Southeast Europe: An Emerging Region in Transition Preparing For EU integration

A background paper prepared by

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Executive Summary

Southeast Europe (SEE) is an emerging region in transition. It has been a laggard in the 1990s, but has started to post positive economic news since 2000. Compared to the New Member States (NMS) from Central Europe and the Baltics, the turnaround in SEE has been delayed by about 5 years (in NMS around 1995 and in SEE around 2000). The process of transition may have been delayed for a somewhat longer period of time because some of the characteristic features of this process, e.g. industrialization, growing exports and restructuring, are starting to take place only in the last couple of years or so. Bulgaria and Romania have advanced as has Croatia while the rest of the region is only now catching up.

Since the turnaround in 2000, the region has been enjoying good economic growth and has increasingly attracted foreign investments. Macroeconomic stability has become a permanent feature of this region, with inflation being kept mostly under control and macroeconomic imbalances remaining at sustainable levels. The fiscal performance has been particularly good, though some risks persist in several countries.

The current year is crucial for SEE because a number of outstanding constitutional and other political issues need to be resolved and the process of integration with the EU should gain speed. These political developments carry with them some risks, especially when it comes to the resolution of the key remaining problem, which is the issue of the constitutional status of Kosovo. In addition, constitutional development of Bosnia and Herzegovina may increase tensions in that country with regional consequences.

In that context it is unfortunate that the EU perspective of SEE has become more uncertain in the last year or so. Though it is expected that Bulgaria and Romania will join the EU at the beginning of 2007, the process of further Balkan enlargement of the EU may depend on the assessment of the EU "absorption capacity". Assuming that this unfortunate term is given some reasonable meaning, it can still be expected that candidate countries, Croatia and Macedonia, will join the EU early in the next decade with the rest being included by about 2015.

These integration prospects should be given a boost with the emergence of the free trade area in SEE, which will take the form of the extension of the Central European Free Trade Area (CEFTA). With regional cooperation improving, with political problems managed and perhaps even solved, and with economic development speeding up, SEE or the Balkans should be finally reintegrated with the rest of Europe.

Fast and sustained economic development is important to this region because of remaining social problems. Because of delayed integration and political and even violent conflicts that ensued with the disintegration of Yugoslavia, employment has become scarce and unemployment high in SEE. The situation in Bulgaria and Romania is better or improving, but in the rest, in the Western Balkans, it is still difficult. Young, uneducated, those who have lost their jobs and women are the hardest hit categories. With aid and assistance decreasing, EU support and especially foreign investments have become crucial. Those should support the improvements in the regional infrastructure and in human capital and especially in the reindustrialization of this region.

Prospects for positive developments are good, assuming that political risks are kept under control and institution-building advances. The region can expect to have a sustained growth of GDP of around 5% in the medium term and even faster growth of industrial production and exports, both of goods and services, should be expected. That opens up favourable business

opportunities for the neighbouring countries too, especially for the more developed ones in Central Europe.

EU integration is crucial for the political and economic development of SEE. Through it, the region should disappear in the sense of security concern and emerge as an economic region with significant potential. These will be beneficial to the EU both in terms of security and when it comes to economic development. Though SEE is a developing region, in the long run the economic potential of it is comparable to that of Central Europe or to the other peninsulas in the South of Europe. For the region itself, EU integration means institutional transformation and modernization that is the key to its political and economic development in the long run.

The speed up of growth that will come as the consequence of transition and improved EU prospects for the SEE will also lead to the rise of income and welfare there and to improvements in the labour markets. Also, improved possibilities for the upgrading of human capital will lead to the improvement in the competitiveness of this region. That should have the consequence of the normalization of the labour markets within and without the region and would have positive effects on flows of migration. The demographic and immigration pressures emanating from this region are exaggerated and most of them are in essence positive for the EU.

In general, a developed region tends to gain from the liberalization of trade and investment with a less developed region and that is the case with the SEE and the EU too and even more so when it comes to the effects on a country like Austria, Greece, Hungary, Italy or Slovenia with larger than average political and economic interests in SEE. The SEE region stands to benefit too as it cements its security and sustains high growth from increased trade and investment with the EU.

Vladimir Gligorov

Southeast Europe: An Emerging Region in Transition on the Way to EU

1. Introduction

Economic developments in Southeast Europe have been positive overall since the end of the Kosovo war in 1999 and the political changes in Croatia and Serbia in the year 2000. Political developments have also been encouraging overall, though the process of stabilization and democratization has not been without occasional crises and other challenges. Integration with the European Union (EU) has also made steady progress though the pace in different countries has been uneven. The prospects in all these three areas – economic and political development and further integration – are generally positive though there are short term risks.

The risks can be seen if the initial expectations and the real situation are compared. It has always been clear that 2006 was going to be a crucial year for Southeast Europe (SEE) or the Balkans. However, the overall environment was expected to be more favourable than it ultimately turned out to be, but the agenda could hardly be changed. Key constitutional decisions were to have been taken throughout the region, regional cooperation was to be stepped up and the Balkan enlargement of the EU was to start with the accession of Bulgaria and Romania on 1 January 2007. It was expected that this series of shocks, some positive overall and some negative for particular countries, would be supported by improved economic developments, with accelerated growth and continuing macroeconomic stability. Last but not least, the region was to be assured of the firm commitment of the EU and its readiness to integrate the countries in the region and support the integration process in every way possible.

The economic situation does continue to improve, albeit with some problems when it comes to macroeconomic stability; the firm commitment on the part of the EU, however, has failed to materialize. Indeed, at the moment it is the very ambiguity of the EU strategy for the region that has contributed the most to the growing mood of uncertainty. The key effect of this heightened uncertainty is potential greater instability in the region. For the time being, the economic consequences are comparatively negligible and the region continues to enjoy healthy growth with stability. However, some of the crucial political shocks have yet to be absorbed and some risks along the way loom large.

In this paper, the overall economic development will be described first, EU integration prospects will bi discussed next, and current developments and short term policy challenges will be then assessed. Regional trade and policy issues will be looked at. Political developments and economic prospects will be treated at the end.

2. Defining the region

There are various definitions of the region of Southeast Europe (SEE). In geographical terms, it is often taken to coincide with the Balkan Peninsula. In terms of political geography it may be taken to include all those countries or political entities (the political part of political geography) that have some part of its territory on the Balkan Peninsula (the geographic part of the political geography). In an even broader definition, that takes into account other criteria too, for instance those of economic or cultural geography, some neighbouring countries or regions could also be included because they have significant (economic or security) regional interests or (economic, demographic or cultural) interests in the region. Finally, intersecting regions could also be considered, for instance Southeast Europe could be a combination of (some parts of) the Balkan region and of (some parts of) the Danube region or of (some parts of) the region of Central Europe.

In the current usage in the International Financial Institutions (IFIs) and in the EU, Southeast Europe includes eight (sometimes nine) countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Montenegro, Romania and Serbia (and sometimes Moldova). This is a set of countries that belong to the SEE or Balkan region in terms of political geography and are also post-socialist transition countries (another distinguishing criterion). This set of countries is sometimes divided into those that belong to Eastern Balkans (Bulgaria and Romania) and those that are in the Western Balkans (all the rest). These complex classifications came about for two reasons.

The reintroduction of the Southeast Europe as a name for this region came about after the end of the war in Kosovo in 1999 that saw the establishment of the Stability Pact for Southeast Europe. The idea behind the Stability Pact was to support stability and transformation in the crises areas in the Balkans through an inclusive regional approach. For that purpose, broader definition of Southeast Europe was implicitly adopted that included all the Balkan transition countries plus some of their Balkan (Greece and Turkey) and Central European (Slovenia and Hungary) neighbours. But the target group for integration and transformation was that of the eight above mentioned countries of Southeast Europe. For purposes of economic and other analysis and aid-planning, The World Bank usually added Moldova.

This wider group of SEE countries consisted of members of the EU, candidate countries and other countries, which eventually became potential candidate countries at the Thessalonica Summit of the EU and the Western Balkans in June of 2003. Out of the eight target countries, Bulgaria and Romania had the Europe Agreements with the EU and became candidate countries while the other six countries were grouped into Western Balkans for which a different procedure of EU integration was devised centred on the instrument called the Stabilisation and Association Agreement (SAA). In the meantime, two of the Western Balkan countries have become candidate countries, Croatia already negotiating for membership with the EU, and Macedonia still waiting for a date to start negotiations. The remaining group of countries (Albania, Bosnia and Herzegovina, Montenegro and Serbia) is in various stages of the Stabilization and Association Process (SAP). To them the emerging state of Kosovo should be added that is tracking the SAP.

As the eight countries included into the region of Southeast Europe have been integrating with the EU at different speed, the region has been shrinking as countries have been graduating from Southeast Europe and moving to the EU. As soon as Bulgaria and Romania join the EU, which will most probably happen on January 1, 2007, Southeast Europe will for all practical purposes coincide with the Western Balkans. From the perspective of the EU, that region has already been divided into two groups of countries: candidate countries (Croatia and Macedonia) and potential candidate countries (the rest). Therefore, increasingly the EU does not include candidate countries into the Western Balkan countries, so that the region of Western Balkans is becoming not very informative. Except in one sense and that is that there is a regional free trade area that is to be formed that all of these countries are to join at the beginning of 2007. Strangely enough it will continue to be called the

Central European Free Trade Area (CEFTA), as all these countries will be expected to join CEFTA, though it will be comprised only of the Western Balkan countries.

Thus, the original region of Southeast Europe that justified the creation of the Stability Pact for Southeast Europe has transformed itself into a region of Central European Free Trade Area. That region will be even smaller once Croatia joins the EU and will continue to wither away as other countries advance on their way to the EU.

With the withering away of the SEE and of the Western Balkan region, regional interests may not disappear, however. If the regional economies continue to improve and intra-regional trade and investment starts moving freely, SEE may eventually prove to be an important economic region. However, in its current status of a collection of small countries and small economies that are jealous of each other and tend to conflict over a host of issues often and also continue to move towards the EU at different speeds, the regional aspect will continue to play a relatively minor if not any more a negative role.

3. Economic transition in comparative perspective

SEE went through a turbulent development in the 1990s, partly because of the violent conflicts on the territory of Yugoslavia, partly because of the lack of political support for transition, and partly because of the confused international involvement and intervention. In any case, the whole region has started to report good economic news only after the year 2000. Even after that date, Macedonia went through a costly internal conflict in 2001, Serbia suffered a setback after its Prime Minister, Dr. Zoran Djindjic, was assassinated in early 2003 and Montenegro gained its independence only in spring of 2006. Also, in parts of Bosnia and Herzegovina economic development started to improve only in the last couple of years while the situation in Kosovo is still quite difficult and economic growth is yet to return to that place.

With these caveats in mind, it is clear that economic growth did return to the region and has stayed, for the most part, at a relatively high level ever since. Average growth rates in most countries of the region have been between 4 and 5% in the last few years (see Table 1 below) and can be assessed to be sustainable. In fact, indicators of macroeconomic stability have been improving in most countries in the region. Inflation has been relatively low or has been decelerating or stabilizing. Public sector balances have been improving and the fiscal balances are mostly sustainable even with foreign aid decreasing. In the last few years, exports have also been growing, though the region still remains reliant on large inflows of imports.

If the developments in the Balkans are compared to those in the Central European economies in transition, now new member states (NMS), an argument can be made that the former are following in the footsteps of the latter. They are exhibiting the characteristics of the catching up economies. It may make sense to list similarities and also dissimilarities between these two groups of countries. To facilitate the comparison a review of some stylized facts about the process of economic transition may be useful.

Democratization: Transition in Europe, unlike perhaps in some other parts of the world, has been closely connected with the process of democratization. Indeed, it has been argued that the strategy of transition that was chosen and implemented in Central Europe can be characterized thus: democracy first, reforms later. Rather than believing that democratization can be attained by piece-meal reforms, the complete change of the political regime was seen as the prerequisite for economic reforms.

Unlike in what are now new member states of the EU, in SEE democratization was often delayed or alternative types of regimes, authoritarian or oligarchic, were tried. In some cases, democratization is still an issue partly because of the unresolved constitutional problems. Both the issue of democratization and of constitutional development will be discussed in some more detail at the end of this paper.

Liberalization and privatization: The main initial reform in transition is that of liberalization of domestic and foreign markets. In conjunction with that is the process of privatization, which usually starts immediately but takes much more time to complete. These two processes are not unrelated and in fact relatively comprehensive liberalization is supportive of the more successful and sustainable process of privatization. The reason is that the transfer of property rights that goes via the market leads to better allocation of resources and produces a more sustainable distribution of property rights.

Again, the process of liberalization was – for different reasons in different countries or sets of countries – somewhat delayed in SEE while the process of privatization was often rigged and contributed in some cases to the misallocation of resources and even to unsustainable macroeconomic imbalances. For instance, Serbia, Montenegro and Bosnia and Herzegovina are yet to join the World Trade Organization (WTO) and are yet to sign an association agreement with the EU. Also, the contribution of the private sector to GDP in SEE is still on average below the level in the NMS.

Foreign investments: In most cases, though not invariably (Slovenia is a notable exception), foreign ownership of assets increases quite dramatically in countries in transition. That is especially true of financial services, trade and also of the industrial sector. Indeed, the inflow of foreign investments, both direct and other, tends to be very large and is sustained over a prolonged period of time. The initial motivation is the opportunity to invest in quite cheap assets, but afterwards the main motive is the opportunity to take advantage of the high potential growth of productivity.

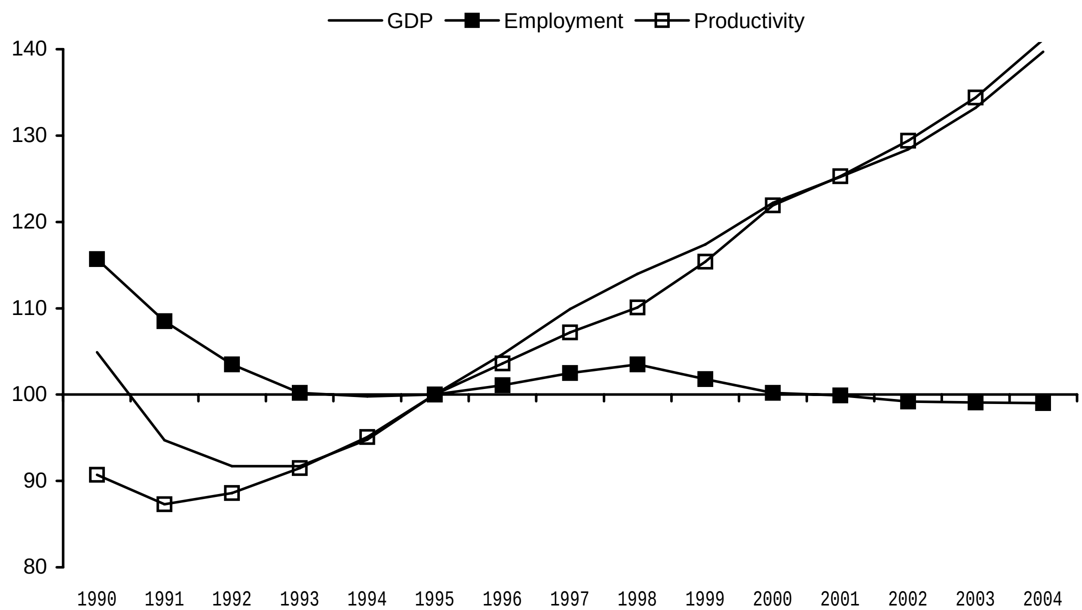
By contrast with the NMS, inflows of foreign investments have been delayed and have become significant in SEE only since the turn of the century. Indeed, in some cases, significant and sustained foreign interest in investing is yet to happen; e.g., in Bosnia and Herzegovina, Macedonia and even Serbia.

Productivity, exports and industrialization: As a consequence of political stability and economic reforms, countries in transition relatively quickly start to experience growth of production and of GDP. Also, in a relatively short period of time, exports start to grow as does the industrial production. In the course of a decade or so, successful economies in transition will surpass, sometimes by quite a lot, their pre-transition GDPs, exports and industrial production. Employment, however, tends to decrease and then stagnate for a longer period of time, so that transitional economies tend to grow by high growth of productivity. There are differences across countries so that employment and unemployment rates may differ significantly, but once some of these factors are controlled for, a clear pattern of productivity driven recovery and growth can be associated with the process of transition. This is well captured by Figure 1 that shows actual growth of GDP, employment and productivity in the NMS. This may be termed catching-up growth in transition. The line for GDP growth can be seen as representing quite well the growth of industrial production and of exports too. Indeed, the latter two tend to grow even faster then GDP, which suggests even faster growth of productivity in industry and in the exporting sector.

Figure 1

GDP, employment and productivity in NMS-8

1995 = 100



Source: wiiw Database incorporating national statistics; wiiw estimates (weighted averages for NMS-8).

This process of catching up has however been delayed in SEE and has been going on for the most part only since the turn of the century. In that, while GDP is growing and the growth is perhaps even accelerating, reindustrialization and the growth of exports are still lagging behind. Similarly, the decline of employment is continuing in many countries and there are unemployment levels that are very high in a number of countries.

Macroeconomic stability: As a rule, macroeconomic stability has proved to be less of a problem in transition than was perhaps initially expected. There are a number of reasons why that is so. One is growth of production and of GDP in general. The additional reason is significant increase of imports that tends to have a stabilizing effect if the monetary policy is not mismanaged. Finally, and perhaps the most importantly, decrease of employment and increase in unemployment tend to produce deflationary rather than inflationary pressures once fiscal policy is put under control.

In this respect, the SEE has proved to be an exception in several instances for different reasons. In some case, high fiscal expenditures, often due to the war effort, have proved to be unsustainable and have led to hyperinflation (e.g., in Serbia), in other cases monetary policy got out of hand with high inflation as the consequence (e.g., Bulgaria in 1996-1997), while yet other cases the collapse of the banking sector led to inflationary and exchange rate problems (e.g., Albania in 1996-1997 and

Croatia in 1998-1999). Inflation is still a problem in some countries and that will be looked at in more detail below.

Sustainability of macroeconomic imbalances: Though inflation may be under control and exchange rate may be stable, macroeconomic imbalances may develop that may threaten the stability of the nominal variables. In transition, three macroeconomic imbalances have proved to be sustainable and to be improving over time. External balances tend to deteriorate initially, with imports outperforming exports, partly because of the significant inflows of foreign financial resources. Still, with the recovery of exports, the sustainability of the foreign obligations has proved to be less of a problem than it was perhaps initially anticipated. Fiscal balances have proved to be more of a problem, though relatively high and sustained growth rate has helped the sustainability of the various budgets. Perhaps the most important imbalance has been that in the labour markets. As already argued, due to the catch-up growth based to a large extent on rising productivity, employment tends to recover more slowly and unemployment in some cases stays at a high level for a prolonged period of time.

In the Balkans, fiscal imbalances have proved to be a problem in some countries where the public sector has collapsed for various reasons. Over time, however, fiscal balances have been restored and have proved to be for the most part sustainable. External balances may prove to be more of a problem because export capacity has been recovering only slowly in most of the region. Growth of export of services has been helpful in a number of cases, but the recovery of exports of goods has been visible only lately. Finally, in some part of the Western Balkans, unemployment is at very high levels and is certainly the key economic, political and social problem.

Policies and institutions: Initially, policies were believed to be the most important, while institutions were expected to adjust to reforms. After a decade of transition, it became an orthodoxy that institutions are important and that institution building and structural reforms are the key to successful transition. In the case of the NBS, institution building was part of the EU integration, so once they were securely on the path to join the EU, reforms of policies and institutions could go together.

In the case of the Balkans, both reform policies and institution building took often a different pat, in some cases because the prospect of EU integration was not very realistic. In fact, Western Balkans is probably the only part of Europe that has disintegrated from the EU before its current process of integration started. In most countries, there was lack of determined commitment to policies of transition and there was a reluctance to reform the institutions. That was mostly the consequence of domestic politics, but it was also in part the consequence of slow EU integration.

4. Prospects for EU integration

Since 2003, when Western Balkans were promised the prospect of membership in the EU, and 2004, when Bulgaria and Romania were seen as joining the EU in 2007, the expectations have been building up that the EU Balkan enlargement will start at the beginning of 2007. The main recent change has been the weakening of the EU commitment to enlargement in Southeast Europe. It is, of course, hard to break promises, all the more so when they have been made repeatedly to the whole region. There is growing uncertainty about the meaning of that commitment. The EU has since decided to determine its ‘absorption capacity’: an unfortunate term lacking any clear meaning. Perhaps the kindest interpretation is that the EU needs to reassess its decision-making structures since current arrangements do not cover the union comprising of more than 27 countries. Assuming that interpretation is correct, the problem is to be seen more as a political rather than a fundamental issue. Nonetheless, in view of this increased uncertainty, it becomes more difficult to predict the course that Balkan enlargement will take. In Table 1 the current forecast has been laid out.

Table 1

SEE EU Accession Forecast

	SAA	**Negotiations**	**EU**	**Euro**
Bulgaria	1995 (EA)	1999	2007	2009
Romania	1995 (EA)	1999	2007	2012
Croatia	2005	2005	2009	2011
Macedonia	2004	2006-2007	2012-2013	2015
Albania	2006	2009	by 2015	by 2017
Bosnia and Herzegovina	2007	2009	by 2015	by 2017
Serbia	2007	2009	by 2015	by 2017
Montenegro	2007	2009	by 2015	since 2002
Kosovo	2007	2010	after 2015	since 2002

The chances are that Bulgaria and Romania, which signed their Europe Agreements (EA) already in 1995, will be welcomed into the EU on 1 January 2007. Croatia is expecting to join around 2010, once the discussions on the Union's 'absorption capacity' and the new financial framework are over. Everything else is highly uncertain. Most of the countries in the Western Balkans will manage to negotiate stabilization and association agreements (SAA) with the EU by the end of 2006 or in 2007. It is increasingly uncertain, however, whether Macedonia will start negotiating for its membership with the EU at the same time. The expectations are that Turkey will not achieve too swift a progress towards EU membership. Indeed, the debate on the 'absorption capacity' will mostly centre on the prospects of Turkish membership. In any case, 2015 looks increasingly unlikely as the date for Turkey's entry into the EU.

The accession of Bulgaria and Romania will come with certain restrictions in order to push the reforms there even after they have become members and to perhaps minimize possible negative effects that their accession may have on them and on the EU member states. Some of these restrictions will refer to labour mobility as the issue of free movements of people and of migration in general has become a concern in most EU member states. Other restrictions will have to do with the justice and home affairs issues.

In the case of Croatia and even more so of Macedonia, the speed of EU integration will mostly depend on the institutional transformation of these countries. No serious economic issues for the member states will be raised by the accession of these two states. The remaining countries of the Western Balkans will not be joining the EU before 2015, at least from the current standpoint.

When it comes to the issue of effects of EU Balkan enlargement on the Balkan countries and the EU, it can be argued, on the experience of the 2004 Eastern enlargement, that most of the effects tend to be internalized already during the process of the implementation of the association agreements, of negotiations and of legal harmonization. No dramatic new consequences follow after these countries enter the EU. Thus, for both the EU and the aspiring new member states, the process of integration is more important then the actual act of integration. During this process of integration, the two main consequences are those on trade and investment on one side and on stability on the other. In general, association agreement bring in significant trade liberalization that tends to push up trade between the EU and the association countries. Investments also tend to increase, sometimes dramatically, because of the decline of risk that goes together with the increased certainty of eventual membership. In addition, macroeconomic and social stability are enhanced because of the swift institutional change, sustainable democratization, and lack of major economic turbulences or crisis.

The benefits are shared by the transforming countries and by the EU member states. The former tend to enjoy steady and often fast growth while the latter get new markets for their products and investments. The impact on the labour markets in both sets of countries tends to be positive too, though that is a more controversial topic.

5. Recent developments

In the recent few years the economic developments in SEE have continued to improve. In a way it can be argued that the year 2000 in the SEE is comparable to the year 1995 in the NMS. In other words, transition is the SEE is lagging by about 5 years behind that in the NMS. Of course, in some countries the recovery started earlier while in the others it took a while longer. On average, however, the year when transition turned around for the region as a whole is 2000.

Since 2004, all the SEE economies (except Kosovo) are growing and in some cases growth is accelerating (see Table 1). Not only GDP but also industrial production is growing as are exports. On top of that, foreign investments are being fuelled by the speed up in the privatization process and by the improved business conditions and also prospects for EU integration. In the last year or so, some policy issues have emerged due to the need to reform monetary policy and to take a fresh look at fiscal policies. In some cases, the issue of foreign debt sustainability has presented problems.

As can be seen from Table 1, macroeconomic imbalances are still significant. Unemployment rates are high, except in Romania, while current account deficits are big, except in the last couple of years in Macedonia. Trade deficits are eve bigger, especially if only trade in goods is taken into account. By contrast, inflation is less of a problem, though Serbia and Romania are still reporting relatively high rates, with the Serbian inflation accelerating in the last couple of years. Overall, however, these developments look sustainable, at least in the medium run.

The prospects seem favourable too. If the region continues to grow at the pace of the last few years or the growth even accelerates, which is possible given that a number of countries are still in the recovery phase of their development, the catching up process that has been seen in the NMS will be repeated in the SEE. That will lead to the easing of the macroeconomic imbalances and especially of that in the labour markets. Already in some countries, Bulgaria and Croatia, unemployment rates are going down and though the labour market situation is by no means satisfactory, it can be expected to be improving before the time of the actual accession of these countries to the EU.

Table 2

Overview developments 2004-2005 and outlook 2006-2007

	GDP real change in % against previous year				Consumer prices change in % against previous year				Unemployment, based on LFS[1)] rate in %, annual average				Current account in % of GDP			
	2004	2005	2006	2007 forecast	2004	2005	2006	2007 forecast	2004	2005	2006	2007 forecast	2004	2005	2006	2007 forecast
Bulgaria	5.7	5.5	5.5	5	6.1	5.0	8	5	12.0	10.1	9	8	-5.8	-11.8	-14.1	-13.2
Romania	8.4	4.1	5.0	4.8	11.9	9.0	8.5	8.0	8.0	7.2	7	7	-8.4	-8.7	-9.5	-9.5
Croatia	3.8	4.3	4	4	2.1	3.3	3.5	3	13.8	12.7	12.5	12	-5.1	-6.3	-6.5	-6.2
Macedonia	4.1	3.6	3.5	4	-0.4	0.5	3	3	37.2	37.3	37	37	-7.7	-1.4	-3.1	-2.9
Turkey	8.9	7.4	5.5	5.5	8.6	8.2	9.0	6.0	10.3	10.3	11.5	11.0	-5.2	-6.4	-7.0	-6.5
Albania [4)]	6.7	5.3	5.2	5.8	3.0	2.4	2.5	2	14.4	14.2	14	14	-4.7	-6.7	-6.8	-6.5
Bosnia and Herzegovina [4)]	6.0	5.5	6	6	0.7	2.9	6	4	43.9	45.4	46	46	-20.9	-22.5	-20.1	-18.2
Montenegro	3.7	4.1	5	5	2.4	2.3	3	3	27.7	28.0	28	28	-7.8	-8.6	-9.1	-7.9
Serbia	9.3	6.3	4	4	11.4	16.2	15	15	18.5	20.8	22	23	-12.6	-8.8	-10	-10

5.1. Growth, trade and balances

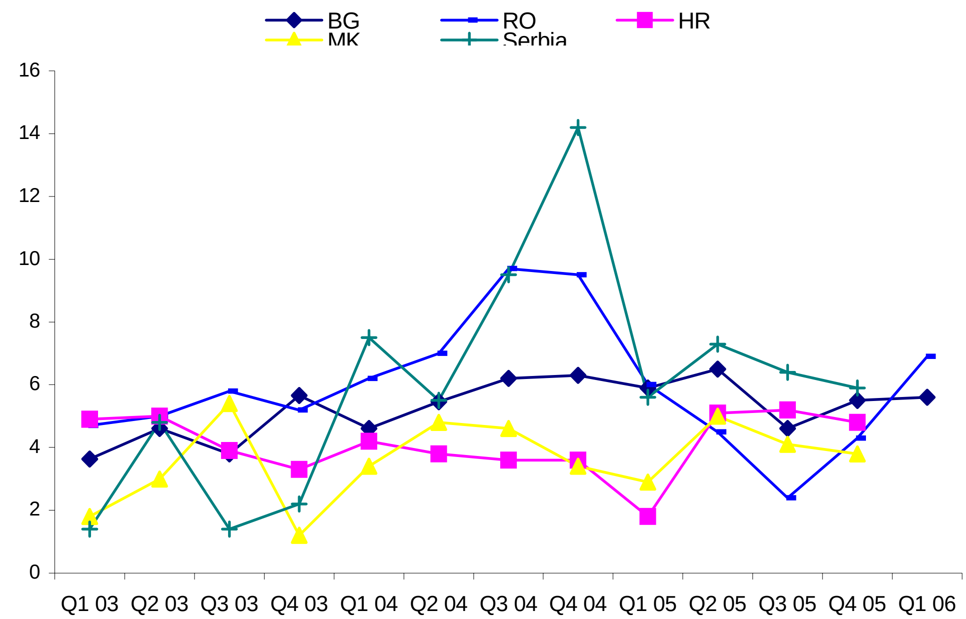
The main source of growth has been domestic demand since the beginning of transition in SEE, and that continues to be the case. Exports of goods have been recovering only recently, while in some countries exports of services, i.e., tourist trade is proving to be crucial drivers of growth. Both consumption and investment are growing strongly in the last couple of years. Private investments are being matched by growing public investments, primarily in infrastructure. There are indications that banks, which are increasingly and in some cases exclusively in foreign ownership, are increasing loans to enterprises, while lending to households remains strong.

The recorded growth rates and growth prospects show some divergence across the region, however. Bulgaria continues to post strong growth rates and the growth prospects of Romania are improving after a slowdown in 2005 (Figure 2). These two countries should get an additional boost once they join the EU and the assessments of their investment risks improve. In the Western Balkans, Bosnia and Herzegovina continues to record growth rates above 5%. Similarly, in Albania GDP is still rising above 5%; however, the long-term prospects may be closer to the latter figure. In the rest of the Western Balkans, growth is not that impressive and has been actually slowing down in a number of cases. Among the better performers are Croatia and Montenegro, with growth rates ranging between 4 and 5%. Serbia also seems to be experiencing accelerated growth that may topple 5% in 2006, after a slowdown in the second part of the 2005 and the first quarter of 2006. Macedonia, however, may still fail to grow at a rate above 4%. The worst growth rates are to be found in Kosovo, though the data there leave much to be desired.

Figure 1

Quarterly GDP, 2003-2006

real change in % against preceding year



Source: wig Monthly Database incorporating national statistics.

In those cases where growth is still comparatively unimpressive that can at least be partly attributed to the slow recovery of industrial production (Figure 3). In Serbia, industrial production started on a slow note after the beginning of transition in the year 2000. Last year's growth was faster, and the prospects for this and coming years are improving as the time passes by, though all that is from a very low level. In Macedonia industrial production has also been posting low growth rates. In both countries, sustained reindustrialization still does not seem to be taking place. As was to be expected, overall GDP growth also raises industrial production; this, however, is mostly an increase in output of existing firms and industries. There are few signs of a wider range of products or improvements in quality. The same holds true for Montenegro, although growth rates are currently better there. The situation is not much different throughout the Western Balkans.

Growth of labour productivity is, as a rule, faster than growth of production, which suggests that restructuring is continuing (compare Figures 3 and 4). That is the consequence of privatization and also of the tightening of the budget constraint because it is increasingly more difficult to obtain subsidies or preferential access to financial resources. Overall, however, the process of reindustrialization that has been so characteristic of transition in Central Europe is still not much in evidence in Southeast Europe.

Figure 2

Gross industrial production in Southeast Europe, 2003-2006

year-on-year growth in %, 3-month moving average

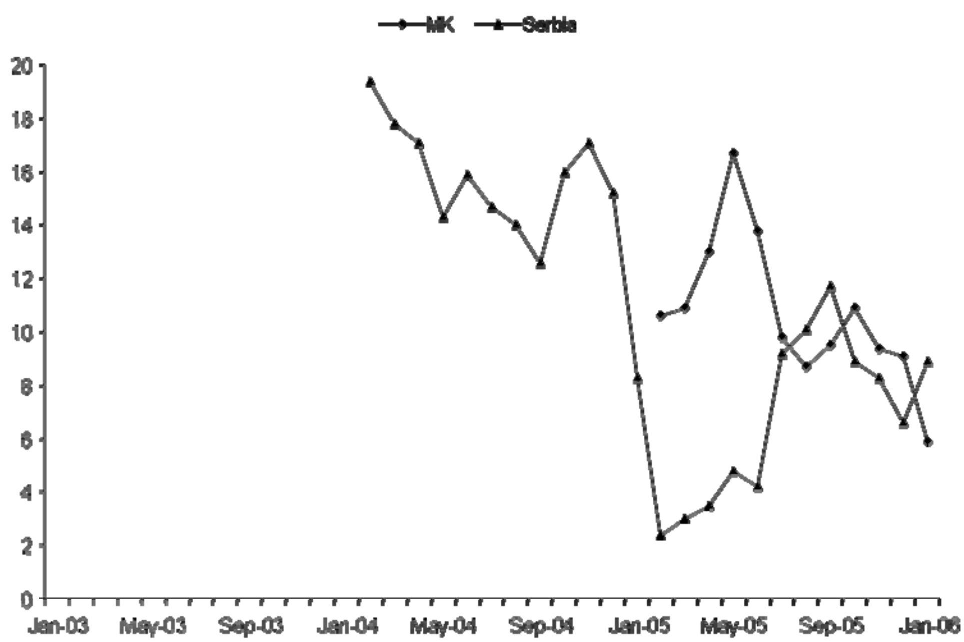
* From 2005 new methodology.

Source: wig Monthly Database incorporating national statistics.

Figure 3

Labour productivity in industry, 2003-2006

year-on-year in %, 3-month moving average



Source: wiiw Monthly Database incorporating national statistics.

One of the specifics of the transition in the SEE is the relatively poorer performance when it comes to foreign trade. The export capacity has been growing in the last few years though the demand for imports is continuing to grow too. The current year, 2006, began with trade balances deteriorating across the region (Table 2). Last year, 2005, in most of the Western Balkans, exports increased more rapidly than imports. In the Eastern Balkans (Romania and Bulgaria), the trend was different. This year the trends in East and West have converged (except for Bosnia and Herzegovina and perhaps Croatia). For the most part, this is attributable to the uninterrupted rapid growth of credits. As a result, trade deficits that were already traditionally high have continued to deteriorate.

Table 3

Foreign trade in Southeast Europe

cumulated data within respective period, based on customs statistics

Exports total (fob)

		2004				2005				2006
		I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q	I Q
Albania	EUR mn	109	238	361	**487**	121	264	398	**530**	144
	change in %	5.3	17.1	22.4	**22.0**	11.1	10.8	10.1	**8.8**	19.2
B&H	EUR mn	316	667	1037	**1441**	397	898	1399	**1934**	551
	change in %	22.9	18.5	18.4	**21.4**	25.8	34.6	34.9	**34.2**	38.9
Bulgaria	EUR mn	1718	3615	5798	**7985**	2081	4386	6800	**9454**	2667
	change in %	5.0	11.2	15.9	**19.7**	21.1	21.3	17.3	**18.4**	28.2
Croatia	EUR mn	1452	3042	4726	**6452**	1492	3334	5166	**7092**	1950
	change in %	6.5	12.8	18.1	**18.0**	2.7	9.6	9.3	**9.9**	30.7
Macedonia	EUR mn	293	598	961	**1348**	368	774	1189	**1640**	375
	change in %	6.7	1.4	7.8	**11.5**	25.6	29.4	23.8	**21.7**	2.0
Romania	EUR mn	4337	9033	13995	**18935**	5095	10527	16466	**22255**	6213
	change in %	14.8	20.4	20.9	**21.3**	17.5	16.5	17.7	**17.5**	22.0
Serbia	EUR mn	523	1169	1948	**2867**	744	1651	2591	**3684**	944
	change in %	-9.1	-0.3	7.5	**17.5**	42.3	41.2	33.0	**28.5**	26.8

Imports total (cif)

		2004				2005				2006
		I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q	I Q
Albania	EUR mn	380	827	1302	**1849**	417	950	1494	**2107**	540
	change in %	-3.2	2.2	7.2	**11.8**	9.7	14.9	14.8	**14.0**	29.6
B&H	EUR mn	935	2157	3425	**4758**	1049	2477	3950	**5715**	1045
	change in %	6.3	8.7	9.8	**11.9**	12.1	14.8	15.3	**20.1**	-0.3
Bulgaria	EUR mn	2412	5331	8209	**11620**	2962	6592	10404	**14682**	3933
	change in %	15.8	17.4	18.4	**20.9**	22.8	23.6	26.7	**26.4**	32.8
Croatia	EUR mn	2919	6483	9855	**13342**	3093	7136	10914	**14922**	3936
	change in %	6.1	8.4	7.4	**6.3**	6.0	10.1	10.7	**11.8**	27.3
Macedonia	EUR mn	493	1086	1666	**2358**	535	1240	1870	**2593**	546
	change in %	-0.6	7.6	11.1	**15.6**	8.4	14.1	12.3	**10.0**	2.1
Romania	EUR mn	5482	11992	18644	**26281**	6669	14740	23066	**32569**	8567
	change in %	20.7	22.2	23.2	**24.0**	21.6	22.9	23.7	**23.9**	28.5
Serbia	EUR mn	1801	3846	5826	**8663**	1526	3574	5838	**8354**	2028
	change in %	17.6	23.4	24.2	**31.2**	-15.3	-7.1	0.2	**-3.6**	32.9

Trade balance

		2004				2005				2006
		I Q	I-II Q	I-III Q	I-IV Q	I Q	I-II Q	I-III Q	I-IV Q	I Q
Albania	EUR mn	-271	-588	-940	**-1363**	-296	-686	-1096	**-1578**	-396
B&H	EUR mn	-620	-1490	-2388	**-3317**	-651	-1579	-2551	**-3781**	-494
Bulgaria	EUR mn	-694	-1717	-2411	**-3635**	-881	-2206	-3604	**-5228**	-1266
Croatia	EUR mn	-1466	-3441	-5128	**-6890**	-1601	-3802	-5748	**-7830**	-1986
Macedonia	EUR mn	-201	-488	-705	**-1010**	-167	-466	-681	**-953**	-171
Romania	EUR mn	-1146	-2959	-4649	**-7346**	-1575	-4213	-6600	**-10313**	-2354
Serbia	EUR mn	-1278	-2677	-3878	**-5796**	-781	-1923	-3247	**-4670**	-1084

Source: wiiw Monthly Database incorporating national statistics.

This should not be all that worrisome given the strong export growth still prevailing in most countries. Thus, import growth and the widening trade deficit are, as a rule, signs of continuing strong growth rather than symptoms of deteriorating competitiveness or a shift in external demand away from the region's exports. In addition to the growth of exports of goods, tourist trade is also growing strongly. The Balkans is very attractive because of its mountains and of its seas as well as of its cultural heritage. Thus, tourism is an important sector in Croatia, Montenegro, Bulgaria and to a lesser extent in all other countries. But the issue of export capacity undoubtedly remains together with the issue of the sustainability of the external balances in view of growing foreign debts and liabilities in some countries.

5.2. Stability is manageable

Inflation has not been a problem in the region, though it has been creeping upwards in most countries in the last year or so (Table 3). Apart from Serbia and Romania, which still have relatively high inflation rates, inflation is accelerating in Bulgaria and is somewhat higher in most other countries. In most cases, however, that is on account of the very low rates inherited from the past. Macedonia is thus emerging from what was to all intents and purposes deflation. Bosnia and Herzegovina is also seeing its inflation rate accelerate somewhat, as is Croatia. Most of these higher inflation rates are being pushed up by increasing oil prices and one-off price adjustments. In Bosnia and Herzegovina the introduction of value-added tax (VAT) at the beginning of the year is having the customary effect, as it is in Montenegro.

Table 4

Consumer price inflation

change in % against preceding year

	2000	2001	2002	2003	2004	2005 1)	2005	2006	2006	2007
							1st quarter		forecast	
Bulgaria	10.3	7.4	5.8	2.3	6.1	5.0	3.8	8.0	8	5
Romania	45.7	34.5	22.5	15.3	11.9	9.0	8.8	8.6	8.5	8.0
Croatia 2)	6.2	4.9	1.7	1.8	2.1	3.3	3.3	3.5	3.5	3
Macedonia	5.8	5.5	1.8	1.2	-0.4	0.5	-0.4	2.7	3	3
Turkey 3)	54.9	54.4	45.0	25.3	8.6	8.2	8.4	8.1	9.0	6.0
Albania	0.1	3.1	5.2	2.2	3.0	2.4	2.2	1.4	2.5	2
Bosnia & Herzegovina 4)	4.9	3.2	1.3	1.1	0.7	2.9	.	.	6	4
Montenegro	20.2	21.8	16.0	6.7	2.4	2.3	1.2	2.9	3	3
Serbia	79.6	93.3	16.6	9.9	11.4	16.2	16.0	14.8	15	15

Notes: 1) Preliminary. - 2) Up to 2001 retail prices. - 3) From 2004 new methodology. - 4) Costs of living.

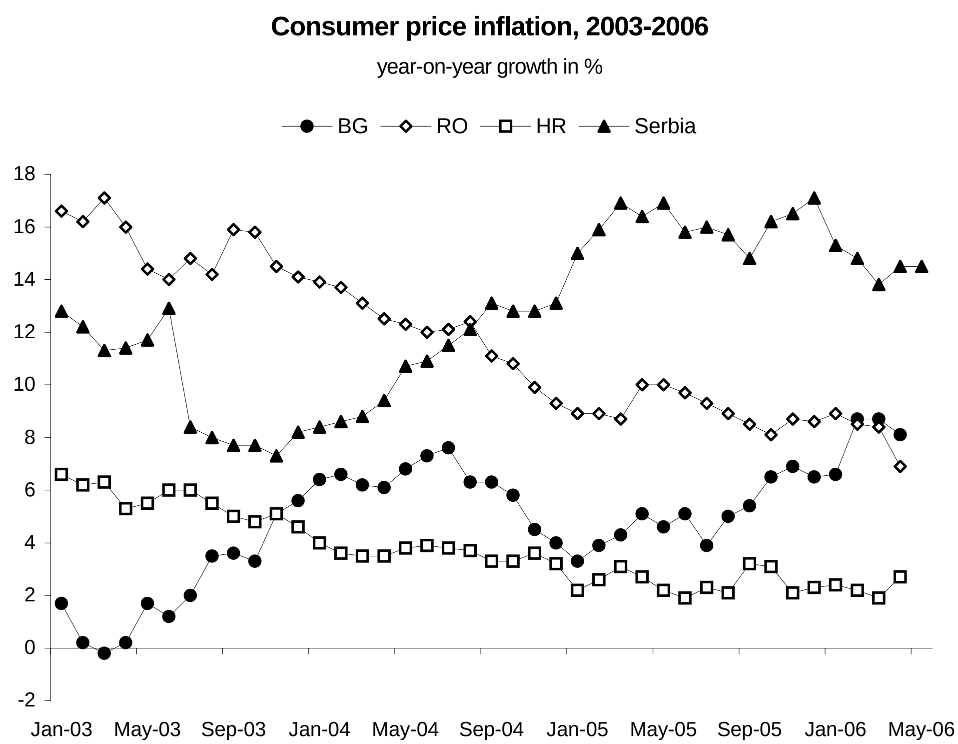
Source: wiiw Database incorporating national statistics, forecast: wiiw.

In Romania, persistent rates of inflation that are above those targeted by the National Bank, that is trying to pursue inflation targeting, may lead to credibility problems for the central bank. In Bulgaria, inflation is harder to keep down because of the currency board regime n place. The only practical instrument that it can rely on is further fiscal adjustment; it can either (a) run higher fiscal surpluses or (b) perhaps run public debt down; however, in a country that has gone through a period of very low wages for almost a decade, the thought of fiscal austerity rouses little enthusiasm. Some degree of nominal convergence may thus be inevitable. As yet it poses no competitiveness-related problems because of the legacy of low exchange rate levels from the past. Furthermore, high growth rates prevent an increase in debt-to-GDP ratios so the country does not have to face the issue of sustainability at the present juncture.

Serbia and Croatia face somewhat tougher problems with respect to macroeconomic stability, although they are different. Croatia has been following a fiscal stabilization track for the past two or three years. Progress has been steady, although the fiscal deficit has remained somewhat higher than originally planned. However, with growth being somewhat higher than expected and inflation nudging slightly upwards, the fiscal deficit may just exceed 3% this year: a comparatively good figure given Croatia's track record. The other significant imbalance is that of the current account, which was higher than planned last year. If it stays at a similar level this year, that may help to stabilize Croatia's debt-to-GDP ratio, which is currently quite high and constitutes the key constraint on faster growth.

It is also to be noted that Croatia has not been shaken by the recent turbulence in the emerging markets. For the most part, this is because the current turbulence has mainly affected the stock markets rather than bonds and loans. Croatia's stock market is small and not of great interest to foreign investors. Thus, the main risk is that yields on bonds and interest rates on credits will start rising, in which case refinancing costs will be a problem for both the public and private sectors in Croatia. At present, there are few indications of problems arising in the short term.

Figure 4



Source: wiiw Monthly Database incorporating national statistics.

The situation in Serbia is quite different. Inflation is essentially a means of rebalancing the public sector – and the fiscal sector in particular. Inflation has not only helped the revenue side of the budget, but it has also led to a cut in real expenditures as reflected in the decline of the latter's share in GDP. However, this cannot be perpetuated at the cost of losing complete control over inflation. On the other hand, a more decisive cut in public expenditures to keep inflationary pressures under control is hardly feasible given the Serbian government's current weak position. As a consequence, expectations seem to be that inflation will settle down at around 15% year-on-year. That figure is based on the assumption that expenditures will not be used to buy support for the government. Otherwise, inflation will accelerate.

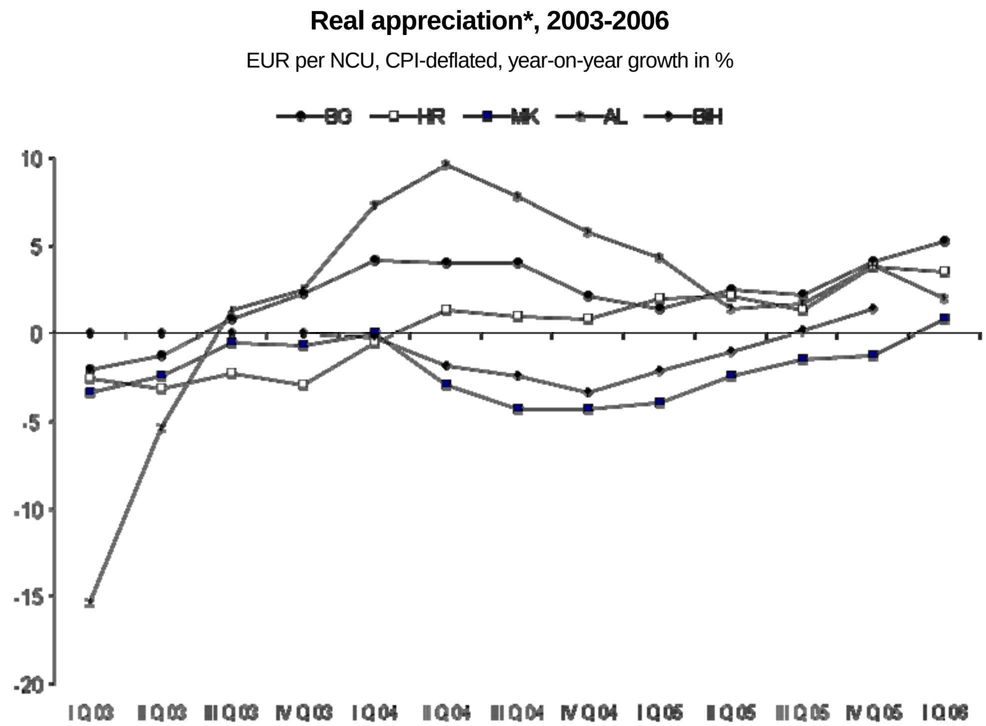
In Romania, the central bank is trying to control inflation and meet its concern over the deteriorating current account. In Romania and Serbia there is some debate on the possible impact that high inflows of foreign loans could have on inflation. Most studies seem to indicate that an increase in foreign loans has only a relatively mild impact on inflation. The main impact is on trade and current account balances. Indeed, increased inflows of foreign currency push the exchange rate up and encourage more imports with a stabilizing effect on inflation. In the case of fixed exchange rates, this mechanism cannot work and thus significant stabilization efforts are called for. In addition, it is often necessary to run high primary fiscal surpluses; it may also prove essential to increase costs for banks and debtors alike. If, however, wages cannot be effectively controlled, especially in a high growth setting, inflation may prove a problem. In Romania, the introduction of inflation targeting aims at containing inflationary expectations, while in Serbia the government does not feel that inflation is a problem at all, at least not thus far.

5.3. Monetary policy is a puzzle

Though inflation has not been a pressing problem in the region since the year 2000, worries have been voiced that fast growth of money and credits may lead to macroeconomic imbalances that may destabilize prices or exchange rates or both. That has challenged monetary authorities in a number of countries. The preferred instrument has been the increase of reserve requirements both as a prudential and as a measure of capital controls, as much of the credit expansion is coming from the inflows of foreign currency. With punishing reserve requirements in some countries, credit growth continues throughout the region with the monetary authorities struggling to cap it, so far with little success in most cases. The reason seems to be that households are not very 'elastic' when it comes to interest rates, partly because they are not really indebted. Similarly, businesses seem ready to borrow at high rates because they expect relatively high growth. Furthermore, opportunities to borrow directly from abroad are increasing, thus rendering the prudential measures and capital controls mostly ineffective.

In the SEE the preferred exchange rate regime is that of one or the other type of fixing. Montenegro and Kosovo use euro, Bulgaria and Bosnia and Herzegovina rely on currency boards based on euro; Macedonia has a strict peg to euro, while Croatia allows some small mostly seasonal fluctuations of its currency that is for all practical purposes pegged on euro. Serbia is planning to move to inflation targeting, but manages its currency heavily at the moment, while Romania has adopted inflation targeting in the second half of 2005, but still intervenes in the foreign exchange market. For the region as a whole, adopting euro is practically the only realistic exit strategy because the households and businesses do not seem to put too much tryst in domestic currency and in the central bank. This is visible from the data on savings, which are overwhelmingly in euro.

Figure 5



* Increasing line indicates real appreciation. Serbia: based on end-of-month exchange rates.

Source: wiiw Monthly Database incorporating national statistics.

Throughout the region real exchange rates are appreciating (Figure 6) partly because of the fixed exchange rate regimes and partly because of nominal appreciation that is a consequence of high inflows of foreign currency. This saps inflationary pressures and could be the support needed for a more relaxed monetary policy, if the monetary authorities were to decide to go in that direction. In

Serbia, real exchange appreciation may have become the key instrument to bring the inflation down. That, however, bodes ill for the growing trade deficit. In Romania, real appreciation has become more moderate since the last quarter of the last year.

Private and overall debt has continued to climb in most countries, though perhaps more slowly than before (Figures 6 and 7). In those cases where central banks have adopted a more relaxed attitude towards the banks' lending activities, interest rates have dropped and credit inflows have abated (Figure 8). Indeed, partly because of the interest rate convergence, foreign capital inflows have undergone reversal in Turkey and perhaps in Hungary, the two emerging economies in Europe that were affected by the recent tightening of liquidity in the global economy. That may turn out to be a problem in SEE also if the monetary tightening in dollar and euro zones continues.

Figure 6

Share of total foreign debt in GDP, 2000-2005

in per cent

Source: National Banks of the respective countries.

While foreign debt does continue to increase in a number of countries, e.g., in Croatia, Serbia, Bulgaria, Romania and to a much lesser extent in Macedonia, debt to GDP ratios are not growing or are growing only marginally (see Figure 7). This is mainly because of fast growth, which hides perhaps a potential vulnerability, because debt to GDP levels could increase significantly and prove not to be sustainable in a number of cases if growth were to disappoint. The fastest growing part of the foreign debt is that of households in most countries (see Figure 8). Though that worries the central banks, private debt is still relatively low in the region, with the possible exception of Croatia.

Figure 7

Share of private foreign debt in total foreign debt, 2000-2006

in per cent

*) 2006 data refer to February 2006.

Source: National Banks of the respective countries.

Figure 8

Minimum interest rates, 2000-2006

nominal NB leading rate in % p.a.

Source: wiiw Monthly Database incorporating national statistics.

As can be checked in Figure 9, interest rates have gone down in most countries in the region reflecting the decline of risks to the financial system and also the increased credibility of price stability. Low interest rates on central banks operations are also an indication that central banks are trying to control the growth of money through the use of prudential or quantitative controls rather than through the operations in the money markets. Given the level of currency substitution in some countries and given the choice of the exchange rate regime in most countries, it may be difficult for any of the central banks, with the possible exception of Romania, to try to increase their credibility and to be more active in the money market. That, however, does not mean that the reliance on the reserve requirements to check the credit expansion is a good choice.

5.4. Foreign investments

Inflows of foreign investments have been stronger in some countries, while other countries continue to receive little or even decreasing amounts of foreign resources. The stock of FDI in the SEE is still lower than that in the NMS (see Table 4), but it is certainly catching up. It is conceivable that foreign ownership of assets may be even high in this region than in the more developed countries of Central Europe in the future.

Table 5

Inward FDI stock as a percentage of GDP

	1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Czech Republic	22.6	31.6	38.6	45.2	47.1	44.7	48.5	51.2
Hungary	42.4	51.1	48.6	53.2	49.7	52.1	56.7	58.9
Poland	12.6	16.5	19.8	22.0	22.0	24.0	30.8	29.1
Slovakia	12.5	16.6	23.3	27.1	31.8	32.8	34.1	34.8
Slovenia	12.6	13.2	14.8	13.4	16.6	20.6	21.2	21.9
New Member States-5	**18.8**	**24.3**	**27.4**	**30.6**	**31.9**	**33.7**	**38.9**	**38.9**
Estonia	31.6	47.0	47.9	53.5	54.0	68.2	81.6	98.4
Latvia	22.4	26.3	26.8	28.5	27.1	26.6	30.4	31.9
Lithuania	14.0	20.2	20.4	22.3	25.4	24.1	25.9	26.5
New Member States-8	**18.9**	**24.6**	**27.5**	**30.7**	**31.9**	**33.9**	**39.0**	**39.4**
Albania	13.2	11.1	12.9	16.3	18.9	20.4	21.9	22.8
Bosnia and Herzegovina	1.6	4.9	7.5	9.2	13.4	23.4	28.5	30.6
Bulgaria	12.0	19.7	17.7	20.6	21.3	28.0	34.6	39.8
Croatia	8.6	13.7	16.2	21.3	25.2	27.7	33.3	42.6
Macedonia	8.5	10.4	14.8	27.0	28.9	31.3	32.4	32.4
Romania	10.2	16.3	17.3	19.3	15.4	18.4	24.7	25.4
Serbia	.	5.7	3.9	9.2	10.6	16.6	19.8	24.5
Montenegro	.	.	.	0.9	7.7	9.7	12.3	34.6
Southeast Europe	**10.6**	**14.8**	**15.9**	**18.2**	**18.0**	**22.0**	**27.3**	**30.6**
Russia	5.0	8.2	12.4	17.6	18.6	20.3	18.3	16.0
Ukraine	6.1	9.2	12.3	12.8	12.7	13.6	13.5	22.2

Source: wiiw

The flow of foreign investments is not uniform across the region. Romania, Serbia, Montenegro and Croatia have recorded higher FDI and other foreign investment inflows in 2005, while others have seen decreases (Table 5). Overall, over the whole transition, foreign investments have been avoiding this region and are only latterly starting to rush in. That is partly because of delayed privatization, relatively high risks and disintegrated markets. With the stabilization and institutional transformation of the region and with the improved prospects for EU integration, investment risks are declining and foreign investors are taking advantage of this emerging and fast growing region. There is an expectation that growing regional integration, especially after the launching of the CEFTA, investors will start developing regional strategies and that should increase the inflow of Greenfield investments that have been conspicuously absent until very recently.

Table 6

Net capital flows (EUR million)

	Bulgaria			Romania		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**
Capital inflow transfer	**2511**	**3005**	**2629**	**4491**	**9054**	**10801**
Capital transfer	-0.2	-0.1	-1.0	188	512	584
FDI	1827	2244	1856	1910	5127	5208
Portfolio	-191	-563	-757	529	-416	685
Financial derivatives	.	.	.	.	.	-24
Other capital (loans)	875	1324	1531	1864	3831	4348
Destination of capital inflow	**2447**	**2625**	**2855**	**4080**	**9938**	**12322**
Current account	1630	1131	2531	3060	5099	6891
Increase reserves	817	1493	324	1020	4839	5431
Errors & omissions	**-64**	**-380**	**226**	**-411**	**884**	**1521**
	Croatia			**Macedonia**		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**
Capital inflow transfer	**4232**	**2385**	**3718**	**200**	**344**	**410**
Capital transfer	72.4	23.1	50.9	-6	-4	-2
FDI	1695	709	1185	85	126	78
Portfolio	869	245	-1049	3	12	189
Financial derivatives	.	.	-88	118	210	144
Other capital (loans)	1595	1409	3619	.	.	.
Destination of capital inflow	**3102**	**1501**	**2785**	**177**	**350**	**399**
Current account	1866	1458	1964	132	334	66
Increase reserves	1236	43	822	45	16	334
Errors & omissions	**-1130**	**-884**	**-933**	**-23**	**6**	**-11**
	Albania			**Bosnia & Herzegovina**		
	2003	**2004**	**2005**	**2003**	**2004**	**2005**
Capital inflow transfer	**318**	**415**	**423**	**1333**	**1304**	**1582**
Capital transfer	139	106	99	411	393	360
FDI	158	269	209	338	488	240
Portfolio	-20	5	-2	.	.	.
Other capital (loans)	41	35	116	584	423	982
Financial derivatives	.	.	.	.	.	.
Destination of capital inflow	**449**	**522**	**579**	**1605**	**1783**	**2073**
Current account	361	286	454	1444	1437	1696
Increase reserves	88	236	125	162	346	377
Errors & omissions	**131**	**107**	**156**	**273**	**479**	**491**

(Table 6 contd.)

Table 6 (contd.)

	Montenegro			Serbia		
	2003	2004	2005	2003	2004	2005
Capital inflow transfer	**87**	**36**	**365**	**2219**	**2486**	**3538**
Capital transfer	.	.	.	.	.	.
FDI	39	51	375	1204	777	1196
Portfolio	1	6	5	.	.	.
Other capital (loans)	47	-20	-14	1015	1709	2342
Financial derivatives	.	.	.	.	.	.
Destination of capital inflow	**56**	**97**	**319**	**2178**	**2635**	**3324**
Current account	102	120	141	1362	2274	1687
Increase reserves	-46	-22	178	815	360	1637
Errors & omissions	**-31**	**61**	**-46**	**-42**	**149**	**-214**

Source: wiiw Database incorporating national bank statistics.

5.5. Fiscal balances improving

Throughout the region fiscal balances continue to be prudent. Given growing trade deficits, it can be argued that more fiscal consolidation would be desirable; that approach, however, has been difficult to sell in a region with relatively low employment and high unemployment rates. In fact, fiscal authorities are apparently planning to relax their tough fiscal stance in a number of cases. A characteristic example is Macedonia where for a number of years fiscal consolidation was the government's paramount priority. This year, however, it is planning a modest fiscal deficit; it seems that this easing of fiscal policy will continue.

Table 7

General government budget balance, in % of GDP 1)

	2000	2001	2002	2003	2004	2005 2)	2006	2007
							Forecast	
Bulgaria	-0.6	-0.6	-0.7	0.0	1.7	3.2	3	1
Romania	-4.0	-3.2	-2.6	-2.2	-1.2	-0.8	-1	-3
Croatia	-6.5	-6.8	-4.8	-6.3	-4.9	-4.2	-4	-3.8
Macedonia 3)	2.3	-6.3	-5.0	-1.1	0.0	0.2	.	.
Turkey			-12.9	-11.3	-5.7	-1.2	-1.4	-1.0
Albania	-7.5	-6.9	-6.0	-4.8	-4.9	-3.4	-3	-3
Bosnia and Herzegovina	-7.0	-3.3	-0.2	0.8	1.8	.	.	.
Montenegro 4)	-6.0	-3.1	-2.8	-3.0	-2.1	.	.	.
Serbia	.	-1.6	-3.7	-4.2	-1.5	.	.	.

Notes: 1) National definition; for Turkey EU definition: net lending (+) or net borrowing (-) according to ESA'95, excessive deficit procedure; for Croatia IMF definition. - 2) Preliminary. - 3) From 2001 excluding privatization revenues, 2005 data projected. - 4) Central government budget deficit.

Source: wiiw Database incorporating national statistics, AMECO; wiiw forecasts.

In a number of other countries, demand for increased transfers and public investments are growing and governments, most of which are not altogether popular with the electorate, seem ready to respond favourably. These pressures can but gain in strength in the future; fiscal policies will thus have to be reassessed in the medium term. In the short term, however, fiscal prudence continues to characterize the region.

One country that has had more problems with its fiscal stance than the other is Croatia. In the last couple of years it has been implementing the policy of fiscal consolidation, which has led to a slow but steady decline in the public deficit to GDP ratio. That has stabilized the expectations about the prospects of this country, as it otherwise has continued to have quite high foreign debt exposure.

An interesting comparison between Croatia on one hand and Hungary and Turkey on the other hand could be made here. Croatia has relied mostly on monetary policy to assure macroeconomic stability, with the consequence that its foreign debt has been growing and its fiscal deficit being a permanent concern. Turkey, on the other hand, has implemented a strong programme of fiscal consolidation, with the consequence that its growth has been very strong while interest rates have declined and the exchange rate has appreciated. In the current more risky environment, however, Turkey has had to hike its interest rates rather strongly, while Croatia is trying to support macroeconomic stability with lower fiscal deficits. Hungary by contrast has been very lax with its fiscal policy relying on the international environment of low interest rates to finance its growing needs for public expenditures. That has now created a need to go through fiscal consolidation that may risk even a recession.

Fiscal balances in most other countries in SEE have proved to be sustainable even in cases where there has been a significant decline in financial aid, as in Bosnia and Herzegovina. There are, however, some developmental problems that go with fiscal prudence, as public investments in infrastructure and human capital tend to suffer. In a number of countries, the governments are planning increased investments in these areas to take advantage of increased inflows of foreign investments in privatization of public assets. Clearly, in that respect, a speed up of the process of EU integration would be helpful as the countries would benefit fro the EU structural funds.

6. Regional trade[1*]

A significant effort has been made by the international community to increase regional economic cooperation in SEE. Clearly the most successful has been the push to liberalize intra-regional trade. In the last five or so years, bilateral free trade agreements have been signed by all the countries in SEE and now the process is under way that should lead to the creation of the free trade area in SEE. As has been argued above, the region is shrinking and this free trade area is perhaps coming a bit late. Also, most countries in the region trade more with the EU and the rest of the world than they trade within the region. Indeed, the existing flows of intra-regional trade may even decline further in the coming years as foreign trade liberalization increases with all the countries joining the WTO and signing Stabilization and Association Agreements with the EU. Still, freeing trade and other economic relations in this region can have only positive effects overall.

Apart form trade, attempt has been made to improve the investment climate in the region with all the countries adopting an Investment Compact, which is an n initiative coordinated by the OECD and the EBRD. This initiative is expected to get a boost from the creation of the free trade area as it is expected that the investors will look at the region as a whole rather than at the markets on country by country bases. Investment Compact could help in the sense that it should supplement liberalization of trade with an indirect mechanism for policy coordination in SEE. If countries in the region commit themselves to certain rules and policies towards investments from within and without

[*] This section was written together with Mario Holzner.

the region, that should create a better environment for both trade and investment. As long as policies are not coordinated, liberalizing trade may mean little is countries could use monetary, fiscal or regulatory instruments to interfere in cross border trade.

This mechanism of indirect policy coordination could be strengthened through the process of integration with the EU. Perhaps the most influential instrument is that of Stabilization and Association Agreements and of the European Partnership that the EU has adopted. Within that, EU is well placed to have a strong influence on the process of liberalization and regional cooperation in SEE. A look at regional trade that follows can give an indication of what can be expected from that.

With the highest export share in intra-regional trade (intra-SEE-7), Macedonia (39%), Serbia and Montenegro (35%) and Bosnia and Herzegovina (32%) can be considered the three core countries in the Balkans. Interestingly enough, of all the SEE-7 countries Serbia and Montenegro also registered the highest increase in their export share to the region over the period 2001-2005. This can be seen in Table 5a, which shows the percentage point changes in export shares over the same period.[2] As a matter of fact, all Balkan countries increased their export shares to the region. Except for Macedonia, all SEE countries experienced a substantial drop in their export shares to their main EU trading partner countries, Austria, Germany, Greece and Italy (EU-4), over the respective period. Table 5b presents the nominal changes in USD million. Thus, it might transpire that a drop in shares still represents a nominal increase, albeit below average.

Table 8a

SEE trade: Exports as % of total (2005) – change in shares, 2001-2005

of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M	RUS
to:								
Albania		0.1	-0.1	0.0	0.0	0.0	0.4	0.0
Bosnia & Herzegovina	0.0		-0.1	**2.3**	-0.3	0.1	**5.0**	0.0
Bulgaria	0.0	0.0		0.3	0.2	0.8	0.4	0.1
Croatia	-0.1	**6.3**	**1.2**		**1.7**	0.8	**2.3**	0.0
Macedonia	-0.3	-0.2	0.0	-0.2		0.4	-0.4	0.0
Romania	0.0	-0.1	**1.0**	0.8	0.0		**-1.8**	0.2
Serbia & Montenegro	**1.2**	**-4.8**	-0.6	**1.2**	**-1.3**	-0.3		0.4
Russia	0.1	-0.1	-0.4	-0.6	0.3	0.0	**1.7**	
EU-4*	**-16.9**	**-5.9**	**-2.4**	**-4.6**	**8.3**	**-4.5**	**-2.7**	**-2.2**
SEE-7	0.8	**1.2**	**1.4**	**4.4**	0.3	**1.8**	**5.9**	0.7
Total change, USD billion	**0.4**	**1.4**	**5.9**	**4.4**	**0.8**	**14.4**	**1.9**	**153.6**

Note: All exports: f.o.b.; *) EU-4 = AUT, GER, GRE, ITA.

Source: IMF Direction of Trade Statistics, Missing data for trade with Serbia and Montenegro substituted from national and mirror statistics.

[2] Percentage point changes above 1 are shown in bold: bold letters in a frame to show positive changes and white bold letters on a black background to show negative changes.

Table 8b

SEE trade: Exports – change in USD million, 2001-2005

to: / of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M	RUS
Albania		1.8	19.7	9.8	8.3	11.4	14.9	44.8
Bosnia & Herzegovina	0.1		5.0	**748.3**	9.4	39.2	**442.2**	28.8
Bulgaria	0.2	0.6		32.9	16.0	388.2	31.6	1109
Croatia	0.5	**298.9**	**141.8**		**72.5**	241.9	**129.8**	751.0
Macedonia	1.9	2.8	126.5	32.0		128.8	162.6	-16.4
Romania	0.1	11.0	**254.9**	79.7	0.4		**-1.9**	1878
Serbia & Montenegro	**12.4**	**148.7**	177.3	**246.6**	**206.9**	114.4		1402
Russia	1.2	2.7	89.7	27.0	15.9	91.8	**148.1**	
EU-4*	**208**	**401**	**1807**	**1577**	**426**	**5299**	**627**	**25370**
SEE-7	15	**464**	**725**	**1149**	313	**924**	**779**	5197
Total change, USD billion	**0.4**	**1.4**	**5.9**	**4.4**	**0.8**	**14.4**	**1.9**	**153.6**

Note: All exports: f.o.b.; *) EU-4 = AUT, GER, GRE, ITA.

Source: IMF Direction of Trade Statistics, Missing data for trade with Serbia and Montenegro substituted from national and mirror statistics.

The situation is quite similar with regard to import shares (see Table 6a). Once again the largest importers in intra-regional trade are Bosnia and Herzegovina (35%), Macedonia (27%) and Serbia and Montenegro (19%), albeit to a somewhat lesser extent. Those core countries in particular (except Serbia and Montenegro) have even markedly increased their SEE import shares over recent years. Moreover, for all SEE countries (except Bulgaria) the import shares from the EU-4 countries once again dropped sharply.

Russia has also been included in the analysis to show that for most SEE countries the share of Russian imports increased over the period 2001-2005. The increase in oil prices was the important determinant in this context. Only Bulgaria experienced a dramatic drop. However, in 2001 the share of Russian goods in Bulgarian imports stood at 20%. Since then, the country's import structure has become more diversified.

What are the reasons then for the deepening of trade integration in the SEE region? Based on earlier studies that used a gravity model approach, this outcome is partly what was to be expected. After a decade of disintegration due to wars and political instability in the 1990s, trade liberalization and the fundamental factors of geographical proximity and common languages brought about a revival in regional trade. The bilateral free-trade agreements between the countries of Southeast Europe have underpinned the process. Moreover, plans are being mooted for a single free-trade zone based on expanding and modifying the current Central European Free-Trade Agreement (CEFTA). By the end of 2006, the process is expected to culminate in the conclusion of a single regional trade agreement. However, given that a great deal of trade liberalization has already been introduced via the network of bilateral agreements, it is debatable whether the multilateral agreement will yield any additional benefits of substance, especially after Bulgaria and Romania have joined the EU. The CEFTA framework continues to be more of a political symbol designed to demonstrate a will for regional cooperation in the course of EU integration.

Table 9a

SEE trade: Imports as % of total (2005) – change in shares, 2001-2005

of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M	RUS
from:								
Albania		0.0	0.0	0.0	0.0	0.0	0.1	0.0
Bosnia & Herzegovina	0.1		0.0	**1.1**	0.0	0.0	0.5	0.0
Bulgaria	0.1	-0.1		0.7	**2.7**	0.1	-0.9	-0.2
Croatia	-0.1	**3.9**	0.2		0.4	0.2	0.6	-0.1
Macedonia	-0.3	-0.3	-0.1	0.1		0.0	**-2.4**	0.0
Romania	0.0	0.5	**1.1**	**1.3**	**4.2**		-0.8	-0.1
Serbia & Montenegro	0.6	**3.6**	0.0	0.5	**1.4**	-0.3		0.0
Russia	**1.5**	-0.1	**-10.2**	**1.7**	-0.9	**1.7**	**1.1**	
EU-4*	**-7.5**	-0.9	**2.1**	**-4.8**	-0.1	**-6.8**	**-6.5**	**2.4**
SEE-7	0.4	**7.5**	**1.3**	**3.6**	**8.7**	0.0	**-3.0**	-0.3
Total change, USD billion	**1.3**	**3.1**	**10.1**	**9.6**	**0.9**	**26.4**	**6.2**	**73.4**

Note: All imports: c.i.f., *) EU-4 = AUT, GER, GRE, ITA.

Source: IMF Direction of Trade Statistics, Missing data for trade with Serbia and Montenegro substituted from national and mirror statistics.

Table 9b

SEE trade: Imports – change in USD million, 2001-2005

of:	ALB	B&H	BUL	CRO	MAC	ROM	S&M	RUS
to:								
Albania		0.1	0.4	0.5	1.8	0.3	13.2	2.0
Bosnia & Herzegovina	2.0		0.4	**328.5**	2.9	11.8	223.0	4.6
Bulgaria	33.9	5.6		150.6	**139.2**	280.2	195.3	93.1
Croatia	10.9	**823.4**	42.8		35.5	82.6	247.4	19.1
Macedonia	9.2	10.4	17.6	79.9		0.3	**207.1**	15.8
Romania	12.9	43.3	**426.3**	**254.3**	**143.0**		126.7	106.0
Serbia & Montenegro	16.5	**452.5**	32.3	129.8	**129.9**	-1.1		161.6
Russia	**48.6**	33.1	**268.8**	**1018**	-14.4	**2070**	**989.1**	
EU-4*	**693**	867	**3654**	**3102**	331	**9107**	**1569**	**18069**
SEE-7	85	**1335**	**520**	**944**	**452**	374	**1013**	402
Total change, USD billion	**1.3**	**3.1**	**10.1**	**9.6**	**0.9**	**26.4**	**6.2**	**73.4**

Note: All imports: c.i.f.; *) EU-4 = AUT, GER, GRE, ITA.

Source: IMF Direction of Trade Statistics, Missing data for trade with Serbia and Montenegro substituted from national and mirror statistics.

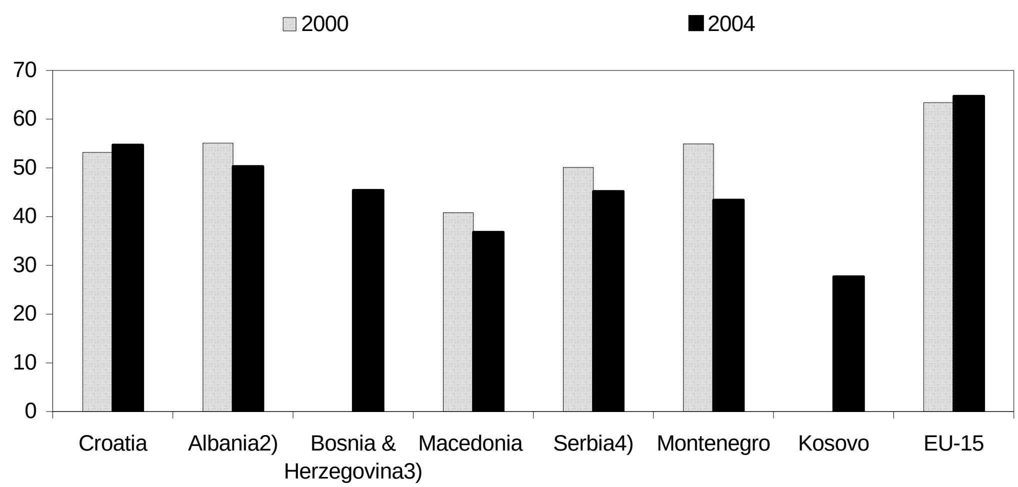
7. Employment is hard to come by

The main economic and social problem in SEE is the situation in the labour markets. In some parts of the region employment rates are very low and unemployment rates are very high. The worst situation by all accounts is in Kosovo, though the data is still not very reliable. Unemployment is also very high in Macedonia and high in most other Western Balkan countries. It is declining in Bulgaria, in part due to emigration, and has been low traditionally in Romania, to a large extent because of the significant rural population. Some of this unemployment is due to various types of rigidities in the labour markets, but the bulk is the consequence of delayed transition that has led to a loss in GDP and especially in industrial production that is much larger than for instance in Central European countries in transition. On top of that, as has been mentioned above, growth in transition is driven more by productivity than by employment and labour intensive economic activities are not doing all that well due in part to increased competition from less developed countries. Thus, the labour market problems will be present for some time in SEE.

Figure 9

Employment rates in SEE countries[1)]

employed in % of working age population 15-64, LFS



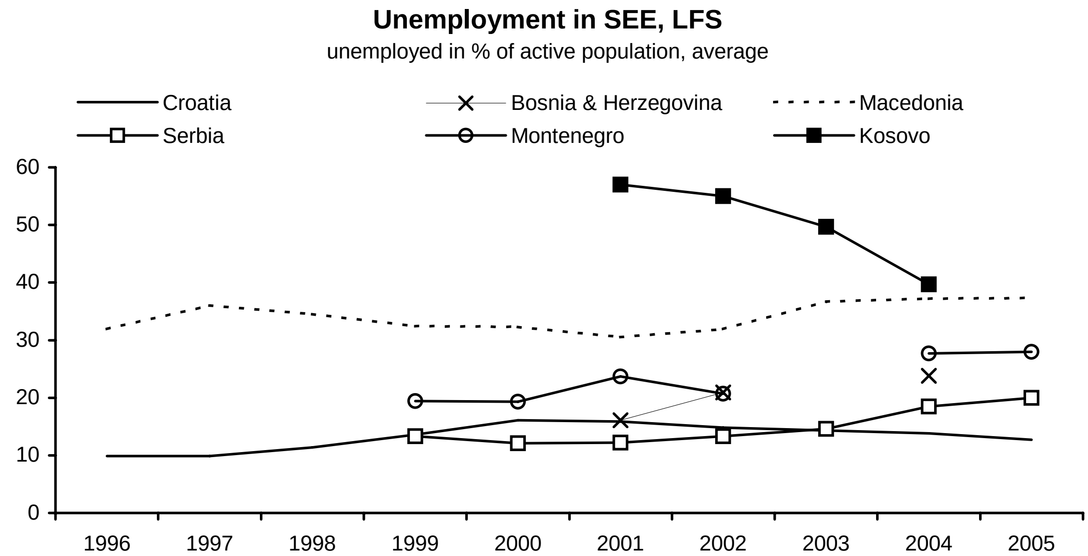
Notes: 1) Employment rates based on EUROSTAT - LFS adjusted series and national LFS statistics; annual average. - 2) Registration data; Working age population: male = 15-59, female = 15-54. - 3) Living in BiH data. 4) 1999-2003: working age population: male = 15-59, female = 15-54.

Source: EUROSTAT; wiiw incorporating national statistics.

Figures 10 and 11 and data available to the Vienna Institute wiiw indicate the following stylized characteristics of labour markets in the SEE:

- Employment rates tend to be low
- Unemployment rates tend to be high
- Long term unemployment is perhaps the biggest problem
- Unemployment among young is exceptionally high
- Unemployment among unskilled labour is high persistent
- Women in some case have worse chances in the labour markets

Figure 10



Source: wiiw incorporating national statistics.

One of the additional reasons that labour markets do not absorb the additional labour is relatively high wages in the Western Balkans. As a rule, wages in that region, with the exception of Albania, are significantly lower than those in Bulgaria and until recently than those in Romania too. Thus, Western Balkans is not competitive compared to Eastern Balkans not to mention other regions in Europe and in the world with low wages. That fact put added emphasis on developmental policies, especially on investments in infrastructure and especially in human capital.

Table 10

Unemployment, LFS definition, annual averages

	in 1000 persons						rate in %				
	2000	**2001**	**2002**	**2003**	**2004**	**2005** [1]	**2003**	**2004**	**2005** [1]	**2006** **forecast**	**2007**
Albania [2]	215	181	172	163	157	155	15.0	14.4	14	14	14
Bosnia & Herzegovina [2]	421	422	442	460	491	523	42.0	43.9	46	46	46
Bulgaria	567	664	592	449	400	330	13.7	12.0	10	9	8
Croatia	298	277	266	256	250	236 I-VI	14.3	13.8	13.1 I-VI	13	12.8
Macedonia	262	263	263	316	309	330	36.7	37.2	37.5	37	37
Romania [3]	821	750	845	692	800	695	7.0	8.0	7.0	7	7
Serbia [4]	426	433	460	500	665	.	14.6	18.5	20	22	23
Montenegro [5]	55	58	58	.	72	.	.	27.7	28	28	28
Turkey [6]	1497	1967	2464	2493	2498	2467 I-IX	10.5	10.3	10	9.7	9.3

Notes: 1) Preliminary. - 2) Unemployment by registration, end of period. - 3) From 2002 new methodology in accordance to EU definitions. - 4) 2004 according to ILO and EUROSTAT, census 2002. - 5) From 2004 according to ILO and EUROSTAT, census 2003. - 6) Civilian Labour Force.

Source: wiiw Database incorporating national statistics, forecast: wiiw.

Picture that emerges here is particularly disturbing because it is based on the labour force survey (LFS) data and thus takes into account the employment in the informal sector. Thus, that sector's importance and positive contribution tends to be exaggerated. There is no doubt that informal economy is important, but if the levels of budget revenues are taken into consideration and the levels of unemployment too, there is a prima facie case to be made that its importance is not overwhelming.

8. Political shocks: three new states

Transition in SEE has been characterized with significant political conflicts and tensions due to the disintegration of Yugoslavia that is still not completely finished. In the Eastern Balkans, political developments have been quite different and that is partly true of Albania too. The rest of the Western Balkans, however, has been disintegrating and that process is yet not over. Indeed, the region is facing the resolution of one of its most difficult problems, which is the determination of the constitutional status of Kosovo and its integration in the region and in the international community. This year has seen the emergence of two new states so far and is expected to end with the emergence of yet another one, that of Kosovo. In addition, Bosnia and Herzegovina is going through an increasingly divisive process of constitutional revision. Once these open constitutional problems are settled, political stability should become much firmer and hopefully sustainable.

In May 2006, Montenegro held a referendum and voted in favour of independence. It is the first of three new countries expected to emerge in the Balkans this year. The other two are Serbia and Kosovo. Indeed, with Montenegro seceding from its union with Serbia, the latter has become an independent state by default. This has caught Serbia unprepared. Although the transfer of power from the state union level to that of Serbia has been smooth and presented few problems at least institutionally, nation- and state-building is another matter. Serbia had become accustomed to functioning along provisional lines; it has yet to adopt a constitution proper and adapt its political and economic strategies to that of a proper nation-state.

The awakening of Serbia will not be complete until the status of Kosovo has been finally determined. That should happen later this year. The expectations, not only in Kosovo, are that it too will become another new state. Its sovereignty will be restricted somewhat in the hope that the shock on the region will dampened somewhat in that way. The specifics have yet to be worked out in the ongoing negotiations in Vienna. Clearly, stability of the new state and in its neighbourhood will be the paramount concern.

Thus, by the end of this year or thereabouts, three new states will have come into being in the Balkans. With that, the process of Balkanization should come to an end. It is still not clear what the political consequences of this proliferation of states will be. Regional stability does not seem to be at risk; the outcome has long been expected in all quarters and the emerging political geography is a foregone conclusion. The political and economic consequences, however, are another matter altogether.

A comment on the prospects of Kosovo as a state might be useful. At the moment, Kosovo depends politically on the international community which bears responsibility for the country's security and also pays some of its bills. Unlike most other Balkan states, Kosovo is totally surrounded by the region. It might to be expected that it would be also politically and economically dependent on the region and especially on the immediate neighbours. In sharp contrast, however, it is significantly less integrated with its neighbours today. This quasi-autarchy with the country reliant on aid and transfers is not conducive to Kosovo's economic development as the country is cut off from the local markets which are essential for its economic development. It is also hard to imagine firms and industries developing in Kosovo without regional strategies and without a view to regional agglomeration. Therefore, trade liberalization and economic integration are of vital importance to Kosovo. For that, it is commonly understood, the issues of its constitutional set up and its democratic development need to be settled and the process of liberalization and transition has to be accelerated.

Everything depends on achieving a state of political normalcy. That is no mean task. It calls for political transformation: not only of Kosovo, which is a hard enough task in itself, but also of Serbia – and perhaps a number of other countries as well. In Serbia in particular, the political fall-out of Kosovo's independence is hard to predict. There is a risk that Serbia will slip into a period of political frustration and it will have a hard time extricating itself from it. Perhaps the most that can be expected, at least given the way things look at the moment, is that Serbia will be ready to normalize its relations with Kosovo without accepting it as an independent state. In other words, Serbia could develop *de facto* international relations with Kosovo without recognizing it as a sovereign state *de jure*. Clearly, Serbia has interests in Kosovo and those will be easier to realize with the normalization of relations, though on *de facto* rather than *de jure* basis. Similarly, Kosovo has interest in developing economic relations with Serbia and could accept the *modus vivendi* of the relations that are *de facto* those of two independent states. The international community, however, may decide to integrate Kosovo as a *de jure* sovereign state.

The solution of the Kosovo issue should not have direct effects on any other constitutional problem in the region. Recently, the internal political scene is Bosnia and Herzegovina has become tenser due to problems with the process of constitutional revision. This is only indirectly connected with the independence of Montenegro and with the expected independence of Kosovo. The key issue in Bosnia and Herzegovina is the transformation of the two entities that this country consists of according to the Dayton Agreement from 1995. The piece-meal reform, which is favoured by the international community, is to transfer more power from the entities to the central institutions. This is not easy to do because of the decision-making structure that gives a veto power to the entities. Thus, if one of the entities, e.g., the Serbian Republic, wanted more autonomy rather than more integration, the latter is all but impossible to achieve. At the moment, the sticking point is the reform of the police, which envisages its integration across entity lines. This has been resisted by the political public in the Serbian Republic and a compromise is hard to see emerging. Indeed, rather than increased integration a process of further disintegration is still a possibility.

As long as these constitutional issues are not resolved, the process of democratization will progress quite slowly. While it can be argued that democratization has progressed in all the other countries and may accelerate in Montenegro after the up-coming parliamentary elections, it is still to stabilize in Serbia, Bosnia and Herzegovina and of course Kosovo. The unsettled constitutional issues will continue to play a role in these countries in the future as they have done in the past.

9. Conclusion

Since the political changes around the year 2000, SEE has seen positive political and economic development together with the steady integration with the EU. The process of political stabilization should become sustainable after the remaining constitutional issues are resolved by the end of this year or thereabout. That should still coincide with the start of the EU Balkan enlargement signalled by the accession of Bulgaria and Romania at the start of 2007. The rest of the SEE should gradually join the EU with the whole process coming to and end around the year 2015.

If this process continues relatively smoothly and if the economic emergence and growth of this region continues, both of which look increasingly probable, the effects on the region and on the EU will be overwhelmingly positive in terms of security and economic benefits.

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Appendix: Southeast Europe: an overview of economic fundamentals, 2005

	Bulgaria	Romania	Croatia	Macedonia	Turkey	Albania	Bosnia and Herzegovina	Montenegro	Serbia	*NMS-8* [1]	*EU-15*	*EU-25* [2]
GDP in EUR at exchange rates, EUR bn	21.45	79.26	30.95	4.63	291.12	6.72	7.54	1.64	19.47	*540.87*	*10263.59*	*10822.38*
GDP in EUR at PPP, EUR bn	58.25	176.07	50.83	12.21	519.45	15.28	17.58	3.65	46.96	*959.81*	*9842.87*	*10822.38*
GDP in EUR at PPP, EU-25=100	0.5	1.6	0.5	0.1	4.8	0.1	0.2	0.03	0.4	*8.9*	*90.9*	*100.0*
GDP in EUR at PPP, per capita	7530	8140	11450	6000	7210	4860	5990	5790	6300	*13160*	*25277*	*23353*
GDP in EUR at PPP per capita, EU-25=100	32	35	49	26	31	21	26	25	27	*56*	*108*	*100*
GDP at constant prices, 1990=100	103.1	111.0	107.7	97.3	175.6	147.3	434.2 [3]	.	.	*140.8*	*137.0*	*137.6*
GDP at constant prices, 2000=100	127.3	131.9	125.7	106.8	123.6	132.7	127.0	112.1	130.8	*120.4*	*108.2*	*109.2*
Industrial production real, 1990=100	80.7	76.7	81.4	53.2	192.6	44.6	.	.	.	*157.7*	*121.6*	*124.7*
Industrial production real, 2000=100	152.3	125.2	126.7	100.7	125.6	117.6	144.4	114.2	106.7	*131.5*	*102.3*	*104.9*
Population - thousands, average	7740	21624	4439	2035	72065	3143	3845	630	7450	*72922*	*389407*	*462017*
Employed persons - LFS, thousands, average	2980	9160	1573	545	22046	932 [4]	631 [5]	185	2900	*29064*	*173446*	*202006*
Unemployment rate - LFS, in %	10.1	7.2	12.7	37.3	10.3	14.2 [4]	45.4 [5]	28.0	20.8	*13.6*	*7.9*	*8.7*
Public sector expenditures, nat. def., in % of GDP	39.7	29.9	.	32.5	30.7 [6]	27.8	38.6 [7]	26.4 [7]	46.5 [7]	*43.6* [6]	*47.6* [6]	*47.4* [6]
Public sector revenues, nat. def., in % of GDP	42.9	29.1	.	32.7	31.8 [6]	24.5	41.5 [7]	24.3 [7]	45.0 [7]	*40.8* [6]	*45.3* [6]	*45.1* [6]
Price level, EU-25=100 (PPP/exch. rate)	37	45	61	38	56	44	43	45	41	*56*	*104*	*100*
Average gross monthly wages, EUR at exchange rate	163	264	844	348	649 [8]	216 [9]	405	326	307 [10]	*807* [8]	*3144* [8]	*2803* [8]
Average gross monthly wages, EUR at PPP	444	587	1387	917	1157 [8]	490 [9]	945	725	740 [10]	*28.8* [8]	*112.2* [8]	*100.0* [8]
Exports of goods in % of GDP	44.1	28.1	23.4	35.4	21.2	7.9	27.6	26.5	19.3	*46.3* [11]	*27.7* [11]	*28.6* [11]
Imports of goods in % of GDP	64.5	37.9	47.6	53.7	30.3	29.8	80.7	57.3	42.4	*48.4* [11]	*27.6* [11]	*28.7* [11]
Exports of services in % of GDP	16.1	5.0	26.0	8.2	7.1	13.8	10.8	19.2	6.7	*8.3* [11]	*8.4* [11]	*8.5* [11]
Imports of services in % of GDP	13.0	5.5	8.8	8.8	3.3	16.4	4.9	7.5	6.6	*7.2* [11]	*7.8* [11]	*7.8* [11]
Current account in % of GDP	-11.8	-8.7	-6.3	-1.4	-6.4	-6.7	-22.5	-8.6	-8.8	*-3.7* [11]	*-0.3* [11]	*-0.5* [11]
FDI stock per capita in EUR	1105	930	2970	735	400	488	598	895	641	*2895*	.	.

NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. PPP: Purchasing power parity - wiiw estimates for Albania, Bosnia and Herzegovina, Macedonia, Montenegro, and Serbia.

1) wiiw estimates. - 2) wiiw estimates, except: employed persons, budget and compensation per employee. - 3) 1995=100. - 4) Employment and unemployment by registration, end of year. - 5) Employees and unemployment (by registration), end of year. - 6) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. - 7) Year 2004. - 8) Gross wages plus indirect labour costs, whole economy, national account concept. - 9) Public sector. - 10) Including various allowances. - 11) NMS-8, EU-15 and EU-25 data include flows within the region.

Source: wiiw, AMECO, Eurostat.