



STABILITY PACT



**SOUTH EAST EUROPE COMPACT
FOR REFORM, INVESTMENT, INTEGRITY AND GROWTH**

**PROGRESS IN POLICY REFORM IN SOUTH EAST EUROPE
MONITORING INSTRUMENTS**

June 2001

PREPARED BY
THE COUNTRY ECONOMIC TEAMS OF SOUTH EAST EUROPE IN CO-OPERATION WITH THE OECD



The Investment Compact promotes and supports policy reforms that aim to improve the investment climate in South East Europe (SEE) and, thereby, encourage increased investment and the development of a strong private sector. Building on the core principle of the Investment Compact that “ownership” of reform rests within the region itself, the SEE countries have developed, with the assistance of the OECD, the Monitoring Instruments as a key instrument for managing progress towards individual and common goals. The Monitoring Instruments are an open and transparent means to describe the practical response, over time, of the SEE countries to the commitments made in the Investment Compact, and, more generally, their commitment to the broader objectives of transition.

The Monitoring Instruments were prepared by the Country Economic Teams of Albania, Bosnia-Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia, Montenegro and Romania, each of which includes members drawn from relevant government ministries, non-governmental organisations, the private sector and international organisations.

The next edition of the Monitoring Instruments, to be published at the end of 2001, will assess which of the planned policy actions included in this document have advanced since the first edition. It will also include private sector views on progress with the reform agenda as well as indices of changes in investment flows in the region. Together these elements will help to monitor advances in reform and show, over time, what impacts the efforts made by governments are having on building a more favourable investment climate.



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Note:

Federal Republic of Yugoslavia: The Monitoring Instrument for Serbia is being prepared by the Country Economic Team for inclusion in the next edition (end 2001)

EXECUTIVE SUMMARY

Measuring progress in implementing reform is a key component of the Investment Compact process. It is vital for South East European countries to manage and track their progress against a coherent set of benchmarks and the Monitoring Instruments serve that purpose. They also make clear to Investment Compact partners, and in particular to private sector investors, that commitments to reform are being matched with policy action in practice.

The policy statements presented in this first edition of the Monitoring Instruments use a common format to describe the programme of structural reform in each South East European country. These detailed policy statements, comprising over 450 specific short-term policy actions underpinned with timeframes and identification of the institution responsible for action, give unique country-specific *and* cross-regional perspectives on the reform process.

Taken together, they attest to the strong similarities among the countries of the region in terms of the issues they face and the range of responses that have been/are being employed, including highlighting where real progress is being made and where obstacles – political, institutional, economic – are hindering reform.

The Monitoring Instruments combine both the achievements that have been made in recent months and the short- and medium-term objectives that have been set. It is clear from the former that significant progress has been made in many areas, (For example, since autumn 2000, almost 30 percent of the legislative reforms initially proposed have already passed into law.)

At the same time, the number of measures in preparation and scheduled for completion in 2001 (more than 300) highlights the scale of the challenge confronting policymakers in the region. This is particularly true given that almost half of this total is legislative initiatives, with a further quarter involving reform of the public administration, both of which can be time-consuming and sometimes controversial endeavours. Nonetheless, the fact that, for example, the governments of Albania and Bosnia-Herzegovina are aiming to complete over 60 percent of their respective (legislation loaded) reform programmes by end-2001 indicates the ambitious targets that the administrations are setting for themselves.

Although completion of legal and institutional frameworks stand out as the over-riding preoccupations of SEE governments, the monitoring matrices bring out two important and positive shifts in focus, discernible particularly in the countries where transition is at a more advanced stage, but appearing also in the others:

- From drafting and adopting legislation to implementing and then enforcing it; and
- From setting up institutions to testing their competence and strengthening their powers.

Such actions (for example in the fields of competition law and policy, corporate governance, commercial law, insolvency regimes and dispute resolution mechanisms) now appear to be higher on the policy agenda in all transition economies. This is a positive sign because they represent the real ‘fundamentals’ or ‘building block’ reforms for a market economy that have been for too long neglected. Although less ‘glamorous’ than privatisation, their impact is likely to prove equally if not more enduring, and just as determinant as a factor to foster economic growth in the region.

A number of factors (both endogenous and exogenous) are influencing this evolution, in particular:

- A political and economic environment more conducive to reform, stemming from 1) the arrival in power (since early 2000) of governments in several countries that are noticeably more committed to the reform process and 2) a period of relative macroeconomic stability, including lower inflation and stable currencies.
- Progress with components of the reform agenda that have in turn exposed the need for greater attention to the enabling environment for business; for example, liberalisation of markets and restructuring of monopolistic state-owned enterprises, as well as the emerging emphasis on SMEs, have highlighted serious weaknesses in the regulation and supervision of commercial transactions.
- The increasing participation of the SEE region in bilateral regional and global trading and investment agreements (most are now members of WTO), which is prompting legal scrutiny of legislative frameworks, their interpretation and implementation. This process contributes to the removal of ambiguities and lack of transparency that could unduly discriminate against non-national investors.
- The conclusion of Accession or Stabilisation and Association Agreements with the EU and successive agreements with the World Bank and IMF, all of which include, to a greater or lesser extent, structural reform requirements.

In spite of these positive signs, potential investors in the region will want to see concrete proof that the legislative, regulatory and supervisory frameworks that are being developed are adequate and that the judiciary has the necessary authority to enforce them, even where strong vested interests are involved. These guarantees will require close political attention and unwavering support.

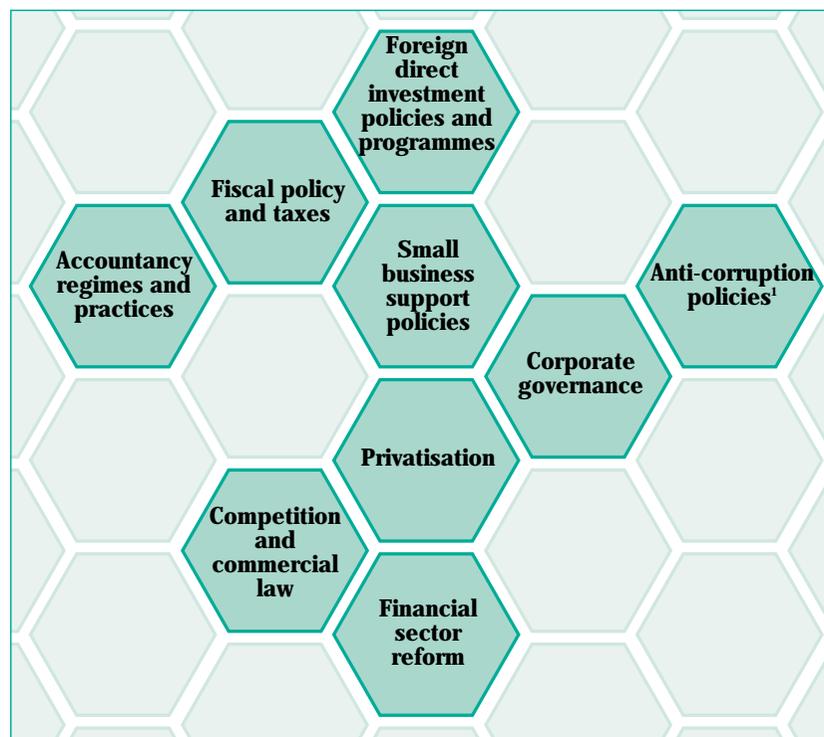
The monitoring process of the Investment Compact provides a means by which to keep political attention focused on the commitments and objectives that have been made. This is especially so for those countries which have endorsed the Monitoring Instruments as official policy statements. The monitoring process can help to ensure coherence in policy formulation and provide a focus, through the Country Economic Teams, for better inter-ministerial and donor co-ordination. Nonetheless, and inevitably, the process stalls on occasion, most often following elections or as a result of internal disagreements within administrations, with the result that the overall reform programme loses vital political support and progress gives way to expediency. The reform process across the region is not self-propelling and needs nurturing both within each country and from the international community.

The monitoring matrices represent an impressive and very ambitious commitment to advancing the process of transition, and it is important to bear in mind that achievement of these goals is by no means “automatic” and in many ways transition remains fragile and vulnerable to short-term political upheavals and economic instability (the current situation in the Former Yugoslav Republic of Macedonia attests to this). The next edition of the Monitoring Instruments (end 2001) should determine whether the general optimism that is reflected in this document was justified.

PROGRESS IN POLICY REFORM

1. Policy Objectives and Planned Actions

The Investment Compact uses the working assumption that improvement of the investment climate and acceleration of economic reform through sound market-oriented policies is the only way to promote a vibrant private sector and increase investment in the economy, both domestic and foreign. Nine inter-related policy areas are recognised as having a particularly significant influence on this process.



The reform programmes presented here are organised mainly around these nine headings, with each country adding supplementary topics where these were deemed relevant to the investment environment. These include, in particular, land reform and property rights issues and external trade policies.

1. More detailed consideration of progress by the countries of South East Europe in combating bribery and corruption is provided through the Stability Pact Anti-Corruption Initiative (SPAI). Information on this project can be found at www.oecd.org/daf/spaicom.

In each of the policy areas, the reform programmes are based on achievement of a limited number of major policy objectives (column 1 of the monitoring matrices), which, in practice, will require implementation of one or several policy measures or individual actions (columns 2 and 3 in the monitoring matrices).

Thus, for example, in the area of FDI policy, the short-term policy objectives of the government of Albania include:

To improve the regulatory and legislative framework for FDI

The actions planned to achieve this objective are:

- Establishment of independent offices for the resolution of commercial disputes.
- Ratification of several agreements related to arbitration.
- Improvement of the performance of judiciary bodies and tribunals, training of judges, attorneys and notaries.

Similarly, in its efforts to fight corruption, the objectives of the government of Montenegro include:

To set up a legal framework and institutions to address issues of corruption

The specific actions planned to achieve this objective are:

- Establishment of special independent anti-corruption agency.
- Preparation of a law on public procurements.
- Preparation of a law on money laundering.

Altogether, the seven countries included here have set around 180 broad policy objectives, all, to a greater or lesser degree, designed to improve the conditions for investment and private sector activity.

To attain these goals, the countries propose over 450 individual policy measures spread across the nine policy areas as follows.

Table 1. **Distribution of initiatives by policy area**

Policy area	Number of policy measures
Foreign direct investment policies and programmes	50
Small business support policies	57
Privatisation	59
Fiscal policy and taxes	65
Corporate governance	5
Competition and commercial law	26
Accountancy regimes and practices	16
Anti-corruption policies	77
Financial sector reform	40
<i>Other (mainly land reform and trade/external relations)</i>	64

At least seven main types of policy action can be identified.

Table 2. **Typology of policy measures proposed in the Monitoring Instruments**

Type of measure	Number ²
Strategic planning and policy review	65
Legislative reform	236
<i>Of which:</i>	
• <i>Adoption of new legislation/Amendment of existing legislation</i>	166
• <i>Regulation and implementation of laws</i>	70
Institutional/administrative reform	121
Capacity-building/training	19
Public information/publicity	30
Financing	16
External relations/international treaties	36

The reform programmes are, therefore, predominantly legislative. These legal reforms constitute the point of departure for a series of supporting measures ranging from establishment of regulatory institutions and specialised policy delivery agencies to capacity-building and training programmes for those involved in implementing new practices or information campaigns to explain to the general public or specific audiences what obligations the new legislation brings with it.

² The total differs from that in Table 1 because some measures include components from more than one type.

It is fair to assume that the processes of reform in each country follow broadly similar sequences, such as:



As a result, the different starting points, in terms of the level of advancement and the length of time that the reform process has been going on, from one country to another come out clearly from examination of the type of measure in each policy area. For example, in the field of competition policy and commercial legislation, the short-term policy actions proposed by Albania and Bosnia-Herzegovina include adopting commercial legislation and setting up a competition regulatory institution, while for Bulgaria and Romania they include enforcement of legislation by the regulatory body and capacity-building for the judiciary. Similarly, in the field of privatisation, Montenegro and Bosnia-Herzegovina are undertaking strategic plans for privatisation of industrial enterprises, while Croatia and Bulgaria, where the industrial sector is already largely in private hands, focus their strategic plans on the restructuring and eventual privatisation of public utilities.

2. Progress to Date and Target Dates

The Investment Compact focuses on measures to rapidly improve the investment climate, a reform programme for the near term that makes a clear statement about the commitment of governments to shared regional goals. Thus, speed of implementation is a key consideration in the reform programmes. Since the process of preparing the monitoring matrices began several months ago, already significant progress has been made. Nonetheless, the scale of the task at hand is also apparent.

The table below, which sets out in percentage terms that proportion of actions completed so far compared with those scheduled for completion in 2001 and later, serves as an indicator of the relative pace of reforms in the different countries of the region. For example, it shows that Bulgaria has moved ahead of the other countries in the implementation of its reform programme, and suggests that the reform programmes that the governments of Albania and Bosnia-Herzegovina, and to a lesser extent Montenegro and Romania, have set themselves are particularly ambitious.

Table 3. **Target dates for all policy measures in the Monitoring Instruments**

	Percentage completed in last 12 months	Percentage for completion in 2001	Percentage with deadline beyond 2001 or not specified
Albania	30	63	7
Bosnia and Herzegovina	14	64	22
Bulgaria	58	33	9
Croatia	42	32	26
FYR Macedonia	37	14	49
Montenegro	40	45	15
Romania	34	45	21

Looking specifically at legislative reform, since autumn 2000, when the countries were asked to identify their priorities and begin compiling a monitoring document, almost one-third of the new or amended legislation has been adopted. Nevertheless, this leaves a large number still to be passed before the end of 2001 if the timetable is to be fully observed. This represents a significant challenge to the legislatures (notably in Bosnia and Herzegovina where the backlog is particularly heavy).

Table 4. **Completion dates for the 166 legislative measures included in the Monitoring Instruments**

	Completed/adopted since beginning of IC period	For completion by end 2001	Longer term (beyond end 2001) or not specified
Adoption or amendment of legislation	47	101	18

Putting together information from the monitoring matrices regarding the overall objectives of reform, the specific policy actions and an indication of the pace of implementation of the reform programmes provides a unique country-specific and regional information source. The following section provides a commentary on some of the main conclusions that can be drawn about the nature of the reform process.

3. Analysis of Policy Priorities

The priority areas for policy action can be grouped under three interlinked headings: 1) policies relating to external commercial relations (mainly investment and trade facilitation), 2) policies relating to enterprises (privatisation, enterprise restructuring and private sector development), and 3) policies relating to the framework for commercial relations (competition, company law, regulatory mechanisms).

3.1 External commercial relations (including inter-regional trade)

Attraction of FDI into the region remains a key policy priority for all SEE governments. Despite improved results in some countries, and impressive totals in others, there is still concern that too high a proportion of the total FDI is directly related to privatisation of key state enterprises and not enough is greenfield investment or directed into private companies.

Although some of the figures, particularly for Croatia, Bulgaria and Romania, are significant, there is a strong correlation between inflows and progress with cash privatisation. For example, foreign investment into Croatia in 1999 was largely made up of proceeds from the sale of shares in the national telecoms company and to Deutsche Telekom (approximately US\$850 million out of a total of US\$1.3 billion) and the figures for Albania include a significant share resulting from the sale of Albania Mobile Communications (AMC). This means that figures can actually drop dramatically from one year to the next even though the general trend in the number of investments made is upward. **A key message from the table below is that FDI figures may suggest good performance in attracting investment through the impact of a single, one-off major privatisation in a particular year.**

Table 5. **Foreign Direct Investment (net inflows recorded in the balance of payments)**

Country	Yearly FDI net inflows (US\$ million)					Cumulative per capita FDI inflows (US\$)
	1996	1997	1998	1999	2000	1989-1999
Albania	97	42	45	51	92	137
Bosnia-Herzegovina	0	0	100	60	100	37
Bulgaria	138	507	537	806	500	284
Croatia	509	302	781	1,350	450	716
FYR Macedonia	12	18	175	27	100	134
Romania	415	1,267	2,079	949	500	252

Source: EBRD Transition Report 2000

In order to attract investment into other sectors of the economy and into new ventures once the more attractive assets have been sold, efforts are being intensified in at least three areas:

- Ensuring a clearer and more predictable legal and institutional environment for business;
- Integrating into international trade and investment agreements; and
- Improving the effectiveness of FDI promotion strategies and the capacity of promotion institutions.

a. Providing a predictable and supportive business environment

In the field of FDI policies, most countries can point to legislation guaranteeing equal treatment for foreign investors, unrestricted repatriation of profits and so on, and many of these laws have been in existence for several years (for example: Albania in 1994, Bosnia 1998, Bulgaria 1997, Croatia 1995). Montenegro enacted its own legislation ensuring equal treatment in November 2000. Legislative initiatives for 2001, if any, are directed towards refinement of existing legislation and enforceability of rules (for example in FYR Macedonia where legislation to improve legal access to real estate for foreign investors has recently been adopted or in Romania where a review of legislation is underway with the aim of simplifying procedures, reducing paperwork and increasing transparency).

Rather than focusing on the specific case of treatment of foreign investors, the Monitoring Instruments highlight a broader initiative to overhaul legal and regulatory systems as they apply to foreign-owned and domestic businesses alike. The reform programmes suggest that major efforts are underway or to be launched in the following fields, each of which has an important impact on investment:

- Reducing administrative and regulatory obstacles to the creation and development of private enterprises - for example, licensing requirements, registration procedures, reporting and accounting regimes. (In some cases, recent FIAS reports are expected to provide the impetus and direction for concrete reform proposals);
- Clarifying and simplifying tax and other regimes to produce a more transparent system, including reduction of the myriad of incentives and exemptions (including those offered to foreign investors) which are often obscure and/or unpredictable in practice;
- Enacting and effectively enforcing commercial laws, in particular, 1) competition legislation and accompanying regulatory institutions and 2) bankruptcy and collateral legislation and accompanying legal recourse mechanisms (discussed in more detail below).

b. Integrating into international trade and investment agreements

The Monitoring Instruments reflect the high priority given by all SEE governments to participation in bilateral, regional and global trade and investment agreements.

Over the past year, the countries of the region have made significant progress in integrating into multilateral agreements: the majority are now members of WTO and either participate in or are negotiating to join regional trading agreements. The Monitoring Instrument show, for 2001, a continuation, if not intensification of this activity, with, for example, Bulgaria in the process of finalising more than a dozen bilateral investment treaties (BITs) before the end of 2001 and Croatia committing itself to signing trade agreements that would put over 80 per cent of its foreign trade under some form of free trade coverage. Moreover, despite many difficulties (relating mainly to the assets of the former Yugoslavia), the Monitoring Instruments suggest that countries in the region are committed to making progress on intra-regional trade and investment agreements (for example, a free trade agreement between Croatia and Bosnia-Herzegovina has been concluded and there have been positive developments on regional trade liberalisation in the context of the Stability Pact³).

³ A memorandum of understanding between the countries of the region on the establishment of a regional free trade agreement is in preparation and will be signed in Brussels in June 2001.

Although many of the bilateral agreements cover what can be considered “marginal” markets for goods and services supplied from SEE countries, the overall impact of these agreements on the framework conditions for investment and enterprise development is more far-reaching, ensuring, among other things, that legislation relating to the rights of investors meets certain minimum international legal standards and that its interpretation is clear and unambiguous. A recurring theme of the Monitoring Instruments is the passage from drawing up and adopting legal instruments to their implementation and enforcement in practice, and to their testing in the courts of law: legal scrutiny of domestic legislation in the context of bilateral and international agreements, and the establishment of precedents in the local jurisprudence, can have a very positive impact.

c. Improving the performance of FDI promotion institutions

The need to complement privatisation-related FDI with investment into privately owned businesses and new ventures puts additional emphasis on the work of investment promotion structures and agencies. While ministries of finance and/or privatisation agencies take most of the responsibility for negotiating sales of major public assets to foreign investors, when it comes to “selling” the competitiveness of a particular country, in terms of its infrastructure endowments or the skills of its labour force, then specialised agencies, with professional marketing and promotion strategies, have a key role to play.

The Monitoring Instruments emphasise two aspects of investment promotion: 1) building stronger institutions, and 2) improving the outcomes from FDI promotion activities. While some FDI promotion agencies, notably the BFIA in Bulgaria, have both a solid institutional status and a wide range of advanced marketing and promotional materials, including use of the internet, most other countries have relatively weak FDI institutions and, consequently, poor quality outreach capacity and tools.

Evidence that this situation is being rectified and that a process of institution building (or rebuilding) and refocusing is taking place can be seen in the reform programmes of Albania, Bosnia-Herzegovina, Croatia and FYR Macedonia. In FYR Macedonia, for example, a Trade and Investment Promotion Department has been established in the Ministry of Economy with the intention of acting as a one-stop shop for the registration of foreign companies. In Romania, this process of institutional strengthening is being supplemented by moves to develop mechanisms through which FDI promotion is integrated into the foreign relations activities of the diplomatic/political community.

3.2 Enterprise policy and private sector development

Increasing the pace of privatisation emerges as a prime policy objective. The Monitoring Instruments bring out three main areas of policy action

- Revision of existing legislation, mainly to improve transparency;
- Acceleration of the sale of large enterprises; and
- Preparation of strategic/public utility sectors for eventual privatisation.

These three elements are present in all countries, though at somewhat differing degrees of advancement, except for Montenegro where the enabling legislation for privatisation is currently in preparation.

In most SEE countries, legislation governing the sale of publicly-owned assets was introduced several years ago. However, experience, both good and bad, has highlighted the need for amendments and revisions, particularly with regard to improving the transparency of sales. Concerns over complex and unclear ownership structures have been seen as a major deterrent for foreign investors wishing to invest in going concerns. Similarly, concerns that privatisation processes favour local, insider interests has also acted as a disincentive to foreign companies even to compete in tenders. Addressing these issues and providing potential investors with more and better-quality information are key goals reflected in the policy programmes for 2001. As an example, a new audit law is planned for adoption in June 2001 in FYR Macedonia, which is intended to improve the auditing requirements of companies earmarked for privatisation and ensure that their financial records are transparent and accurate.

A pervasive obstacle to privatisation in some countries, notably Yugoslavia successor states, is the issue of disputed property rights and restitution, which remains only partially resolved. As a result, land reform, completion of land registration and legal procedures for dispute resolution are often included in Monitoring Instruments as key policy objectives linked to privatisation (as well as investment promotion and private sector development).

With regard to overall progress on privatisation, there is significant variation across the region. The mass privatisation phase is completed in most countries, and its rapid completion in the others is a priority (both entities in Bosnia-Herzegovina and in Montenegro).

Progress with privatisation of larger assets, on the other hand, has been much less uniform (see Table 1 in the Appendix). Bulgaria is the only SEE country to have successfully privatised over 50 per cent of all large state-owned enterprises according to EBRD estimates for 2000, with Croatia, FYR Macedonia and Romania having privatised more than 25 per cent, and Albania and Bosnia still to launch comprehensive programmes (though some sales have taken place). The process in Montenegro is at an even earlier stage, but the enabling legislation is either in place or will soon be adopted.

On the positive side, directly negotiated sales of the more attractive state-owned industries (fixed line telecoms, GSM, major banks, tourist facilities) are taking place at a relatively fast rate, and legislative and institutional efforts to promote such sales stands out as a high priority in the short term for all governments (for example, the sale of a second GSM licence in Albania (the first having been sold for almost US\$100 million) and an additional 16 per cent share of Croatia Telecom (one-third of which was sold to Deutsche Telekom in 1999 for US\$850 million)). As noted above, the proceeds from these sales often represent the lion's share of FDI in the region, and constitute an important short-term source of revenue to offset other transition costs (related to reining in of public expenditure, accession to WTO, various agreements with the EU, etc.).

The key obstacle to faster privatisation of large enterprises more generally tends to be the disposal of major loss-making enterprises for which cash privatisation is unlikely unless preceded by significant restructuring, including disentanglement from soft budget processes and other forms of support provided by the state. For example, EBRD's assessment of progress last year shows that few countries had seriously tackled the issue of enterprise restructuring (see Table 2 in the Appendix), with only Croatia receiving a qualified recognition of efforts to financially isolate major loss-makers and reform subsidy policies. Croatia's efforts to liquidate poor performing enterprises remains a key element of the policy programme for 2001, though the legal process so far has been slower than expected, resulting in a backlog of cases that need to be addressed this year.

Judging from the reform programmes presented here, sustained action to address the problem of persistent loss-making industries and to restructure sectors will be prompted from two directions:

- Moves to tighten control of public expenditure and ensure long-term fiscal sustainability; and

- Preparation of strategic sectors for privatisation, notably pre-privatisation restructuring of large state-owned enterprises, including public utilities.

An important policy objective for 2001 in most countries (often proposed in agreement with the IMF) is improvement of the procedures governing public expenditure; in particular, tightening of internal budget processes and establishment of a single “Treasury” to unify government accounts. The allocation of the treasury function to an agency linked to or within the Ministry of Finance, which has been achieved or is in progress in most if not all countries, is designed to curtail overspending and the build-up of debt by individual government departments, agencies and enterprises. It also facilitates the financial isolation (and subsequent restructuring or liquidation) of loss-making state owned enterprises, whose soft budget constraints and state guarantee rights represent a major drain on the coffers of all SEE countries. The main obstacle to faster progress in this area is usually the employment or social consequences of abrupt intervention and the fact that many significant loss-makers are in “strategic” sectors.

The next, but problematic, phase in the privatisation process in most countries is preparation of strategic sectors for privatisation, notably pre-privatisation restructuring of public utilities. The Monitoring Instruments suggest that initial steps are underway. Although mainly at the advanced planning phase, these generally concentrate on unbundling core and subsidiary activities and imposing hard budget controls on the enterprises concerned. This process will be accompanied by preparation of legislation liberalising markets (e.g., electricity, gas) and permitting the sale of licences (for example, comprehensive legislation along these lines is being developed in Croatia). In practice, dismantling complex state monopolies has started slowly and utility pricing that reflects economic costs is still the exception rather than the rule, so this process is likely to be laborious. Moreover, before privatisation of these sectors takes place, sound regulatory institutions will be needed to ensure that public monopolies are not simply transformed into private monopolies.

3.3 Framework for commercial relations

As noted above, the extent to which legislation governing business transactions is comprehensive, clear and enforced is increasingly recognised as playing an important role in determining levels of investment, particularly from the perspective of foreign investors whose information needs and legal status may differ from those of nationals. The over-riding impression given by the Monitoring Instruments is that SEE governments are, somewhat belatedly, and in some cases under pressure from the international community, prioritising legislative and institutional efforts in at least two main areas:

- Competition policy⁴; and
- Commercial law.

In the field of competition policy, the scores assigned by EBRD (see Table 3 in the Appendix) attest to the fact that results so far have not been particularly encouraging.

Although new or amended legislation has been introduced in most countries recently, differences emerge in the capacity of the administrations to enforce regulations. In the more advanced countries, notably Bulgaria, Croatia and Romania, some efforts have been made to promote a competitive environment and to initiate proceedings through newly established competition councils or similar agencies to break up major monopolies, but initiatives have been far from systematic. In other countries, the legislation is generally in place but the regulatory back-up is still lacking

4. Under the Investment Compact, a new Regional Flagship Initiative on competition policy and institutions has been launched, with Slovenia, FYR Macedonia and Bulgaria as lead partners with the OECD, and in cooperation with the EU.

However, the reform programmes presented in the Monitoring Instruments suggest that efforts are being reinforced and that some important steps will be taken in the coming months. For example:

Between January and December 2000, the Bulgarian Commission for the Protection of Competition announced 156 decisions, of which an increasing number are based on the application of *acquis* norms. As a support to this, the government is also taking steps to generate a “culture of competition” to underpin the new legal framework. In Croatia the two main areas of upcoming activity are harmonisation of competition legislation with EU norms (with technical support from the German government) and institutional strengthening of the Agency for the Protection of Market Competition whose purview currently excludes public utility markets. In Albania, an Economic Competitiveness Directorate with responsibility for clarifying the mechanisms for monitoring competition issues in Albania. In Bosnia, both the legislative framework and the institutional support still need to be completed, but a key step will be the establishment of a Competition Council in June this year.

Nonetheless, for all countries the need to promote competition through addressing the monopoly positions held by major conglomerates, as well as setting up supervisory institutions, continues to be a central issue. As noted above, however, advances in the areas of enterprise restructuring and price liberalisation should clear the way for these fledgling institutions to take on a more active role. Negotiation on accession to the EU and conclusion of Stabilisation and Association Agreements with the Commission appear to be the key impetus driving the adoption and implementation of new laws in this complex field.

The situation with respect to commercial legislation is similar, in the sense that bankruptcy and collateral laws have been introduced in most countries but their enforcement is inconsistent. The Monitoring Instruments, therefore, include a strong focus on speeding up processing of legal claims.

Regulation and supervision also stand out as key issues in the financial sector, this time prompted by concern to avoid the disastrous bank failures of the past and create more robust banking sectors

Overall, substantial progress has been made in establishing solvent banking sectors in SEE countries. Consolidation of the banking sector depends to a large extent on ensuring significant foreign participation in privatisation of major banks combined with tightening of the regulatory requirements in order to force insolvent banks to close or merge. While the complexity of the portfolios of many formerly state-owned banks has caused significant delays in the sell-off process, significant advances have been made in all countries. The Monitoring Instrument suggests the process is all but complete in both Bulgaria and Croatia, where the major bank sales took place last year, and includes major bank privatisations in the pipeline in Albania (Savings Bank, which is the main savings repository) and Romania (Banca Agricola, which is under special management and has been recapitalised, and the Romanian Commercial Bank, which is the country’s largest bank). In Bosnia-Herzegovina, plans for bank privatisation are currently being considered by both entity governments for adoption in the first half of 2001 with stabilisation of the sector a priority.

At the same time, although significant progress has been made in establishing regulatory and supervisory institutions and a legal framework, a question mark remains as to the degree to which these bodies can exert sufficient control over the sector.

The limited authority that the supervisory bodies enjoyed at their inception, as well as their limited experience, constrained their initial effectiveness in practice in picking out poor performing financial institutions and taking firm remedial action. However, the Monitoring Instruments reflect a strong focus by all of the governments (supported by IFIs) on building more robust institutions, with strengthening of the central bank’s supervisory authority and of its competency a priority in several countries. For example, the National Bank of Romania is working to improve its supervisory and regulatory control

over the banking sector by means of improved risk management and auditing, including an early warning system developed with the IMF to pick out troubled banks. The supervision departments of the Croatian and Bulgarian central banks have also been given additional powers of scrutiny and expanded authority for direct action.

With regard to non-bank financial institutions, the point of departure for the monitoring process is significantly less advanced than for the banking sector. The EBRD assessment for 2000 (see Table 4 in the Appendix) concludes that while securities exchanges have been established some trading in government paper and/or securities is taking place; and the basic legal instruments needed to issue securities have been adopted, there is still little liquidity and trading volumes are very low. The Monitoring Instruments show that the institutional infrastructure for secondary markets - independent share registries, secure clearance and settlement procedures, and regulatory frameworks - is being introduced in most countries. However, there is a sense that trade in securities will depend heavily on further progress with privatisation (which up to now has been the main source of trading).

These reforms (for example in the fields of competition law and policy, corporate governance, commercial law, insolvency regimes, dispute resolution mechanisms and supervision of the banking sector) now appear to be higher on the policy agenda in all transition economies. This is a positive sign because they represent the real 'fundamentals' or 'building block' reforms for a market economy that have been for too long neglected. Although less high profile than privatisation, their impact may well be enduring, and prove just as determinant as a factor to foster economic growth in the region.

4. Monitoring the Process of Reform

Existing and potential investors in the region want concrete proof that the legislative, regulatory and supervisory frameworks that are being developed are adequate and that the SEE governments are committed to building a clear and predictable environment for business. These guarantees will require unambiguous political attention and support. The Monitoring Instruments can provide a tool for maintaining this political focus.

The reform programmes contained in the Monitoring Instruments provide some evidence of progress in recent months and show that the governments of SEE countries have set themselves ambitious targets for 2001 and beyond. However, stating objectives and achieving them are two very different things.

The next edition of the monitoring matrices will assess which of the planned policy actions included in this document have advanced since the first edition. It will also include private sector views on progress with the reform agenda as well as indices of changes in investment flows in the region. Together these elements will help to monitor advances in reform and try to show, over time, what impacts the efforts made by governments are having on building a more favourable investment climate.



APPENDIX

EBRD TRANSITION INDICATORS

EBRD transition indicators provide a convenient estimation of the relative starting points of each country (except Montenegro) in some of the key policy areas when the Investment Compact began. These scores, ranging from 1 (little progress) to 4+ (standards typical of an advanced industrial country), are based on evaluation of both quantitative and qualitative information gathered by EBRD, a full description of which can be found in the *Transition Report 2000* (EBRD).

Table 1. **Large-scale privatisation**

Country	Score
Albania	2
Bosnia	2
Bulgaria	4
Croatia	3
FYR Macedonia	3
Romania	3

EBRD classification criteria:

1. Little private ownership
2. Comprehensive programme almost ready for implementation; some sales completed
3. More than 25% of large enterprises in private hands or with sales at an advanced stage; unresolved issues
4. More than 50% of large enterprises in private hands, with significant progress in corporate governance
- 4+ Standards typical of an advanced industrial economy

Table 2. **Governance and enterprise restructuring**

Country	Score
Albania	2
Bosnia	2-
Bulgaria	2+
Croatia	3-
FYR Macedonia	2+
Romania	2

EBRD classification criteria:

- 1 Soft budget constraints; few other reforms to promote corporate governance
- 2 Moderately tight credit and subsidy policy but weak enforcement of bankruptcy legislation and little action taken to strengthen corporate governance and competition
- 3 Significant and sustained action to harden budget constraints
- 4 Substantial improvement in corporate governance
- 4+ Standards typical of an advanced industrial economy

Table 3. **Competition policy**

<i>Country</i>	<i>Score</i>
Albania	2-
Bosnia	1
Bulgaria	2+
Croatia	2+
FYR Macedonia	2
Romania	2+

EBRD classification criteria:

1. Little private ownership
2. Comprehensive programme almost ready for implementation; some sales completed
3. More than 25% of large enterprises in private hands or with sales at an advanced stage; unresolved issues
4. More than 50% of large enterprises in private hands, with significant progress in corporate governance
- 4+ Standards typical of an advanced industrial economy

Table 4. **Securities markets and non-bank institutions**

<i>Country</i>	<i>Score</i>
Albania	2-
Bosnia	1
Bulgaria	2
Croatia	2+
FYR Macedonia	2-
Romania	2

EBRD classification criteria:

- 1 Little progress
- 2 Formation of securities exchanges; some trading in government paper and/or securities; rudimentary legal framework for the issuance of securities
- 3 Substantial issuance of securities by private enterprises; establishment of independent share registries, secure clearance and settlement procedures, and some protection of minority shareholders; emergence of non-bank institutions and associated regulatory framework
- 4 Securities laws and regulations approaching IOSCO standards; substantial market liquidity and capitalisation; well-functioning non-bank institutions and regulatory system
- 4+ Standards typical of an advanced industrial economy