UDC: 334.722:338.2]:303.725.3(4-11)
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INSTITUTIONAL REFORMS AND IMPROVING THE BUSINESS CLIMATE IN SOUTHEAST EUROPEAN COUNTRIES: AN EMPIRICAL ANALYSIS

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Abstract
The process of economic and political transition in the countries of Southeast Europe (SEE) as a result of weak institutional capacities, permanent economic, political and security crises even after three decades has not ended. In the last decade, economic policy makers in transition countries have focused on creating a favorable business climate as the main strategy for a country's economic development.
According to Stern (2002) the "business climate" or business environment is the political and institutional environment that affects the attraction of more investment and the greater lending to the real sector of the economy. The focus of this study will be on institutional reforms to improve the business climate in SEE countries based on World Bank indicators and assessments.
The analysis for the period (2010-2018) reveals significant differences in the level of business climate between SEE countries despite the fact that certain countries are part of NATO and the EU while other countries are outside these structures. EU membership and meeting the Copenhagen criteria for the authors of this research are compatible with the World Bank's "Doing Business" criteria.
Keywords*:* **Business Climate, Doing Business, SEE countries, European Union, World Bank.**

1. Introduction

In the last decade, economic policy makers and multinational companies have increasingly focused on creating an attractive business environment as a strategy for a country's economic development.

According to Stern (2002) the business environment is identified with the current and future political and institutional environment in the function of economic development.The business environment covers all the factors that influence the rate of return on investment and the risks that businesses face.This general definition of business environment includes three categories (Xu, 2010):

1. The first category includes macroeconomic aspects such as: fiscal policy, monetary policy and exchange rate policy, policies that affect lending to the real sector of the economy, for example, high tax rates will reduce the rate of return, while inflation will increase the volatility of the rates of return and all these factors will influence the growth of business risk.
2. The second category includes governance, institutions and political stability.
3. The third category includes the infrastructure needed for productive investments, such as transport, electricity and communications.

In recent decades, the issue of institutional reforms and their impact on business sector development has become very relevant. Developing countries are poor because their current institutions provide insufficient incentives to stimulate economic growth. This argument raises the question not only of the kind of institutions they need to create, but even more important is how those countries can develop institutions that will serve the purpose of business development (Chang, 2005).

The delays and poor quality of structural reforms implemented in SEE countries still remain major barriers to attracting investment despite the fact that serious progress has been made towards creating a favorable business environment mainly formally.

This improvement of the business environment addresses the adoption of economic and legal legislation recommended by the IMF, WB, EU and other relevant international institutions.

The "Ease of Doing Business" indicator does not include areas such as: level of corruption, independence of the judiciary, market size, political and economic risk and the functioning of public institutions. Consequently, this indicator does not reflect the full attractiveness of the business environment as a prerequisite for attracting greater investment in the function of economic development (Osmani, 2015).

The Maastricht Treaty on EU Integration (Euro convergence criteria) sets out five basic criteria that aspiring EU members must meet. Three criteria focus on monetary convergence related to price stability, exchange rate stability and long-term interest rates nominal convergence.

The two additional criteria are focused on real convergence and relate to fiscal deficit and public debt. All countries that have been part of this analysis have successfully met the Maastricht criteria and have assured sustainable macroeconomic stability such as monetary stability, exchange rate stability and long-term interest rate stability at various levels. The SEE countries analyzed have very different levels and trends in terms of fiscal deficit and public debt as a consequence of the political governing conjunctions in the analyzed decade.

The Copenhagen Treaty on EU Integration (Euro convergence criteria) encompasses two basic criteria: the existence of a functioning market economy and the capacity to cope with competitive market pressures.

EU member states from the SEE region by meeting the Copenhagen criteria have achieved positive results that are also manifested by significant improvements in some important elements of the business climate. In the SEE countries that are in the process of joining the EU as long as meeting the Maastricht criteria has provided macroeconomic stability, however, these countries still have significant delays in meeting the Copenhagen criteria.

Serious delays have been identified in building a functioning market economy followed by insufficient development of the non-banking sector, high levels of tax evasion and the informal economy and insufficient institutional capacity to cope with competitive market pressures (Osmani&Mazllami, 2014).

2. Literature Review

Rich literature exists on the field of institutional reforms and improving the business climate.

According to Stern (2002) the"business climate" or business environment is the political and institutional environment that affects the attraction of more investment and the greater lending to the real sector of the economy. The authors Berger &Udell (2006) through their study have argued that institutional reforms affect businesses' access to finance and the attraction of local and foreign investment.

According to (Kremer, 1993) the effects of the business environment often vary according to specific contexts and there are often country-specific difficulties in this regard. According to (Shleifer, 2005) to accomplish the key objective of this study it is useful to consider three types of relationships between government and businesses and the social environment to achieve the desired social outcomes: market discipline, private litigation and enforcement public through regulation. Empirical evidence from the authors' studies (Acemouglu, Johnson, & Robinson, 2001) suggests that countries which have a lower enforcement of property rights in the context of institutional reforms tend to have lower aggregate investment, limited access of firms in finance and slower economic growth.

According to (Kokorović, 2014) institutional reforms should address issues related to some aspects of the financing environment, such as: information environment, legal, judicial and bankruptcy environment, social environment, tax environment and regulatory environment.Many studies have been conducted to analyze the impact of labor market regulation on improving the business climate, especially for the private sector of businesses.

3. Research Methodology

In order to meet the objectives of the paperthat is the ranking of the countries by indicator,Doing Business,of the World Bank between the countries that are members of the EU and the countries that are in the process of EU integration.The timeframe for the research is 2010-2018 including the following countries: The Republic of Albania (ALB), the Republic of Kosovo (RKS),North Macedonia (MKD), Montenegro (MNE), Bosnia and Herzegovina (BIH), Serbia(SRB), Croatia (CRO) and Bulgaria (BG).

By using common statistical and descriptive methods we provide a proper empirical and comparative analysis of the process of improving the business environment, the realization of foreign direct investment among these countries, some of which are EU member states and others are in the process of joining UE, meeting the Maastricht and Copenhagen criteria in advance. Empirical evidence from the authors' studies (Acemouglu, Johnson& Robinson, 2001) suggests that countries which have a lower enforcement of property rights in the context of institutional reforms tend to have lower aggregate investment.

4. Institutional reforms and structural elements of doing business in SEE countries

The World Bank through its Doing Business reports provides comprehensive data on institutional reforms being undertaken by all countries around the world to improve business climate and economic development. Within the 190 countries, the World Bank annually reports on the progress of institutional reforms and their impact on the business environment, including the countries of Southeast Europe that are the subject of analysis in this paper. Through its Doing Business Reports, the World Bank reports on 11 criteria that must be met by all countries in order to improve the business climate as a function of business development and the economy in general. Doing Business, integrates 11 business areas that demonstrate the complexity and cost of regulatory processes and the area of strengthening legal institutions and improving the business environment (Osmani, 2015).

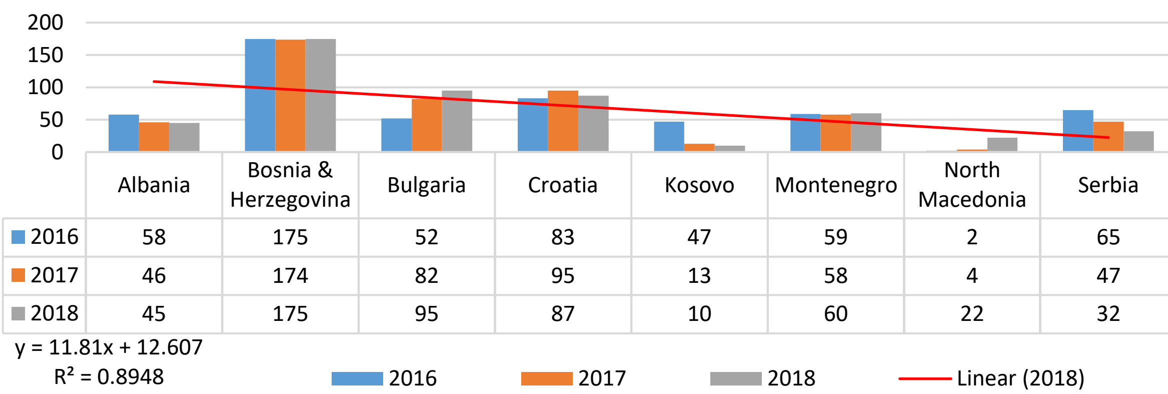
Table 1. Structural elements of doing business and describing institutional reforms

Structural elements of ,,Doing Business,,	Eleven areas of business regulation
1.Starting a business	Procedures, time, cost and paid-in minimum capital to start a limited liability company
2. Obtaining a construction permit	Procedures time and cost to complete all formalities to build a warehouse, quality control and safety mechanisms in the building permits system.
3. Supply with electricity	Procedures, time and cost to connect to the grid, reliability of power supply and tariff transparency.

4. Registration of property	The procedures, time and cost to transfer a property and the quality of the land management system.
5. Obtain bank loans	Mobile collateral laws and credit information systems.
6. Protection of investors	The rights of small shareholders in related party transactions and corporate governance.
7. Payment of taxes	Payments, timing and overall tax rate for a firm to comply with all tax regulations as well as post-filing processes.
8. Trade across borders	Time and cost to export product of comparative advantages and import of auto parts.
9. Implementation of contracts	Time and cost to settle commercial disputes and the quality of litigation.
10. Solving Insolvency	The time, cost, outcome and recovery rate for a commercial bankruptcy and the strength of the insolvency legal framework.
11. Labor market regulation	Flexibility in employment regulation and aspects of job quality.

In the framework of the many areas assessed by Doing Business, three are key structural elements: the complexity of the legislation, the cost of making business and the strengthening of legal institutions in the function of doing business.

Starting a business measures the minimum capital requirement paid, the number of procedures, the time and cost for a small to medium-sized company to start and operate its business officially.In order to make the data comparable for the 190 economies analyzed, the World Bank uses a standardized business that is 100% domestically owned, has start-up capital equal to 10 times per capita income, engages in general activities industrial or commercial and employs 10 to 50 workers per month after operations start (World Bank Group, Doing Business, 2018).



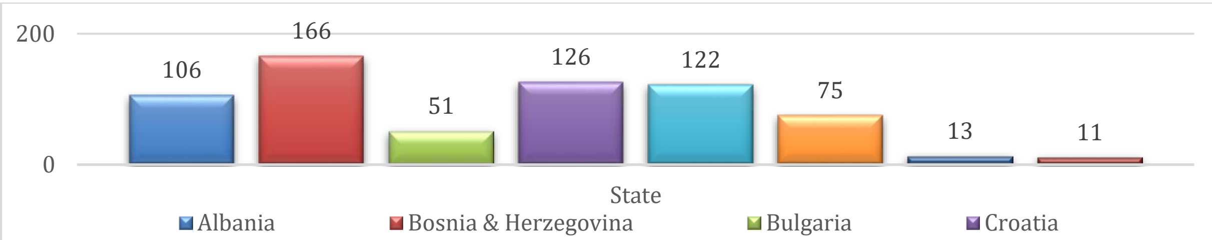
	Albania	Bosnia & Herzegovina	Bulgaria	Croatia	Kosovo	Montenegro	North Macedonia	Serbia
2016	58	175	52	83	47	59	2	65
2017	46	174	82	95	13	58	4	47
2018	45	175	95	87	10	60	22	32

Graph.1 Comparative analysis between SEE countries - Starting a business

Based on figure 1 in 2018 the best ranking countries based on this criterion are: Kosovo (10), North Macedonia (22), Serbia (32), Albania (45) and Montenegro (60). The countries with the lowest ranking are Croatia (87), Bulgaria (95) and Bosnia & Herzegovina (175).

If we consider the total cost of opening a business, in the period (2010 – 2018) we have a drastic cost reduction from 43.3% to 1%. Such a large decrease in cost as a percentage of per capita income comes as a result of simplifying the procedures for starting a new business. Considerable improvement of Kosovo is a result of the fact that since 2013 the governments of this country adopted many institutional reforms that eliminated bureaucratic barriers and set the minimum amount of capital and fee for business registration thus maximizing the business registration process.The very low ranking of Croatia (87) and Bulgaria (95) as EU member states is a consequence of the fact that the procedures and capital required for business registration are rigorous and require a larger amount of capital for start-ups than businesses other SEE countries that are not members of the EU.

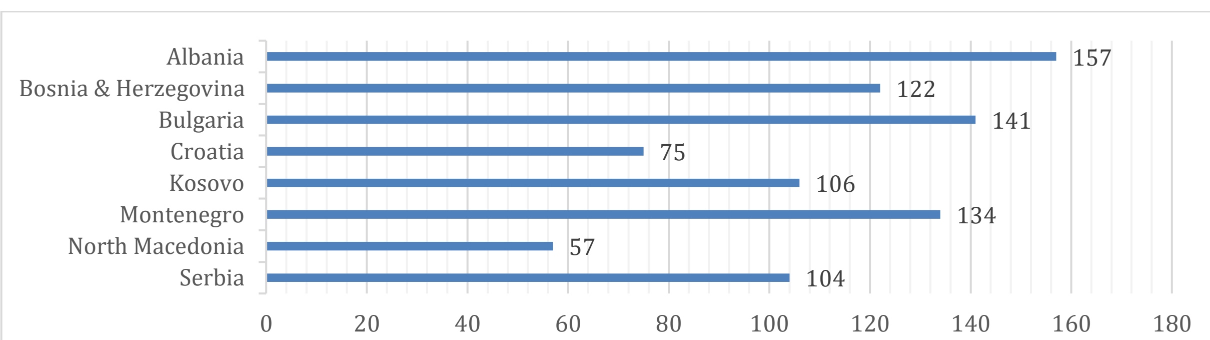
Indicators of construction permits take into account the following procedures: the procedures needed to legally construct an object, the time to complete all required procedures, the required cost that is taken as a percentage of the value of the object and the quality control index of construction.



Graph. 2 Comparative analysis between SEE countries - Obtaining a construction permit

Among the SEE region countries for 2018 according to the World Bank data, Serbia and North Macedonia are two countries that rank better than other countries in the region on the regulatory and construction cost of business facilities.These countries (Serbia and NorthMacedonia) have made serious progress in granting the facility permission to build on a very short timeframe and with a low cost for the construction permit compared to most otherscountries ranked by the World Bank.

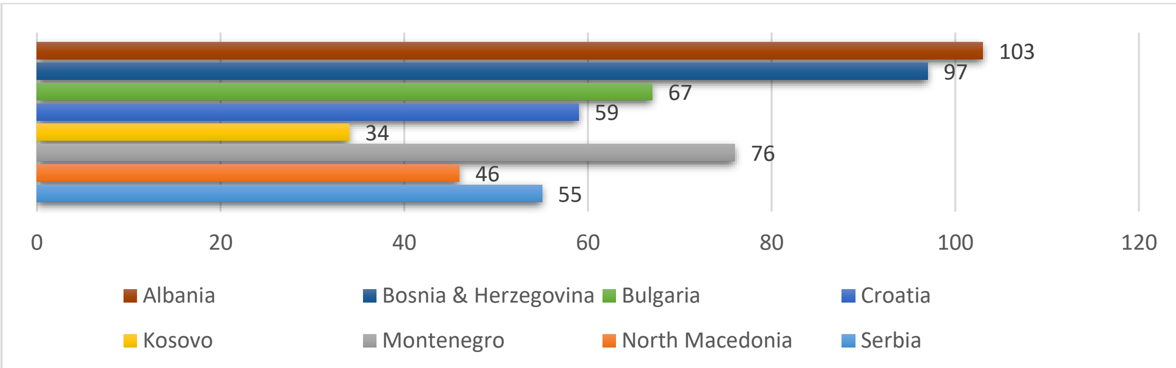
The very low ranking for obtaining business building permits in the case of Albania, Kosovo and Bosnia and Herzegovina in particular reflects a very high bureaucracy associated with corruption of institution leaders which has a very negative effect on potential investors in these countries.Electricity supply is evaluated by including all procedures required for a local business to ensure a permanent access to electricity and supply for a standardized facility as well as the time and cost to complete them. These procedures include applications and contracts with electricity companies, removal from other agencies, and external and final works of this approach (WBG, Doing Business, 2013).



Graph. 3 Comparative analysis between SEE countries - Power supply

Within the countries of the region, North Macedonia and Croatia have made the most progress in simplifying procedures, reducing time and reducing the cost of electricity supply. The data presented in figure 3 rank Albania, Bulgaria, Montenegro and Bosnia & Herzegovina as countries that need to take concrete institutional steps towards simplifying procedures and ensuring a stable electricity supply in sufficient levels to the business sector.

Property registration is one of the most important criteria that affect the creation of a favorable business environment as a guarantee that investment in real estate is safe and a prerequisite for investing in technology at the most advanced stages. Securing formal ownership rights is important in the lending process as well, but it also has a significant impact on improving the business climate.

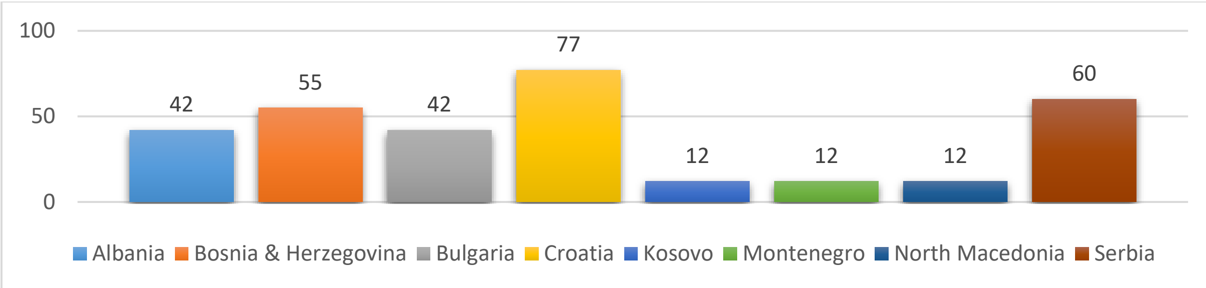


Graph. 4 Comparative analysis between SEE countries - Registration of property

Effective land management is an important part of institutional reforms, where if formal property transfer is costly and complicated, formal property titles can be re-evaluated informally. Therefore, in cases where property is informally administered, there is little chance of being accepted as collateral for loans, limiting access to finance (World Bank Group, Doing Business, 2015).

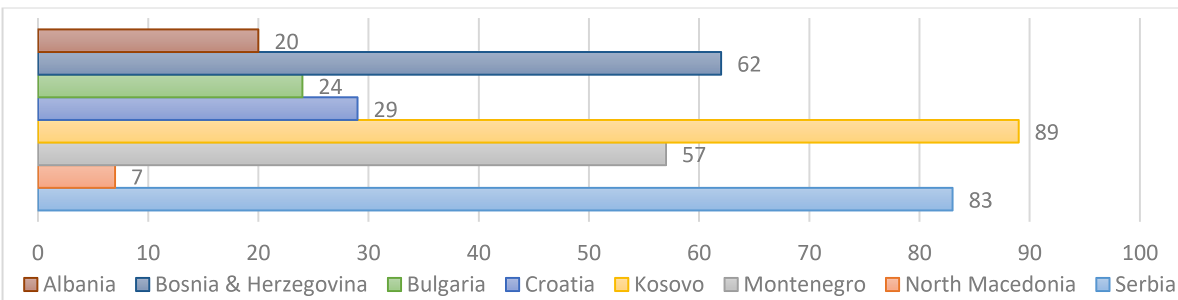
Enhanced property registration legislation has been adopted by Kosovo and, based on these rational and non-bureaucratic procedures, is ranked 34th, followed by North Macedonia at 46th and Croatia at 59th. At the bottom of this criterion is Bosnia and Herzegovina ranked 97th and Albania ranked 103rd in the world. A very asymmetric ranking of SEE countries according to this important criterion for the creation of a favorable business environment raises serious doubts about the fulfillment of the Copenhagen criteria by EU member states and disputes the formal aspect in relation to the real implementation of the property reforms based on the criterion of the World Bank.

Access to credit is one of the criteria that are of great importance in improving the business climate for small and medium-sized businesses. The main frameworks that can facilitate access to credit are: credit information systems and collateral and bankruptcy laws.Credit information systems enable lenders to analyze the financial history of a potential borrower when assessing risk and allow borrowers to create a good credit history that would facilitate their access to credit. Collateral laws enable businesses to use their assets, especially movable property as security to obtain new financial capital, while creditors' rights are associated with higher private sector credit to GDP ratio (WBG, Doing Business, 2018).To assess the efficiency of reforms implemented in lending procedures, the World Bank assesses four important indicators of credit access: the legal rights index, credit information index, credit registry coverage, and credit bureau coverage.



Graph. 5 Comparative analysis between SEE countries-Access to credit

The strength of legal rights index is measured by two factors: the rights of borrowers and lenders through collateral laws (0-10) and the protection of creditors' rights secured through bankruptcy laws(0-2). The Credit Information Index measures the scope and access of credit information distributed by credit bureaus and credit registries (0-8).The credit information index in 2018 is rated 6 out of 8 points. Ranking results based on this criterion reflect a paradoxical situation. Kosovo ranks 12th despite the fact that the cost of lending is the highest in Europe, while Croatia, as an EU member, ranks 77th in the world.



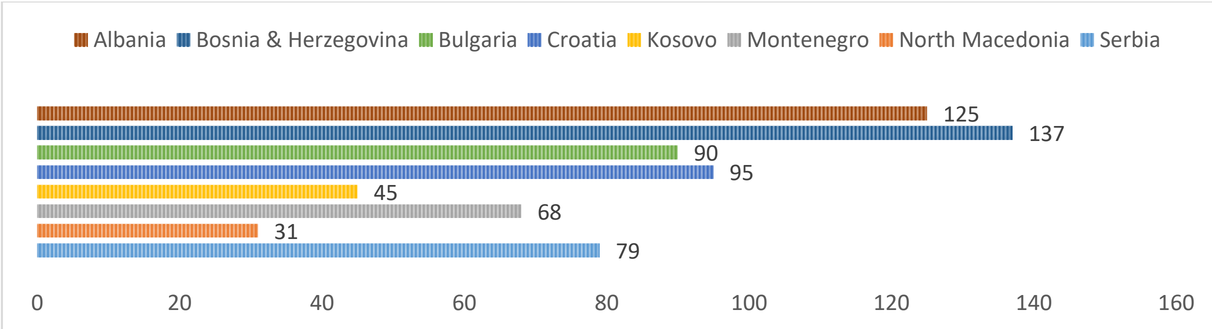
Graph. 6 Comparative analysis between SEE countries - Investor protection

Investor protection is an important issue for companies' ability to raise capital, restructure and diversify capital. Effective regulations precisely define transactions with related parties, promote clear and efficient disclosure requirements, require shareholder participation in major company decisions, and set detailed standards of accountability for the company (World Bank Group, Doing Business, 2016).

A World Bank study reveals that investors worry about financial means and seek laws that protect them. According to the study, the presence of legal and regulatory protection for investors affects up to 73% of the investment decision (World Bank Group, Doing Business, 2011).

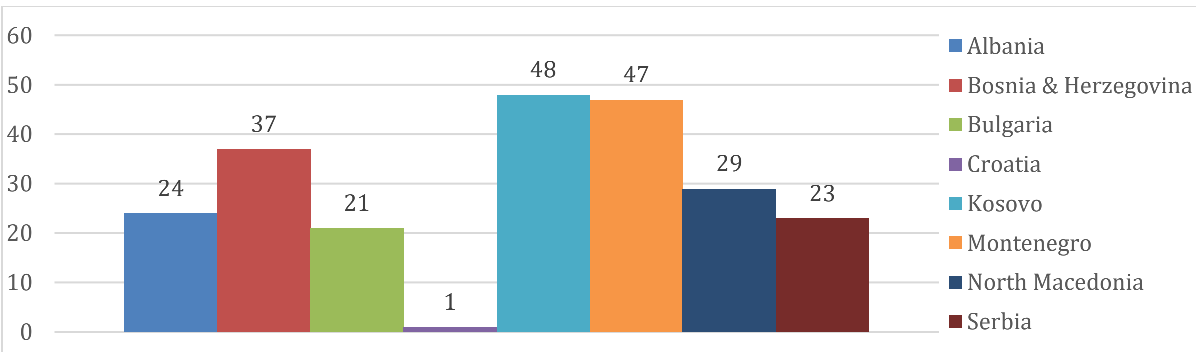
Within the SEE countries, Northern Macedonia, Albania, Bulgaria and Croatia have a better ranking in terms of institutional reforms undertaken in investor protection. The countries with the lowest progress in investor protection are Montenegro (57), Bosnia & Herzegovina (62), Serbia (83) and Kosovo (89).

Paying taxes is important and the level of tax rates should be carefully selected and the unnecessary complexity of tax rules avoided. Businesses that rank better in the ease of paying taxes tend to perceive that tax rates and tax administration are less of a hindrance to business according to the World Bank (WBG, Doing Business, 2016).



Graph. 7 Comparative analysis between SEE countries - Paying taxes

Within the countries of the region, the countries that have most reformed the tax system and created tax payment facilities are North Macedonia, Kosovo, Montenegro and Serbia. Facilitating trading between different economies in today's globalized world is increasingly important for business.

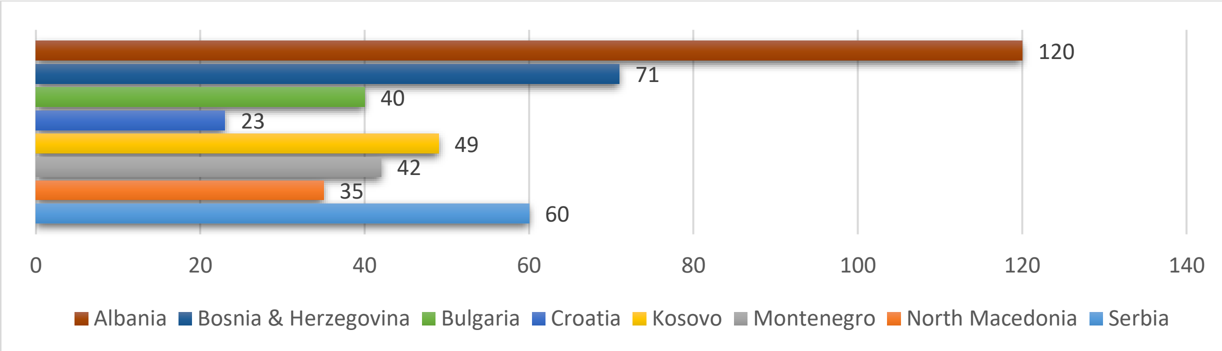


Graph. 8 Comparative analysis in SEE countries - Trade Facilitation

Bureaucratic customs procedures, multi-document requirements, inefficient port operations, and inadequate infrastructure result in additional costs and delays for exporters and importers, hampering trade potential. In general, trade facilitation has the effect of reducing tariffs for businesses exporting goods and services.

According to the data presented in figure 8, Croatia is the first country in the world in terms of trade facilitation, enabling many local businesses but also foreign businesses to export at lower costs and lower tariffs. Kosovo's unfavorable position relates to complicated trade cooperation relations with Serbia and Bosnia & Herzegovina which in turn affects cooperation with other countries despite the fact that the SEE countries are members of the Ceftas.

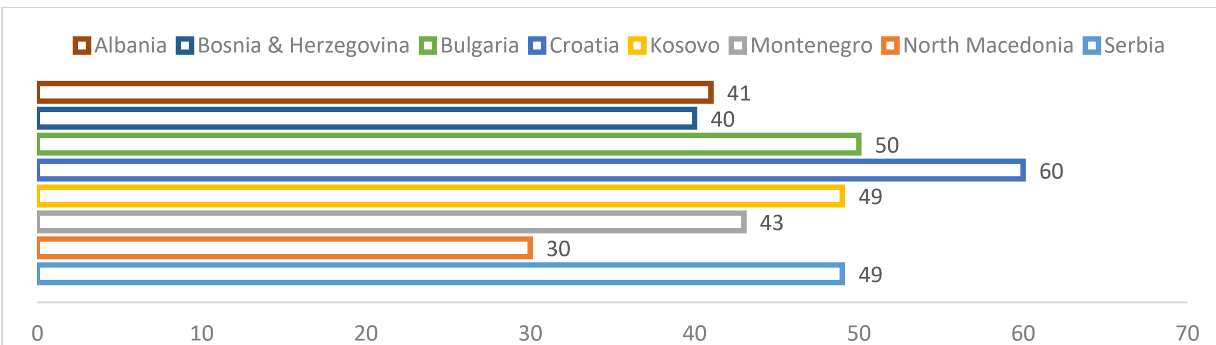
Contract enforcement is one of the important criteria to improve the business environment for the SME sector is contract enforcement. Effective dispute resolution has many benefits for the business sector. Courts are essential for entrepreneurs because they interpret market rules and protect the economic rights of businesses. Efficient and transparent courts stimulate new business relationships because companies know they can rely on the courts if a new client fails to pay. Speedy litigation is very important for small businesses, which may not have sufficient financial resources to stay in business while awaiting the outcome of a lengthy litigation (World Bank Group, Doing Business, 2017).



Graph.9 Comparative analysis of SEE countries - Implementation of contracts

In 2018, the legal process quality index is rated at 9.5 out of 18 possible points. Croatia is ranked 23rd, followed by North Macedonia, and Albania is 120th at the bottom. This low ranking of Albania argues the justification of the Wetting process in this country's judicial system that has been in place for more than two years but with symbolic results and a temporary blockade of the judicial system as a result of the elimination of a significant number of judges and prosecutors incriminated.

The insolvency solution requires a functioning bankruptcy filing system as a filter, ensuring the survival of profitable companies by reallocating their inefficient resources.



Graph.10 Comparative analysis in SEE countries - Solving insolvency

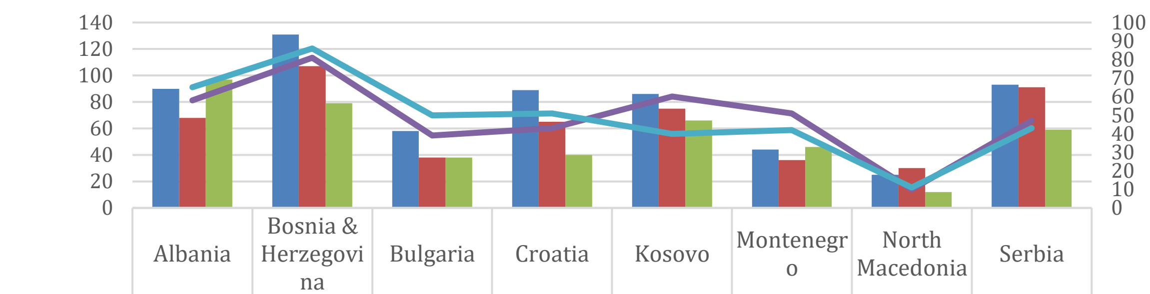
Rapid and effective bankruptcy procedures result in businesses quickly returning to normal operations and increasing returns on equity to creditors. By clarifying the expectations of creditors and debtors about the outcome of bankruptcy proceedings, good functioning bankruptcy procedure systems can facilitate access to finance, maintain more sustainable businesses and grow the economy sustainably (WBG, Doing Business, 2015).

According to figure 10, North Macedonia is one of the countries that has mostly undertaken reforms and facilitated the process of bankruptcy of companies followed by Albania and Bosnia & Herzegovina.According to 2018 data, Croatia remains one of the lowest ranked countries in terms of reforms undertaken in terms of easing bankruptcy issues, ranking last among the SEE countries. This fact argues that meeting the Copenhagen criteria in terms of building a functioning market economy has been partially met even after 10 years of Croatia's EU membership.

The regulation of the labor market as a system involves four bodies of law: employment, industrial relations, social security and occupational health and safety laws. Employment rules are needed to enable efficient contracting between employers and workers and to protect workers from discriminatory or unfair treatment by employers.

The World Bank's Doing Business indicator measures flexibility in regulating employment, working hours and dismissals in a manner consistent with the conventions of the International Labor Organization (WBG, Doing Business, 2010).Employment laws are needed to protect workers from arbitrary or unfair treatment and to ensure effective contracting between employers and workers.

One of the most important indicators that assess labor market regulation in a country is the labor quality index.Figure 11 reflects positive trends in improving the business climate in all the countries of SEE region. The overall positive trend integrates in itself high asymmetry between the different SEE countries. The biggest improvements have been made by countries that are further away from the NATO and EU integration process, such as North Macedonia and Kosovo with the exception of Bosnia and Herzegovina, which is the country with the lowest ranking of all countries analyzed.



	Albania	Bosnia & Herzegovina	Bulgaria	Croatia	Kosovo	Montenegro	North Macedonia	Serbia
2014	90	131	58	89	86	44	25	93
2015	68	107	38	65	75	36	30	91
2016	97	79	38	40	66	46	12	59
2017	58	81	39	43	60	51	10	47
2018	65	86	50	51	40	42	11	43

2014 2015 2016 2017 2018

Graph. 11 Integral comparative analysis of doing business in SEE countries

A more detailed analysis of the 11 criteria that are part of the World Bank's Doing Bussines indicator identifies asymmetric achievements and failures from the analyzed countries. This fact substantially disputes the validity of this indicator as a reliable indicator of measuring the attractiveness of doing business in the SEE countries analyzed.

5. Conclusions

In the last decade, South East European countries, in the framework of the process of meeting the Maastricht and Copenhagen criteria during the EU integration process, have implemented permanent institutional reforms aimed at maintaining macroeconomic stability, promoting a functioning market economy and creating a climate, appropriate business as preconditions for dynamic economic development.

Among the 11 indicators assessed by Doing Business, the key structural elements are: complexity of legislation, cost of doing business, property registration, access to credit, level of taxation, strengthening of legal institutions to enforce contracts and resolution of insolvencies in order to facilitate doing business.

Implementation of permanent institutional reforms in the SEE countries has resulted in asymmetric “business climate” improvements in the analyzed period. At the end of 2018, the most successful countries according to the integral indicator “Doing Business” are North Macedonia, Kosovo and Montenegro, while Albania and Bosnia and Herzegovina have the poorest results.

The two EU member states, Croatia and Bulgaria rank 50th and 51st, respectively, and are far below North Macedonia, which is ranked 10th in the world.This ranking raises serious doubts about the validity of the Doing Busines indicator, given the fulfillment of the Copenhagen criteria that these countries have adopted for more than a decade when they joined the EU.

Despite the continuous improvement of the business climate in the SEE countries, this improvement in the business climate has not been accompanied by an increase in investment in general and FDI in particular.In this regard, North Macedonia is paradoxical as the country ranks 10th globally for a favorable business climate, but has the lowest FDI level among Southeast European countries and beyond.Faster integration of SEE countries into NATO and the qualitative fulfillment of the Copenhagen criteria in the EU integration process are important prerequisites for improving institutional reforms as prerequisites for improving the business climate, successfully combating the informal economy, tax evasion and corruption, and attracting the largest volume of FDI as a whole region of Southeast Europe.

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