



European Bank
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Bridging the Gaps?

Private Sector Development, Capital Flows and the Investment Climate in South-Eastern Europe

by

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Discussion paper – comments welcome.

*The views expressed in this paper are those of the
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Abstract

This paper provides an overview of private sector activity and investment in south-eastern Europe (SEE). The importance of the private sector is growing in all countries of the region. The private sector is dominated by SMEs, especially micro enterprises, and much economic activity takes place in the untaxed informal sector. Lack of finance is a key constraint for enterprises and foreign inflows therefore play a crucial role as a source of finance for new investment. To date however, capital flows to the region have been relatively modest and net foreign direct investment declined in 2002 relative to the previous year. Recent years have seen progress in transition and an improvement in the investment climate, but businesses perceive access to finance, taxation and, in some cases, corruption and low quality of judiciary as the main obstacles to doing business. In conclusion, bridging the gaps in living standards and capital flows between the region and central Europe will take time, but can be facilitated by targeted measures to increase access to capital, reduce the size of the informal sector, enhance the investment climate and facilitate cross-border trade.

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1. Introduction

South-eastern Europe (SEE) is a region where both optimists and pessimists can find plenty of evidence to support their views on future prospects.¹ On the positive side, economic performance over the past few years suggests that SEE is firmly on the recovery path and making up for lost time. For the region as a whole, economic growth in 2001-2002 was between 4 and 5 per cent per annum, well above average growth rates both in the eurozone and in those countries scheduled to join the EU in 2004. But after a decade of conflict, stagnation and economic decline there is a long way to go if SEE is to catch up on its richer neighbours to the north and west. With the exception of Croatia, conventional measures of economic activity in the region are typically far lower than in the transition economies of central Europe and the Baltic states (CEB). There is also a risk that, after the accession wave in 2004, the gap in living standards between SEE and CEB will widen. Countries in SEE for which EU membership and access to pre-accession funds and assistance are distant prospects are facing declining official inflows from abroad, opening up another gap that private foreign investors are, so far, reluctant to fill.

How can the SEE region bridge these gaps in living standards and capital inflows over the medium- and long-term? From the outset, it should be noted that countries in the region are at very different stages of transition and development. The problems and challenges facing Croatia, for example, where GDP per capita exceeds that of several EU accession countries, differ markedly from those facing Moldova, with a GDP per capita less than one-tenth of Croatia's.² The two countries targeting EU accession in 2007 – Bulgaria and Romania – together with Croatia, are well ahead of the rest of SEE in terms of progress towards a fully-functioning market economy.³ Much of the debate about SEE recently has therefore focused on what to do with the western Balkans and how EU assistance to, and cooperation with, this part of SEE might evolve.⁴ Ultimately, however, there is a limit to what outside assistance can do. Future growth and prosperity in the region, and bridging the gaps identified above, depend above all on a healthy, growing private sector.

The importance of private sector development and the benefits of a good investment climate are widely recognised. What is less clear, however, is how best to foster entrepreneurship and investment. In SEE, many initiatives have been undertaken in recent years to promote market-oriented reforms, some with the support of bilateral and multilateral donors and institutions. To date, however, these efforts have brought limited benefits. While recognising significant differences among countries in SEE, it is broadly true to say that, compared to CEB, the private sector is less vibrant, enterprises face greater difficulties in doing business, and domestic and foreign investment flows are, in per capita terms, far lower. Much progress has been achieved since the end of the Kosovo conflict and launch of the Stability Pact for South East Europe in mid-1999, but a new impetus is needed to consolidate these gains.

¹ The definition of south-eastern Europe varies according to different authors and institutions. In this paper, south-eastern Europe refers to the eight recipient countries of the Stability Pact for South East Europe: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Moldova, Romania, and Serbia and Montenegro. Note that this definition is wider than the one in the EBRD's *Transition Report*, where Croatia is included with Central Europe and the Baltic states, and Moldova is grouped with the rest of the Commonwealth of Independent States (CIS).

² This comparison is based on estimates that are not adjusted for purchasing power parity.

³ See, for example the annual EBRD *Transition Report* (various issues).

⁴ See, for example, a recent report by the European Stability Initiative (2003), which argues the case for an enhanced regional policy by the EU in the western Balkans.

This paper provides a comprehensive overview of the current state of the private sector in SEE, recent trends in capital and other inflows, and progress in institutional development and investment climate improvements. It attempts to bring together different elements of the picture, linking private sector development and capital flows with indicators of progress in transition and the investment climate, in a unified way.⁵ It also draws out policy implications from the analysis, drawing on lessons learned from the experience of other countries.

The structure of the paper is as follows. Section 2 examines the size and composition of the private sector in SEE. It shows that the share of the private sector in formal GDP is typically lower in SEE than in CEB, reflecting the somewhat slower progress in privatisation. The vast majority of enterprises are small and medium enterprises (SMEs), with micro enterprises dominating in most countries. However, the size of the informal sector is relatively large in SEE, and once this is taken into account, the private sector share is similar to that of CEB. Entrepreneurship is strong but incentives for enterprises to register are weak and domestic sources of new finance for business creation or expansion are limited. As a result, inflows from abroad continue to play a key role as a source of investment funds.

Section 3 summarises the composition of, and trends in, capital flows to the region. Given the importance of fresh outside capital, the recent figures are disappointing: total *net* capital flows to SEE were down by about 22 per cent in 2002 relative to 2001. Net foreign direct investment fell by about 18 per cent in the same period. These figures are not necessarily a cause for alarm – 2001 was a record year for FDI and the levels in 2002 are similar to those in 1999 and 2000 – but there is little indication of the sustained rising trend that is needed to bridge the gap created by falling official flows and to push the region onto a high growth path. FDI in the region is quite “lumpy” in that the totals are largely driven by a few large transactions, usually privatisation-related. Greenfield investment remains very limited and in several countries, total FDI levels are often exceeded by remittances from expatriates living abroad. These remittances are sometimes channelled into small business creation and investment but mostly go to finance consumption of imports.

Section 4 examines the business climate, drawing both on EBRD transition indicators and recent survey results from the second round of the EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS). Encouragingly, the business climate as perceived by enterprises operating in the region seems to have improved somewhat since 1999, the year of the first BEEPS. However, several countries in the region are lagging seriously behind in institutional development and implementation capacity. Enterprises typically see access to finance and taxes as the biggest obstacles to doing business, but in some countries corruption and the low quality of the judiciary also rank highly as obstacles in their day-to-day operations.

Section 5 concludes the paper by focussing on several areas where governments, bilaterals and multilateral institutions can work together with the private sector in the region. These include measures to tackle the informal sector, targeted improvements to the investment climate and legal environment, and proposals to break down borders and help create a genuine region where trade and investment flows across borders are straightforward and mutually beneficial.

⁵ Aspects of private sector development in SEE are explored in World Bank (2000), Liargovas and Chionis (2002) and Falcetti, Sanfey and Taci (2003).

2. Structure of the private sector

2.1. Size and composition

In south-eastern Europe, the past decade of transition, combined with conflict and sanctions in some cases, has taken its toll on the economy, and especially on large, state- and socially-owned enterprises. All countries in the region suffered deep recessions in the early 1990s and only Albania now has a GDP level that exceeds (in real terms) the 1989 value.⁶ The severe de-industrialisation has led to deep poverty in many regions and unemployment rates that in several cases are among the highest in all transition countries.⁷

Small and medium enterprises (SMEs) are now the main source of economic growth across the region. Table 1 shows the extent to which SMEs operate in the economy. The number of SMEs per 1000 inhabitants is in double digits in most countries, and in Bulgaria is comparable to the number in Hungary, though less than in the Czech Republic or Poland. Micro-enterprises (defined as enterprises with less than 10 employees) play a significant role, especially in Albania where they account for more than 98 per cent of registered SMEs. Notwithstanding the difficulties with doing business (discussed below), a strong spirit of entrepreneurship appears to have taken root in the region.

Throughout the region, nearly all SMEs are now privately owned, and the private sector dominates economic activity in most countries in SEE. The extent of private sector activity in each country is unclear; measurement is a difficult task in countries where coverage of the emerging new enterprises is patchy and national statistical offices are under-resourced. The EBRD reports an approximate estimate each year in the *Transition Report*, but it is based on a certain amount of informed guesswork as well as on official data. Table 2 shows these estimates and compares them to averages for CEB and the CIS. In weighted terms, about 60 per cent of GDP in SEE comes from the private sector, less than in CEB (76 per cent) and the CIS (67 per cent), although the latter is heavily weighted by Russia, where about 70 per cent of GDP is private.

⁶ See EBRD (2003), Table A1.1.

⁷ It should be noted that the measurement of the “unemployment rate” in transition economies is fraught with difficulties (see EBRD, 2000, chapter 5). For example, unemployment in Bosnia and Herzegovina is officially around 40 per cent of the labour force, but may be less than half that level according to World Bank estimates, because many of those officially registered as unemployed have jobs in the informal sector.

Table 1: Number of enterprises in south-eastern Europe (2000)

	All SMEs (incl. micro)	Micro only	Large	SME per 1000 inhabitants
SEE				
Albania	56,442	55,143	76	16.5
Bosnia and Herzegovina	n/a	n/a	n/a	n/a
Bulgaria	224,211	207,643	741	27.6
Croatia	59,907	47,368	529	13.7
FYR Macedonia	27,938	25,985	194	14.0
Moldova	18,898	15,138	2,525	5.2
Romania	395,416	365,510	n/a	17.6
Serbia and Montenegro	68,207	n/a	1,032	8.0
CEB-Visegrad				
Czech Rep.	876,990	830,601	1,671	85.1
Hungary	275,671	249,388	1,030	27.4
Poland (1999)	1,816,957	n/a	3,497	47.0
Slovak Rep.	60,310	48,662	610	11.2

Note: According to the old European Union (EU) definition, an SME is defined as an enterprise with less than 250 employees, and a micro-enterprise is one with 1-9 employees. These definitions have recently been revised by the EU to incorporate annual turnover limits, but these are not used here. All data refer to the year 2000, except for Poland where the data are from 1999.

Source: EBRD survey of national authorities.

Table 2: Private sector share in GDP (2002)

SEE	Private Sector/GDP (percentage)
Albania	75
Bosnia and Herzegovina	45
Bulgaria	70
Croatia	60
FYR Macedonia	60
Moldova	50
Romania	65
Serbia and Montenegro	40
<i>SEE average (unweighted)</i>	58.1
<i>SEE average (weighted)</i>	60.9
<i>CEB average (unweighted)</i>	75.6
<i>CEB average (weighted)</i>	76.4
<i>CIS average (unweighted)</i>	54.1
<i>CIS average (weighted)</i>	66.6

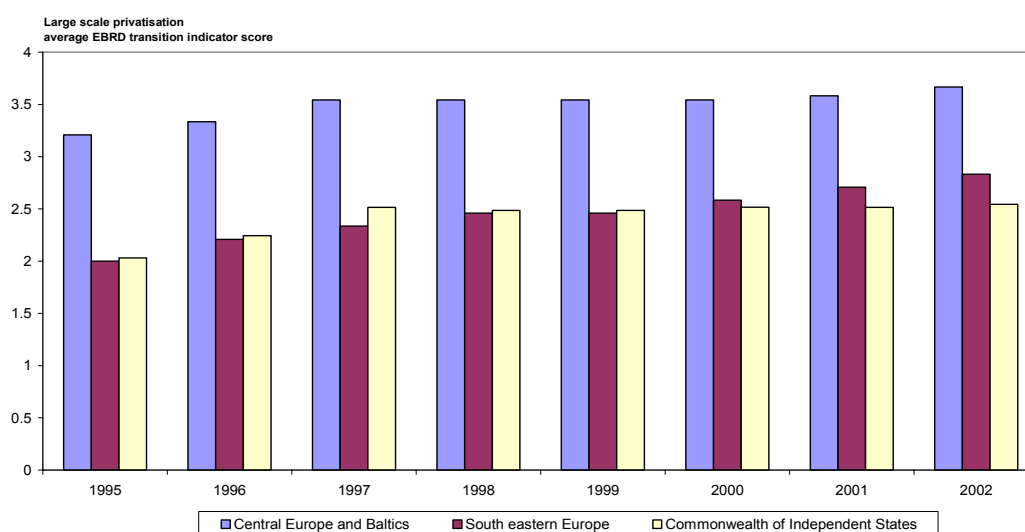
Note: The private sector share of GDP is calculated using available statistics from both official and unofficial sources. The accuracy of estimates is constrained by data limitations, and estimates are rounded to the nearest multiple of 5. Weighted averages are calculated using the dollar value of GDP in each country. SEE is defined in footnote 1, and the CIS averages exclude Moldova.

Source: EBRD (2002).

2.2 Privatisation

Given the growth of SMEs in SEE, combined with the fact that many state industries have either closed down or reduced output to minimal levels, it may seem surprising that the state still accounts for such a large share of economic activity. Part of the explanation is that privatisation has been slower to take off in this part of the world than in central Europe. It is still in the early stages in several countries, including Bosnia and Herzegovina, and Serbia and Montenegro.⁸ However, this is an area where significant progress has been made in recent years, especially in large-scale privatisation. Chart 1 highlights this point by showing the EBRD's transition scores for large-scale privatisation, averaged across the three broad regions – CEB, SEE and CIS. The chart shows that SEE overtook the CIS in 2000 and is catching up on the more advanced transition countries of CEB.

Chart 1: Progress in large scale privatisation, 1995-2002



Note: the scores are averages across countries for the EBRD transition indicator for large-scale privatisation. The score ranges from 1, indicating little private ownership of large enterprises, to 4+ with more than 75 per cent of enterprise assets in private ownership and effective corporate governance.

Source: EBRD (2002).

Privatisation in itself is not a panacea for the problems facing the region. The way in which privatisation is carried out is also important. The evidence from more than ten years of enterprise restructuring in transition economies is that privatisation is strongly correlated with enterprise restructuring, at least in non-CIS countries, and that on average, privatisation to outsiders is associated with 50 per cent more restructuring than privatisation to insiders.⁹ Change of ownership in itself is not enough, because privatisation to insiders often leaves in charge vested interests, who have little incentive to reform, and reduces the potential interest of outside investors.¹⁰ However, it is obvious that the benefits of privatisation also depend on the quality of assets being sold. Even in countries of SEE that have not yet advanced far in large-

⁸ At the start of transition, the countries of former Yugoslavia had a head start in terms of private sector development, but subsequent events led to delays.

⁹ See Djankov and Murrell (2002).

¹⁰ See Zinnes, Eilat and Sachs (2001).

scale privatisation, there is probably a limited amount left that is worth selling, with the exception of public utilities and some other large enterprises in parts of the region.

2.3. Size of the informal economy

Informal economic activity is, by its very nature, difficult to measure in any economy. However, there is good reason to believe that the size of the informal sector in SEE, as a percentage of formal sector activity, is large compared both to advanced industrial economies and to transition economies in central Europe and the Baltic states. Informal activities thrive in weak states where enforcement of the rule of law is patchy and barriers to entry are large.

Measuring the size of the informal economy raises a number of conceptual issues, quite aside from the difficulties associated with coming up with hard data. Different definitions of “informal” activities have been proposed in the literature.¹¹ A broad definition would encompass both legal and illegal activities. The former includes behaviour that would be legal, if it were reported to the authorities and taxes and other charges paid. The latter would include smuggling of goods and people, fraud, prostitution and the like, possibly involving barter rather than monetary transactions. The distinction is an important one to make: organised crime is recognised by all governments in the region as a serious problem and one that needs to be tackled energetically and, as far as possible, eliminated. In contrast, many people take a more relaxed view of legal but unrecorded activities, in view of the contribution that they make to providing employment and alleviating poverty. There is therefore much less urgency at present about bringing the informal sector into the official net.

A number of researchers have tried to estimate the size of the informal economy in south-eastern European economies. This is a difficult task. First, some national statistical authorities already make an effort to include some estimate of informal activity in recorded GDP, and hence any calculation of the ratio of informal to formal GDP may be a significant underestimate.¹² And second, it is not clear what the appropriate method for measuring the informal sector. Various methods have been proposed, some involving direct survey method and others using indirect means, such as looking at the discrepancy between national income and expenditure statistics, but all have their difficulties and drawbacks.¹³

With these caveats in mind, Table 3 presents estimates calculated by Schneider (2002a) of the size of the informal economy in SEE countries relative to Gross National Product (GNP), and for selected CEB countries as a comparison. Two conclusions are immediately apparent. First, the figures for SEE are broadly similar across countries: the ratio of the shadow economy to GNP in most countries is about one-third. Moldova, the poorest country in the region, and FYR Macedonia are outliers, with a ratio closer to one-half, while Serbia and Montenegro has, perhaps surprisingly, the lowest share at just under 30 per cent.¹⁴ Second, the share of informal activities in the total is significantly lower in the advanced transition countries of CEB, where it is typically one-fifth to one-quarter of total economic activity, while the OECD average is somewhere around 18 per cent.

¹¹ For a recent survey, see Schneider and Enste (2000).

¹² The distinction between *unrecorded* and *unreported* economic activity is stressed by Dean (2002).

¹³ See Schneider and Enste (2000) for a discussion of the merits of different methods.

¹⁴ Krstić (2002) estimates the share at around one-third in 1997, down from over 50 per cent in the hyperinflationary year of 1993.

Table 3: The informal sector as share of GNP in SEE

Country	Informal sector/GNP
<i>South-eastern Europe</i>	
Albania	33.4
Bosnia and Herzegovina	34.1
Bulgaria	36.9
Croatia	33.4
FYR Macedonia	45.1
Moldova	45.1
Romania	34.4
Serbia and Montenegro	29.1
<i>Central Europe – Visegrad</i>	
Czech Republic	19.1
Hungary	25.1
Poland	27.6
Slovak Republic	18.9
<i>16 W. Europe OECD</i>	
	18.0

Note: Estimates are derived using a dynamic multiple-indicators, multiple-causes (DYMIMIC) model, as explained in Schneider (2002a). All figures refer to 1999/2000, except FYR Macedonia where the estimate is 2000/2001 and is taken from Schneider (2002b).

Source: Schneider (2002a, 2002b).

It should be noted at this point that the measurement of informal activity is inevitably sensitive to the method used. For example, Bulgaria's share of unofficial economy to official GDP in 1995 is estimated by Lackó (1999) at either 34 per cent or 56.7 per cent, according to the type of method used. In Albania, the IMF (2003) is sceptical about the low official estimate of unrecorded activities and notes that the majority of economic activities may well be in the informal sector. Notwithstanding these technical measurement difficulties, however, it is clear that informal activities play a bigger role in SEE countries than in the transition countries of CEB, and once this is taken into account, the *real* share of the private sector in economic activity in SEE is close to the share in more advanced transition countries.

Should governments in SEE be concerned about the size of the informal economy? It is true that a vigorous informal sector can be an indication of entrepreneurial spirit, as well as providing a social safety net for those who work in it. However, the disadvantages of a big informal sector, in terms of foregone revenue to the exchequer and unfair competition to the formal sector, are so large that bringing the informal sector into the formal economy should be a top priority throughout the region.¹⁵ The concluding section of the paper discusses ways in which this might be achieved over the medium term.

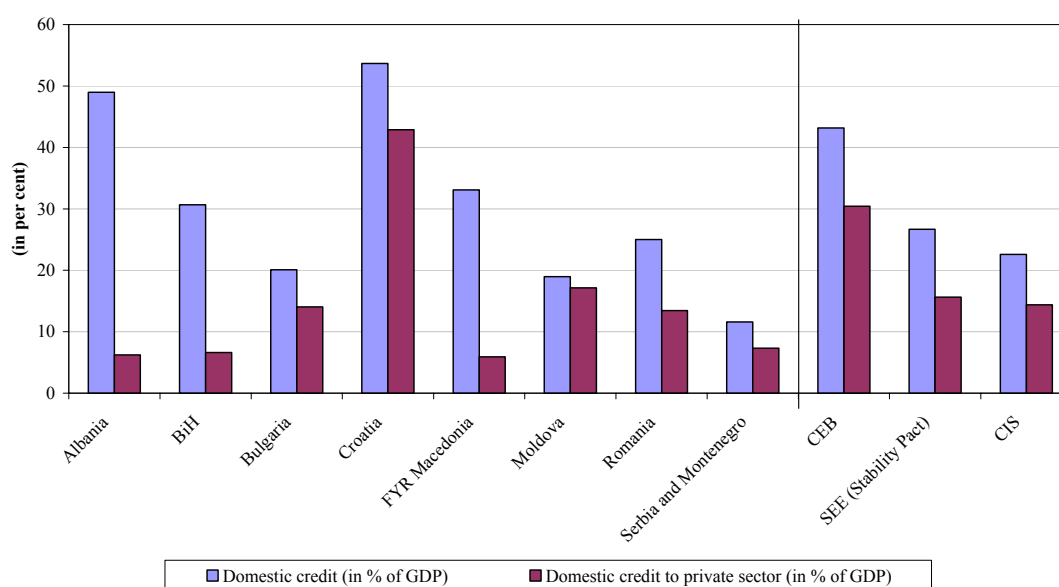
¹⁵ Muent, Pissarides and Sanfey (2001) report evidence from a survey of legal enterprises in Albania that competition from the informal sector is the biggest obstacle they face in doing business, outweighing even access to finance or taxes.

2.4 Access to Finance

Access to finance is a critical determinant of private sector development in all economies, as it affects both market entry and subsequent growth. After more than a decade of transition in SEE it is clear that domestic sources of finance are inadequate; the banking sector has generally failed to meet private sector demand for new loans. There are a number of ways of seeing this. One rather crude measure of the level of banking sector intermediation to the domestic economy is the ratio of domestic credit (both to the whole economy and to the private sector) to GDP.

Chart 2 illustrates the point with snapshot data for end-2001. For the region as a whole, the ratio of total domestic credit to annual GDP was 27 per cent (weighted average), ranging between 11.6 per cent in Romania to 69.1 per cent in Croatia. While this level is higher than the intermediation in the CIS region at 22.6 per cent, it is much lower compared to the CEB regional average of 43.2 per cent (and the Euro Area average of 108.8 per cent). The private sector credit-to-GDP ratio was particularly low in some countries (less than 10 per cent in Albania, Bosnia and Herzegovina, FYR Macedonia and Serbia and Montenegro). Even when it is higher, as in Croatia for example, this is partly a reflection of connected lending to related parties, which in turn shows up in a high percentage of non-performing loans.

Chart 2. Bank intermediation in SEE, in 2001



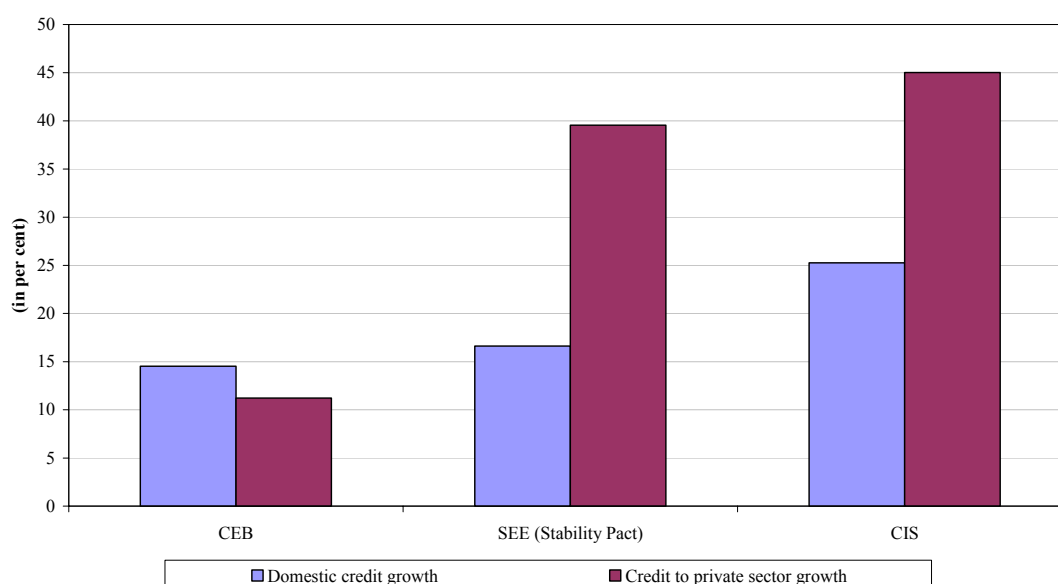
Source: EBRD and IMF, International Financial Statistics.

The structure of the banking sector in SEE partly explains the low level of lending to the private sector. In all SEE countries the banking sector at end-2001 was highly concentrated with the largest five banks accounting for between 49 per cent of the total assets in the sector in Serbia and Montenegro and 87 per cent in Albania. Furthermore, access to retail deposits has been historically concentrated with the savings banks which have a larger branch network. However, their lending behaviour towards the private sector has been affected by their restructuring and privatisation, and the high level of accumulated non-performing loans in their balance sheet. For example, in Albania, the Savings Bank, accounts for about 60 per cent of total assets

and 64 per cent of total deposits as of end-2001, while its lending to the private sector was suspended in end 1998, when the bank was prepared for privatisation.¹⁶

SMEs are affected even more by the lack of access to bank finance since banks generally prefer to lend to large enterprises. Access to bank lending for SMEs, other than from IFI- and donor-funded programmes targeted specifically for this purpose, is very limited in almost all the region. Because of the perceived riskiness of this type of lending, banks typically impose high collateral requirements, high interest rates and short-term maturities. But this is not the whole story. Banks themselves often have poor credit-evaluation skills, and face a weak enforcement of the legal framework for creditor protection. The growing presence of foreign banks, due to both privatization and foreign entry in the sector, has not solved the issue of non-performing loans across the region, especially in the countries of former Yugoslavia, and is only gradually leading to higher lending volumes to the private sector.

Chart 3. Growth of bank intermediation in 2001



Source: EBRD and IMF, International Financial Statistics..

The speed of reforms in the banking sector in all countries in the region has increased recently, often after countries faced banking crises.¹⁷ The privatisation process is advancing and close to completion in a number of countries, and the presence of foreign strategic investors in the sector has slowly improved the level of bank credit to the private sector. As chart 3 demonstrates, bank credit to the private sector in SEE grew in 2001 by about 40 per cent, on average, much faster than the CEB region that saw an average private sector bank credit growth of about 11 per cent.¹⁸ However, access to finance from international banks has not compensated for the low level of domestic bank lending. International bank lending to the non-bank private sector is virtually non-existent in most of the region apart from the more advanced countries such as Croatia, Bulgaria and Romania, where it has significantly increased. In 2001, the stock of international bank lending to non-bank private sector in Romania reached

¹⁶ As of May 2003, this privatisation has not yet taken place, due to lack of investor interest at the first tender in 2002.

¹⁷ See EBRD (2002).

¹⁸ Some of the growth in bank credit may involve the substitution of formal for informal credits.

about 94 per cent of domestic bank lending to the private sector at the end 2001, while in Croatia it amounted to about 43 per cent and in Bulgaria about 23 per cent.

3. Investment and other capital flows

3.1. Sources and definitions

The previous section concluded that the private sector in SEE is growing, driven by SMEs, but that opportunities for investment and expansion are limited. Foreign capital is therefore needed, the more the better, especially as total net capital inflows to SEE have been historically small, not only compared to other emerging markets but also to the more advanced reformers of CEB. In 2002, the countries of the SEE region attracted little more than 15 per cent of total net capital inflows to transition economies.¹⁹ Moreover, while net capital inflows to transition economies as a whole recovered to a record US\$ 42.3 billion in 2002, higher than the pre-Russian crisis levels, the total net capital inflows to SEE declined by 22 per cent last year, to an estimated US\$ 7.1 billion in 2002 compared to US\$ 9.2 billion in 2001 (See Table A.1 in the Annex). The size of this drop is somewhat surprising and needs further investigation. To a large extent it is explained by the fact that 2001 was a record year in terms of net official capital inflows to SEE, due to the combined effect of the opening up of Serbia and Montenegro (which attracted relatively large capital inflows) and the jump in capital inflows following the introduction of the Euro.²⁰

Some definitions should be clarified before delving further into the figures on capital flows. The IMF's World Economic Outlook – the main source of data on capital flows in this paper – distinguishes between *private* and *public* capital, according to the nature of the investing agent/institution. Total capital flows can also be broken down by type. Foreign direct investment (FDI) is defined as net inflows of investment to acquire a lasting management interest (10 per cent or more of voting stock) in an enterprise operating in a country of SEE other than that of the investor. It is the sum of equity capital, reinvested earnings, and other short/long-term capital. Net portfolio inflows are defined as bond and non-debt equity securities (the sum of country funds, depository receipts, and direct purchases of shares by foreign investors) issued by SEE countries and purchased by foreigners, net of similar assets issued by other countries and held by private and institutional investors of SEE. Other capital inflows consist of loans from outside the country, including bank loans, both from international financial institutions and from other banks and lending institutions.

¹⁹ See EBRD (2003). Note that data on capital flows for 2002 are preliminary estimates and may be subject to further revision.

²⁰ Some of the euro-related inflows may be transfers rather than capital inflows. For Bosnia and Herzegovina, the IMF (2003a) records an increase in "other capital" inflows of more than US\$ 1 billion in 2001, reflecting the introduction of the euro, but notes explicitly (page 32, footnote 4) that "[T]he amounts may be overstated and may in fact reflect private transfers from abroad."

Chart 4. Total net private and official flows to SEE, 1996-2002

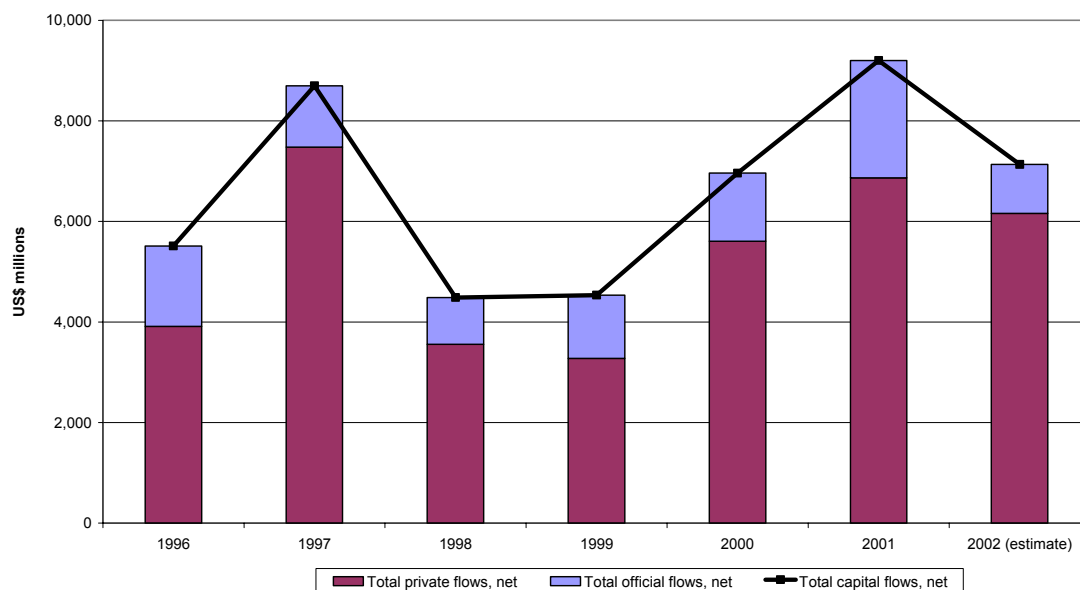
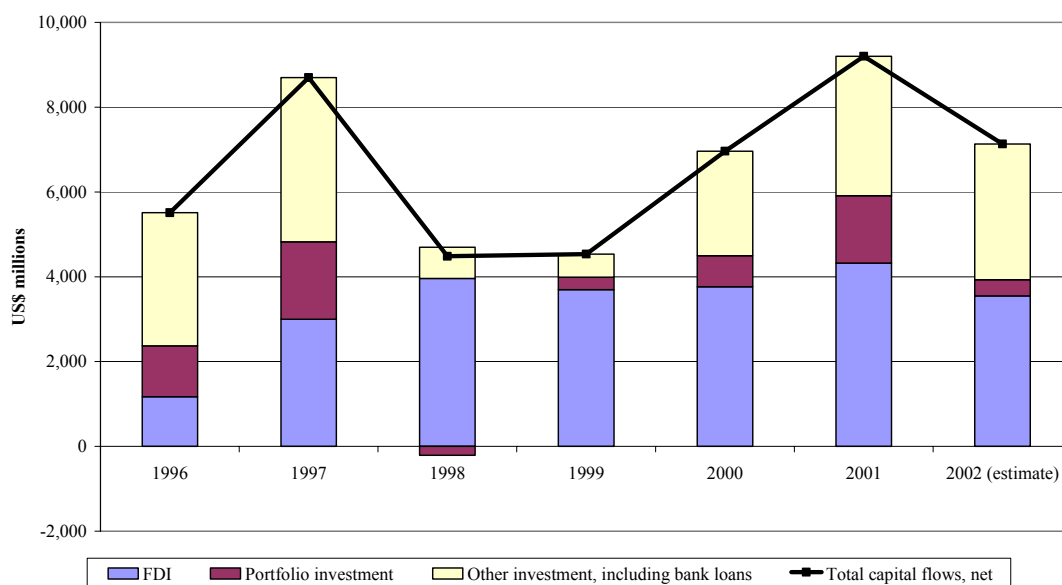


Chart 5. Total net capital flows to SEE by type, 1996-2002



Sources: EBRD, Institute of International Finance, Inc., IMF International Financial Statistics, National authorities and World Economic Outlook.

3.2. Official and private flows

Turning first to the official/private distinction, chart 4 shows that the decline in total net capital flows to SEE in 2002 is largely attributable to a sharp drop in total official net inflows to the region, which more than halved compared to 2001. These flows are

projected to decline even further in the coming years, as aid to the western Balkans²¹ will be gradually phased out (and existing loans from official institutions repaid) and, for the region as a whole, will only partly be compensated by the expected increase in EU pre-accession funds to Bulgaria and Romania. Private capital inflows, which account for more than 85 per cent of the total, have been more volatile over time than official flows. Investor confidence fell in the late-1990s but private flows to SEE have recovered since then, although they do not yet match the record level of US\$ 7.5 billion achieved in 1997. Moreover, private capital inflows are mainly concentrated in the more advanced reformers of the SEE region, i.e. Bulgaria, Croatia and Romania.

3.3 Foreign direct investment

So far, the bulk of net (private) capital inflows to SEE has taken the form of foreign direct investment (FDI), which accounted for about 50 per cent of total capital inflows to the region in 2002. Chart 5 shows that total net FDI inflows to SEE have been quite stable – over US\$ 3.5 billion per annum since 1998. But since the beginning of transition in 1989, cumulative FDI inflows per capita to SEE have been less than one third of those to CEB, totalling only US\$ 462 against US\$ 1623 of CEB.²² Furthermore, in contrast to CEB where the large-scale privatisation process is nearing completion and the majority of FDI inflows take the form of greenfield or brownfield investments, FDI inflows to the SEE region are still largely driven by big ticket sales of state assets.

The close link between FDI inflows and privatisations in SEE is illustrated in Chart 6, which shows the annual change in *gross* FDI inflows to SEE and the change in privatisation revenues.²³ The two have moved in the same direction over time, except in 1999 when FDI inflows fell slightly but privatisation revenues remained buoyant on the back of several large transactions in the region. The degree of co-movement, as measured by the correlation coefficient between these two variables, is significant and much higher for SEE countries (0.68) than for CEB (0.49). The attraction of non-privatisation related FDI is becoming an increasingly important challenge for the SEE region.

Net FDI inflows to SEE in 2002 fell by 18 per cent compared to 2001. Is this a sign of declining investor interest? Such a conclusion would be premature in our view. First, 2001 was a record year for FDI to the region and the figure for 2002 is similar to those recorded in 1999 and 2000. Second, the fall in FDI can be largely explained by the failure to complete some key strategic privatisations last year in countries like Albania (Savings Bank), Bulgaria (Bulgarian Telecommunications Company and Bulgartabac), Croatia (Croatian Telecom), and Romania (Banca Comerciala Romana). FDI is forecast both by the IMF and the EBRD to recover this year, as some of the delayed privatisations are expected to be finalised or re-launched, and the global environment is also expected to improve in the second half of the year. In the short-term, there is still an important pent-up supply of utilities and large enterprises for sale, especially in Romania and Serbia. Over the medium term, however, the

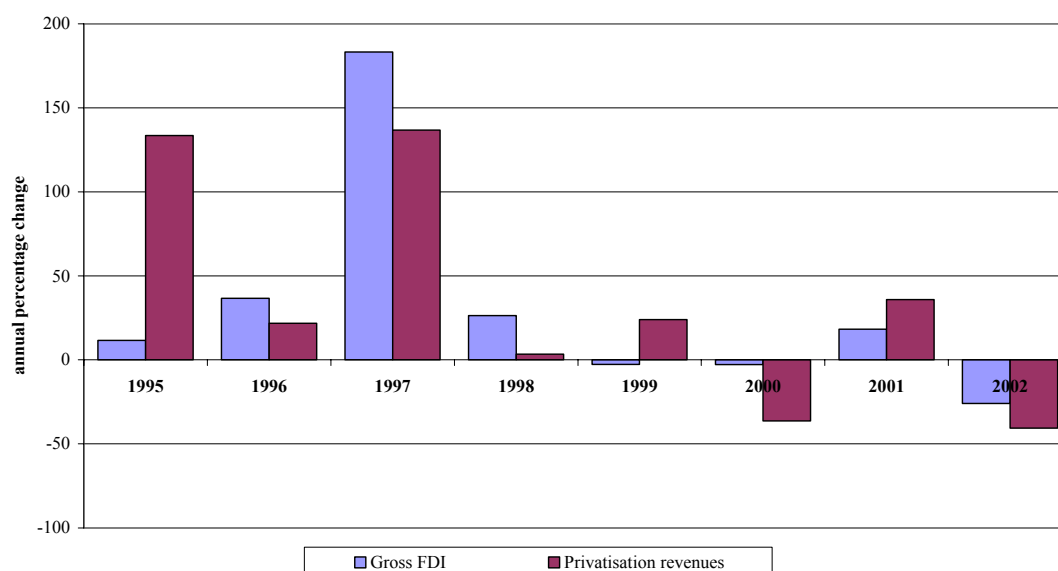
²¹ The western Balkans consists of the five countries in the EU's Stabilisation and Association Process: Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, and Serbia and Montenegro.

²² See EBRD (2003). Christie (2002) estimates a gravity model of FDI and shows that FDI to SEE countries is lower than would be predicted by the simple model.

²³ This chart uses gross FDI inflows to examine FDI from an investment perspective rather than simply a net financing or saving-investment perspective. With the exception of Croatia, which undertakes significant outward FDI, this distinction does not significantly alter the FDI data for most of the SEE countries (see EBRD, 2003, Box 2.1 for more details).

fundamental problem remains – once all the “crown jewels” are sold, how can the region attract more greenfield FDI?

Chart 6. Gross FDI inflows and privatisation revenues in SEE, 1995-2002



Sources: EBRD and United Nations Conference on Trade and Development (UNCTAD 2002, 2003).

3.4 Net portfolio and other capital flows

Turning briefly to other capital flows, net portfolio inflows to SEE have been negligible compared to the amount invested in the more advanced countries of CEB, Russia and the natural resource-rich countries of CIS. They have also been subject to higher volatility, as shown by Chart 5. Only Bulgaria, Croatia and Romania have received significant portfolio inflows in the past. Most of these have been attracted to the region through sovereign international bond issues, while access to international equity financing remains very limited. Other investments, including net bank loans, represent the second largest component of total capital flows to SEE, constituting almost 45 per cent of total net capital inflows in 2002. As this is a residual category in the capital account balance, it follows the general trends of total capital inflows and collects various forms of capital (short and medium/long term capital) that can be subject to misreporting.

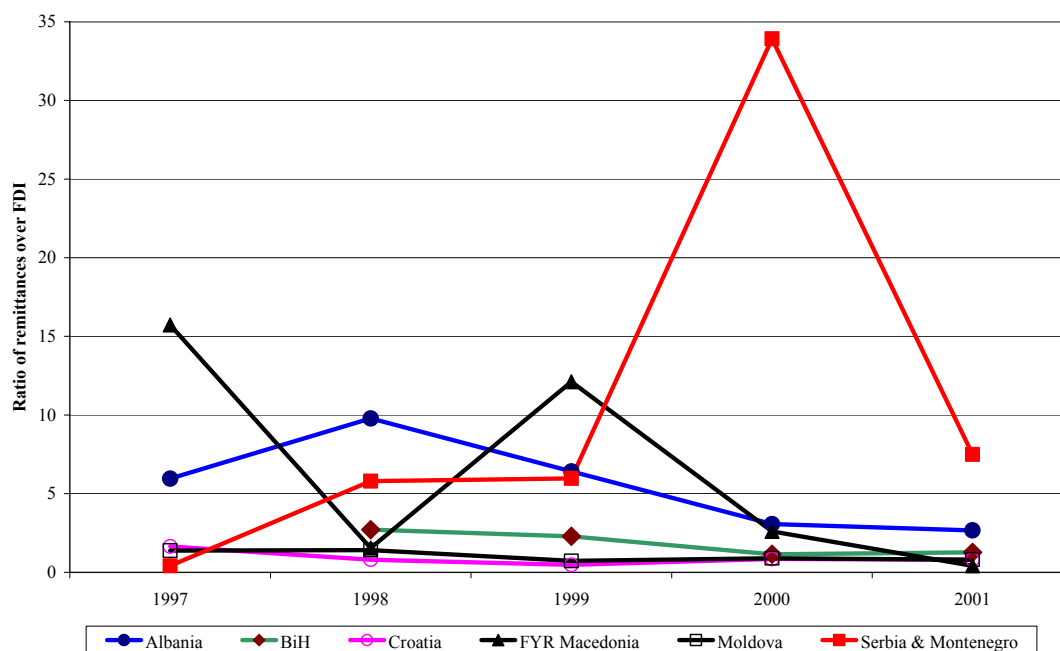
3.5 Remittances

In the absence of large-scale capital inflows, and given the constraints on domestic credit, an item on the *current* account of the balance of payments – transfers from abroad or remittances – provides an alternative source of finance. Several countries in SEE have seen large-scale emigration during the 1990s. The long-term costs to a country of permanent emigration are obvious but in the short-term there is a potential upside, in the form of the inflow of remittances back to the home country. As noted recently by the World Bank (2003), remittances are second only to FDI as a source of external funding for developing countries, and two countries in SEE – Albania and Serbia and Montenegro – are among the top 20 countries in the world ranked by remittances as a percentage of GDP in 2001.²⁴

²⁴ See World Bank (2003, Figure 7.4).

It is very difficult to gather accurate information about the level of remittances, as they are often transferred through unusual channels and are not reported. Chart 7 uses available estimates to highlight the extent of remittance flows to some countries by showing the evolution of the *ratio* between remittances and FDI. In most years the ratio is above one, sometimes by a large distance as in FYR Macedonia (1997 and 1999) and Serbia and Montenegro (2000) when FDI was negligible. Perhaps surprisingly, remittances appear to be less important in Bosnia and Herzegovina, though as noted earlier (footnote 20) this may be a mis-reporting issue.

Chart 7. Ratio of remittances to FDI for selected SEE countries



Source: EBRD and IMF.

Among emigrants, the propensity to remit declines over time as people lose contact with the home country and make a new life abroad, but this is a gradual process. Countries like Albania, FYR Macedonia and Serbia and Montenegro will continue to receive large inflows for the foreseeable future. But can these inflows be channelled into productive sources of investment and wealth-creation, or will they simply be used to finance imports of consumption goods? The evidence on this question is much harder to find. In Albania, a recent survey of business people shows that remittances account for about 17 per cent of the capital source for the establishment of firms.²⁵ However, as long as these countries remain poor, people will continue to use money sent from abroad for basic survival rather than long-term investment.

4. Institutional reforms and the investment climate

4.1 Transition indicators

Many reasons have been advanced to explain the disappointing level of FDI to SEE. Undoubtedly the conflicts in parts of the region over the past decade have given all of SEE an image problem that it is still trying to shake off. However, the more fundamental reasons for investor caution are, first, the slow progress towards

²⁵ See Kule et al. (2002).

introducing and implementing the standards and institutions of advanced industrial countries, second, the range and magnitude of obstacles that investors face once they start doing business, and third, the small markets and problems of cross-border trade in the region.

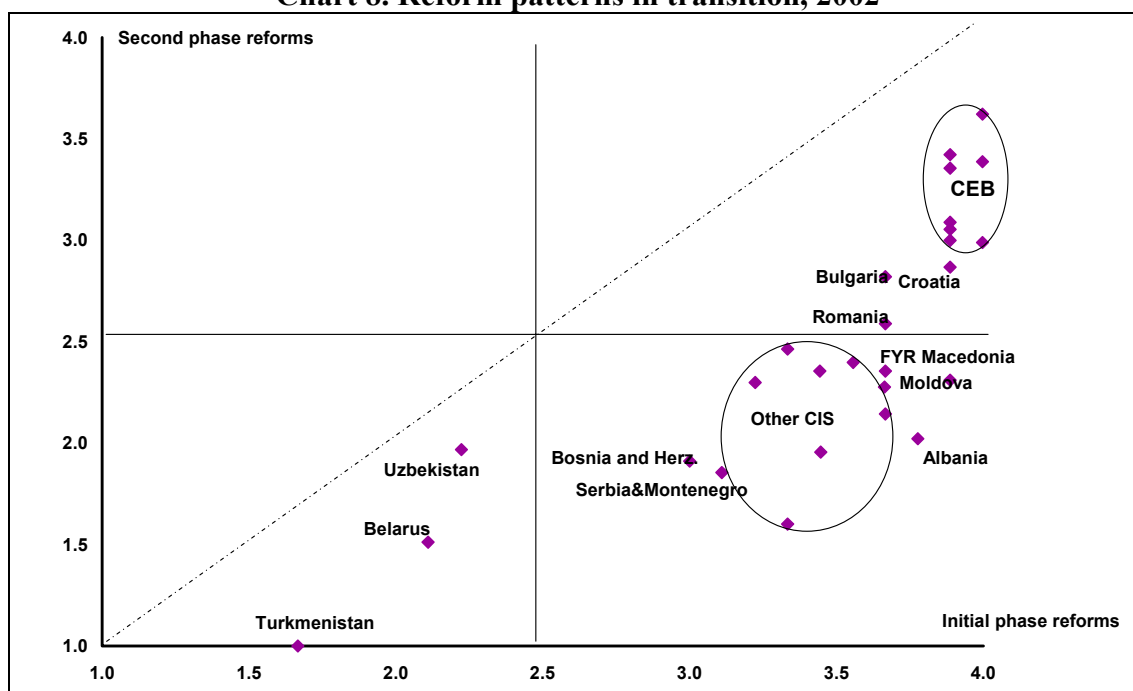
The EBRD transition indicators, published and updated each year in the *Transition Report*, measure the progress in different areas of transition. The scores range from 1, which represents little or no change from a planned economy, to 4+ which represents the standard of an advanced market economy.²⁶ “Initial” or “first phase” reforms – so-called because they are usually the first things that governments in transition countries do – are small-scale privatisation, price liberalisation, and trade and foreign exchange liberalisation. “Institutional (second-phase)” reforms cover large-scale privatisation, governance and enterprise restructuring, competition policy, banking sector, security markets and non-bank financial institutions, and infrastructure.

These transition indicators have achieved a wide currency in the literature on transition economies, largely because they are easy to interpret and allow one to measure and compare, albeit rather imperfectly, relative progress in transition across countries and time. Previous *Transition Reports* have noted the strong correlation across countries between the average transition score and FDI per capita, especially if one excludes the resource-rich CIS countries which attract substantial FDI inflows despite being laggards in reform. Causation probably runs both ways: foreign investment is attracted to countries that pursue reform, and the presence of FDI is itself a spur to further reform and progress towards a market economy.

Which are the areas in which SEE lags behind? As usual the answers differ widely by country. However, one insight can be derived from a breakdown of the average transition indicator using the distinction between first and second phase reforms described above. Chart 8 shows that the imbalance between first and second phase reforms is more accentuated in the countries of the SEE and most of the CIS. With the exception of Croatia, Bulgaria and Romania, the countries of SEE lie on the lower-right area of the chart area showing the largest discrepancy (or distance from the 45 degree line). While the liberalisation and large-scale privatisation has progressed well in these countries (with only Bosnia and Herzegovina and Serbia and Montenegro delayed somewhat) institutional reform has advanced much more slowly. Weak state capacity and political uncertainty are the most important reasons for the lack of progress in institution-building in SEE.

²⁶ These are ordinal indexes, and therefore the scores are not directly comparable across different dimensions of transition. That means that moving from a score of 1 to 2 is not necessarily the same as moving from 3 to 4, and a score of 3 in one dimension, e.g. price liberalisation, is not equivalent to a 3 in another reform area. In calculating cross-country averages, scores with a plus or minus attached are translated into numerical values by adding or subtracting 0.33.

Chart 8. Reform patterns in transition, 2002



Source: EBRD (2002).

4.2. Investment climate and obstacles to doing business

The EBRD transition indicators do not fully address important aspects of economic governance, such as taxation, business regulation, corruption and organised crime, and do not take account of the complex relationship between enterprises and the state. To collect information on these areas, the EBRD and World Bank designed the Business Environment and Enterprise Performance Survey (BEEPS), which was first launched in 1999. The BEEPS was repeated in 2002 by surveying close to 6,000 firms across 26 countries of the EBRD region, including all SEE countries.²⁷ The BEEPS asked entrepreneurs to evaluate economic governance and state institutions and to assess the extent to which the business environment creates obstacles to the operation and growth of their businesses.

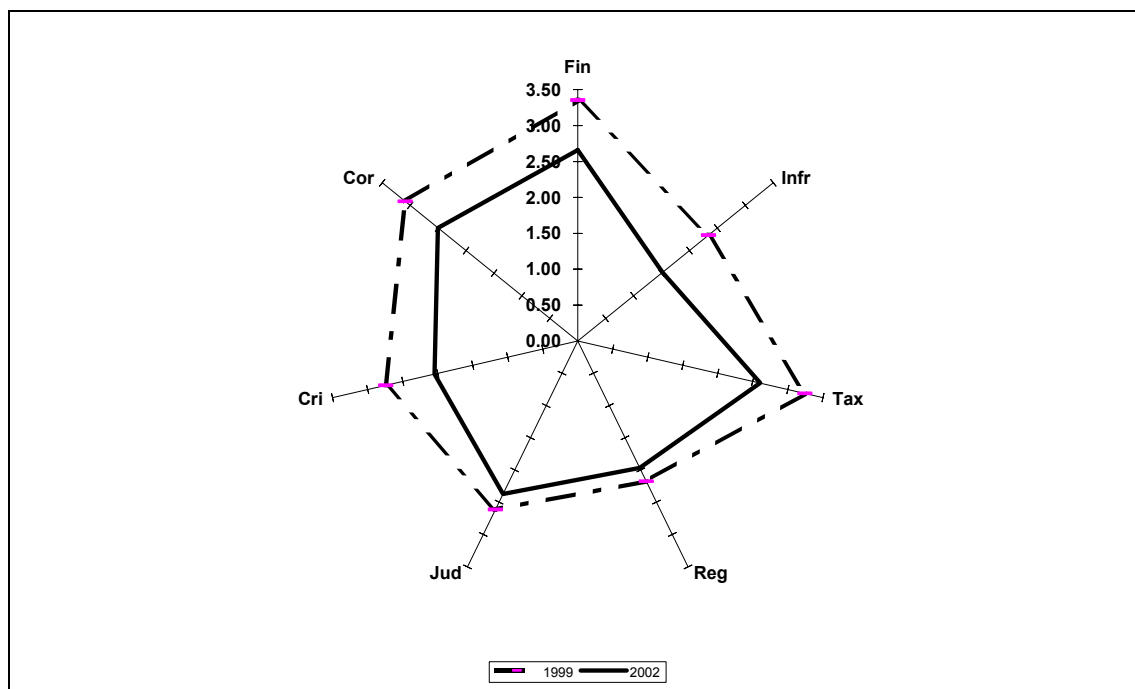
In particular, the 1999 and 2002 BEEPS asked firms to assess how the functioning of the state, physical infrastructure and financial institutions affect their business operations. Seven broad areas, directly or indirectly related to the functioning of the state and public administration, were assessed. These are: taxation, business regulation, the judiciary, crime, corruption, finance and infrastructure. Firms were asked to assess how problematic these factors are for the operation and growth of their business on a scale of 1 to 4. In contrast to the EBRD transition scores, a low score is a *good* result: a score of 1 represents a minor or insignificant obstacle while 4 indicates a major obstacle.

Chart 9 summarises the average response to the business environment question of the more than 1,600 firms interviewed in SEE in 2002, and compares it to the average replies of the 1999 round of BEEPS. The result appears to show that the business environment has improved significantly across almost every dimension since 1999. The areas showing most improvements are: Infrastructure, Access to Finance, Crime, Taxation and Corruption. The country-by-country charts in Appendix A.2 show a

²⁷ The only EBRD country where the survey was not carried out was Turkmenistan.

large variation across countries, with the largest improvement typically recorded in the quality and access to infrastructure.

Chart 9. Business environment over time in SEE



Source: BEEPS (1999, 2002)

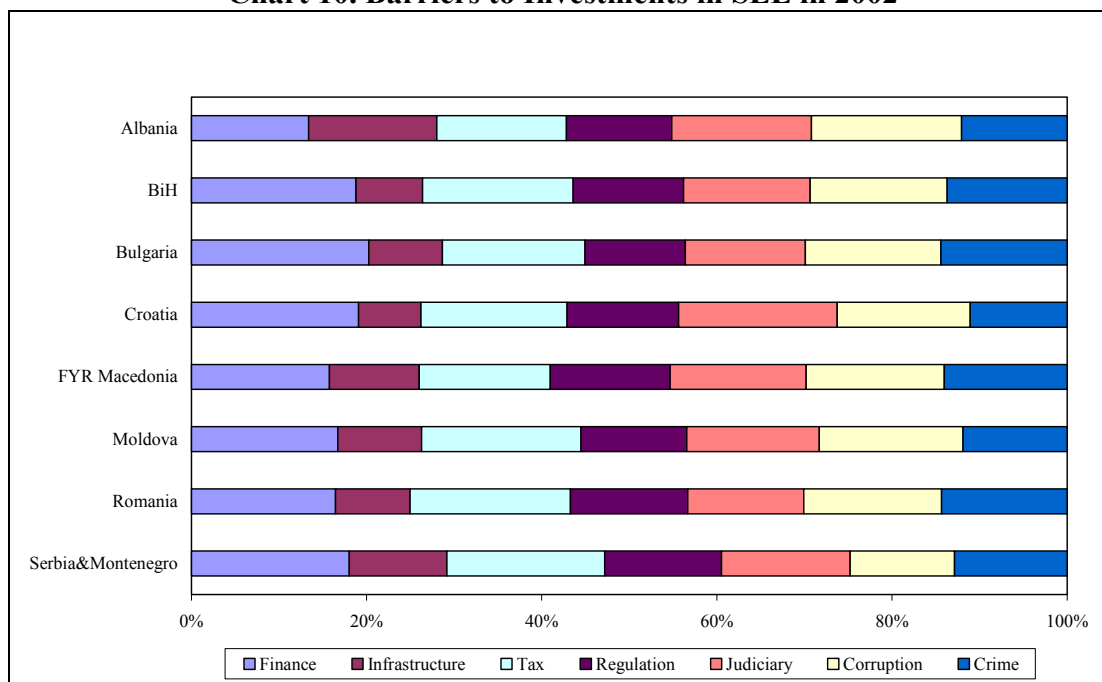
These encouraging results should be interpreted cautiously, for several reasons. First, although the sample selection criteria were the same, the two rounds of BEEPS are not directly comparable, first, because the actual sample of interviewed enterprises is different, and second, because the formulation of the questionnaire has been slightly modified. This issue is particularly serious in the case of the infrastructure question, and this may partly explain why the biggest improvement has been recorded along this dimension. Second, as explained in the EBRD *Transition Report 2002*, a first comparison of the 1999 and 2002 BEEPS suggested that the business cycle may strongly influence people perceptions of the business environment. Therefore, in order to compare the underlying quality of the business environment across countries and over time, some statistical adjustments on the 1999 and 2002 BEEPS data had to be made, so as to isolate the influence of the business cycle from the qualitative judgements. Adjusted results were used to construct business environment scores that reflect the business climate that would prevail if all countries shared the same macroeconomic performance.²⁸

Turning to the BEEPS of 2002 only, Chart 10 illustrates the results in a different way. It shows a ranking of the barriers to investment for every country by translating the average response for business environment questions for each of the seven areas

²⁸ This involved running a regression of the qualitative assessments of the business environment at the firm level on the characteristics of firms (size, ownership and location within a country), reported quantitative measures of the businesses environment that relate to the qualitative assessments, the average growth rate over the past year and country dummy variables to allow for any other country specific effects. The predicted values from this regression were then used to derive “adjusted” qualitative business environment assessments, which control for the business cycle by setting the macroeconomic growth rate to be equal to the average of all countries.

identified above into a percentage of the total scores (across all dimensions) to barriers to investments. This depiction brings out the importance of access to bank finance as the major barrier to investment across all countries of the SEE, with the sole exception of Albania. In all countries except Albania, Croatia and FYR Macedonia, the second major barrier to investment in the SEE is perceived to be taxation, involving obstacles from both tax administration and the tax rate. In these three countries, corruption and quality of the judiciary are highlighted as major problems.

Chart 10. Barriers to Investments in SEE in 2002



Note: the chart shows the *relative* importance of each obstacle for a given country, but does not permit cross-country comparisons of the importance of a given obstacle. Such a comparison can be inferred from the graphs in Annex A.2, but should be made cautiously as the answers can depend on country-specific factors and perceptions that are not captured in the data.

Source: BEEPS (2002)

Finally, the BEEPS allows us to investigate the main sources of investment for both large enterprises and SMEs (see Charts 11a and 11b). Internal funds are by far the main source of financing new investments for enterprises throughout the region, especially for SMEs. In Croatia the major source of finance for new investments for large enterprises is borrowing from commercial banks while in Albania the government remains a significant source of finance for large enterprises. Again some variation between countries and across types of enterprises is evident. In Croatia internal funds cover only about 50 per cent of SMEs' financial needs for new investments while the reliance on internal funds reaches 87 per cent in Serbia and Montenegro and about 79 per cent in Albania. For large enterprises, internal funds account for between 29 per cent in Croatia and 84 per cent in Moldova. Borrowing from commercial banks (including domestic and foreign banks) covers a relatively small percentage of financing needs for new investments for SMEs, confirming that SMEs are the ones that suffer most from lack of access to bank lending.

Chart 11a. Sources of SMEs financing for new investment (2002)

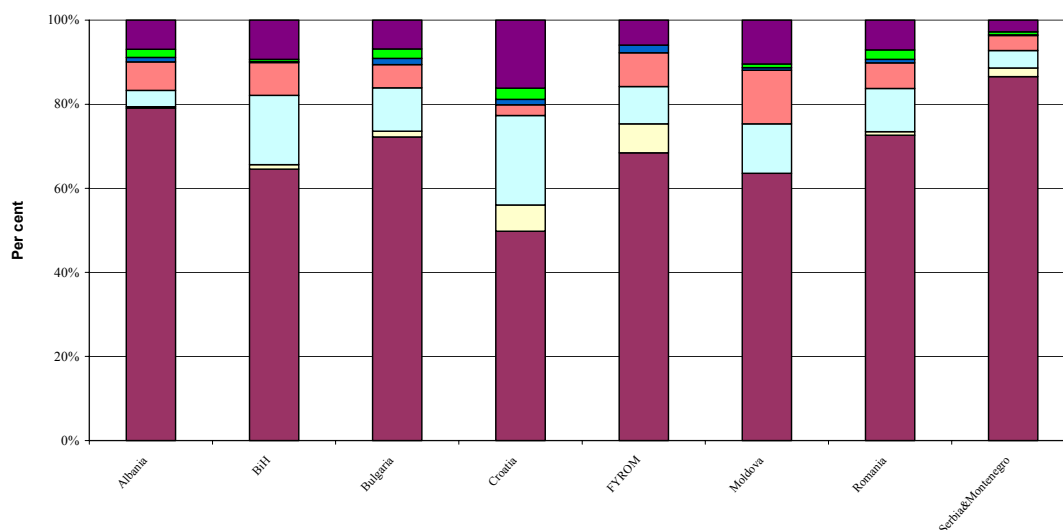
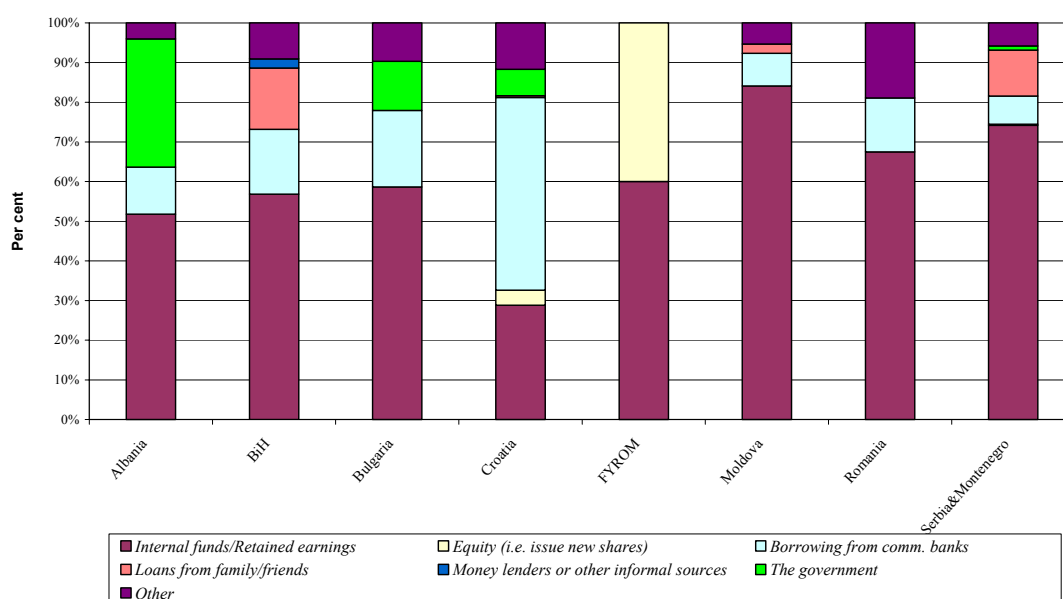


Chart 11b. Sources of large enterprises financing for new investment (2002)



Note: Figures on FYR Macedonia are included in Chart 11b for completeness but are based on a tiny sample of four enterprises (which answered the relevant question) only.
Source: BEEPS (2002).

5. Policy implications

The transition period for south-eastern Europe has been a rough one and has led to large gaps, both in living standards and in investment flows, between SEE and CEB. Can these gaps be bridged in the years to come? Our review of the current state of private sector development does not provide a definitive answer to this question. The region is more stable than at any time in the past 15 years, it is growing faster than its richer neighbours, and it is making progress towards stronger institutions and a better

investment climate. Despite this good news, net capital flows to SEE (including FDI) fell last year while domestic savings and investment remain low, inhibiting the flow of funds to new investment. These problems are particularly acute for the western Balkans and Moldova, where progress in transition has been slower and greenfield FDI at negligible levels. The largest economies in the region – Bulgaria, Croatia and Romania, two of which are scheduled to join the EU in 2007 – have the potential to be a locomotive for the whole of SEE, but only if the smaller economies show the willingness and capacity to respond to forthcoming challenges.

While recognising the differences among the countries of SEE, the paper has nevertheless argued that there are several common themes and issues with broad applicability to the whole region. These include the high degree of activity in the informal sector, the relative weakness of investment flows and access to credit, the continuing problems of taxation and corruption and the slow progress in institutional reform. For all countries in the region, long-term prosperity depends on a strong commitment to tackling these problems. Unexploited opportunities clearly exist for potential investors in SEE, and with a combination of a vigorous entrepreneurial spirit and wages in most countries well below those in central Europe, the region should be ripe for further growth and investment. The international community, and the European Union in particular, can play an important role in ensuring that scarce funds are carefully targeted and, where appropriate, supplemented to benefit those regions that most need the funds.²⁹ The international community can also step in when investor confidence is low. But ultimately it is up to businesses in the region itself to perform if long-term prosperity is to be assured.

How can the business climate be enhanced and foreign investors attracted to the region? It is worth emphasising once more that the challenges differ considerably across countries. In providing policy advice, one should not try to fit these eight countries into an artificial strait-jacket, but rather tailor it to the specific circumstances of each country. One should also avoid vague generalities. Too often, countries in the region are treated to “motherhood and apple pie” advice such as “improve corporate governance” or “tackle corruption”, advice that no-one would seriously argue against but that often comes with little or no specifics on how to achieve these worthy goals. In considering what sort of assistance might be given to the region there is an increased need to get “value for money”, partly because other parts of the world may have a greater claim on scarce donor resources, but also because there is a perception that much of the money targeted at the region in recent years has been wasted. The value for money principle is a useful one but should be interpreted carefully as some benefits are long-term in nature and not easily quantifiable.

With these considerations in mind, we would argue that for more focussed targeting of assistance in the following areas:

Tackle the informal sector: Section 2 demonstrated that the size of the informal sector in SEE is relatively large. The dilemma facing governments in the region is the following: a crackdown on informal activities would restore confidence in the rule of law, create a level playing field and reduce fiscal pressures through enhanced corporate revenue, but at the same time it may exacerbate poverty and lead to social unrest. Our view is that the problem has to be tackled sooner rather than later, but it must be done carefully with a focus on the benefits of operating in the formal sector.

²⁹ This point is argued persuasively by the European Stability Initiative (2003).

An over-emphasis on punitive measures could be counter-productive, unless it is clearly targeted (as in the recent example of Serbia) at organised crime. Carrots as well as sticks are necessary.

We propose several measures for reducing the informal sector. First, tax incentives could be used on a selective basis to encourage SMEs to register, following the successful experience of some western countries in this regard. Second, registration should be made easier and more systematic. Once businesses are registered, their activities can be tracked more closely by, for example, the introduction of compulsory fiscal registers, as the recent positive experience of Bulgaria and FYR Macedonia demonstrates. Third, the role of business advisory services could be expanded as many would benefit from support for marketing, business plan preparation and the like. Such support could be linked explicitly to business registration drives. The Business Advisory Service Programme (donor-funded and based at the EBRD) has operated successfully for a number of years in several countries of the region and may be a model in this regard. While some government and/or donor support might be necessary initially, the long-term financial benefits of such support should outweigh the short-term costs.

Enhance access to finance: Lack of access to finance is a key constraint to growth in the region. Although most countries have the appearance of competition in the banking sector, and indeed have a large number of banks, in reality ownership is typically concentrated, often leading to a cosy, virtual cartel among a small number of banks. In addition, banking crises that accompanied the reform process in many of these countries have affected the depositors' confidence in the sector as well as the lending behaviour of banks. The low level of bank lending is explained by the lack of long-term funding, poor credit skills, and the weak enforcement of the legal framework for creditor protection. The problem of low intermediation is also related to the large size of the informal sector, which causes low tax revenues and high fiscal deficits. Banks often prefer to finance the budget deficit through the purchase of treasury bills – a safe and profitable activity – rather than engage in the more risky business of providing loans to enterprises. In addition, a consistent complaint by banks throughout the region is that applications for loans are often accompanied by poorly-prepared or non-existent business plans.

The international community can help alleviate the problem of lack of finance in a number of ways. A sustained commitment to working with local banks can lead to increased intermediation, even when the banking sector is concentrated, as the experience of CEB demonstrates. Targeted assistance to SMEs both through credit lines with the local banking sector and through new SME-dedicated institutions, can help to kick-start the enterprise sector as well as strengthening banks' lending skills. The joint EU/EBRD SME Facility in accession countries (including Bulgaria and Romania) is an example of how international institutions can work with local banks to reach the riskier parts of the enterprise sector, and may be profitably extended to the rest of the region. However, such a commitment should be on commercial terms; well-meaning attempts to provide subsidised loans have been unsuccessful because of the lack of commercial discipline they engender and should not be repeated. Twinning programmes between western banks and those in the region can also be a valuable source of skills transfer, as banks in SEE learn from more experienced partners elsewhere.

Work with businesses on investment climate measures: All governments in the region are well aware of the importance of foreign direct investment, and demonstrated this commitment by signing in July 2002 a formal commitment to common principles and best practice in attracting investment. All countries are actively participating in the OECD-led South East Europe Compact for Reform, Investment, Integrity and Growth (the “Investment Compact”), an initiative of the Stability Pact. However, given the problems with the investment climate identified earlier, it is clear that there is much to be done if solemn declarations and good intentions are to translate into concrete improvements.

The OECD has recently worked with countries in the region to come up with specific, time-bound targets in each country. Progress on each target is monitored regularly through “monitoring instruments” (see e.g. OECD, 2003). In principle this is a welcome initiative, in that lack of progress in any area is now laid out for all to see. However, the choice of the target is sometimes now well thought-through, being either too ambitious or not linked to the concerns of businesses. What is missing is the link with the private sector and foreign investor community, a fact well recognised by the OECD (2003), which notes that future time-bound targets should reflect more the views of the private sector, which can help in making the target more specific and capable of implementation. In this regard, more co-operation among foreign investors in the country can help to identify the key problems that investors face in doing business. Foreign investor associations are active in some countries of the region but not in others; where they are present they have an important role to play in policy dialogue with the government.

Enhance trade and cross-border cooperation: There has been much rhetoric in recent years about “regional co-operation” in SEE. One recent initiative sponsored by the Stability Pact has been the signing of bilateral free trade agreements (FTAs) among all countries in the region. The end-2002 target for signing all 21 FTAs (excluding Moldova which joined the process later and has a different timetable) was missed but only just – as of early-2003 all are now signed and either ratified or in the process. The problem is that the effects of FTAs by themselves are minimal. The intention is to turn SEE into one common market but the reality is that barriers to trade within the region remain formidable. A new approach is needed if levels of intra-regional trade are to increase significantly.

Several initiatives should be pursued more vigorously to enhance trade both within the region and externally. First, it should be recognised that bilateral trade agreements are only a first step towards a common free-trading area. International technical support will be crucial here in setting up such an area and ensuring that it works in a meaningful way. In this regard, support could be made conditional on quantifiable targets of real progress in terms of moving goods quickly across borders and reducing corruption. Second, more can be done to facilitate the provision of guarantees for trade. In recent years, international institutions such as the EBRD and World Bank, with support from bilateral donors, have taken an active role in this area. The EBRD’s Trade Facilitation Programme provides guarantees to banks for export and import transactions both within and to/from the region, while the World Bank’s Trade Guarantee Programme loans, guarantees and insurance to exporting companies in the region. Such initiatives have had a significant but limited impact so far, and a selected expansion of such facilities in terms of coverage, maturity of guarantees and other measures may be warranted. And third, the international community can go further in terms of opening up their own markets for goods from SEE.

Facilitate the flow of remittances: The outflow of people from a number of countries in SEE during the 1990s has caused enormous damage to the human capital of the region. However, many of those who left are willing to help those left behind by sending money home. Mostly this money goes to finance imports – without them, the trade imbalances in the region would by necessity be much smaller and standards of living would be lower. But remittances can also finance new investment and, if channelled through the banking sector, can help develop financial intermediation.

Countries in the region can make a greater effort to stay in contact with expatriates, and to highlight investment opportunities back in the home country. The recent experience of “financial fairs” in the US for immigrant (mostly Mexican) workers (see World Bank, 2003, chapter 7) may provide a useful lesson for the region. Among other things, such fairs encourage emigrants to use the banking system when remitting money to the home country, thereby strengthening the banking system at home as well.

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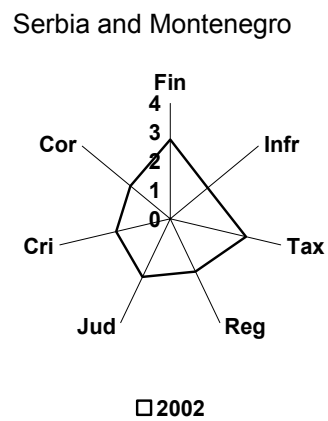
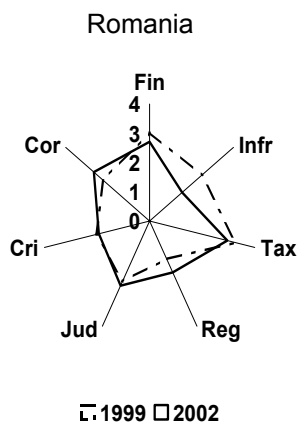
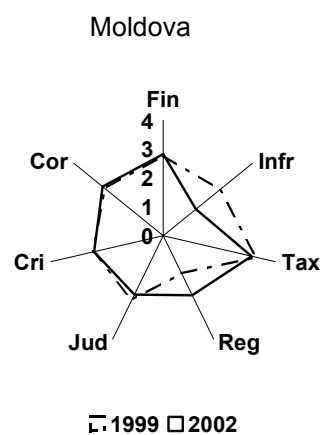
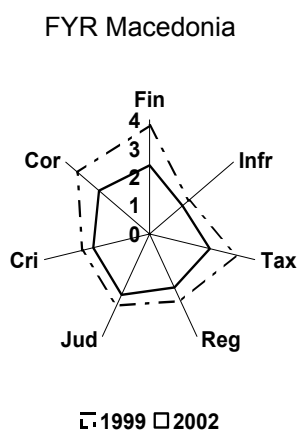
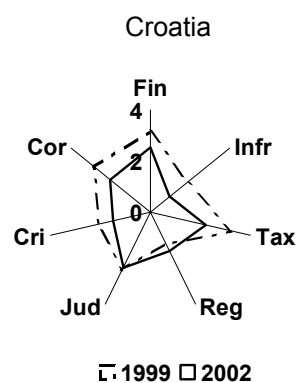
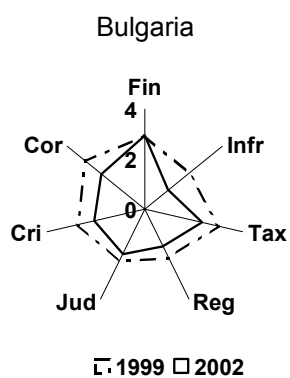
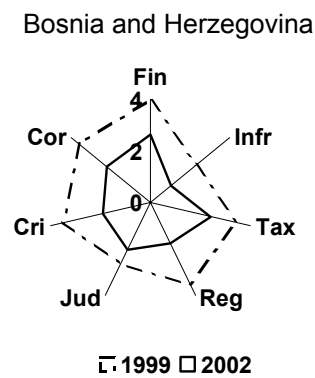
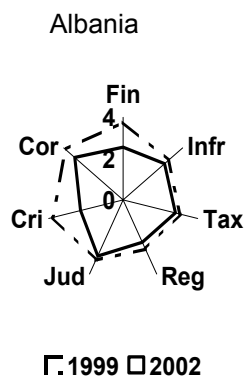
Annex A.1

Table A.1.1
Total net capital flows by regions (US\$ million)

	1996	1997	1998	1999	2000	2001	2002
							(estimate)
<i>Transition economies</i>							
Total capital flows, net	24,906	34,188	38,554	15,723	-1,083	36,136	42,309
FDI	12,850	16,123	21,830	24,403	23,312	25,221	27,695
Portfolio investment	14,687	24,650	12,800	4,561	-6,297	8,452	9,265
Other investment, including bank loans	-2,632	-6,586	3,924	-13,241	-18,098	2,462	5,348
Total private flows, net	19,442	-1,724	22,002	16,422	-2,008	37,704	44,307
Total official flows, net	5,463	35,911	16,553	-699	925	-1,568	-1,998
<i>Central eastern Europe and the Baltic states (excluding Croatia)</i>							
Total capital flows, net	11,683	11,360	22,598	21,656	23,904	26,404	33,606
FDI	7,303	7,416	12,504	16,093	17,465	16,767	19,342
Portfolio investment	1,161	3,065	4,268	5,380	6,056	7,687	8,850
Other investment, including bank loans	3,219	879	5,825	183	382	1,951	5,414
Total private flows, net	11,412	11,249	22,610	21,396	23,771	26,201	33,430
Total official flows, net	271	111	-12	260	133	203	176
<i>South-eastern Europe</i>							
Total capital flows, net	5,512	8,700	4,486	4,534	6,962	9,201	7,135
FDI	1,171	2,998	3,960	3,693	3,761	4,322	3,551
Portfolio investment	1,200	1,829	-212	295	734	1,592	377
Other investment, including bank loans	3,141	3,872	738	546	2,466	3,286	3,207
Total private flows, net	3,911	7,481	3,558	3,277	5,606	6,869	6,160
Total official flows, net	1,601	1,219	928	1,256	1,356	2,331	974
<i>Commonwealth of Independent States (excluding Moldova)</i>							
Total capital flows, net	7,711	14,128	11,470	-10,467	-31,949	531	1,568
FDI	4,377	5,708	5,366	4,617	2,086	4,132	4,803
Portfolio investment	12,326	19,757	8,743	-1,114	-13,088	-827	37
Other investment, including bank loans	-8,992	-11,337	-2,639	-13,970	-20,946	-2,774	-3,272
Total private flows, net	4,119	-20,453	-4,166	-8,251	-31,384	4,634	4,717
Total official flows, net	3,592	34,581	15,636	-2,216	-564	-4,103	-3,149

Sources: EBRD, Institute of International Finance, Inc., IMF *International Financial Statistics*, National authorities and *World Economic Outlook*.

Annex A.2: Business environment over time by country



Source: BEEPS (1999, 2002).