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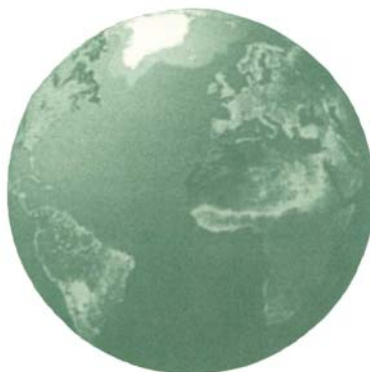
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AT A TURNING POINT?
The Southeast European Economies



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FOREWORD

In recent years, politicians and economic-policy decision makers pay increasing attention to the processes in the Southeast European region on account of its diminishing economic and political risks, and accelerating or stabilizing high-level growth, *i.e.* factors which have all appreciated the area. Consequently, foreign investors show a growing interest in the terrain as they attach high hopes to market opportunities that may yield substantial market expansion and profit gains.

However, despite the undisputable stabilization, the economic processes of the region leave a set of questions open. On the one hand, the conditions of sustainable development have only evolved in the smaller part of the region, while several countries are still being engaged in creating the foundations of economic activity, eliminating serious imbalances and introducing market reforms, on the other. Favourable processes can be enhanced as policies of the European Union towards the region – characterized by ambivalence in the nineties – have become unambiguous. Relations between the EU and Southeast Europe received a sounder framework, although the integration process in most Balkan countries is in an initial phase, yet.

Besides stabilization, the acceleration of privatization processes in the area facilitated the more active presence of foreign investors. In some countries foreign-owned firms or enterprises with foreign participation already contribute to improving the structure of economy and easing unemployment. Hungarian companies enter the region in growing numbers too, though there are only firms of larger size that dominate investment activity, so far. Smaller firms confine themselves to invest in a limited circle of countries.

In our opinion, it must be treated as a priority that Hungary's relations with Southeast Europe should help diversify Hungarian foreign trade and improve the growth prospects of the economy by additional impulses. The analysis of the processes outlined above has belonged to the major research fields of the Institute for World Economics for years. In this number of Working Papers we examine the features of development and the factors influencing investment in the region (Romania, Bulgaria, Croatia, Serbia and Montenegro, Macedonia, Bosnia-Herzegovina and Albania) from the viewpoint of the European integration and the Hungarian economy.

GROWTH PROCESSES AND THEIR SUSTAINABILITY IN THE SOUTHEAST EUROPEAN REGION

Tamás Novák

1) STABILISATION OF THE SOUTHEAST EUROPEAN REGION

During the past 4-5 years economic stabilisation in the Southeast European countries has been a common feature. GDP growth rates are relatively high, the rate of inflation is low or it is moderating, foreign direct investments are on the increase due to decreasing regional risks and comparably low production costs. Despite the quite similar processes in these countries, the region itself is far from being a more or less unified economic area, neither in terms of economic development, nor in international relations. There are huge differences between them regarding per capita income, pace of economic transformation and the potential economic and political risks. Intra-regional economic relations continue to be limited in spite of the strong impetus coming from abroad (Stabilisation and Association Process *i.e.* the objective of establishing regional free trade), and complementarity is very small between production structures. Meeting the accession requirements of the EU are hampered by distorted economic structures. In certain countries technological back-

wardness makes the modernisation of economic structure especially difficult due to extremely high capital requirements (for example Bosnia-Herzegovina, Albania).

The region in economic sense can be considered as a 3+4 structure. Three countries have better prospects for EU accession (Romania, Bulgaria, Croatia), while the prospects for the other four countries are very vague. In economic terms the situation in Romania and Bulgaria in regional comparison is quite good partly due to earlier started transformation and to the increasing adjustment needs associated with the EU integration process. From the economic-situation point of view, the Western Balkans require relatively similar handling. (Croatia is outstanding from this group owing to its economic development level and the stability of its economic structures.)

Although the growth trends in the region are similar, the growth factors may differ from country to country. The first group consists of countries that have stronger market-economic bases and grow quickly, structural reforms are relatively well advanced, FDI inflow is strong and develops capacities for satisfying export needs or domestic demand. The countries of this group have concluded EU talks or are already in acces-

sion negotiations. In their case, in spite of some alarming signs, only the rate of growth is the question. In the second group, countries initiated some reforms in economic transformation under favourable international economic conditions. These reforms are either the starting of longer-term structural reforms, the speeding up of privatisation, or temporary artificial business support. The sustainability of artificial business support is questionable and recession can surely be expected in case of a slowdown in reforms or worsening international conditions. To the third group those countries belong that experience positive business cycle as a result of relative stabilisation of regional political environment, international aid and support, and related foreign direct investments. In these countries the long-term real-economic base is missing, the development of production capacities requires a longer time and the results are not certain at all. If aid dependence could not be replaced with real-economic base, the economic development cannot be well established in the long run. Between the second and the third group there is no firm demarking line, countries belong to one or the other group alternatively. When judging the potentials of the region an additional aspect is that the business cycle in the region is currently different from the one experienced in Western and Central Europe. The catching up of Central and Southeast European countries with the developed West entails substantial convergence process that sooner or later leads to the synchronisation of growth processes, too. The Southeast European region is at the beginning of this convergence process which means a substantial growth difference compared with the developed Western European countries. This situation drives companies in the more developed countries, where growth rates are much lower, to invest into this high-growth region that offers further business opportunities and secure continuous company growth.

While the situation of Romania and Bulgaria is stabilised in the long run by EU membership, the economic development of the Western Balkans, shaped by political and security-policy processes, can be structured along three scenarios that basically determine the prospects for the next 5-6 years.

- * Large economic setback in the region's economic development: intensification of regional rivalry, increasing international isolation. The setback may differ from country to county, but this may destroy the region's favourable perception in the rest of the world. Some countries may drift to the periphery and the integration perspectives worsen.
- * Step by step integration: internal stability, strengthening of international cooperation, solid internal security situation, continuous fulfilment of accession conditions.
- * Progressive integration: successful domestic transformation, strengthening regional stability, EU membership, market economy.

Given these framework conditions the economic perspectives for the next years seem to be favourable. Investment expectations are positive in the wake of economic stabilisation, advantageous cost factors, expanding markets, and in some cases even privatisation supply is promising.

It is extremely important to note that the majority of Western Balkan countries are entirely depend on foreign transfers. The efficient transformation of domestic economies at present is not possible from own resources only. That is why the stabilisation and association process and its coordinated donor policy is a most important condition.

2) GROWTH PROCESSES

The economic development level of the Southeast European countries heavily lags behind that of the Central European countries. Calculated on purchasing power parity (PPP) per capita GDP in the region ranges from 25% to 47% of EU25 average.

Table 1
Per capita GDP as % of EU25 average
(PPP)

	1991	1995	2000	2001	2002	2003	2004
Albania	10	15	15	19	19	20	20
Bosnia-Herzegovina	-	-	25	25	26	26	27
Bulgaria	35	31	27	28	29	30	30
Croatia	42	37	41	42	44	45	46
FYROM	30	25	26	24	25	25	25
Romania	37	37	25	26	26	30	32
Serbia	-	-	24	24	24	24	24
Hungary	51	49	53	56	58	60	61
EU25	100	100	100	100	100	100	100

Source: Eurostat, WIIW

Calculated at current exchange rate, the low development level of the region is even more obvious. According to the data for 2004, per capita GDP is only 6.5-11% of EU15 average (without Croatia).

The majority of the countries even in 2005 did not reach the pre-transition GDP level, the farthest from which are Serbia and Bosnia. (These two countries suffered the largest loss in the middle of the nineties, but their growth performance today is not much better than those of the other countries from the region, thus their relative position cannot improve substantially.)

During the past five years the average growth rate has surpassed 5% in Bulgaria, Romania, Albania, and it was very close to that in Serbia, Macedonia and Bosnia-Herzegovina. However, the simple growth rates can hide some qualitative factors that can significantly modify the judgement of the growth processes.

While some of the countries show a relatively stable growth, in other cases there are significant changes year by year due either to outside business cycle or to modifications in economic policy (privatisation, domestic demand, *etc.*). After the stabilisation program introduced in 1997 Bulgaria has entered into a sustained and relatively high growth-rate period, as Romania did it after 2001. Albania and Bosnia have developed relatively quickly and without bigger fluctuations during the past few years, but these two countries are the least developed ones in the region. On the other hand, Serbia and FYROM show large fluctuations, unfavourable domestic or foreign processes easily destabilise these countries. After the very fast economic growth in 2004, in 2005 a certain

Table 2
Per capita GDP as % of EU15 average
(calculated at exchange rate)

	2000	2001	2002	2003	2004
Albania	5.13	6.49	6.70	6.92	7.99
Bosnia-Herzegovina	5.93	6.22	6.38	6.65	6.77
Bulgaria	7.31	8.10	8.61	9.14	9.75
Croatia	19.66	21.09	22.34	23.27	24.30
FYROM	8.39	7.96	8.12	8.20	8.30
Romania	7.84	8.45	9.11	9.44	10.62
Serbia	3.85	6.50	8.25	9.02	9.26
Hungary	21.63	23.96	27.80	29.02	31.23
EU15	100.00	100.00	100.00	100.00	100.00

Source: Own calculation based on Eurostat data

Table 3
Real GDP growth
(%)

	2000	2001	2002	2003	2004	2005*
Albania	7.3	7.6	4.7	6.0	5.9	6.5
Bosnia-Herzegovina	5.9	4.5	5.5	3.0	5.0	5.0
Bulgaria	5.4	4.1	4.9	4.5	5.6	5.5
Croatia	2.9	4.4	5.2	4.3	3.8	3.0
FYROM	4.5	-4.5	0.9	2.8	2.9	4.0
Romania	2.1	5.7	5.1	5.2	8.3	5.5
Serbia	5.2	5.1	4.5	2.4	8.6	4.0

* forecast

Source: National statistical offices, central banks,

slowdown took place in the majority of the countries.

3) SUSTAINABILITY

The key factor of future development in the whole region is the sustainability of current growth rates. Besides the application of convenient economic policy, the international processes also play an important role (especially the achievement of EU membership or its concrete promise), but the preparedness of the institutions, their capability for change also play a role. This problem does not affect each country equally; e.g. Bulgaria and Romania are more solidly based, not least because of their immediate EU accession, while the bases of the countries of former Yugoslavia are weaker. There can be significantly less problems in those countries where exports and investments play an important role in GDP growth. The basically domestic-consumption-based growth is very sensitive in these very small countries to increasing current-account deficit.

During the past years there were significant increases in household consumption in Romania, Bulgaria and Croatia. On the one hand, the growth

of consumption did not crowd out (private) investments, since they were partly supported by the tight budget and the huge foreign-capital inflow. On the other hand, there were significant differences: while Bulgaria and Romania were able to acquire capital for productive investments, the investment activity in Croatia concentrated on tourism and highway building, but the technological change in the economy was postponed.

Each country examined is characterised by large or very large unemployment rate and it has not decreased significantly in spite of substantial economic growth. Unemployment data are not very reliable, however. The various methodologies show very different results. All in all, it can be seen that the unemployment rate fluctuates between 30-45% in Bosnia, FYROM and Serbia, and it is also very close to this band in Albania. These data refer to the lack of production capacities, the failed structural change and the weak employment-creating ability of the private sector. In certain countries the official unemployment rates seem to be favourable, but these do not refer to successful adjustment, but rather the continuous postponement of structural reforms that may lead to significant increases in unemployment rates. (This effect is expected to be the largest in Romania.)

While the managing of unemployment is an everyday economic-policy task, in

Table 4
Unemployment rate
(% - LFS)

	2000	2001	2002	2003	2004
Albania	16.8	16.4	15.8	15.0	14.4
Bosnia-Herzegovina	38.0	39.2	40.9	42.0	42.8
Bulgaria	16.9	19.7	17.8	13.6	11.9
Croatia	16.1	15.9	14.8	14.3	13.8
FYROM	32.3	30.5	31.9	36.7	37.2
Romania	7.1	6.6	8.4	7.0	8.0
Serbia	12.1	12.2	13.3	14.6	18.5

Source: National statistical offices, central banks

the longer run demographic processes can also cause serious problems. This arises from negative population growth, fast increase of the elderly and the visible emigration of the younger generation. The opposite process, namely the immigration, also creates very difficult situation as it is the case in Serbia-Montenegro where the inflow of nearly 700.000 people without employment creation resulted in serious problems.

Inflation shows a favourable trend. Hyperinflation was everywhere stopped,

Table 5
Average yearly inflation
(%)

	2000	2001	2002	2003	2004	2005*
Albania	0.1	3.1	5.2	2.3	2.9	-
Bosnia-Herzegovina	4.8	3.1	0.4	0.6	-0.4	2.5
Bulgaria	10.3	7.4	5.8	2.3	6.2	4.5
Croatia	6.2	4.9	1.7	1.8	2.1	3.3
FYROM	5.8	5.5	1.8	1.2	-0.4	1.2
Romania	45.7	34.5	22.5	15.3	11.9	9.0
Serbia	79.6	93.3	16.6	9.9	11.4	15.0

* forecast

Source: Eurostat, national statistical offices

and during the last years its rate has become one-digit, but its sustainability is questionable for many reasons. Firstly, the moderation of inflation was generally not accompanied by structural reforms. Secondly, several central price controls remained that should have been eliminated (the later the liberalisation, the greater the price jump). Thirdly, in most of the countries the overvalued domestic currencies temporarily protect the country from imported inflation. It is a question how long this situation can be sustained as this may hamper exports and the development of competitive production, and affects the companies producing to the domestic market (due to the artificially low import prices).

Another probably positive sign is the relatively low general government deficits (except for Croatia). The relatively balanced budget is explained by the abandonment of independent exchange-rate policy (Bulgaria) or the postponement of structural reforms (Serbia, Romania), and sometimes by the obligation to meet the conditions of the international institutions. However, an excessively fast decrease of deficit easily can have negative consequences (especially if the decrease was not accompanied by structural reforms; see the example of Croatia). On the other hand, fiscal consolidation plays a very important role in managing current-account deficits. However, without the implementation of structural reforms this is a stabilisation policy in vain as it results in lower GDP dynamics. Without growth impacts connected to structural change (reform) it is a question how growth could be quickened. The harmony between growth and balance is very difficult to find: in Bulgaria, owing to structural reforms and decreasing budget deficit, growth remained very quick; in Macedonia stabilisation was connected with slow growth while in Croatia imbalances increased parallel with the slowing of GDP growth.

Table 6
General government balance
(as % of GDP)

	2000	2001	2002	2003	2004	2005*
Albania	-7.5	-6.9	-6.0	-4.6	-4.6	-
Bosnia-Herzegovina	-7.0	-3.3	-0.2	0.8	0.4	0.0
Bulgaria	-0.6	-0.6	-0.7	0	1.7	1.5
Croatia	-6.5	-6.8	-4.8	-6.3	-4.9	-5.0
FYROM	2.3	-6.3	-5.6	-1.6	-1.3	-1.5
Romania	-4.0	-3.2	-2.5	-2.3	-1.1	-1.0
Serbia	-0.9	-1.4	-4.5	-4.2	-1.7	0.5

* forecast

Source: Eurostat, national statistical offices,

Table 7
Balance of the current account and its components
(as % of GDP)

	Trade balance		Transfers		Current account	
	2002	2003	2002	2003	2003	2004
Albania	-21.9	-19.6	13.7	13.6	-6.7	-4.4
Bosnia-Herzegovina	-58.4	-55.4	22.7	22.2	-24.5	-23.3
Bulgaria	-12.5	-14.0	3.4	3.5	-9.2	-7.4
Croatia	-27.3	-24.3	4.8	4.9	-6.9	-4.5
FYROM	-18.4	-20.9	15.9	14.7	-3.3	-7.7
Romania	-7.8	-9.0	4.0	4.2	-6.0	-7.5
Serbia	-24.2	-31.7	12.1	15.3	-9.2	-13.1

Source: Central banks

One of the most important characteristics of the regional economic processes is the high and further increasing foreign-trade deficit. Deficit is above 50% of GDP in Bosnia, close to 30% in Serbia, and it ranges between 20-25% in Albania, Croatia and Macedonia, while it is "only" 10% in Bulgaria, Romania and Croatia. Foreign-trade deficit does not mean a barrier to growth until it can be financed from other sources (from other revenues or from riskless increase of foreign indebtedness). The very bad foreign-trade performance is not reflected entirely in the current account. Some of the countries obtain substantial revenues from services (Croatia, but Bulgaria too, started to receive increasing gains from tourism), and in other countries the large FDI inflow plays an important role. Imbalances are further mitigated by unilateral transfers from abroad. Such transfers are ranging between 13 and 25% of GDP in Serbia, Albania, Macedonia, Bosnia and Albania, meaning that these transfers play an important role in the currently experienced relatively fast growth and relative macroeconomic stability.

One may say that without the continuous huge inflow of FDI trade and current-account balances cannot be financed in the medium term. In addition, smooth development is only expected under these circumstances if foreign capital places emphasis on export-oriented development rather than on domestic-

market activities. Although in recent years the capital inflow into the region has substantially increased, the real breakthrough only took place in Bulgaria, Romania and Croatia – in countries where EU talks have already required substantial adjustment, or where some unique conditions evolved. In the other countries capital inflow could not exert an overall impact, certain services sectors and some well-positioned companies or branches became the target of FDI instead.

Table 8
FDI
(EUR million)

	2000	2001	2002	2003	2004	2005*
Albania	155	232	151	158	275	-
Bosnia-Herzegovina	159	133	282	338	400	400
Bulgaria	1103	903	980	1851	2114	1800
Croatia	1142	1503	1195	1788	921	1100
FYROM	189	493	83	84	122	90
Romania	1147	1294	1212	1946	4098	4000
Serbia	55	186	502	1197	775	1500

* forecast

Source: Central banks

A common problem in the region's countries is the appreciation of domestic currencies. This process in some countries is the result of the catching-up process and it is connected to the development of a more competitive economic structure. The strengthening of capital inflows also supports the appreciation. The most important reason behind the appreciation is, however, the very large difference between domestic and foreign inflation levels. None of the countries eliminated this effect by depreciating the local currency since the fight against in-

flation and the maintenance of price stability is one of the most important economic policy objectives in this region, not least because of the bitter experiences with inflation during the nineties. This strategy is reflected in pegged exchange rates in many countries, and the countries with currency-board regimes do not even have an independent monetary policy. This situation in the future may influence the flow of international capital as the overvalued currency with increasing production costs may weaken the attractiveness of these countries for FDI. This could especially be unfavourable for the production and export of labour intensive products (a clear example is the already high-wage-costs Croatia).

In fact, each country in the region emphasises its willingness for long-term sustainable growth and the necessary structural changes. It can be seen, however, that the implementation of reforms in many countries depends on the conditionality approach practiced by the international organisations. This conditionality means EU adjustment to Romania and Bulgaria while in case of the other countries only IMF and donor coordinators can force to implement the necessary but unwanted reforms. Risks are also associated with the frequent ambiguities in privatisation policies and the manifest distrust of foreign capital.

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PRIVATIZATION AND FOREIGN DIRECT INVESTMENT ON THE BALKANS

Miklós Szanyi

1) WHAT PRIVATIZATION IS GOOD FOR?

Hungarian capital owners have the opportunity to invest abroad through participating in foreign countries' privatization processes. Privatization was in some countries and in certain periods the primary tool of foreign investment. This will probably be also the case in some countries of the Balkans. Practice with privatization showed important differences in various countries, and so the extent and ways of foreign participation also varied. It is therefore important to overview the background of privatization policies, first of all those political and economic goals that governments wanted to achieve, as well as the gathered empirical evidence up until these days.

Privatization was not invented in the transition economies. The idea of privatization first came up in the context of developed countries' state-owned public-utility service sectors in close relationship with the mainstream economic thought typical for the 1980's, principally with the neoliberal approach. The economic role of the state was to be reduced in general, hence the direct involvement through state-owned companies was regarded especially disadvantageous. The

companies that worked mostly on monopolistic market conditions were regarded by critics inefficient. The expectation was that a proper market regulation and the privatization together enabled firms to improve their operation. And if efficiency was not increased, losses were expected to be shifted over to consumers, thus state budget was still relieved from financing the losses or inefficient operation.

We must realize that the privatization tasks of transition economies largely differed from this neoliberal concept, which was also explicitly declared in the Washington Consensus. Privatization in these countries spread to a more substantial part of the economy and affected very heterogeneous groups of companies from the sectoral, financial aspects but also regarding operational conditions. Therefore, the originally elaborated efficiency task of privatization did not come into the foreground in most cases. This precondition of meaningful privatization was treated by governments axiomatic. In practice the real impact of privatization on corporate operations of former state-owned firms was rarely reviewed. Where there was such review, it was always done *ex post*.

It is therefore not very surprising that governments of transition economies tried to achieve a number of other political

and economic goals through privatization, meanwhile they thought that operational efficiency of the privatized firms would improve automatically. Therefore, from the point of view of operational efficiency, undifferentiated privatization campaigns led to ever increasing functional disorders of privatized firms, even if new owners were private. Such problems sometimes forced governments to rethink privatization concepts, the due consideration of operational efficiency. Sometimes renationalization and new privatization of former state companies was unavoidable.

But what other goals did governments try to solve through privatization? We must first mention the quickest and fullest possible elimination of political and economic structures of the previous communist regime. According to several renown economists and politicians the primary task of privatization in the transition economies was the marginalization of the political and economic exponents of the previous regime. We may also add, that the old cadres were to be replaced by a new elite. New cadres were to be supplied with adequate economic power. For example, in the former Czechoslovakia the new owners were expected to be the bourgeois middle class that the government wanted to strengthen (partly re-establish). In the Ukraine, just to mention another extreme policy, privatization was intended to directly support the new (?) political elite. Active policy makers were the primary beneficiaries of the privatization process. The main political content of privatization in most transition economies was therefore the direct or indirect political support of the new political elite.

Some forms of privatization induced substantial capital flows. State-budget revenues could be directly increased through incomes from privatization sales. In case of selling to foreign investors the deal automatically improved also the current account. If additionally, governments used privatization revenues to re-

duce external debt, a third balance-improving effect was achieved. Privatization could therefore substantially improve the internal and external balance of transition economies.

2) PRIVATIZATION PRACTICES YESTERDAY AND TODAY

Governments of transition economies tried to facilitate the achievement of other important economic policy goals as well. The priorities differed from country to country and in time, too. The applied privatization methods also varied. Before starting the analysis of the privatization methods it is important to emphasize the role of the time factor. More precisely, we state that identical privatization methods worked differently and produced different results early in the transition process of Central and Eastern Europe than today. This has several reasons. First of all, countries in the second and third wave of the transition process already possess the experience of the forerunner economies. The Czech Republic, Hungary and Poland applied rather different privatization methods, sometimes with success, sometimes without, and their experience is available now.

On the other hand, transition process has affected the economies of the Balkans for several years, even the least open Albanian and Serb economies. This means that governments have already started to solve the complex set of transition tasks. Some of these goals have been achieved or are being achieved. Therefore, governments may devote more time and effort for the thorough elaboration of adequate privatization policies. It is of course another question how much they can utilize this opportunity. Most of the recent larger-scale privatization deals have resulted in much substantial privatization revenues received

for state-owned companies and their concessions than in the early phase of the transition process. This is also due to the fact that foreign investors gathered sufficient experience in Central and Eastern Europe, thus the investment risk of the region became moderate in the meantime.

But the time that has passed since the start of the transition process could also have brought some negative consequences for the privatization process. There are rather many state-owned companies on the privatization market that can be kept operational only with substantial subsidies from the budget. The privatization of such companies has become increasingly difficult. The social requirements (in terms of employment, supply security, *etc.*) that impeded their sale before have not been reduced. This way these companies have departed further from the norms of market economic principles. In some countries these anomalies are not isolated cases but regular practice. Competitiveness of the Ukrainian heavy industry was largely supported until recently through low energy prices guaranteed by bilateral agreements of Ukraine and Russia. When the agreement was cancelled, Ukrainian economy was threatened with immediate collapse. Similarly, in neighbouring Romania, up until the last phase of the EU accession negotiations, it was not clear if state paternalism or market-driven competition would determine economic actions. We can observe the same dilemma in the countries of the Western Balkans. After introducing these systemic aspects of transition we can turn our attention to the different privatization methods that may play a role in the countries of the Balkans.

Best known from the Hungarian practice is tender sale to high bidder, regarded as the most suitable method to find "real owners" that are adequate for the future needs of the privatized companies. This can be domestic or foreign investor alike. Preference of one against the other depends on the general priori-

ties of governments. Very often governments reject foreign participation in privatization, or they allow it only in form of direct sales or invitation tenders. The exclusion of foreign participants may be disadvantageous from several aspects (lower sales revenue, less available capital for reorganization investments, weaker international competitiveness, *etc.*). Domestic investors pursue usually smaller adjustments in corporate activity that results in smaller drop in employment, and a more likely retaining of at least parts of the former supplier network, which can be rather beneficial for the economy as a whole.

The other main advantage of the tender sale against other privatization techniques is the higher revenue that can be collected by the state budget from the sales transaction. It is important also from this point of view that the transactions are transparent and monitored, and corruption is reduced as much as possible. In fact, Balkan countries are in a favourable position in this regard. Privatization is not a quick campaign. More time and effort can be devoted to the individual sales procedures. The problem here is therefore not a technical one but intentional: governments want to control and direct the redistribution of state assets. There is no political will in many cases to organize open tender sales because not the economic but the political rationale determines the process of privatization. There were several cases when liabilities of state companies were not fully listed prior to signing of the privatization contract, which would have been unavoidable in case of an open tender process. Since there is no major privatization sales campaign, privatization tenders usually achieve high sales prices now.

During open tenders foreign investors also may have an opportunity of participation. In the case of other privatization techniques there are only indirect possibilities of foreign participation. Like in Hungary, also in the Balkan countries

the application of tender sales very much depends on the actual situation of the state budget and levels of external indebtedness. If there is no alternative solution of restoring budget equilibrium it is very simple to use privatization revenues for this purpose. From this aspect situation of Croatia and Serbia can be regarded as critical. Though in case of Serbia collective ownership models of state manufacturing industry makes privatization especially difficult also from the technical, judicial point of view. The situation is similar here to some problems of Polish privatization where extensive worker participation as well as the special status *Solidarnosc* makes it difficult to sell some state-owned companies. The Hungarian experience also showed the importance of the active participation of corporate management in the process of privatization.

The second basic privatization method is the distribution among the population coupons that represent ownership rights in state properties. This method can also be interesting for foreign investors, since though indirectly, this also enables them to participate in the privatization process. The main aim of this method was to create and strengthen the wealth of the middle class through the gratis distribution of vouchers. However, large parts of the middle class did not want to become bourgeois and did not care much about the received ownership. Huge amounts of the coupons were sold to various agents before transferring them into real property. The concentration of real property rights continued after the transfer of coupons for corporate securities. In many cases controlling shares of the securities ended up in the hands of insider investors. Depending on details of regulation foreign investors could also establish companies that could participate in the collection of vouchers and corporate securities. Another opportunity of foreign participation was to purchase the collected securities from domestic funds. The essence of the privatization process

through coupons was that despite of government will and the inclusion of several intermediate stations, ownership rights were concentrated and transferred to either domestic or foreign strategic investors.

Voucher privatization postponed corporate adjustment process considerably. First-tire owners lacked devotion, skills as well as the necessary capital for active participation in corporate governance and adjustment. Coupons were collected primarily by agencies of state-owned banks in the Czech Republic. They were the same banks who were the major creditors of the "privatized" companies. In these cases the otherwise separated roles of the owner, creditor and policy maker interfered thus intensifying opportunism and in many cases also corruption. The result was continuous deterioration of market positions and financial conditions of these firms. In the later phase of the privatization foreign investors also had to recover the accumulated financial and adjustment deficits. The political goals of voucher privatization were not achieved either. The incumbent management remained in position in most cases. Insiders could even strengthen their position through the voucher privatization.

There is, however, another, much less complicated and cheaper way of insider privatization. This is the simple distribution of state property among the clientele of the new political elite. This type of "client-privatization" becomes important in all those countries where there are no serious democratic traditions and institutions (like in the CIS countries), or where privatization was started before setting up the democratic institutions (like in the Western Balkans). It is needless to analyze very long how much danger "client-privatization" means for corporate restructuring, institution building or the credibility of economic policy. Also, from the point of view of foreign investment this is the worse solution. Direct participation is almost impossible or

bound to heavy corruption. The risks of indirect participation in form of buying out from the clientele are very high, too.

In some countries, due to the absolute lack of democratic institutions, political leadership possesses state companies as if they were their own personal property. This situation is similarly not transparent and corrupt as the previously mentioned client-privatization. In such countries not only ways of obtaining property but also the basic legal conditions of corporate functioning are not clear or not properly regulated. It is therefore very difficult to obtain digestible information from state companies, since they work under conditions that can change entirely after transforming ownership. Foreign investors restrain their interest in these countries to capturing markets, hence they can obtain concession for operation only if they purchase together with the concessions the local service supplier. The brave pioneers are sometimes rewarded by very high revenues. If previous market conditions are kept after privatization (e.g. market protection) an improvement in productivity and efficiency may bring very high rates of return on investment in these cases.

There are further less important but not negligible methods of privatization. Assets of state firms can be purchased in bankruptcy procedures. Management/employee buyouts were also frequent. There was some kind of restitution in each transition country and many of them had campaigns of "small privatization" (sale of retail shops, small workshops). In some countries these methods obtained more emphasis. For example, in Poland privatization through liquidation led to the actively controlled privatization method of several hundreds of companies. Employee buyouts may play an important role in Serbia, where this privatization method can be "sold" as a clear continuation of the strong collective socialist ownership patterns. Experiences with employee ownership in Hungary suggest, however, that this is in

many cases an intermediate step of transferring property to strategic owners, or to insider privatization (i.e. management buys out employee ownership). Lastly there is also the option of privatization through the stock exchange but this method may not receive serious attention on the Balkans, since capital markets of these countries are rather underdeveloped and there are only very few firms to qualify for public offering.

3) PRIVATIZATION AND FOREIGN INVESTMENT ON THE BALKANS

Foreign direct investment attraction depends largely on privatization policies wherever there is still substantial state property in the region. Bulgarian privatization has continued uninterrupted since 1997, where almost 90% of the state property that was foreseen for privatization has already been privatized. On the other hand one third of all state property was kept in state management. This means nearly 600 companies, with majority state ownership in 63 companies. The main task of the coming years will be the reduction of state-ownership shares. This will affect mainly the electricity sector, travel, military industry and cultural institutions. The energy sector is under reconstruction according the EU norms. Production and servicing is separated into different companies. NEK (the energy supplier) and Bulgargas is expected to be privatized in 2007. The rather politicized privatization of Bulgartabac may also be completed earlier.

A privatization sales campaign in the Romanian services sector is expected in the near future (regional energy and gas suppliers). Issues of bank privatization are also topical. AVAS privatized 62 larger and medium-sized firms in 2004,

but there are over 1500 companies in the agency's portfolio. The accelerated privatization of these firms is expected shortly through the involvement of foreign investors.

It is more difficult to foresee the future speed and extent of privatization in Croatia. The Privatization Fund possesses 1100 firms at present, one third in manufacturing, one third in services and tourism, and there are also over 100 companies in the construction business. Previous privatization transactions did not prefer foreign participation. The new owners became the employees of the companies, the state pension fund, as well as citizens who received property in restitution. Bigger items are the HEP electricity supplier company, Osiguranje insurance company, as well as numerous firms in the heavy industry, including shipyards (many of them are heavily indebted). Similarly, much state-owned real estates (bound to tourism) could be sold. Currently it is not clear whether the Croatian government decides to open for foreign participation or continues the previous domestic-oriented practice.

Serbian prospects are parallel with the Croatian experience largely due to the common heritage. Privatization was started here very late, only in 2003. According to the most current privatization plans 70% of state property is to be sold to strategic partners, and employees can buy out a further 15%. Especially important could be privatization in the energy sector, in the chemical industry, food industry and in services. Foreign investments are needed also in the renovation of the badly damaged or destroyed linear infrastructure systems. Currently, state firms are prepared for later privatization, but the sporadic concrete privatization experiences in Serbia show rather limited level of commitment in favour of foreign investors. Most current negative example is the case of the Nis oil refinery, the majority ownership of which was sold to foreign investors. After signing, the conditions of the contract

were changed by the government reducing foreign ownership to a minority share. The foreign investor naturally withdrew from the deal. Important part of the preparations is clearing corporate-asset portfolio from non-performing claims. The writing off of debts should limit payment arrears in the Serbian economy.

Generally speaking, in the next future, the amounts of foreign direct investment will largely vary among the countries of the Balkans. One component of the potential level is the size of available state property that can be privatized (also depending on the quality of assets), the other is the willingness of governments to open up privatization process to foreign investors. The political will is determined by general political goals, and by the public perception of selling assets to foreign investors. In the new EU members, as well as in those countries that will most probably join the Union in 2007, quick and decisive privatization actions are expected because it is implicitly required in the process of taking over the *aquis*. In other countries, however, the process may be substantially slower and more controversial.

From the viewpoint of the development and modernization of Balkan countries' economies privatization and foreign investment may play a crucial role. From the angle of sustainable development and capital attraction, privatization investments, greenfield investments and the reinvestment of locally generated profits are regarded rather differently. The high peaks in the FDI records of certain countries are mainly attributed to one or a few major privatization deals. The pool of privatization is exhausted by time, thus, FDI attraction cannot be based on lucrative privatization offerings for ever. Substantial privatization opportunities still exist in the Balkan countries, but the sale of big business has been started in Romania and Bulgaria, reducing potential future stock. On the other hand, Croatia

and Serbia do not pursue FDI-friendly privatization policies.

Comparing the composition of FDI stock, though there are big differences across countries and years, FDI stocks are still largely dominated by privatization deals. Nonetheless, the yearly inflow figures sometimes show the priority of greenfield investments. In case of Bulgaria one can observe the change of tendencies that the forerunner transition economies experienced 5-8 years ago. Greenfield investments together with reinvested profits and loan-financed expansions of existing facilities contributed to some 70% of the capital stock in 2005. In Romania large privatization revenues (Petrom in 2004) limited the relative share of greenfield investments. But out of the 56 received investment applications in the first half of 2005 35 aimed greenfield projects or the expansion of capacities. On the other hand, in the ex-Yugoslav countries (less Slovenia) no major greenfield investment has been carried out up until recently. Croatian sources state that some 20% of FDI inflow was greenfield investments, but they were mostly small-scale projects, employing less than 4% of manufacturing labour. In the case of Serbia there are two major greenfield investments in the services sector.

The sectoral penetration pattern of FDI in the Balkan countries is rather mixed. This heavily depends on pursued privatization policies. In most countries there have been strategic branches of the economy, or at least firms of strategic importance that should not be opened up to foreign investment (energy sector, banking sector, most of the communal services, some manufacturing branches). On the other hand, the structural composition of FDI also depends on the sectoral patterns of the host economies. There are, for example, large investment projects in tourism in Bulgaria and Croatia. The importance of structural patterns is evident if we compare Bulgaria and Romania. Romanian FDI con-

centrates on manufacturing, meanwhile the share of manufacturing investments in Bulgaria is only 24%. It is telecom, trade and the energy sector which are more deeply penetrated in Bulgaria. Croatian FDI structure is more similar to the Bulgarian with the reservation that joint ventures (with minority foreign ownership) play an important role in Croatian FDI stock. The structure of the limited Serbian FDI stock, on the other hand, is similar to the Romanian. Out of the 15 largest privatization investments, 10 were carried out in manufacturing.

Beneficial effects of privatization and FDI can be illustrated by the structural changes of the economies. Following the 1997 stabilization efforts FDI inflow intensified in Bulgaria and resulted in observable structural change and increasing export performance. Romania still fights with rather serious structural problems that have to be solved before joining the European Union. Privatization may play an important role in this process. On the other hand, structural adjustment will also require the closure of many large state-owned companies thus increasing unemployment in several regions. Without the current intensive subsidization these companies cannot survive. Croatia and Serbia are not forced to eliminate direct subsidization of ailing state firms. Surviving state paternalism is coupled with a less FDI-friendly political environment. Hence, on the one side, the elimination of inefficient activities is not enforced, on the other, the creation of new structures by FDI is not supported. The outcome of long-term structural rigidity can be predicted. A clear sign of structural weakness is the 10,000 Croatian firms that are regarded illiquid. Payment arrears in the country achieve USD 2 billion. In Serbia not even the pre-war levels of economic activity were achieved until recently.

Even if we expect successful economic policies in these countries the current high level of unemployment will not be reduced substantially on the short run.

Due to belated privatization unemployment will most probably even increase. Most unemployed in these countries are unskilled, and they have therefore only limited chances to obtain jobs in internationally competitive sectors. The problem cannot be solved with ad hoc measures. Privatization contracts may set employment conditions, but on the longer run levels and structure of employment will be shaped according to the needs of the private owners. The short-term consequences of maintaining excessive employment limits international competitiveness and reduces the chances for successful restructuring. The problem is worse if domestic owners act and there is employee ownership. Foreign companies developed their practice how to overcome employment conditions, shaping extent and structure of employment according to their needs. If employment requirements are too strict foreign investors simply withdraw.

Hungarian companies pursued different strategies in their investments abroad. Some companies tried to buy majority ownership at once (e.g. OTP), others gradually increased their ownership share, also according to the availability of state assets. Such step-by-step approach is plausible in countries with

investment restrictions, for example in Croatia. Since investment restrictions are fully in contrast with EU regulations and principles, the elimination of them can be expected in all those countries that are serious in their aim of becoming members. Hungarian investors invested the largest amounts, mainly in the privatization process. Out of the 10 largest Hungarian outward FDI projects 9 were privatization related. More sizeable manufacturing investments, on the other hand, are shared between privatization and greenfield projects. Videoton purchased a factory in Bulgaria, meanwhile Pannonplast and Dunapack established new greenfield investments in Romania and Croatia, respectively. Most of the small investments belong to the greenfield category. In case of the small investments there are no ownership restrictions even if bigger investments or privatization deals are strictly regulated and controlled (Croatia, Serbia). Hungarian investors experienced problems mostly in Croatia (not in Serbia, because there are only a few Hungarian investments, yet). Most of them were related to property rights. The lack of clear rules and regulations of obtaining property is a major barrier of investment.

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THE RELATIONS OF THE EUROPEAN UNION WITH THE BALKAN COUNTRIES*

Tamás Szemlér

INTRODUCTION

For the European Union (EU), the political and economic stability of the countries in its direct neighbourhood, as well as the calculable development of its relations with these countries is of great importance. The development of the external relations of the EU in the last decade is characterised by the institutionalisation and structuring of these relations.

The above statements are especially valid for the countries of the Balkan peninsula. After the economic recession following the systemic change and, in the case of former Yugoslavia, the armed conflicts, the EU has become very interested in the stabilisation of the region. It has already been clear at the creation of the structured system of relationships that the countries of the region differ from each other to a great

extent regarding the level of their economic development, political stability and democracy – all these aspects are crucial from the EU point of view when it considers establishing closer institutionalised relations with a country.

Due to this heterogeneity of the region, we find here countries which are already at the threshold of EU membership (Bulgaria, Romania), a country which could already open the negotiations on its accession (Croatia), while the other countries are much further from full EU membership, and are connected to the EU by other contractual relations (or just work on formulating these ties).¹

This paper presents an overview of EU relations with the Balkan countries. In what follows, we deal separately with the countries having already concluded their accession negotiations (Bulgaria and Romania) and the other countries. (These latter have the common feature of participating in the Stabilisation and Association Process (SAP) for the Western Balkans. Besides the bilateral relations with the EU – but definitely not

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¹ Slovenia, a former Yugoslav Republic is an EU member since 2004. Thus it is much more advanced in this respect (among other respects) than the countries observed here. In this paper we do not examine the EU-Slovenian relations.

independently from them – we also discuss the actual situation and future prospects of regional cooperation.

1) THE COUNTRIES AT THE THRESHOLD OF EU MEMBERSHIP

The leaders of two of the Balkan countries – Bulgaria and Romania – have already signed the treaty on EU accession. The expected date of the entry of these countries into the EU is 1 January 2007, but this date can be postponed in both cases if the EU finds that the country does not comply wholly with EU requirements regarding the preparation for membership and related reforms.

Despite the fact that Romania has made steps in bilateral relations the earliest – it was the first country of the Soviet bloc establishing official relations with the European Communities –, at the beginning of the 2000s, both countries were on the same track regarding their EU relations (*Table 1*).

The EU has provided financial support for the social and economic development of the two countries (a precondition of tightening the relations). Until 2002, Bulgaria has received about 1.35 bn euros of support in the framework of the PHARE Programme; the framework for 2003 was 94.9 million euros for national programmes, and 28 million euros for cross-border cooperation; for 2004, respectively, 172.5 million euros and 36 million euros were available for Bulgaria from PHARE resources. Concerning the two newer pre-accession funds (ISPA and SAPARD, both are in operation since 2000), Bulgaria has received about 463 million euros ISPA and 287 million euros SAPARD support until 2004. Romania –

Table 1
The relations of Bulgaria and Romania with the EU – the main steps

Year	Bulgaria	Romania
1974		Romania's inclusion in the Community's Generalised System of Preferences
1980		Signing of the Agreement on Industrial Products
1990	Bulgaria and the European Economic Community signed the Agreement on Trade and Cooperation; the PHARE Programme was opened to Bulgaria	
1991		Signing of the Trade and Cooperation Agreement; the PHARE Programme was opened to Romania
1993	March: the Europe Agreement for Bulgaria and the Interim Agreement on Trade and Related Matters were signed	February: the Europe Agreement for Romania and the Interim Agreement on Trade and Related Matters were signed
1995	February: entrance into force of the Europe Agreement December: application for EU membership	February: entrance into force of the Europe Agreement June: application for EU membership
1999		December: Helsinki European Council's decision to open the accession negotiations
2000		February: formal beginning of the accession negotiations
2004		December: closure of the accession negotiations
2005		April: signing of the Accession Treaty in Luxembourg
2007		January 1 – planned accession date; delay by 1 year is possible if preparations are not continued

Source: European Commission

due to its considerably bigger size (especially concerning population) has received much more substantial financial support than Bulgaria: the total amount of EU transfers to Romania in the framework of the three above programmes until 2004 exceeded 4.8 bn euros. Support for 2004 exceeded 900 million euros (from the total amount of 908 million euros, 433.3 mn euros belonged to PHARE [from this, 405.3 million euros for national programmes, 28 million euros for cross-border cooperation], 158.7 million euros to SAPARD, and 316 million euros to ISPA).²

EU support assures important financial resources for both countries: in the period 2004–2006, each year, this support equals to about 2% of GDP in Bulgaria, and 1.5% of GDP in Romania. After accession, EU financial support for both countries is expected to show a considerable (although partly gradual) increase.

2) THE COUNTRIES OF THE STABILISATION AND ACCESSION PROCESS

The SAP is the framework programme of the EU for Albania, Bosnia-Herzegovina, the former Yugoslav Republic of Macedonia and Serbia-Montenegro including Kosovo as defined by the UNSCR 1244. Although Croatia has begun its accession negotiations with the EU in October 2005, it also participates in the process. This is in line with the important principle that the SAP is the policy of the EU towards the countries of the Western Balkans throughout

the whole process of their full integration into the Union.

The SAP is a long-term process, providing a general framework for the countries of the region for their relationship with the EU, and at the same time it takes into account the differences in political and economic development between them (both the general framework and the differences can be followed in *Table 2*). By launching the SAP, the objective of the EU is to assure the conditions of peace, political stability, freedom and economic development in the region. In order to reach these objectives, the EU proposed the countries of the region the prospect of full membership; the most important milestone on the road leading to this objective is the Stabilisation and Association Agreement (SAA) for each country.

For the SAP countries, the EU provides “country-shaped” combinations of trade concessions (Autonomous Trade Preferences), economic and financial support (the CARDS programme; see *Table 3*), and contractual relations. Besides bilateral relations, the encouragement and support of regional cooperation is also an important element of the structure of relations in the framework of the SAP.

The SAP launched in 2000 (at the EU–Balkans summit held in Zagreb) has received new impetus at the Thessaloniki European Council in 2003, which, by approving the “Thessaloniki Agenda”, reinforced the SAP as the policy of the EU towards the Western Balkans, and confirmed the EU integration prospects of the SAP countries, as well (the countries participating in the process can join the EU, once they will be ready for it).

² Source of data:

http://www.europa.eu.int/comm/enlargement/bulgaria/eu_relations.htm,
http://www.europa.eu.int/comm/enlargement/romania/eu_relations.htm.

Table 2
The relations of the countries of the Western Balkans with the EU – the main steps

Year	Albania	Bosnia-Herzegovina	Croatia	Macedonia-FYROM	Serbia-Montenegro
1992	Trade and Cooperation Agreement between the EU and Albania. Albania becomes eligible for funding under the EU PHARE Programme	April: Bosnia-Herzegovina declares independence – the civil war starts			
1995		November: the Dayton Peace Agreement puts an end to the war			
1996				The former Yugoslav Republic of Macedonia becomes eligible for funding under the EC PHARE programme	
1997	Regional Approach. The EU Council of Ministers establishes political and economic conditionality for the development of bilateral relations				
1997				April: Signature of a Cooperation Agreement and financial protocol to promote global co-operation; Agreement on Trade in Textile Products; Agreement in the field of Transport	
1998		June: EU/Bosnia-Herzegovina Consultative Task Force is established		The Cooperation Agreement and the Agreement in the field of Transport enter into force	
1999	The EU proposes the new Stabilisation and Association Process (SAP) for five countries of South-Eastern Europe				
1999	Albania benefits from Autonomous Trade Preferences with the EU				
2000	June: Feira European Council (June 2000) states that all the SAP countries are "potential candidates" for EU membership November: At Zagreb Summit, the SAP is officially endorsed by the EU and the Western Balkan countries				
2000	Extension of duty-free access to EU market for products from Albania				October: Fall of the Milosevic regime. November: "Framework Agreement FRY (Former Republic of Yugoslavia)-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

Year	Albania	Bosnia-Herzegovina	Croatia	Macedonia-FYROM	Serbia-Montenegro
2001	First year of the new CARDS programme specifically designed for the SAP countries				
2001	The Commission recommends the undertaking of negotiations on SAA with Albania		29 October: Signature of the Stabilisation and Association Agreement (SAA)	9 April: Signature of the Stabilisation and Association Agreement (SAA) 1 June: Entry into force of the Interim Agreement (covered the trade and trade-related parts of the SAA) July: The Council adopts a Joint Action on an EU Special Representative August: Signature of the Framework Agreement in Ohrid	July: Start of the EU-FRY Consultative Task Force
2002	October: Negotiating Directives for the negotiation of a SAA with Albania are adopted	March: Joint Actions are adopted for the appointment of an EU Special Representative (EUSR) and the launching of the EU Police Mission (EUPM)			March: Signature of the Belgrade Agreement on a restructured State Union
2003	June: At Thessaloniki Summit (June), the SAP is confirmed as the EU policy for the Western Balkans. The EU perspective for these countries is confirmed (countries participating in the SAP are eligible for EU accession and may join the EU once they are ready)				
2003	31 January: Commission President Prodi officially launches the negotiations for a SAA between the EU and Albania. These negotiations are presently ongoing.	November: The Commission produces a Feasibility Study assessing Bosnia-Herzegovina's capacity to implement a future Stabilisation and Association Agreement. The study concludes that negotiations should start once Bosnia-Herzegovina has addressed 16 key priorities	February: Croatia applies for EU membership		February: Entry into force of the Constitutional Charter July: Enhanced Permanent Dialogue replaced the format of the Consultative Task Force
2004	June: Council decision on the principles of a European Partnership for Albania	June: : EU decides on a European Partnership for Bosnia-Herzegovina December: EUFOR replaces SFOR ("Althea" operation)	April: European Commission issues positive opinion on Croatia's application for EU membership application June: European Council confirms Croatia as candidate country December: European Council sets 17 March 2005 as start date for negotiations conditional upon full cooperation with the International Criminal Tribunal for the former Yugoslavia	22 March: Application for EU membership 1 April: Entry into force of the SAA 17 May: EU Council requests the Commission to prepare an Opinion on the application 14 June: Council decision on the European Partnership for the former Yugoslav Republic of Macedonia 14 September: First meeting of	June: Council decision on the European Partnership for Serbia and Montenegro October: Council conclusions on the twin-track approach

Year	Albania	Bosnia-Herzegovina	Croatia	Macedonia-FYROM	Serbia-Montenegro
				the Stabilisation and Association Council between the EU and the former Yugoslav Republic of Macedonia 1 October: Hand over of the Commission's questionnaire on the preparation of the EC Opinion	
2005	December: Council decision on the principles of a revised European Partnership for Albania	October: Following significant progress by Bosnia-Herzegovina in addressing the 16 key priorities identified by the 2003 Feasibility Study, the Commission recommends the opening of negotiations for a Stabilisation and Association Agreement and submits draft negotiating directives to the Council November: The Council adopts the negotiating directives for the negotiation of a Stabilisation and Association Agreement (SAA) with Bosnia-Herzegovina and authorises the Commission to open negotiations. Negotiations are officially opened in Sarajevo on 25 November	1 February: Stabilisation and Association Agreement enters into force 16 March: EU postpones start of accession negotiations but adopts framework for negotiations with Croatia 26 April : First meeting of Stabilisation and Association Council; meeting of extended "EU troika" on Croatia's cooperation with the International Criminal Tribunal for the former Yugoslavia 3 October 3.: Start of accession negotiations	14 February: Hand over by the Government of the replies to the EC questionnaire to the Commission 16 December: At the European Council, Macedonia gets candidate status	April: The Commission adopts a Feasibility Report which concluded that Serbia and Montenegro is prepared to negotiate a Stabilisation and Association Agreement with the EU
2006	18 February: Signature of the Stabilisation and Association Agreement (SAA)				

Source: European Commission

Table 3
CARDS programme allocation for 2000–2006
(million euros)

	2000	2001	2002	2003	2004	2005	2006	Total
Albania	33.4	37.5	44.9	46.5	63.5	44.2	45.5	315.5
Bosnia-Herzegovina	90.3	105.2	71.9	63.0	72.0	49.4	51.0	502.8
Croatia (transfer to pre-accession from 2005)	16.8	60.0	59.0	62.0	81.0	-	-	278.8
Macedonia (FYROM)	13.0	56.2	41.5	43.5	59.0	45.0	40.0	298.2
Serbia and Montenegro ^a	650.5	385.5	351.6	324.3	307.9	282.5	245.5	2547.8
Interim Civilian Administrations	10.0	24.5	33.0	32.0	35.0	36.0	35.0	205.5
Regional	20.2	20.0	43.5	31.5	23.0	47.9	42.0	228.1
Other ^b	141.5	118.0	11.0	17.0	22.5	19.7	19.8	349.5
Macro-Financial Assistance (grants) ^c	70.0	120.0	100.0	15.0	16.0	33.0	50.0	404.0
<i>Total</i>	<i>1045.7</i>	<i>926.9</i>	<i>756.4</i>	<i>634.8</i>	<i>679.9</i>	<i>557.7</i>	<i>528.8</i>	<i>5130.2</i>
Croatia pre-accession 2005–2006						105.0	140.0	245.0
<i>Total (including Croatia 2005–2006)</i>						<i>662.7</i>	<i>668.8</i>	<i>5375.2</i>

General remarks:

- * Figures for the year 2006 are purely indicative and correspond to the multiannual indicative programming (MIP);
 - * Figures include assistance from PHARE and Obnova where relevant in 2000, and from CARDS 2001 and onwards;
 - * 2005 budget implementation. Re-use of recoveries from 2004/5, *i.e.* above budget allocation 2005: 6 million euros for Macedonia (FYROM), 7.5 million euros for regional programme.
- a) Includes the Republic of Serbia, the Republic of Montenegro and the province Kosovo, which is currently under UN administration. Amounts for Serbia in 2002–2003 include assistance from Regional Programme for Integrated Border Management destined for the whole of FRY/Serbia and Montenegro. In 2004, 8 million euros for that purpose is shown under the regional programme.
- b) Until 2001 (incl.): Humanitarian aid, Specific Measures, Rapid Intervention Operations, EIDHR and GFSP; From 2002 (incl.): Administrative costs and the Western Balkans' contribution to the European Training Foundation.
- c) For 2000–2002: disbursements and *not* commitments.

Source: European Commission (http://www.europa.eu.int/comm/enlargement/cards/financial_en.htm)

Table 4
Free trade agreements in Southeastern Europe
(as of 9 June 2005)

	Albania	Bosnia-Herzegovina	Bulgaria	Croatia	Macedonia	Moldova ¹⁾	Romania	Serbia-Montenegro ²⁾	UNMIK/Kosovo ³⁾
Albania		Applied: 01/12/04 WTO ⁴⁾	Applied: 01/09/03 WTO	Applied: 01/06/03 WTO	Applied: 15/07/02 WTO	Applied: 01/11/04 WTO	Applied: 01/01/04 WTO	Applied: 01/08/04 WTO	Applied: 01/10/03 WTO
Bosnia-Herzegovina	Applied: 01/12/04 WTO		Applied: 01/12/04 WTO	Applied: 01/01/05 WTO	Applied: 01/07/02 WTO	Applied: 01/05/04 WTO	Applied: 01/12/04 WTO	Applied: 01/06/02	II round FTA negotiations: 2005 II. n.év
Bulgaria	Applied: 01/09/03 WTO	Applied: 01/12/04 WTO		CEFTA 01/03/03 WTO	Applied: 01/01/00 WTO	Applied: 01/11/04 WTO	CEFTA 01/07/97 WTO	Applied: 1/06/2004 WTO	Under examination
Croatia	Applied: 01/06/03 WTO	Applied: 01/01/05 WTO	CEFTA 1/03/2003 WTO		Applied: 11/06/97 Revised: 11/06/02 Applied: 1/07/02 WTO	Applied: 01/10/04 WTO	CEFTA 01/03/03 WTO	Applied: 01/07/04	
Macedonia (FYROM)	Applied: 15/07/02 WTO	Applied: 01/07/02 WTO	Applied: 01/01/00 WTO	Applied: 11/06/97 Revised: 11/06/02 Applied: 11/07/02 WTO		Applied: 01/01/05 WTO	Applied: 01/01/04 WTO	Initialised: 31/05/05	IV round FTA negotiations: 08/06/05
Moldova ¹⁾	Applied: 01/11/04 WTO	Applied: 01/05/04 WTO	Applied: 01/11/04 WTO	Applied: 01/10/04 WTO	Applied: 01/01/05 WTO		Applied: 17/11/94 WTO	Applied: 01/09/04 WTO	
Romania	Applied: 01/01/04 WTO	Applied: 01/12/04 WTO	CEFTA 01/07/97 WTO	CEFTA 01/03/03 WTO	Applied: 01/01/04 WTO	Applied: 17/11/94 WTO		Applied: 01/07/04 WTO	Under preliminary analysis
Serbia-Montenegro ²⁾	Applied: 01/08/04 WTO	Applied: 01/06/02	Applied: 01/06/2004 WTO	Applied: 01/07/04	Initialised: 31/05/05	Applied: 01/09/04 WTO	Applied: 01/07/04 WTO		
Kosovo ³⁾	Applied: 01/10/03 WTO	II round FTA negotiations: 2005 II. n.év	Under examination		IV round FTA negotiations: 08/06/05		Under preliminary analysis		

¹⁾ Moldova is associated to the process with an extended timeline; ²⁾ Serbia & Montenegro started negotiation process when it was known as FR Yugoslavia; therefore, both names may appear on the agreements; ³⁾ All agreements in line with UNSCR 1244; ⁴⁾ FTA notified to WTO

Source: http://www.stabilitypact.org/trade/FTA%20Matrix%20_9%20June%202005.xls

Making trade relations easier – both *vis-à-vis* the EU and between the countries of the region – is an important element of SAP. Trade with the EU is encouraged by trade concessions provided by the Union (since 2000, 95% of the exports of the five SAP countries to the EU are exempt from any customs duties and quantity restrictions), while intra-regional trade is to be supported by a series of bilateral free-trade agreements (involving the five SAP countries, Bulgaria, Romania, Moldova (as an associated partner), and Kosovo (treated separately from Serbia and Montenegro in this respect). The matrix of the Southeast European bilateral free-trade agreements (*Table 4*) is expected to be completed soon, and they are planned to be transformed into a multilateral free trade agreement in 2007.

Trade data of the region (*Tables 5–8*) show that there has been progress achieved in intra-regional trade between 2000 and 2004. However, the quite often low weights (in absolute terms, generally still modest) of external trade among each other, and the trade deficits (reflecting in many cases the lack of ex-

port products) of the countries show clearly that these countries face considerable economic difficulties (and in some cases, their performance is highly dependent on external – principally EU – aid and financial assistance). It is important to note that – partly due to the specific features of the region – the share of trade with the EU within the total trade of these countries does not give us any reason to draw general conclusions. (The highest share of EU trade in the region – exceeding even the Hungarian figures – is registered in the case of Albania.)

The trends reflected in the data of *Tables 5–8* are – despite the difficulties – positive: the trade potential of the region is slowly but continuously increasing. The weight of the SEE-7 in EU exports increased from 0.9% in 2000 to 1.4% in 2004. In Hungarian exports, the SEE-7 increased their share from 4% in 2000 to 6.5% in 2004. This tendency – despite the quite uneven distribution due to different factors – is promising, and is expected to be continued if the region can continue its peaceful development.

Table 5
Southeast European (SEE 7) trade with the EU and Hungary: exports (% of total), 2000

From \ To	Albania	Bosnia-Herzegovina	Bulgaria	Croatia	Macedonia	Romania	Yugoslavia	European Union	Hungary
Albania	-	0	0.5	-	1.3	0.1	0.0	0.0	0.1
Bosnia-Herzegovina	-	-	0.2	10.6	1.7	0.1	14.7	0.0	0.7
Bulgaria	0.0	0.0	-	0.1	1.8	1.8	1.2	0.1	0.2
Croatia	0.1	7.2	0.1	-	3.7	0.2	-	0.2	0.6
Macedonia	1.9	1.0	2.3	1.3	-	0.1	12.2	0.1	0.1
Romania	0.0	0.7	1.8	0.1	0.2	-	-	0.4	2.0
Yugoslavia	-	21.6	7.8	-	22.2	-	-	0.1	0.3
SEE 7	2.1	30.5	12.6	12.0	30.9	2.3	28.2	0.9	4.0
European Union	93.4	47.6	51.2	50.5	46.1	60.6	37.7	-	70.0
Hungary	0.0	0.3	0.6	1.3	0.3	3.0	3.6	1.2	-
Total (bn USD)	0.3	1.0	4.8	4.4	1.3	10.4	1.7	2240.7	26.9

Source: WIIW, http://www.wiiv.ac.at/balkan/files/data/export_SEE_2000

Table 6
Southeast European (SEE 7) trade with the EU and Hungary: imports (% of total), 2000

To \ From	Albania	Bosnia - Herzegovina	Bulgaria	Croatia	Macedonia	Romania	Yugoslavia	European Union	Hungary
Albania	-	-	0.0	-	0.2	-	0.1	0.0	0.0
Bosnia-Herzegovina	0.0	-	0.0	1.0	0.5	0.1	4.7	0.0	0.0
Bulgaria	2.5	0.3	-	0.1	5.7	0.6	8.7	0.1	0.1
Croatia	1.0	14.4	0.1	-	3.0	0.0	-	0.1	0.2
Macedonia	1.9	0.7	0.4	0.7	-	0.0	3.5	0.0	0.0
Romania	0.7	0.4	3.5	0.2	0.5	-	3.9	0.3	0.8
Yugoslavia	-	5.7	0.4	-	10.0	-	-	0.0	0.0
SEE 7	6.1	21.4	4.4	2.0	19.8	0.7	20.9	0.5	1.1
European Union	75.6	33.2	44.0	54.3	49.4	63.0	40.9	-	66.4
Hungary	0.9	5.7	0.9	2.3	1.1	3.6	3.3	0.9	-
Total (bn USD)	1.1	3.6	6.5	7.9	2.1	12.1	3.7	2328.3	34.2

Source: WIIW, http://www.wiiv.ac.at/balkan/files/data/import_SEE_2000, Eurostat COMEXT

Table 7
Southeast European (SEE 7) trade with the EU and Hungary: exports (% of total), 2004

To \ From	Albania	Bosnia - Herzegovina	Bulgaria	Croatia	Macedonia	Romania	Serbia - Montenegro	European Union	Hungary
Albania	-	0.1	0.4	0.3	1.2	0.1	0.4	0.0	0.0
Bosnia-Herzegovina	0.0	-	0.1	14.1	1.9	0.1	17.7	0.1	0.5
Bulgaria	0.0	0.1	-	0.3	1.8	1.7	1.2	0.2	0.5
Croatia	0.1	18.5	0.5	-	6.8	0.8	4.2	0.3	1.3
Macedonia	0.8	0.4	2.2	0.9	-	0.1	7.2	0.0	0.1
Romania	0.0	0.0	3.3	0.7	0.2	-	1.0	0.6	3.2
Serbia-Montenegro	2.6	16.2	3.6	3.6	31.6	0.9	-	0.1	0.9
SEE 7	3.6	35.2	10.1	20.1	43.6	3.6	31.7	1.4	6.5
European Union	84.5	60.0	57.0	62.6	44.6	71.0	51.6	-	78.6
Hungary	0.0	4.1	0.9	1.3	0.2	3.7	3.2	1.1	-
Total (bn USD)	0.5	1.8	9.1	8.1	1.5	22.3	3.4	3641.3	55.3

Source: WIIW, http://www.wiiv.ac.at/balkan/files/data/export_dot_see_2004

Table 8
Southeast European (SEE 7) trade with the EU and Hungary: imports (% of total), 2004

From \ To	Albania	Bosnia-Herzegovina	Bulgaria	Croatia	Macedonia	Romania	Serbia-Montenegro	European Union	Hungary
Albania	-	0.0	0.0	0.0	0.2	0.0	0.2	0.0	0.0
Bosnia-Herzegovina	0.1	-	0.0	2.1	0.3	0.0	2.9	0.0	0.1
Bulgaria	2.3	0.3	-	0.3	8.7	0.9	3.6	0.2	0.2
Croatia	1.3	22.7	0.2	-	3.2	0.2	3.0	0.1	0.2
Macedonia	0.9	0.6	0.2	0.7	-	0.0	3.5	0.0	0.0
Romania	0.9	0.5	2.4	1.2	0.7	-	2.2	0.5	1.5
Serbia-Montenegro	0.6	10.9	0.3	0.8	11.2	0.1	-	0.1	0.2
SEE 7	6.1	34.9	3.2	5.2	24.2	1.2	15.4	0.9	2.2
European Union	72.5	59.7	59.4	69.6	59.5	72.0	56.3	-	71.4
Hungary	0.9	5.4	2.2	3.2	3.1	5.8	5.1	1.1	-
Total (bn USD)	2.3	5.5	13.9	16.6	2.5	33.2	9.9	3680.8	59.6

Source: WIIW, http://www.wiiw.ac.at/balkan/files/data/import_dot_see_2004

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HUNGARY AS AN EXPORTER OF CAPITAL*

András Inotai

For almost one and a half decades, one of the many aspects in which Hungary has produced an outstanding performance compared to other countries in the region was that it managed to attract the most international capital per head. According to UN figures, as of the end of 2004 the stock of foreign direct investment in Hungary exceeded USD 60 billion. This was practically on a par with the USD 61 billion invested in Poland, a country four times as big as Hungary, and exceeded the foreign capital stock registered by the Czech Republic by almost 10% (56 billion USD). It was 10% short of the figure registered by Austria.¹

There are significant differences in the structural features of foreign capital. Foreign trade and corporate figures both demonstrate that foreign investments operating in Hungary produce at a higher technological level, with increasingly significant domestic added value. Unlike some countries in the region, investors did not decide to establish a base in Hungary purely with a view to the domestic market. It was part of the global or European strategy of international

corporations, in order to organically incorporate the Hungarian production base into their transnational networks. Owing to an early start, Hungary was the first country in the region where foreign capital was able to recoup investment costs and make a profit. It shows the owners' enduring trust that the overwhelming majority of this profit is re-invested into the Hungarian economy. It will take a few more years for the economies of most countries in the region to reach this stage.

Over recent years, the majority of international capital has started to grow into the Hungarian economy "organically," which is reflected by the expansion of supplier networks. This is due partly to favourable environmental conditions, partly to EU membership. This makes a presence in the Hungarian production and sales markets attractive for more and more small and medium-sized foreign enterprises. However, we cannot deny the effect of spontaneous development, either. As a result of bilateral learning over a decade, some of the community of potential Hungarian producers managed to upgrade to the requirements of transnational corporations in terms of quality, technology, finance, volume of production. Meanwhile, international corporations realized that in several areas, they are able to cooperate with competitive Hungarian partners.

There is considerable regional competition for international capital, with par-

* This study is based on a document prepared for the Ministry of Economy and Transport dealing with the environmental conditions and future capital export opportunities of Hungary, through the analysis of seven selected countries (Bulgaria, Croatia, Poland, Romania, Serbia-Montenegro, Slovakia and Ukraine).

¹ UNCTAD. World Investment Report 2004. New York, 2005.

ticular foreign corporations deciding on where to set up a site and neighbouring countries sometimes succeeding in attracting the capital. However, so far much of this success has been only superficial.

In the meantime, little attention has been paid to the other side of capital flow, namely the development of capital export of the individual countries.

This issue never was on the agenda in the region in the first decade of the system changes. The financial resources and energies of economic policy were tied up in managing and overcoming the transformation, launching convergence with West European standards, and the reorganization and revival of companies. However, a new stage is evolving. While capital import remains dominant, capital export has come into the picture, primarily through the representation of certain Hungarian "regional corporations." Once again, Hungary is taking the lead.

According to our calculations, Hungarian capital invested abroad exceeds USD 6 billion. That is as much as one-tenth of foreign direct investments in Hungary.

1) PREMATURE CAPITAL EXPORT?

International experience suggests that in a period of fast growth and successful convergence, the economic modernization of a country requires the involvement of significant external resources. These can be financed by direct investments, international loans and sometimes non-refundable external resources, such as EU funds.

Meaningful capital export usually emerges at a higher level of development. That is unless we are talking

about escape of capital, such as has happened for decades in Latin America, or the transfer of high and easily-earned profits at home, as found in the case of oil producing and exporting countries.

Looking at several macroeconomic development indicators, Hungary has not reached the level necessary for meaningful export of capital. Therefore, early capital export requires the involvement of more external resources than would be necessary otherwise. The capital outflow has to be replaced, to keep the current account in balance and sustain a manageable external public debt.

Still, there is a case for premature capital export.

Unlike former experiences in the world economy, in today's international economy capital flows and competes practically without restrictions. Everybody is affected, whether they want to participate in this competition or not.

Moreover, other Central and East European countries launched comprehensive privatisation strategies in recent years, or are about to launch such programs. This opens opportunities for Hungarian companies for acquisition of companies and markets. These must be captured now, not in a decade, when the macroeconomic situation of the capital-exporting country might offer better conditions.

It is also true that the strong regional activity of Hungarian enterprises is inseparable from the economic and mental reforms that were launched decades earlier, and have created a more developed microeconomic environment in Hungary compared to neighbouring countries. The hidden benefits of that are reflected in the remarkable activity of Hungarian capital.

2) FACTS AND FIGURES

It is impossible to accurately determine the stock of Hungarian capital invested abroad. Statistics from the National Bank of Hungary published in the current account do not contain minor investments.

However, in more than one neighbouring country, there are hundreds or thousands of such firms operating. These are particularly to be found in areas with an ethnic Hungarian population, such as the Székelyföld in Romania.

In addition, re-investment of profits deriving from earlier investments will increase the capital stock. So will investments oriented toward expansion and development that are not financed by capital export from Hungary, but by other means, such as loans borrowed in the host country or on the international market.

Differences in the “mirror statistics” may be as high as several hundred million euros. Ukrainian figures show a much higher Hungarian capital portfolio than the corresponding Hungarian figures. The situation is the opposite in the case of Romania.

The available figures include transactions executed not by Hungarian companies, but by foreign companies located in Hungary. A case in point is the investment of Magyar Telekom – called Matáv at the time – in Macedonia, or, most recently, in Montenegro. This was financed from profit of the foreign parent company, earned in Hungary.

Without going into detailed debates regarding the volume of exported capital, a comparison of various Hungarian and international sources suggests that the portfolio of Hungarian capital

abroad reaches USD 6 billion. Some claim it is as high as EUR 6 billion.

This figure exceeds the indicators of every other Central East European country that underwent system changes. The UN document referred to above mentions a Hungarian portfolio of USD 4.5 billion, based on data as of the end of 2004, as opposed to the Polish portfolio of USD 3 billion, the Czech one of USD 2.7 billion, or the USD 2.5 billion figure for Slovenia.

Hungary’s leading position is particularly remarkable since the Czech Republic – despite the disintegration of Czechoslovakia – still has an obvious destination for capital in Slovakia, while Poland has a traditional investment “homeland” in CIS countries, primarily Ukraine, and Slovenia has the states of former Yugoslavia.

Hungarian capital export is very territorially concentrated. About 80-85% of the portfolio has been invested in the immediate region. The first stage of capital export of every country involves acquiring neighbouring markets.

Perhaps the best example is Austria, which became a leading capital exporter of the region in the 15 years following the political and economic changes. Its capital exports in Central-East and Southeast Europe are much more significant than the country's economic weight.

Slovakia is the country that has received the highest stock of Hungarian capital (USD 1.56 billion), followed by Romania (USD 1.02 billion) and Croatia (USD 936 million). The portfolio in Bulgaria and Macedonia also is significant.²

Hungarian capital plays the most significant role in the economy of Macedonia, having a share of one-third in the entire foreign investment stock of this

² In Hungarian capital export outside the region, the Netherlands takes the lead, while the portfolio of Hungarian capital is lower in Germany, Austria and overseas.

Balkan state. That comes from Magyar Telekom's investment alone.

In other countries, the portfolio of Hungarian capital is made up of several large investments and many minor enterprises. In Slovakia, within the entire foreign direct investment portfolio, the Hungarian ratio is over 10%. The ratio is a significant 5-7% in Croatia, Bulgaria, Romania and Serbia-Montenegro. (See *Table 1*)

As for the sectors in which the Hungarian investments happen, in certain countries the service sector is predominant. That includes not only Magyar Telekom, but also the oil firm MOL and OTP Bank, as well as the real estate investments of TriGránit. In other countries, with far more modest capital amounts, Hungarian investments are predominantly in the processing industry, including food, pharmaceuticals, packaging and electronic parts. Hungarian

interests are strongly service-oriented in Macedonia and Montenegro, where Magyar Telekom plays a determining role, and also in Slovakia. Services are significantly over-represented within investments in Romania, Croatia and Bulgaria, though these countries also have significant processing industry investments from Hungary. On the Polish market, the weight of industrial investments is higher, apart from TriGránit's construction projects.

In terms of investment type, Hungarian corporations typically become involved in privatisation. Apart from TriGránit's projects, all major Hungarian purchases between 2000 and 2005 were associated with privatisation and can be traced back to the activities of the three Hungarian "regional multinationals" (*Table 2*). In some of these, Hungarian corporations acquired full ownership at the moment of the purchase, in other cases they acquired minority or majority

Table 1
The stock of Hungarian direct investments in Central and Southeast European countries compared to all foreign direct investments (data as of 2004)

Target country	Stock of foreign capital (million USD)	Hungarian capital stock (million USD) ^(a)	Share of Hungarian capital stock (%)
Slovakia	14501	1 560	10.8
Croatia	12989	936	7.2
Bulgaria	7569	480	6.3
Romania	18009	1020	5.7
Serbia and Montenegro	3947	180	4.6
Ukraine	9217	130	1.4
Poland	61427	180 ^(b)	0.3
For comparison:			
Albania	1514	0 ^(c,d)	0 ^(c,d)
Bosnia-Herzegovina	1660	0 ^(c,d)	0 ^(c,d)
Macedonia	1175	384 ^(e)	32.7
Czech Republic	56415	10 ^(e)	1.8
Slovenia	4962	20 ^(c)	0.4
Austria	62657	52 ^(b)	0.08

Notes: ^(a) Figures provided by the Ministry of Economy and Transport, converted into dollars at an exchange rate of HUF 250/euro; ^(b) Does not include the value of the TriGránit capital investment now in progress; ^(c) Based on the 2003 year-end figures of KSH, converted from HUF to euro at a rate of HUF 240/euro; ^(d) The figures of KSH at the end of 2003 imply minimal levels of Hungarian capital, HUF 34 million in Bosnia and HUF 15 million in Albania; ^(e) Figures of the German-Hungarian Industry and Trade Chamber (DUIHK), converted into dollars at an exchange rate of HUF 250/euro

Source: Author's calculations, based on UNCTAD. World Investment Report 2004 (2005), German-Hungarian Industry and Trade Chamber (2005), Central Statistical Office (2005).

shares, which they usually have later tried to develop into full control.³

Table 2
Largest Hungarian privatisation investments abroad

Year	Company	Purchased company	Country	Purchase value (million euros)
2000	Mol Rt.	Slovnaft	Slovakia	300
2001	Matáv Rt.	MakTel	Macedonia	300
2002	OTP Rt.	IRB	Slovakia	40
2003	Mol Rt.	Slovnaft ^(a)	Slovakia	350
2003	OTP Rt.	DSK	Bulgaria	280
2003	Mol Rt.	INA ^(b)	Croatia ^(b)	430
2004	Mol Rt.	Slovnaft ^(c)	Slovakia	200
2004	TriGránit	Silesia City Center	Poland	110 ^(d)
2004	OTP Rt.	Novabanka ^(e)	Croatia ^(e)	236
2005	Matáv Rt.	Telekom Montenegro	Montenegro	137

Notes: ^(a) raise of shareholding to 70%; ^(b) shareholding of 25%; ^(c) raise of shareholding to 98%; ^(d) based on the figures of the National Bank of Hungary; ^(e) shareholding of 73%

Source: Ministry of Economy and Transport, as quoted in Világgazdaság, 20 July 2005

Unlike the services and financial sectors, Hungarian investments in the processing industry sometimes take the form of mergers, acquisitions or greenfield investments. Small enterprises, which have been founded by the thousand, used both of these approaches, but greenfield investments are more significant in this category.

Some corporations that are expressly large in regional terms (*Table 3* contains an incomplete list), and many micro enterprises, are simultaneously involved in Hungarian capital export.

It follows from the differences in firms' sizes and capital strengths that large corporations cover almost the entire area of the given country, or even handle individual countries of the region as part of a comprehensive regional

strategy for Central Eastern Europe and the Balkans. By contrast, the geographical limitations of small enterprises are

obvious. They have modest capitalization, experiences and language skills, and more or less deficient knowledge of the legal and economic environment of the target country. That means their investment decisions can hardly ever overcome the boundaries of their direct geographical environment, cross-border cooperation and the Hungarian–Hungarian business framework.

The market strategy of companies established with Hungarian capital in other countries reveals some interesting features. The determining objective is market acquisition. That applies to financial, services and, industrial investments.

In the latter category, corresponding to international experiences, the investments primarily improve opportunities for Hungarian exports. This is especially typical of minor enterprises, and within that category, commercial outlets located close to the border, which carry a significant quantity of Hungarian goods.

Other investment motives that are typical of international corporations are still underdeveloped, if they apply at all. The most important of these is the relocation of domestic production motivated by cost benefits. This process is expected to pick up speed in the upcoming years. But in this regard, there is already a small number of investments in which the Hungarian company reexports some of the production from the neighbouring countries to Hungary. It can sell the products at a competitive price, with

³ This is not necessarily the most favourable strategy chosen by the given Hungarian enterprise, but the rules of privatisation – especially in Slovakia before its EU membership, in Croatia and Serbia until now – have excluded the acquisition of 100% foreign ownership.

Table 3
Market presence of selected Hungarian companies in some Central
and Southeast European countries

Company	Bulgaria	Croatia	Poland	Romania	Serbia and Montenegro	Slovakia	Ukraine
Bábolna							X
Danubius				X		X	
Dunapack	X	X	X				
EGIS			X	X			X
Fornetti		X	X				X
Globus			X				
Litexco	X						
Mol		X		X		X	X ^(a)
OTP	X	X				X	
Pannonplast				X			X
Richter Gedeon			X	X			X
TriGránit	X ^(b)		X	X		X	
TVK							X ^(a)
Transelektro							X
Videoton	X						X ^(b)
Vegyépszér						X ^(b)	
Masped	X ^(b)						
BorsodChem			X ^(c)				
Matáv					X ^(d)		
Other(s) ^(e)		X		X			X

Notes: ^(a) terminated its activity in the meantime; ^(b) planned investment; ^(c) investment to be launched; ^(d) purchase of the telecom of Montenegro; ^(e) companies with major volume in food industry, construction industry, machine industry and consulting

Source: Prepared by the author based on different country studies.

quality appropriate to the Hungarian market.

The low raw material intensity of Hungarian industry is one reason why there are hardly any companies investing in neighbouring countries because of mineral materials available there. The exception is raw material for food in Poland, which contributed to the decision of a Hungarian company to start production there.

The medium or low technological quality of the region, and the unilateral export of technology from the West, have prevented any foreign investments associated with obtaining technology. But, as shown by Ukrainian examples, there is potential of this kind.

Probably it is their low level of capitalization that has prevented Hungarian

enterprises from considering in their strategic decisions the fact that certain countries of the region are already EU members, two more could become members in 2007, and the establishment of free trade with countries of Southeast Europe is in progress. Moreover, although Southeast European countries have concluded bi-lateral free trade agreements under the Stability Pact, and

Ukraine offers access to the Russian market, these facts do not seem to have significantly affected investment decisions.

3) WHAT DOES THE REGION OFFER?

Both the expectations of the individual countries and international forecasts anticipate that, if the critical level of stability at home and in the region is maintained, Central-Eastern and Southeast European countries will continue to provide the most dynamic economic growth in Europe. In the medium term, their

annual growth rate may be two or three times as high as the EU15 average.

Accordingly, while the financing needs of the region are increasing, so is the interest of international capital. In recent years, Romanian and Bulgarian capital imports have especially jumped, mostly owing to increase of revenues from privatisation, but also due to greenfield activities.⁴

In addition to fast growth, this internal demand will increasingly be shaped by the movement of company site advantages, as well as the pace and nature of privatisation. Regarding the latter, we see a mixed picture. Apart from the postponed privatisation of some corporations, Slovakia and Bulgaria have entered the last stage of privatisation. Poland and Romania are somewhere in between, since both still have significant state-controlled assets. While the Romanian government continues privatisation unchanged, the communication of the new Polish government is controversial. The list of companies for privatisation is still very long in Croatia and, most of all, in Serbia-Montenegro.

Privatisation through foreign capital may be made dependent on certain conditions. These could include partial preservation of state or domestic ownership, job creation, or the continued employment of the former labour force. This will prevent the influx of significant international capital, detouring investments into the narrow domestic market that

will result in better profits in the short term.

Restrictions on imports, quite significant in more than one case, further consolidate this distorted structure. And there are cases where, realizing the restricted opportunities, the foreign company will regularly take its profits out of the country, as opposed to initiating investments for development and expansion.

Every country attaches high hopes to the investment-stimulating effects of EU membership. The free-trade zone in the Balkans, now becoming a full-fledged arrangement, is similarly perceived as a favourable development to a lesser extent. The bigger market will stimulate the interest of international capital, and thus the competition among possible sites for industrial development. Production scaled to regional or Europe-wide dimensions could hardly be set up in every country of the region.

As shown by the Hungarian example, a multinational enterprise will want to serve the entire region from a particular location unless it caters exclusively for the internal market. That means that within a reasonable time frame, it will not establish parallel capacities in the region.

Another, probably exaggerated expectation is related to the geographical relocation of the existing Central European operations of international companies. This expectation is based on the assumption that the EU membership of Central-Eastern European countries will increase production costs, owing to requirements of environment protection, consumer protection and other statutes, along with increasing wages and appreciation of currencies. Therefore, multinational corporations are expected to relocate their manufacturing and service centres to the East and Southeast European region, triggering export-driven growth in certain countries of the region. That was a process already witnessed in Hungary a

⁴ At the end of 2004, the portfolio of foreign direct capital registered in Romania exceeded USD 18 billion, in Croatia the corresponding figure is 13 billion, in Bulgaria 10 billion and in Ukraine 9 billion. In contrast, according to UN figures, Serbia-Montenegro only attracted less than USD 4 billion. In other words, there is still less foreign direct investment operating in the whole of Southeast Europe than in Hungary alone. However, in upcoming years this may change to the benefit of Southeast Europe. If nothing else, the various order of magnitude of privatisation reserves could trigger such a change.

decade ago, and then in the Czech Republic and Slovakia as well.⁵

Although we cannot rule out this scenario completely, we must remember the restricting factors. Investment decisions – especially in the case of investments becoming technology-intensive – are driven by more than differences in wages or tax regimes. The legal, political and economic environment, and increasingly the socio-cultural environment, are at least as important.

In many cases, the determining factor in choosing a site is the development level of physical infrastructure and, within that, the time taken to reach a particular site. In this context, Southeast Europe is in a geographically adverse position compared to Central Europe.

In addition, in certain countries, human infrastructure dropped below the critical mass, which could cause problems with capital attraction and preservation.⁶

Finally, the existence or lack of a network of suppliers significantly influences the inclination of international companies to move operations to a new country. Within specified geographical boundaries, a company that is not part of the economy of the current host country and does not have its own local production and service network is more likely to move its production facilities. It is much more difficult to relocate when organic relations are in place and the network of suppliers is in place. Recreating these in a new site would require substantial expenditures and long-term

high risks, even though, at first glance, the new site may offer cost benefits. Certainly, though, some expressly wage-intensive production is moving east and southeast. Several international corporations will make efforts to exploit the benefits of the internal market to a higher extent. As part of the process of multinational enterprises building up their own networks, certain supplier activities will be relocated to East and Southeast European economies. And the East and Southeast neighbourhood of Hungary may mean an interesting new field and challenges, especially for companies intending to invest in the region in the future. We primarily anticipate American and Canadian investors, but companies from the Far East may also appear.

Two fundamental challenges of economic policy that most countries have to face may remain, or even grow.

One is the narrowing of the channels of foreign capital influx as privatisation progresses, unless new capital can be introduced to maintain these revenues, which are vital for the financing of successful modernization and convergence. In this sense, EU development funds may be very significant. However, in the foreseeable future the countries of the former Yugoslavia will only capture a small share of this. Even more important is whether greenfield investments, and the developing and expanding activities of international capital will take off. The situations of Bulgaria and Romania seem more favourable here than that of Ukraine or the Western Balkans.

The other dilemma is the necessity to shift the key driving forces of sustainable growth. Currently, the significant economic growth is fed by the artificial stimulation of internal demands in almost every country. This can only be maintained in the short term. Exports and investments must become the engines of growth. The basic condition for that is not just the attraction of even more for-

⁵ Assuming that communications and measures that would discourage or deter foreign direct investments will not negatively effect the Hungarian economic environment and policy making.

⁶ Over the past decade, almost every Southeast European country experienced mass emigration. It was mostly the well-educated, young, mobile, flexible, entrepreneurial and risk taking labour force that was involved. In upcoming years, the lack of this community could become the biggest obstacle to sustainable growth and more sizeable capital import.

eign capital but, more importantly, the appearance and availability of export-oriented multinational corporations.

4) OUTLOOKS, OPPORTUNITIES AND TASKS

While Hungarian capital operating in the region cannot avoid participating in fierce international competition and taking its chances on the market, its opportunities and investment chances are influenced by certain peculiar circumstances.

Even conservative estimates state that in the next five years, the stock of Hungarian capital operating in the region will double. This means that in 2010 it may reach EUR 11-12 billion, corresponding to a capital export of about EUR 1 billion a year. One successful, large-scale privatisation transaction may make this forecast not only achievable, but easy to exceed.

Individual countries' economic development and transformation into market economies stand at various levels of maturity.

Therefore, the opportunities of capital export are country dependent. In some countries, the continuation or acceleration of privatisation provides promising opportunities for investment. However, there are countries where a simpler and more transparent legal framework might lead to beneficial results. That is especially owing to the necessities deriving from EU membership or preparation for membership.

It should also be anticipated that the improvement of regional market conditions – free trade – will begin to have a role in Hungarian companies' investment decisions. Experiences so far, and the gradually evolving institutional and per-

sonal corporate networks, can be used to support these decisions.

Certain new aspects also should be taken into account in Hungarian politics and economic policy. The net capital import needs of the Hungarian economy should be met, even with increasing capital exports. For that, EU funds and the continuing lively foreign capital influx provide a reliable basis. On the other hand, steps must be taken in advance to prevent job losses in Hungary owing to Hungarian capital relocating to neighbouring countries. A structural upgrading is necessary, shifting domestic production to higher added value and more technology-intensive activities. This requires future planning by companies and an appropriate governmental economic policy.

Moreover – and only partly owing to demographic problems – regional capital relationships should be more and more assessed from the point of view of available human capital. And not in the form of traditional labour force imports, but by outsourcing of production to enable the involvement of this labour potential into the increasingly competitive activities of Hungarian companies.

While most Hungarian “regional multinationals” have carefully elaborated strategies, small and medium-sized enterprises require significant training and preparation. Some are certain to surpass the levels reached by now. They will want more than just a local niche market.

Progress should be made in three areas. Hungarian companies with settled bases abroad should be encouraged to integrate in the supplier network of multinational corporations operating in the region. Second, they may require assistance when they take some of their production abroad, owing to cost benefits, aiming to serve the Hungarian market from there. Finally, the build-up of a network between Hungarian small and mid-sized enterprises operating abroad

and small and mid-sized enterprises of the host country should be supported adequately. This can be one of the significant tools of regional expansion, and sometimes even a key factor of successful performance in the EU. In order to implement the above-mentioned targets, a decisive role has to be attached to capital-export-supporting Hungarian government institutions. One part of this structure has been established long ago, as the Budapest headquarter of ITD-Hungary and its regional offices cover almost all countries of Central and Southeast Europe. The credit policy of the Eximbank belongs to this structure as well. Similarly, essential tasks will be assumed by Corvinus Investment Bank, especially focusing on providing active support to Hungarian capital export.

EU membership and the continued territorial expansion of integration carries potential benefits. Economic policy and diplomacy have significant tasks in this field, too. National development plans should be coordinated, both in the area of cross-border cooperation (euro-regions) and the infrastructure and environmental developments covering the entire East and Southeast European region. This applies not only to existing EU member states, such as Slovakia or Poland, and not only to Romania and Bulgaria, but also to the Western Balkans, a region managing other Union resources.

When it comes to improving the environment for Hungarian capital export, the transfer of EU-related Hungarian experience in an organized framework, such as courses, professional training, twinning programs and successful application for EU funds, may have a special and efficient, albeit indirect role.

The existing and potential build-up of sites also assumes active economic diplomacy. There is strong competition in the region to capture the best investments, but potential alliances are available in this competition. The opportunities of

concerted action should be considered with Italian, Slovenian, Greek and Turkish capital, and enterprises active in Southeast Europe, as well as with Polish firms focusing on East Europe, and with Slovak and Romanian partners.

5) FINAL REMARKS

The increasing presence of Hungarian capital in neighbouring countries also depends on preserving and enhancing the stability of the region, as does sustainable economic growth in Hungary in general. Focusing on the future environmental conditions of capital export, the stability of the region has increased in recent years, but we cannot exclude reversals.

It is likely that privatisation will continue, even accelerate in certain countries. Decisions on privatisation will be shaped – as everywhere – not only by economic but also by political considerations. That is a reason why Hungarian diplomacy should play an active role.

Another key requirement for successful Hungarian capital export is that it should be increasingly based on business considerations, and should not be ethnically driven. The system of incentives in Hungarian economic policy should be developed and enhanced in this regard. Close economic relations in general, and capital relationships in particular, can weaken or eliminate historically developed and inherited negative stereotypes. In addition to the direct economic benefits, the dynamically expanding Hungarian capital export in the region will also produce these benefits.

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