

INVESTMENT COMPACT FOR SOUTH EAST EUROPE

REPORT OF ACTIVITIES
Investment Compact for South East Europe

MAY 2005 - MAY 2006

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1. HIGHLIGHTS OF KEY REFORMS IN SEE

1.1. Progress and Challenges in Improving the Investment Environment for SEE

After coordinated national and international efforts, the overall region of South East Europe (SEE)¹ has stabilized and is experiencing a steady annual growth rate of 5%. Major privatizations have taken place in all countries and FDI inflows have steadily increased, topping 11 billion USD in 2005.

The SEE region has made significant progress in designing and implementing reforms, especially in the areas of:

- **Investment policy** – all SEE countries have implemented reforms to encourage equal treatment of foreign and local investors. For example, Romania adhered to the Declaration on International Investment and Multinational Companies in 2005.
- **Investment promotion** – Some of the SEE countries defined investment promotion strategies (e.g. Bulgaria) and all of them set up investment promotion agencies. For example, Bulgaria adopted the Law on Investment Promotion and the National Investment Promotion Strategy improving services and information available to investors; Croatia recently established the Croatian Trade and Investment Promotion Agency (APIU).
- **Tax policy** - the SEE region is continuing to decrease corporate income tax and improve tax administration. SEE has some of the lowest corporate income taxes in Europe: Bulgaria – 15%; Romania – 16%; Serbia – 10%; Montenegro – 9%.
- **Competition policy** – is progressing through the development of legal and institutional frameworks following the EC standards. For example, Romania and Bulgaria harmonized the competition legislation with the EU standards; Bosnia and Herzegovina adopted a new competition law modeled on EC law.
- **Regulatory Reform** – is progressing and has remained a priority for all SEE countries. For example, Moldova successfully implemented the Guillotine Law and has started a second phase of the same project; Bosnia and Herzegovina implemented the Bulldozer Initiative.

Significant steps have also been taken towards achieving a greater regional ownership of the investment reform process:

- Regional Co-Chairmanship of the Investment Compact for South East Europe by Romania in 2003/2004 and Bulgaria in 2005/2006.
- SEE Investment Forum chaired by Romania in 2003/2004 and Bosnia and Herzegovina in 2005/2006.
- SEE Enterprise Forum chaired by Albania in 2005/2006.
- Regional network of Foreign Investor Councils since 2004.
- 2005 Ministerial Conference which took place in an SEE country for the first time (Bulgaria).

The SEE region, however, has several **key challenges** facing it in the coming years, especially regarding:

- **Private investment** – the level of private investment in the SEE region, both domestic and foreign, remains insufficient. Policies are needed to promote more green-field and SME investment.
- **EU integration** – the process of EU integration is driving reform in SEE countries. The accession of Bulgaria and Romania to the EU will redefine the area and pose new challenges for the countries on the accession path, for example:
 - Once Romania joins the EU, stricter visa agreements will be required between Romania and neighbouring SEE countries (Moldova and Serbia).
 - With accession to the EU, Bulgaria and Romania will no longer be members of the Network of Bilateral Free Trade Agreements.

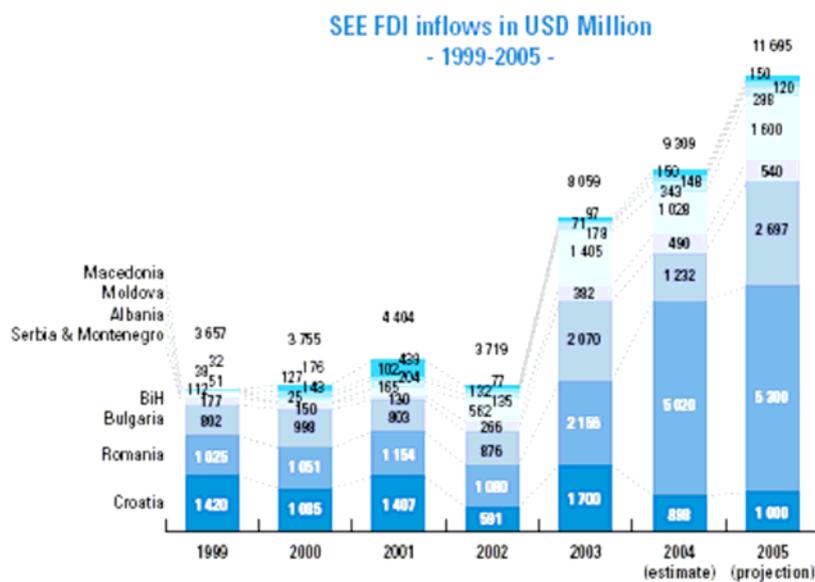
¹ The countries of South East Europe are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR of Macedonia, Moldova, Romania, Serbia and Montenegro

- **Implementation** – many SEE countries have ratified key legislation to improve the investment environment. The challenge now is to demonstrate concrete application of the principles that were ratified.
- **Competitiveness** – the SEE region is facing strong competition from China and other newly industrialized nations.

1.2. Macro Economic Indicators

ANNUAL GROWTH IN REAL GDP (%)			
	2004	2005	Forecast 2006
Albania	5.9	5.9	5.9
Bosnia and Herzegovina	5.1	5.5	6.0
Bulgaria	5.7	5.5	6.0
Croatia	3.8	4.3	4.6
FYR Macedonia	4.1	3.5	3.5
Moldova	7.3	7.1	5.0
Romania	8.3	4.1	5.5
Serbia and Montenegro	7.2	5.1	5.0

Sources: World Bank 2005 World Development Indicators - 2004 EBRD Transition report – INSTST Albania



Source: EBRD

AVAILABLE COUNTRY RATINGS IN 2006

	FITCH	ICBA	MOODY'S	STANDARD & POORS
Albania				
Bosnia and Herzegovina			B3 (RUR)	
Bulgaria	BBB (stable)		Baa3 (stable)	BBB (positive)
Croatia	BBB- (Stable)		Baa3 (stable)	BBB (stable)
FYR Macedonia	BB (positive)			BB+ (stable)
Moldova	B- (stable)		Caa1 (stable)	
Romania	BBB- (stable)		Ba1 (positive)	BBB- (stable)
Serbia and Montenegro	BB- (stable)			BB- (positive) and BB (positive)

2. 2005-2006 INVESTMENT COMPACT ACTIVITIES BY AREA OF FOCUS

2.1. Evaluation and Monitoring of Progress

1) Development of the Investment Reform Index (IRI):

Concept

The IRI is a comparative evaluation of progress in investment reform in SEE. It is based on a collaborative process that incorporates feedback from SEE governments, the private sector, and other international organizations.

The objectives of the IRI are:

1. Structured evaluation.
2. Targeted support in implementation.
3. Regional collaboration and Peer review.
4. Public and private sector involvement.

The **main differentiating factors** of the IRI:

- **Focus on a very specific region** where history, culture and geography allow for more relevant benchmarking between countries.
- **Tripartite participatory approach** to evaluation and measurement including government, private sector, and the OECD.
- **Comprehensive evaluation** of the investment environment structured along ten key dimensions in line with OECD standards.
- **Does not only measure but also provides guidance** on how to improve through good practices.
- **“Meta – Index”** which incorporates existing work already conducted by other organizations (e.g., World Bank’s Doing Business report).

Key activities and outputs of the IRI process

1. First round of country missions conducted by the Investment Compact to present and explain the IRI and identify key policy priorities (**Completed: February 2006**)

Outputs:

- Present the IRI process & review the preliminary positioning of each country.
- Update on progress with reforms targets in the June 2005 Monitoring Instruments.
- Identify, discuss and set annual reform targets.
- Identify new Economic Team (CET) Leaders where necessary, in order to allow for improved interaction with SEE countries, improved coordination of IC related country activities, and to strengthen the regional ownership of the reform process.

2. Finalization of the IRI toolkit and first evaluation of SEE countries by the Investment Compact team based on available secondary sources. (**Completed: February 2006**)

Outputs:

- Finalise IRI toolkit on seven policy dimensions.
- Finalise preliminary measurement by the Investment Compact team of the seven policy dimensions.

3. SEE countries conduct self-evaluation along IRI dimensions. (**Completed: March 2006**)

Output:

- Receive self-evaluation along the seven policy dimensions sent by the SEE governments

4. Investment Compact team conducts second level measurement with support of local consultants to further incorporate:

- a. Primary data from each SEE country.
 - b. Input from specialized government bodies (ex.: Competition authorities, Investment promotion Agencies).
 - c. Input from the private sector (Foreign Investor Councils, Chambers of Commerce, BAC, BIAC etc).
- (Ongoing: February – May 2006)**

Outputs:

- Collect and review evaluation results from the local consultants and inputs from private sector.
- Incorporate and process additional information in the Investment Compact evaluation.
- Prepare preliminary policy and country-specific assessment.

5. Second round of country missions to review and discuss IRI results for each country (**Completed: March – April 2006; Bosnia and Herzegovina – May 2006**).

Outputs:

- Discuss preliminary evaluation results with SEE governments.
- Consult with private sector representatives and include their feed-back in the evaluation.
- Finalise policy and country-specific assessment.

6. Preparation and discussion of the first draft of IRI publication at the Investment Compact Project Team Meeting (**Rome, May 2006**).

7. Finalization and publication of IRI (**September 2006**).

2.2. Support in Implementation of Investment Reform

ACTIVITIES OF THE SEE ENTERPRISE FORUM (SME POLICY)

1) Implementation of the European Charter for Small Enterprises to support entrepreneurship and enterprise development in Western Balkans in cooperation with the European Commission, the EBRD, the European Training Foundation (2006)

Outputs:

- Renew the European Charter for Small Enterprises process for 3 years by SEE governments
- Develop and apply the SME Policy Index on the evaluation to enterprise policy, covering the ten policy dimensions of the Charter and providing the framework for a comparative monitoring process
- Company surveys and focus groups interviews
- Regional report on policy findings

2) February 2006 (Istanbul) – Workshop on Enterprise Development and Employment Generation - tools to facilitate enterprise development jointly organized by the Stability Pact and the OECD Investment Compact

Outputs:

- Finalization of the SME Policy Index
- Regional paper on Start-up Support

ACTIVITIES OF THE SEE INVESTMENT FORUM (INVESTMENT POLICY AND PROMOTION)

1) Investment Seminar of SEE Investment Promotion Agencies (IPAs) in Japan (May 2005)

Outputs:

- Share best practices on investment promotion techniques
- Promote the region to Japanese key potential investors
- Build image

2) Investment Forum in Bulgaria, Moldova (September 2005), and Romania (October 2005)

Outputs:

- Present country investment opportunities
- Promote the countries to key potential investors
- Build image

3) 3rd edition of the *Investors of the Year* Awards for the largest Greenfield investors, largest privatization and largest job creators at regional and country level (June 2005)

Outputs:

- Build regional and country image and awareness within the international business community
- Promote FDI as a means to boost sustainable economic development and growth

ACTIVITIES OF OTHER REGIONAL NETWORKS: REGULATORY REFORM, COMPETITION POLICY, AND CORPORATE GOVERNANCE

1) Publication of the 2005 Progress Report based on the Review of Regulatory Governance (country by country and regional reviews):

Outputs:

- Assess performance of efforts and progress made by SEE countries in reducing administrative barriers to investment
- Formulate policy recommendations

2) Seminar on Regulatory Policy and Tools for Trade, Investment and Governance (November 2005)

Outputs:

- Identify regulatory barriers that impede cross-border trade among SEE countries,
- Peer review with CEE countries (Czech Republic, Slovakia, Slovenia, Poland, Hungary) on administrative requirements for green-field investments and the role of local and regional authorities in the inward implantation of investment (land use and building permits, use of land as a strategic asset)
- Discuss potential for regulatory impact analysis and other tools including consultation and increased transparency of regulations to address trade issues and the needs of small and medium enterprises.
- Formulate policy recommendations

3) Annual Meeting of SEE Network of Competition Authorities (December 2005)

Outputs:

- Present the Investment Reform Index – Competition Policy and the Investment Compact preliminary evaluation of competition policy
- Discuss competition policy developments and specific cases in SEE countries
- Formulate recommendation on how to design an efficient competition authority
- Nominate a new chair of the SEE Network of Competition Authorities (Romania)
- Define the future working agenda of the network

REGIONAL PROJECTS

EC-OECD Project on “Strengthening Development and Implementation of Investment and Trade Policy in the Western Balkans” (2006-2007)

Outputs:

- Thorough evaluation of the FDI data systems collection and dissemination in SEE countries, using IMF/OECD methodology
- Identification of short and long term policy recommendations to improve FDI Statistics
- Improvement of countries ability to analyze the impact of investment on a key set of economic variables (e.g. trade, employment, spillover effects, tax revenue, etc)
- Improvement of countries ability to identify short to medium term investment trends in the economy
- Enhance regional co-operation among officials
- Improvement of countries ability to properly evaluate investment and trade policies on both ex-ante and ex-post basis

COUNTRY-SPECIFIC PROJECTS

Foreign Direct Investment Project in the Republic of Moldova – designed to improve the investment environment (2006-2007)

Outputs:

- Improve the legal and economic environment for investment and investment promotion by defining an FDI strategy for Moldova
- Delivery of the FDI Strategy to the Moldovan Government by end of June 2006
- Measure the actual positive impact of FDI in the national economy and in particular its leverage effect on the development of the domestic SME sector
- Set up inward and outward investors missions (with the support of OECD Countries) to strengthen business representatives links

- Set up a Steering Committee (including the Moldovan Ministry of Economy, the OECD Investment Compact, MEPO, the Foreign Investors Association and the National Chamber of Commerce of Moldova) to monitor the project implementation. First meeting of the Steering Committee took place on 7 April 2006. The Steering Committee will have quarterly meetings
- Set up an Advisory Committee which includes the OECD Investment Compact, EBRD, World Bank, UNDP, USAID, GTZ and the European Commission Delegation in Moldova.

2.3. Private Sector Support

1) Co-operation with Investment Compact partners from the private sector: Business and Industry Advisory Committee to the OECD (BIAC), the Business Advisory Council to the Stability Pact (BAC), Foreign Investors Councils (FIC), and the SEE Regional Network of FICs

Outputs:

High private sector input in IC activities regarding:

- the monitoring process (the Investment Reform Index)
- the reform implementation and investment promotion (input in EPPA surveys)
- the political support (input and participation in the business session of the Ministerial)

2) Strengthened public - private sector dialogue at national level: Most recent FICs have now established strong links to national governments and established regular and specialized consultation process

Outputs:

- Improve dialogue with governments
E.g.: In 2005, 6 month after the publication of its White Book, the FIC Serbia organized a "Reality check conference" with the Serbian government, in order to stake stock of progress made, obstacles met in addressing impediments to investment and business development identified in the 2005 White Book
- Enhance reform implementation thanks to a better identification of obstacles, formulate practical recommendations (FIC White Books) and improve monitoring of progress made by SEE countries.

3) Strengthened cooperation and sharing at the regional level: The Investment Compact helped establish the SEE Regional Network of FICs in 2004 which had led to the publication of the Regional White Books of Foreign Investors in SEE (e.g. Moldova launched the White Book in October 2005, Romania launched the new White Book on May 2006).

Outputs:

- Better identify and improve response to common reform issues faced by foreign investors in the region as well as to reform issues of a regional nature
- Strengthen the business image of the region
- Pool the expertise of individual FICs for an enhanced public and private sector dialogue on common reform priorities in the region
- Network invitation to the Annual EBRD Meeting in Belgrade
- Network participation in the OECD-IC 4th Ministerial in Sofia (June 2005) and endorsement of the Joint Business Statement at the 4th OECD-IC SEE Ministerial
- Meeting of Regional Network of SEE Foreign Investors Councils (December 2005)

2.4. Political Support

1) Bulgaria continues as Regional Co-Chair of the Investment Compact (2005 – 2006)

Outputs:

- Ensure regional ownership and involvement of SEE countries in the reform process and IC activities
- A new co-chair is to be identified

2) 4th Ministerial Conference in Sofia (2005)

Outputs:

- Take stock of progress made with reforms, discuss and adopt regional priorities, providing SEE countries with an official open platform to commit on common reform priorities for 2006
- Endorse a Ministerial Declaration outlining directions for reforms in 2005-2006
- Endorse a Joint Business Statement outlining business reform priorities in SEE

3) Bi Annual Project Team Meetings gathering the OECD team and representatives of countries and international organizations member of the Stability Pact for South East Europe

Outputs:

- Define and assess the performance of the Investment Compact strategy
- Identify possible obstacles and adopt appropriate responses
- Maximize the Investment Compact activities with all major reform stakeholders in SEE
- Approve the Investment Compact achievements and communicate them to the wider international community

4) Organization of a Seminar on best practices relating to parliamentary procedures (2005), and Publication of a Report (2006) at the heart of the reform process and change in transition economies, focusing on Serbia and Montenegro and Bosnia and Herzegovina (2005).

Outputs:

- Share best practices in line with Investment Compact regional ownership approach between the two SEE countries
- Streamline the process of adoption of new legislation
- Strengthen SEE parliamentary understanding of their key role in the reform process