethnically/socially fragmented labour force.

As Chart 1. shows, in the recent years a stable decrease in the unemployment rate could be perceived only in the case of Croatia (after reaching its peak at 17% in 2000, it gradually decreased to 11.1% by 2006). According to the available data in the last few years Albania had the second lowest unemployment rate (it decreased from 18% in 1999 to 13.8% in 2006) in the region. However, as the latter indicator is based on the number of the registered unemployed, it does not reflect the real tensions of the labour market. Furthermore, there are several factors which indicate significant imperfections of the Albanian labour market.

CHART 1. DEVELOPMENT OF THE UNEMPLOYMENT RATE IN WESTERN BALKAN COUNTRIES (1997-2006)



Source: Eurostat

Although the unemployment rates in Croatia and Albania are already considered as high by European standards (the EU-25 average was 8.2% in 2006), the difference is much more

[1] LFS surveys have been conducted in Kosovo since 2001 (there was a methodological modification in 2004 which creates a structural break in the time series), in Montenegro since 2004 and in Bosnia since 2006.

significant in the case of the region's other countries. The proportion of jobless population has been the highest in 2006 in Kosovo (44.9%), in Bosnia (44.2%) and in the former Yugoslav Republic of Macedonia (36%). However the international comparability of the Bosnian data is problematic, as for the period between 1999 and 2005 only the official unemployment rate is available, which had not been calculated by using the ILO methodology. The Labour Force Survey data is available only for 2006, according to these statistics, the unemployment rate was 31.1%. The increase in the level of unemployment in Montenegro also reflects a statistical change as from 2004 a new methodology is used which is harmonised with the EU requirements: according to the latter the proportion of unemployed labour force was 30.3% in 2005. In Serbia despite high economic growth rates in recent years, unemployment is a major challenge as its value has been gradually increased from 14.5% in 2002 to 21% in 2006.

Overall the region is henceforward characterized by a jobless growth, as the dynamics of economic growth has not been reflected in the development of the employment rate. On the one hand, the stagnant trends may reflect solid growth in labour productivity and real wages; on the other hand, they indicate that the benefits of the recoveries are not widely spread across the labour force. The symptoms of high unemployment among the youth, large proportion of long-term unemployed people within the labour force and growing share of the informal employment are roughly typical of each Western Balkan country. Similarly those underlying mechanisms of the transition process, which have induced the current situation of the labour market, are similar across the region's countries.

On the demand side of the labour market at the beginning of the transition process it was expected that starting privatisation would improve the business climate, so new investment and further jobs would be realised by the private sector. However political instability, insufficient savings, the expansion of the shadow economy, the inadequate infrastructure, the lack of proper protection of intellectual property rights and the administrative barriers to setting up businesses have discouraged both foreign direct investment (FDI) and domestic new investment in the past decade. The unemployment had grown as a consequence of the privatisation itself and also the levelling off in hidden unemployment in government institutions.

On the supply side of the labour market the unsatisfactory structure of the education system and the lack of integration of the vocational training strategies into the economic, social, tax, enterprise and regional policies induced mismatch between the workers' skills and the employers' needs and thus raised unemployment. Strong employment legislation caused labour market rigidities and the emerging high wage rates have been often in disparity with the productivity of labour.

As a consequence of the above-mentioned factors of the transition process, structural employment has evolved in the majority of the Western Balkan countries throughout the last decade.

The full-scale and detailed analysis of the aforementioned tendencies would go beyond the scope of the present analysis as currently the focus is on the latest developments of unemployment in the countries of the Western Balkan region. Some of the available key indicators are presented in Table 1. and the recent developments are summarised below based on the Annual Progress Reports (2007) of the European Commission.

TABLE 1. GDP GROWTH AND KEY LABOUR MARKET INDICATORS IN THE WESTERN BALKANS, 2006 (%)

	GDP growth	Employment rate[2]	Unemployment rate[3]	Unemployment rate of the youth[4]	Long-term unemployment rate[5]	Informal employment rate[6]
Albania	5.0	49.7*	13.8	26.8	9.2	75
Bosnia and Herzegovina	6.2	35.0	31.1	61.0	28.4	42
Croatia	4,8	55.6	11.1	28.8	6.7	12
Kosovo	n.a.	28.7	44.9	75.5	41.1	n.a.
Macedonia	3.1	39.6	36.0	59.8	31.1	32
Montenegro	6.5	34.8*	30.3	20.1	58.2	27
Serbia	5.7	49.9	21.0	47.8	17.0	30

*Source: Eurostat, World Bank, *latest available data for 2005*

ALBANIA

In Albania the unemployment rate continued to decrease from 14.1% in 2005 to 13.8% in 2006 and it has slightly moderated to the value of 13.5% in Q2 2007[7]. However - as it had been already mentioned - the indicator is based on the number of the registered unemployed, while the informal employment rate in Albania is the highest in the region (75%), which implies that the administrative indicator significantly underestimates the extent of unemployment. It also has to be taken into consideration, that the large agricultural sector absorbs many job-seekers in low-quality, low-earning positions (in 2006 58% of the active population was employed in the agricultural sector). The considerable proportion of unemployment among youth (26.8%) and the significant long-term unemployment (65% of the total registered unemployed) are also alarming.

Job creation in Albania may be enhanced by increasing gross fixed capital formation (it has increased from 30.3% of GDP in 2005 to 32.6% of GDP in 2006) and expanding net flows of FDI (it has increased from 3.3% of GDP in 2005 to 3.6% of GDP in 2006). Subsidised programmes continued to foster employment of vulnerable groups and a specific programme exists to facilitate the integration of young graduates in the labour market. However the strengthening of the statistical capacity is necessary in order to make the labour market policy design and planning more efficient.

BOSNIA AND HERZEGOVINA

In Bosnia and Herzegovina according to the official data, unemployment rate increased slightly from 43.9% in 2005 to 44.2% in 2006, while the first Labour Force Survey which was conducted in April 2006 by the BiH Statistical System indicated an unemployment rate of 31%. The sizeable difference between the levels of the survey-based and the registered data reflects the existence of a large and growing informal market. In 2006 the unemployment of the youth

[2] Share of population aged 15-64 that is in employment.
[3] Share of labour force that is unemployed.
[4] Share of labour force aged under 25 that is unemployed.
[5] Share fo labour force that is unemployed for 12 months or more.
[6] Definitions vary by country. Source: The Labor Market and Education and Training in the Western Balkans, World Bank, 2007
[7] Source: INSTAT

was the second highest in the region (61%) and the long-term unemployment was also significant (28.4%). However the Bosnian labour market is also characterized by serious structural rigidities (high taxation of labour, distorted wage-setting mechanisms, law labour-mobility). The provision of relatively high and not enough well-targeted social transfers reduce the unemployed persons' incentive to actively seek a job.

Job creation in Bosnia may be boosted by the increasing inflows of FDI (it has increased from 5.5% of GDP in 2005 to 5.8% of GDP in 2006), especially as a sharp rise of the volume of FDI inflows is expected in 2007. The main problem in connection with employment policies is the lack of a state-level action plan, especially because not only the institutional structure, but the labour market itself is also fragmental. The lack of accurate data is a major obstacle for effective policy design also in the case of Bosnia, thus reforming of the unemployment registration is an urgent task.

Kosovo

In Kosovo the labour force survey based unemployment rate increased from 41.4% in 2005 to 44.9% in 2006 which was the highest in the Western Balkans. Unemployment rates for young persons and minority members are rising faster than the average at 10.4% and 4% respectively (for Kosovo Serbs the rate is 6.3%).

In Kosovo the poor physical infrastructure significantly hinders the expansion of the private-sector activity which contributes to the lack of job creation. However in 2006 the government continued to invest with donor assistance into the communications and transport. Another restrictive factor in job creation is that Kosovo does not have a comprehensive employment strategy, so far an overall programme has been launched only on the area of youth employment in 2006 with the aim to moderate the extremely high unemployment of youth (75.5% in 2006). However, the strengthening of the statistical capacity is also needed in the case of Kosovo in order to ensure a more effective policy design.

Former Yugoslav Republic of Macedonia

In the former Yugoslav Republic of Macedonia although the unemployment rate remains at a significantly high level, it decreased slightly from the rate of 36% in 2006 to 35.8% in the first quarter of 2007. The weak link between the economic growth and the level of employment similarly to other Western Balkan economies implies that a large part of unemployment is structural and other data shows that it mainly affects the young (59.8% of the labour force aged under 25 was unemployed in 2006) and the poorly qualified. As the informal employment's proportion to the labour force is approximately 32%, the unemployment could be probably overestimated.

The job creation has been recently constrained in the former Yugoslav Republic of Macedonia by the low levels of domestic investment (gross fixed capital formation accounted for 17% of GDP in 2005) and the low volume of FDI inflows (1% and 2% of GDP in 2006 and the first half of 2007 respectively). Although the government has launched a programme to attract FDI (e.g. by establishing free economic zones), its impact has remained limited until now. Generally the unclear property rights, slow legal procedures and fragmented responsibilities between the central and local governments are impeding FDI. In contrast to the low levels of new investment, the job creation has been promoted by the adoption of the new labour code in 2005, which - among others - made the labour contracts more flexible. The adopted National Employment Strategy 2010 and the national Action Plan for Employment 2006 set ambitious objectives, but the capacities have to be improved in order to match these targets and to complete the requirements of the EU accession.

Montenegro

In Montenegro the officially registered unemployment rate decreased from 14.7% in 2006 to 11.8% by end-August 2007, which value differs significantly from the labour force survey based data (according to the latter unemployment was 30.3% in 2005). In Montenegro, the proportion of the long-term unemployed (58.2%) is the largest in the region while youth unemployment (20.1%) and the estimated informal employment (27%) are among the lowest in the region. However in Montenegro the employment has a strong seasonal pattern (construction, agriculture and tourism).

Job creation may be fostered in Montenegro as net FDI on annual basis increased from 24.2% of GDP in 2006 to 28.4% by the end of June 2007. In 2006 the authorities had invested 1% of GDP in active employment measures, which aimed to create jobs for 7.6% of the labour force. The regulatory framework of the active labour market measures is ensured by the recently drafted human resources development strategy for the period of 2007-2011. Legislation of allowing tax relief for hiring unemployed persons has been already adopted and the main task in the future remains the further improvement of labour market flexibility.

Serbia

In Serbia the unemployment rate stood at 21% of the total workforce in 2006 and unemployment decreased by about 4% on a year-on-year basis during the first half of 2007. Similarly to other countries of the region, youth unemployment remains high (47.8% of the total labour force aged under 25) and large proportion (30%) of the active population is engaged in the informal economy.

SMEs and the private sector in general are playing a growing role in job creation in Serbia, which may be enhanced by the positive trends in investment (gross fixed capital formation increased from 17.3% of GDP in 2005 to 17.9% of GDP in 2006) and the record level FDI (13% of GDP in 2006). However the volume of the FDI inflows moderated to 4.1% of GDP in the first half of 2007. The government provides financial and advisory support for setting up SMEs, which may create further jobs. Vocational education is aimed to be harmonised with the needs of the employers. The implementation of National Employment Strategy 2005-2010 is in progress, although it has yielded limited results. The main task in the close future is to eliminate high social security contributions and labour market inflexibilities in order to increase job creation in the formal sector.

Croatia

In the region the Croatian economy is characterized by the most favourable employment tendencies. The employment growth accelerated significantly from 0,8% in 2005 to 3,4% in 2006. Although for 2007 a slowdown is expected, upward revisions are likely. LFS-based unemployment rate decreased from 12.3% in 2005 to 10.5% in 2006. Long-term unemployment rate was moderate in Croatia (6.7% in 2006) compared to the other economies of the region. However youth unemployment is considerable even in Croatia (28.8% in 2006), albeit to a lesser extent than in the majority of other Western Balkan countries.

The more significant volume of new investment in the recent years in the Croatian economy resulted in a more positive effect on the job creation than in other countries. On the one hand, gross domestic fixed investment – driven in particular by stronger private investment – increased from 28.6% of GDP in 2005 to 30% of GDP in 2006. On the other hand, net inflow of FDI almost doubled as a percentage of GDP to 7.4% in 2006, mainly due to direct equity investments. In the case of Croatia unit labour cost data is also available; it decreased by 1% in 2006, which shows that the growth in real wages has been less than that of the average labour productivity. This indicates that – unlike in the majority of the Western Balkan countries – disparity does not exist between the two indicators (in other countries of the region as a result of labour market rigidities the growth in real wages is higher than the growth in labour productivity which negatively affects the labour demand). Active labour market measures (e.g. boosting of entrepreneurship and self-employment) have also significantly contributed to job creation and their further realisation is planned to continue in the framework of the Annual Plan for Employment Promotion 2007. However regional disparities in unemployment are still considerable in Croatia, the qualification and skills levels of the Croatian labour force are often mismatched with the employers needs and they are also lower than in the EU. Advancement also on these areas is necessary for the successful accomplishment of the relevant requirements of the EU accession.

Romanian Energy Sector Being Restructured

Global challenges for economies in the energy area are considerable. World energy consumption was projected to increase by over 70% from 2003 to 2030 and an estimated USD 20 000 billion investment will be needed to meet demand over the next thirty years. Southeast Europe has a strategic position, exporting electricity through the Balkans and transiting Russian natural gas to Western Europe and Turkey. Romania, together with Bulgaria, joined the North Atlantic Treaty Organization (NATO) in 2004 and the European Union (EU) in 2007. Romania's energy sector presents many opportunities for investors, as well as many challenges.

As a new member of the EU, Romania must comply with European legislation promoting free competition, in which the former state owned industries can no longer expect to enjoy a monopoly. This gives new opportunities for foreign investors - particularly from other EU member states - to enter the Romanian market. Consequently, more and more foreign investors have decided to see the advantages of the Romanian energy sector in recent years. In the following, we focus on the altering Romanian energy industry.

Oil Sector

Romania is net oil importer, depending primarily on Russia for most of its supply. However, Romania has the largest oil reserves in Central and Eastern Europe and it is a mature oil producing country. Romania has estimated reserves of 956 million barrels of oil. In 2005, the country domestically produced roughly 115 000 of its 241 000 barrels per day consumption. Romania dominates South Eastern Europe's downstream petroleum industry, with ten of the region's eleven refineries. Because its refining capacity far exceeds domestic demand, Romania exports a wide range of oil products and petrochemicals. The largest energy company in Romania is Petrom. The company operates 15 000 oil and gas drilling operations onshore and seven offshore platforms in the Black Sea. Rompetrol is the second largest oil company, while Lukoil is a Russian company that controls the Petrotel-Lukoil refinery.

Natural Gas Sector

Romania contains proven natural gas reserves of 3600 billion cubic feet. Although it is Central and Eastern Europe's largest producer of natural gas, Romania's production has fallen significantly in recent years. Romania is a net natural gas importer, with supplies coming from Russia along the southbound Progress pipeline. Romania imports 25 percent of its 636 billion cubic feet domestic demand from Russian company Gazprom. Romania continues to use a state monopoly, Romgaz, for the exploration of its natural gas deposits (in spring 2006, the Romanian government decided to delay the sale of a 51 percent stake in Romgaz, the country's largest gas producer). State-owned company Romgaz supplies over half of the national output.

A number of pipeline projects is planned in Romania to increase natural gas transport capacity. The Nabucco project, launched in 2002, entails the construction of a pipeline from the Caspian Sea region to Western Europe, bypassing Russia. Negotiations concerning the Nabucco project between the natural gas companies of five countries - Bulgaria's Bulgargas, Romania's Transgas, Turkey's Botas, Hungary's MOL, and Austria's OMV - concluded in June 2006, when Nabucco Company Pipeline Study Group was formed to undertake construction of the natural gas pipeline network. The Nabucco project aims to transport natural gas from the Caspian Sea and Central Asia, including Iran, Azerbaijan, Turkmenistan and Kazakhstan, to the countries of Central and Eastern Europe. The project has received widespread support from the EU since the project would lessen the region’s dependence on Russian gas. Construction of the 1 760 mile, USD 5.8 billion pipeline is set to begin in 2008 and end in 2011.

Electrical Energy

Romania's sole nuclear plant, Cernavoda currently maintains two working reactors. Its first reactor went on stream in 1996 and accounts for about 10 percent of Romania's power generation. In July 2006, the Romanian Finance Ministry borrowed USD 153 million from Bance Comerciala Romana, the country’s largest lender, to finance the completion of the second reactor. The reactor entered commercial use in October 2007 and now nuclear power provides roughly 18 percent of total energy needs of Romania. 25 October 2007 was the deadline to receive binding bids for the licence to build and operate units 3 and 4 in Cernavoda, an investment estimated at 2.2 billion euros. After the further expansion at Cernavoda, nuclear power will generate roughly a third of Romania’s power by 2015. The Cernavoda plant was initially designed to have five reactors but it will stop at four. At the official opening of the plant's second reactor Romanian Prime Minister Tariceanu said that after completing units 3 and 4 Romania must continue to develop its nuclear system. A second power plant is needed to ensure that the country is not dependent on oil and gas energy resources.

Energy Sector Strategy

The Romanian government has recently approved a plan on important changes in the country’s energy sector. These changes include creation of a new holding company that will merge state-owned nuclear, thermal and hydroelectric power companies. The motive of this step is to increase efficiency, boost renewable energy, modernise and protect critical infrastructure, and diversify import sources and transport routes. Varujan Vosganian, Romania’s Finance and Economy Minister said that the government will own 25-40% of the new holding company, investment fund Fondul Proprietatea will hold 20%, and the remaining shares will be listed on the Bucharest stock exchange. At some point in the future, the government expects the holding company to be fully privatised. Vosganian said that European Union newcomer Romania will become an important electricity exporter in the region by 2020, as the strategy envisages doubling the country's power output to around 100 TWh by 2020, more than estimated domestic consumption. The ambitious conception is based on mainly the above mentioned nuclear power expansion, however, there are also further opportunities for hydro plants to construct. At the first half of the decade, there has been a significant hydro power expansion as shown in *Table 2*.

Table 2. Romanian Electric Energy Production (TWh).

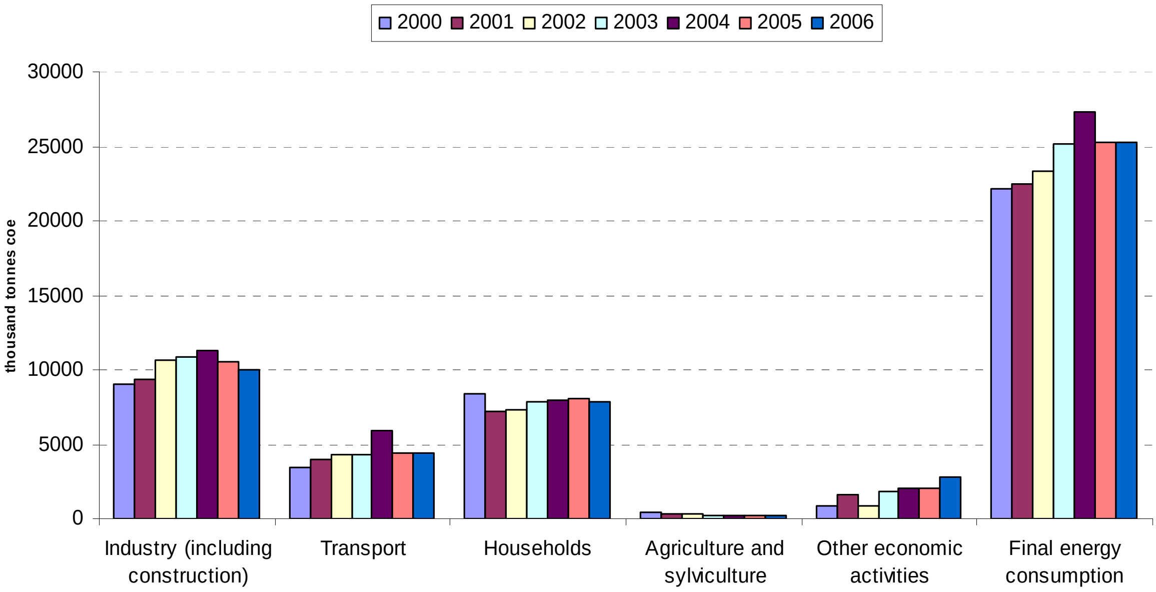
	2000	2005
Thermoelectric	31.701	33.651
Hydroelectric	14.778	20.207
Nuclear electric	5.456	5.555
Total	51.935	59.413

Source:Statistical Office of Romania

DISCUSSION

The Romanian economy has been growing at a high rate, with many companies opening new offices in the capital and other parts of the country. As a result, the standard of living of much of the population has increased significantly, while new office and residential developments are springing up in many areas of Bucharest and other major cities. All this has led to increased energy consumption at the first half of the decade.

CHART 2. ROMANIAN ENERGY CONSUMPTION



Source: Statistical Office of Romania

On the other hand, EU accession has also meant that Romanian energy providers must comply with increasingly rigorous environmental standards. The challenge for investors in the Romanian energy sector is to satisfy the needs of both business and domestic consumers, while also promoting sustainability.

The Romanian energy industry needs significant investment to bring its technology up to date, since many installations are 35-40 years old. According to an estimate by the Ministry of Economy and Finance, the costs will be approximately EUR 30 000 million between now and 2020, with the government expecting most of the funding to come from the private sector. There is some EU funding for the Romanian energy sector available for 2007-13, but this is relatively low (around EUR 600 million) and available only for certain sectors, with a strong emphasis on improvement of environmental standards. Therefore, the gap will need to be filled by the private sector, presenting many opportunities for those prepared to take a long-term view.

The most common method of privatisation in the energy sector has been to find a strategic investor, however in the future capital markets are expected to play a greater role through to the sale of shares on European stock exchanges. Privatisation, in all its forms, brings both management know-how and a strong culture of corporate governance. The Romanian stock exchange is currently developing financial instruments for the energy sector, which will allow some pre-privatization financing, and expects these to be available towards the end of 2007.

CURRENT ACCOUNT TRENDS IN THE WESTERN BALKANS

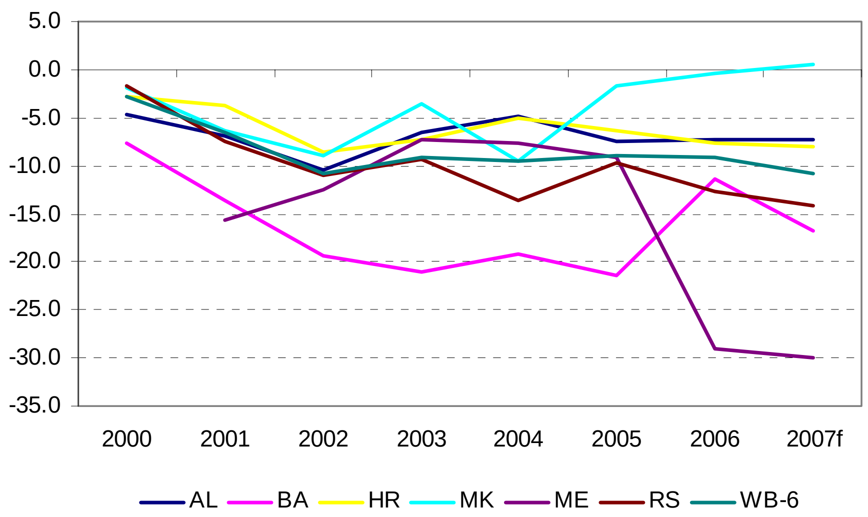
INTRODUCTION

In the Western Balkan countries macroeconomic environment improved significantly during the last years of this decade. Economic growth accelerated to 5-6% in almost all countries in the region, inflation was reduced to 2-3% in most countries and fiscal position remained at a manageable level. However, the countries in the region have to face with two significant macroeconomic challenges in recent years. One of them is the extremely high unemployment and low employment rate. The average unemployment rate is 20% in the region and it even exceeds 30% in Bosnia and Herzegovina and the former Yugoslav Republic of Macedonia as well, according to the official statistics. Besides high unemployment, current account deficit causes problems in these economies. This article tends to review and summarise the main processes related to external imbalance in the region.

EXTERNAL IMBALANCES

In 2000 current account balance was in deficit in all Western Balkan countries, however, the deficit exceeded 5% of GDP only in case of Bosnia and Herzegovina. The region's average current account deficit reached only 2.8%. As economic growth returned to region in the new millennium current account balance started to deteriorate. Since domestic demand contributed significantly to the acceleration of GDP growth, it had a negative impact on the current account balance. Increasing domestic demand was the main engine of the growth of imports. On the other hand, the industry sector's restructure process and privatisation progressed slowly and these countries had to compete with more competitive economies in the neighbouring region which resulted in lower presence of foreign investors. Accordingly, the export sector in these economies remained relatively weak which could not contribute to counterbalance the import boosting impact of high domestic demand.

CHART 3. EVOLUTION OF CURRENT ACCOUNT DEFICIT IN THE WESTERN BALKANS, 2000-2007* (% OF GDP)

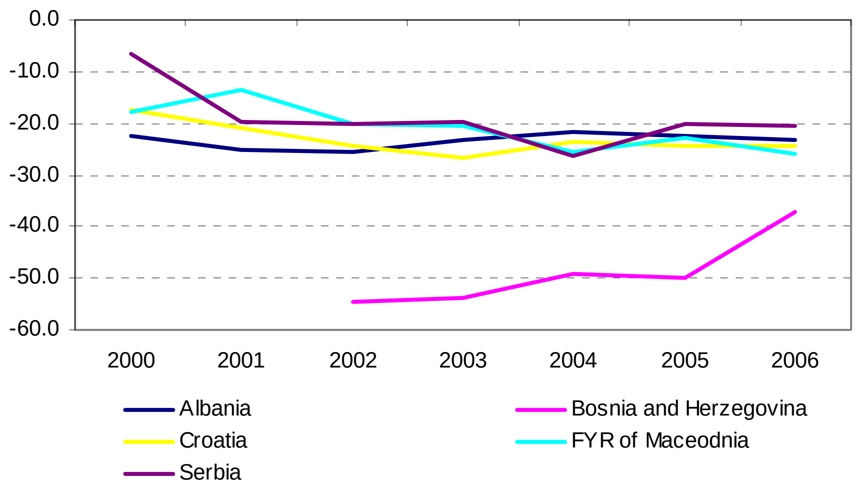


*Note: * f - forecast; Source: national banks, ICEG EC*

In 2006 the picture changed significantly and the average current account deficit increased to 9.2% of GDP. The largest worsening of the current account balance was observable in Serbia between 2000 and 2006. Current account deficit increased from 1.7% to 11.6% of GDP, or it increased from less than EUR 500 million to EUR 2.8 billion. However, the highest current account deficit was achieved by Montenegro, where CA deficit is close to 30% of GDP. Besides Montenegro and Serbia, the current account deficit exceeded the 10% threshold in 2006 in Bosnia and Herzegovina as well. There was only one country in the region which was able to achieve significant improvement in current account balance, namely the former Yugoslav Republic of Macedonia. While CA deficit went gradually up close to 10% of GDP in 2004, current account is expected to be in a surplus in this year. However, external imbalance is expected to increase in all the other economies in 2007.

Analysing the main components of the current account balances in the region one can easily notice that the main reason why current account balances have a huge deficit is the large deficit of trade balances. Foreign trade deficits reach 20-40% of GDP in these economies which reflect well the weak export structure of the WB countries. A few years ago trade deficit exceeded 50% of GDP, while it declined to under 40% in recent years. The lowest deficit was reached in Serbia where trade deficit slightly exceeded the 20% threshold (20.4%).

CHART 4. EVOLUTION OF TRADE BALANCE OF GOODS IN THE WESTERN BALKANS, 2000-2006 (% OF GDP)



Source: national banks, ICEG EC

After transition the companies operated in these countries lost their former traditional export markets and had to face with a more competitive international environment. In line with the liberalisation process import of goods started to increase while the performance of export sector lagged behind due to slow progress in reforms and privatisation and to the not so favourable political and business climate in the region. As a result import increased gradually while export started to recover significantly later. In the new millennium export of goods increased by 10-20% annually while the growth pace of imports also reached 4-20% in these economies. That is, the growth pace was almost equal in case of export and import, however, the significant difference between the nominal value of export and import resulted into widening trade balances, except for Bosnia and Herzegovina.

Regarding the other components of the current account, it should be mentioned that services balance and current transfers also play an important role in these economies. In case of Croatia, a huge amount of money pours into the economy each year via tourism sector.

Accordingly, services had a surplus of close to 17% of GDP in 2006. Services balance has a significant surplus (5% of GDP) in Bosnia and Herzegovina as well, while the role of tourism is increasing in Montenegro too.

Concerning current transfers, it is a considerable counterbalancing factor mainly in the smaller, less developed Western Balkan countries. While current transfers reach 3-10% of GDP in Croatia and Serbia, it is more significant in the other WB countries reaching 14-25% of GDP. It is noticeable that 25% of the GDP is transferred from abroad to the population and to the government. Basically, the largest part of this component is the transfers of the workers employed abroad who send back money to their families. To put it in another way, these transfers finance partly the significant import of goods of these economies.

It is also worth reviewing the evolution of foreign direct investment inflows in these economies since this element is a desirable financing method of current account deficit. During the analysed period (2000-2006) foreign direct investments reached 4-6% of GDP in average. Accordingly, FDI was able to finance only a small part of the current account deficit. The two larger countries were able to exceed 5% of GDP while the other smaller economies reached only 4-5% annually.

To compare the WB countries to Central and Eastern European countries, it is worth mentioning that in the more advanced CEE Member States export sector – and foreign direct investments - played a key role in economic growth in course of the last 15-20 years, accordingly trade balances evolved in a more favourable path. Consequently, trade balances had and has a lower CA deficit in the Visegrad countries. However, other components, such as current transfers have smaller contribution to the development of the current account balance in comparison with the WB countries.

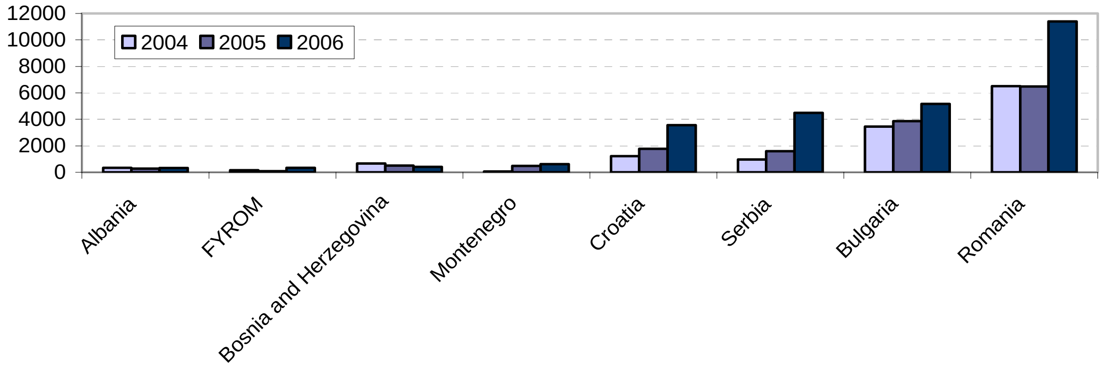
Conclusion

The big question is if current trend is sustainable or not. As it was mentioned current account deficits exceed 7% in all countries except for the former Yugoslav Republic of Macedonia and are above the 10% threshold in Bosnia and Herzegovina, Montenegro and Serbia. One can observe that the trend is worsening; during the last six years current account deficit increased from less than 3% of GDP to almost 10% in average due to widening trade deficit. The other components of the current account were able to counterbalance only partly the huge deficit and foreign direct investments also remained moderate in this period. In the near future current trend is not expected to change. Economic growth is expected to be fuelled by consumption and investments which boost imports, while the recovery of the export sector is a slow and gradual process. On the other hand, the monetary policy has limited influence on these factors since fixed or quasi fixed exchange rate regimes were applied in most WB countries in the region. Accordingly, fiscal policies need to be extra cautious not to overheat the economy with increasing public spending which may result in further deterioration of the current account balance. It is clear that current situation is challenging and this issue remains one of the key macroeconomic problems of the region in the future years.

Foreign Direct Investments in Southeast Europe

FDI inflows reached record levels in 2006 in Southeast Europe (SEE). FDI inflows to the region grew by 74% in 2006 compared to the previous year. While the region attracted a little more than USD 15 billion FDI in 2005, in 2006 more than USD 26 billion investments were realised. FDI stock exceeded a value of USD 108 billion, however with that result the region is still among the least favourable investment areas in the world. According to the World Investment Prospects Survey 2007-2009, Southeast Europe ranks only the eighth (out of 11) in the preference list of investors. The region is only a little more preferred investment target for multinational enterprises than West Asia.

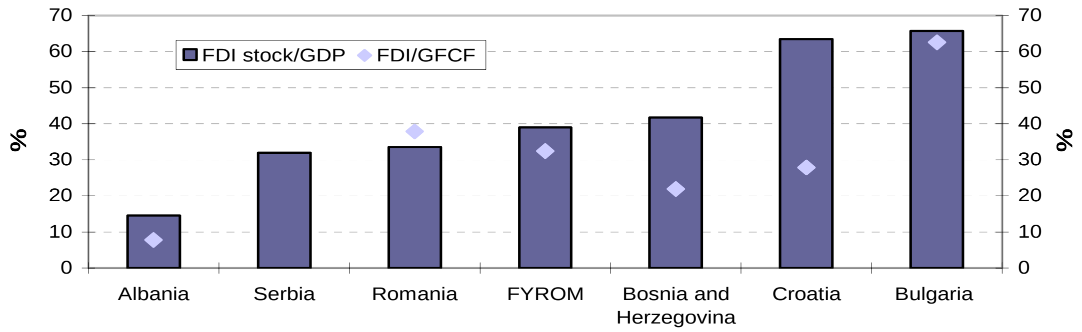
Chart 5. FDI inflows in the SEE countries, 2004-2006 (millions of USD)



Source: UNCTAD

Since SEE countries are still in transition period, in contrast with EU countries economic growth is high in the region, growing number of foreign investments can be expected in the future. However, SEE economies perform very differently considering FDI developments. FDI developments is said to be significant in Romania, Bulgaria, Croatia, Serbia, and the former Yugoslav Republic of Macedonia (FYROM), while Albania and Bosnia and Herzegovina could not attract sizeable investments in 2006. Increasing FDI is on the one hand have been driven by privatisation processes in the whole region. On the other hand, the fact of EU entry has made more attractive Romania and Bulgaria for multinational investors.

Chart 6. FDI stock as a percentage of GDP and FDI/Gross Fixed Capital Formation, 2006 (%)



Source: UNCTAD;Notes: No FDI/GFCF data for Serbia, No FDI/GDP and FDI/GFCF data for Montenegro

Albania

In regional comparison Albania performs extremely weakly in attracting FDI. FDI stock per GDP ratio has not improved since 2000. FDI as a percentage of gross fixed capital formation (GFCF) remained henceforward low. Albania behind FYROM represents the second worst FDI Performance Index among SEE countries. However, FDI inflow in 2006 was 17% higher than in the previous year, it did not exceed the value of FDI inflow of 2004 (USD 338 millions). According to the World Economic Forum's Global Competitiveness Report 2007-2008, the most problematic factors for doing business in Albania are inadequate supply of infrastructure, corruption and inefficient government bureaucracy. Furthermore, the country offers very unfavourable business and innovation climate for investments.

Bosnia and Herzegovina

In Bosnia and Herzegovina FDI inflows show decrease in the last three years (2004-2006). In accordance with that FDI/GFCF ratio dropped continuously. However, in the first half of 2007 Bosnia and Herzegovina gained more than EUR 1.2 billion FDI, which is two times higher than in the whole previous year. In 2007 the expected amount of FDI is EUR 2 billion. Considering sectoral distribution of FDI stocks, one can observe that 38% of the investments are present in the manufacturing sector. The second most important investment target is the banking sector, followed by telecommunication and trade. Austria, Serbia, Croatia and Slovenia are the top four foreign investors in Bosnia and Herzegovina.

Bulgaria

In contrast with Central European economies Bulgaria and Romania could not become dominant FDI recipients during the nineties due to macroeconomic instability, unfavourable investment climate, inadequate infrastructure and slow privatisation process. Today, Bulgaria is the second most important investment target among SEE countries, partly because of EU membership, economic and institutional developments. 20% of foreign investments in the SEE region were realised in Bulgaria, considering both FDI inflow and FDI stock in 2006. FDI inflow has increased since 2001 continually. FDI inflow in 2006 was significantly, namely 40% higher than in the previous year. The pre-accession process had influenced business environment very positively. Improvement can be observed if taking into account FDI Performance Index, FDI/GDP and FDI/GFCF ratios. Among SEE countries the highest FDI stock as a percentage of GDP was present in Bulgaria in 2006. Also the most net new investments in fixed capital assets were realised in Bulgaria. Bulgaria's share in global FDI inflows to its share in global GDP improved significantly during the last 15 years. While Bulgaria ranked on the 92nd place in 1990-1992 in the UNCTAD FDI Performance Index rankings, in the 2004-2006 period, the country jumped to the 7th place. Bulgaria is popular principally among Austrian, Greek, Holland and English originated companies. 15-15% of the investments were established in financial intermediation and real estate, renting and business activities branches. Beside other dominant service sector investments (telecommunication, trade, transport, hotel) manufacturing remains henceforth important.

Croatia

Croatia represents a relative high FDI/GDP index (63.5%). Since 2004 the development of FDI inflow has been continuous. In 2006 the FDI inflow accounted for EUR 2 713 millions. In the first two quarters of 2007 Croatia attracted 80% of the previous years' FDI inflow. The most important investors are originated from the EU. One-fourth of the investments were realised by Austrian enterprises. Netherlands is the second most important investor in Croatia, followed by Germany, France and Luxemburg. It is worth mentioning that Central European investors are also active in the country. Hungary is considered to be the sixth most important source of FDI. Taking into account sectoral distribution of FDI, one can see that high proportion of FDI was invested in financial intermediation, in manufacture of chemicals and chemical production and in post and telecommunication branches.

Former Yugoslav Republic of Macedonia

Before 2005 the level of FDI was extremely low in FYROM. In 2006 the growth of FDI inflow was more than three-fold compared to the previous year. In accordance with that FDI/GFCF ratio improved significantly. Consequently, the country's rank in the UNCTAD FDI Performance Index moved up to the 64th place in 2006 from 86th in 2005. Between 1997 and 2005 48% of the total investments were realised in the service sector, predominantly in telecommunication and financial intermediation. The share of manufacturing sector was 44%. The top three investors in this period originated from Hungary, Greece and the Netherlands. In the first half of 2007 the value of FDI inflow exceeded USD 100 millions. In this period the most popular sectors were the financial and telecommunication sectors, followed by manufacturing. The most active investors stem from France and Austria.

Montenegro

Montenegro gained EUR 505 million in 2006, which was 32% higher than in the previous year. Investment per capita increased almost three-fold in 2006 compared to 2000. Most investments were realised in the financial (36%) and tourism sectors (22%). Between 2001 and 2006 the major foreign investors originated from Greece, Belgium, Japan and Hungary. In the first half of 2007 Montenegro attracted record FDI inflow. Due to high economic growth investment activity is expected to growing.

Romania

Due to the prospect of EU accession Romania became the favourite investment location in 2006. FDI inflow in 2006 almost doubled compared to 2005. More than 40% of all investments in the region was realised in Romania. FDI stocks reached USD 41 billion. Consequently, FDI per GDP ratio also improved. Romania's rank in the UNCTAD FDI Performance Index moved up from 101st place in 1990-1992 to 21st place in 2006. In 2006 record value (USD 5 billion) of cross-border M&A were realised in the country. Also the number of greenfield investments increased significantly. 362 greenfield projects were carried out in 2005. By 2007 considering the value of FDI, the most important investors are Dutch, Austrian, French, German and Italian originated. Taking into account the number of foreign enterprises, Italian, German, Turkish and Hungarian companies are in majority. Foreign direct investments were carried out principally in industry (50%), services (28%), wholesale trade (7%) and retail trade (6%). Big size of the market, relatively low labour costs and improving business climate offer a great investment potential for foreign investors.

Serbia

Serbia attracted the third highest FDI in 2006 in the SEE region. FDI increase was almost three-fold compared to 2005. Financial sector, transport services, processing industry and real estate investments were the most popular among foreign companies in the first half of 2007. Principally investors from Austria, Luxemburg and Greece prefer Serbia as investment location.

CONCLUSIONS

SEE countries show a diverse picture considering FDI developments in the last years, while the whole region can be characterized by high economic growth. Most economies gained record level of FDI, while some could not enhance foreign investors' interest. Due to relative low labour costs, manufacturing remains one of the most important investment target, however growing number of investments have been realised in banking and telecommunication sectors. According to World Investment Prospects Survey 2007-2009, growth and size of local markets, access to regional markets and cheap labour are the most important locational advantages in the SEE region. However, investment climate and government efficiency is still inadequate in most countries.

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