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Special analysis

Attractiveness of Central and Eastern European Countries for Investors

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Introduction

The economies of EU member states the Czech Republic, Hungary, Germany, Poland, Austria, Romania, Slovakia and Bulgaria are experiencing moderate growth, after having overcome the recent economic crisis.

This is not a region of economic tigers, but it mainly consists of countries that have achieved high living standards, with quality education and a labour force with buying power who know their worth.

What is significant is the pro-export orientation of the mentioned countries, of which Slovakia, Germany and Austria use the euro, which under the EU's valid rules will also be adopted in the years to come by all member states that do not yet use the euro (except for the UK and Denmark, which have opted out).

Challenges for these countries include sustainable public deficits and the fight against unemployment, both of which are generally related to the recent financial crisis. In the recent period it has also been necessary to maintain positive inflation and especially long-term sustainable economic growth.

The countries are using a wide range of grants and incentives to attract foreign investors. The assistance programmes can be used in these countries to gain support from public budgets, usually within the range of 10 to 50% of eligible expenditures, depending on the size of the company and the country or specific region.

Countries also differ with regard to direct taxation, and Central and Eastern European states in particular are among those in the European environment who are trying to attract foreign investors to relatively low tax rates.

The countries can be characterised by a high level of protection for foreign investors and effective public administration from a global perspective.

Basic geographical and demographical indicators of selected EU states in 2014

	Number of inhabitants (in thousands)	Area (square km)	Currency	Length of roadways (km)	Share of population with internet*)
CR	10,512	78,867	Koruna	734	63.5%
Hungary	9,879	93,028	Forint	1,477	62.5%
Germany	80,780	357,022	Euro	12,819	80.6%
Poland	38,495	312,685	Złoty	2,737	58.3%
Austria	8,508	83,871	Euro	1,719	72.2%
Romania	19,943	238,391	New Leu	337	39.0%
Slovakia	5,416	49,035	Euro	417	75.0%
Bulgaria	7,245	110,879	Lev	458	46.9%

*Source: IMF, CIA World Factbook, European Commission; *) data for 2013*

Macroeconomic Development

In recent years, the country with the most growth in the monitored region has been Poland, whose average growth in GDP reached 3%. Poland enjoys a large internal market, strong domestic consumption and sensible long-term macroeconomic policy. Other relatively fast growing economies among the selected states include Slovakia and Germany.

Both countries are very export-oriented, with strong exposure to growing Asian markets (Germany directly and Slovakia indirectly through German customers). Both countries' success can also be attributed to previously carried out structural reforms (tax and social reforms in Slovakia and labour market reforms in Germany), and the German export engine has also benefited from the euro, which is relatively weak for Germany.

According to the European Commission's estimates, in 2015 and 2016 Poland will maintain its role as the regional economic leader with growth of 3.2% and 3.4% respectively. Slovakia, Romania and the Czech Republic will also achieve solid performance.

Inflation pressures are not a problem in today's Europe, and in some states, especially in the southern part of the continent, there tend to be concerns about pressure from deflation instead. The relatively largest inflation in the monitored region is expected this year in Romania (1.2%).

Of the monitored states, Poland and Bulgaria will experience moderate deflation this year. If the European Commission's prognosis comes true, inflation in all member states in 2016 should reach positive values.

Estimate of key macroeconomic indicators for 2015 (in %)

	GDP growth	Inflation	Current account balance*)	Balance of public budgets*)	Public debt*)
CR	2.5	0.8	-0.3	-2.0	44.4
Hungary	2.4	0.8	4.4	-2.7	77.2
Germany	1.5	0.1	8.0	0.2	71.9
Poland	3.2	-0.2	-1.5	-2.9	49.9
Austria	0.8	1.1	2.6	-2.0	86.4
Romania	2.7	1.2	-1.1	-1.5	39.1
Slovakia	2.5	0.4	0.8	-2.8	54.9
Bulgaria	0.8	-0.5	2.1	-3.0	27.8
EU	**1.7**	**0.2**	**1.9**	**-2.6**	**88.3**

*Source: European Commission, *) to GDP*

The monitored states are mostly very pro-export focused and have their current account balances either in a surplus or approximately level. A certain extreme is Germany, which has a current account surplus of 8% of GDP due to factors including the weak euro. Relatively the worst result in this category is in Poland, with a deficit of -1.5% of GDP. A certain problem for these states is the condition of public finances.

Although the states fulfil the Maastricht criterion related to the share of the state budget deficit in GDP, which must be lower than 3%, but even so there is room for improvement. The amount of public debt, which in these states is below the EU average, is also related to state budget deficits.

Labour Market

The selected EU member states represent a large labour force with huge buying power. Of the monitored states, except for Slovakia and Bulgaria, all of them have lower unemployment levels than the EU average. Austria and Germany can boast of a low unemployment level hovering at around 5%. The Czech Republic is close with a 6.1% unemployment level. Of these countries, the one with the highest unemployment in 2014 was Slovakia with 13.4%, which is relatively low compared to the 25% unemployment in Spain and Greece.

In view of the positive outlooks for economic growth in the coming years, the situation is also expected to improve on the labour market, which should be reflected in further growth in households' consumption.

Setting the minimum wages remains up to individual member states and is not handled at the EU level, so the minimum wage is not the same throughout the EU. Of the 28 member states, no minimum wage has been set in Denmark, Finland, Italy, Cyprus, Austria or Sweden.

Although none of these states has a statutory minimum wage, the wages there tend to be consistent with typical wages in individual sectors and industries.

In Germany there are set tariffs for certain occupations and professions, like in Austria.

Labour market indicators in selected member states in 2013

	Secondary school graduates[1)]	University graduates[2)]	Labour force (in thousands)	Unemployment level[3)]
CR	72.4%	20.5%	4,937	6.1%
Hungary	60.0%	22.5%	3,938	7.7%
Germany	57.9%	28.5%	39,531	5.0%
Poland	64.4%	25.8%	15,568	9.1%
Austria	62.4%	20.7%	4,175	5.0%

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Romania	60.6%	15.7%	9,247	7.0%
Slovakia	72.0%	19.9%	2,329	13.4%
Bulgaria	56.3%	25.6%	2,935	11.7%
EU	**46.7%**	**28.4%**	**216,508**	**10.2%**

Source: Eurostat, European Commission; 1) the share of secondary school graduates ages 25 to 64 among the total population in the particular region, 2) the share of university graduates ages 25 to 64 among the total population in the region, 3) data for 2014

Newly since 1 January 2015, there is a set hourly minimum wage of EUR 8.5 in Germany, which has the highest minimum wage in the monitored states, when expressed in euros. The lowest minimum wages are in Bulgaria and Romania.

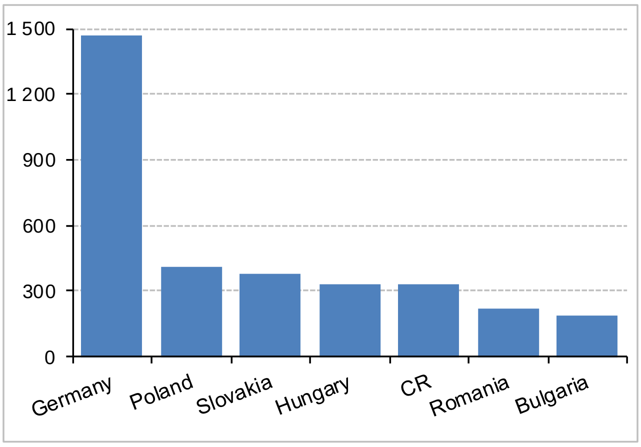
Other labour cost comparisons are presented by an overview of average monthly labour costs. Labour costs are an employer's expenditures related to employing workers.

They include compensation for employees (including wages, salaries in money and in kind and employers' contributions to social security), costs for professional education and other expenditures (such as costs for hiring workers, expenditures for work clothing and taxes on wages considered labour costs minus any received support).

Labour costs are also an important factor related to individual member states' competitive positions.

There are major differences in average monthly labour costs both in the monitored member states among individual sectors.

Minimum monthly wage in 2015 (euros)



Source: Eurostat

There have generally long been lower labour costs in former Communist countries in Central and Eastern Europe (mainly in Romania and Bulgaria).

It will perhaps surprise no one that of the selected countries, Austria and Germany have the highest labour costs.

Average monthly labour costs in selected sectors in 2013 in EUR

	Business sphere	Processing industry	Construction	Wholesale and retail; ...	Transport and storage
CR	1,573	1,480	1,467	1,512	1,493
Hungary	1,364	1,336	1,080	1,220	1,250
Germany	4,356	4,867	3,510	3,662	3,526
Poland	1,294	1,173	1,139	1,076	1,170
Austria	4,562	4,713	4,212	3,830	4,673
Romania	879	745	704	772	918
Slovakia	1,263	1,255	1,210	1,118	1,127
Bulgaria	542	434	425	544	580
EU	**3,526**	**3,525**	**3,132**	**3,027**	**3,318**

Source: Eurostat

Subsidies and Investment Incentives

All European countries, including the monitored countries, are seeking to attract foreign investors with various incentives and grant programmes. In order to maintain a fair competitive environment on the single market, these programmes are adjusted at the central level in Brussels in the form of regional support.

Its aim is to support less developed regions within the EU and to contribute to their development, mainly through support for investments and new job creation. Regional support may be provided to all member states in a maximum amount set by the European Commission.

In order for regional support (in the form of grants or investment incentives) to be provided to an investor, the particular investment mainly must be compatible with the internal market, meaning that it must be an investment with a clearly defined aim that is in the common interest. Each investment must need state intervention, must be proven to be suitable for regional support and must have a motivational effect.

Support must be restricted to a minimum, and it is necessary to limit its negative effects and prove its transparency. Regional support does not apply to the steel or synthetic fibre industry or to support for airports and energy. The special form of support also relates to the fisheries, aquaculture and agriculture sectors, as well as to transport (these sectors can also be partially or entirely excluded from regional support).

Support for these sectors is defined individually by the EU.

Overview of regional support types in the selected member states for the entire period of 2014-2020

	Maximum intensity of regional support for NUTS II regions			
	small businesses	mid-sized businesses	large businesses	exceptions + regions without support
CR	45%	35%	25%	Prague without support
Poland	45-70%	35-60%	25-50%	Warsaw (2014-2017, max. 15%) (2018-2020, max. 10%)
Slovakia	45-55%	35-45%	25-35%	Bratislava without support
Romania	55-70%	45-60%	35-50%	Bucharest and Ilfov 10-35%
Hungary	45-70%	35-60%	25-50%	Budapest 20-35%
Germany	30-50%	20-30%	10-20%	
Austria	30%	20%	10%	
Bulgaria	50-70%	50-60%	50%	Yugozapaden 25-45%

Source: European Commission

Taxes – Basic Overview

In the area of taxes, harmonisation has occurred in the EU practically only in relation to indirect taxes, which are regulated by European directives that set rules related to the number and amounts of individual rates.

Harmonisation is at a high level both for selective indirect taxes imposed on selected commodities (consumer taxes) and for general indirect taxes, which in the EU have the form of VAT.

The basic VAT rate must not be lower than 15% according to European directives, and member states can apply one or two reduced rates, which, however, must not be lower than 5%.

However, the directives also allow a rate lower than 5% (known as the super reduced rate) following a certain temporary period. Austria uses a certain other type of exception in the form of a "parking rate" of VAT of 12% (for wine from farms). The parking rate eases the transition from the reduced VAT rate to the basic rate.

For individual income taxes, individual EU states determine on their own what their resulting form will be, in relation to the number and amounts of rates and to tax discounts, etc.

The system of harmonisation throughout the EU is not very developed for corporate income taxes as for VAT and consumer taxes. There is cooperation among members in particular in relation to preventing double taxation and fighting tax evasion.

The systems and development of rates and taxable income for individual income taxes are overseen by individual EU states. Therefore, the structure of these taxes is very extensive.

From relatively simple systems, in which states have implemented flat tax rates or in which they have several sliding progressive rates, to different taxation based on social status, etc.

However, some EU states add various surcharges and local rates to the general or basic tax rates (such as Germany). In Germany, there is also a 5.5% solidarity surcharge. Therefore, the maximum or total corporate tax rate tends to be higher than the basic rate (around 30% in Germany's case).

If you are looking for the lowest corporate tax rate in the EU, you will find it in Bulgaria, where it is 10%.

Overview of tax rates (in %)

	Income tax rates		VAT rates	
	for individuals	for legal entities	reduced rate	basic rate
CR	15 / 22	19	10 / 15	21
Hungary	16	19	5 / 18	27
Germany	0 / 14-42 / 45	15	7	19
Poland	18 / 32	19	5 / 8	23
Austria	0 / 36,5 / 43,2 / 50	25	10	20
Romania	16	16	5 / 9	24
Slovakia	19 / 25	22	10	20
Bulgaria	10	10	9	20

Source: EK (DG TAXUD), KPMG, Deloitte, EY, Ministries of Finance; European Commission, VAT Rates Applied in the Member States of the European Union

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