

## PEST Analysis

### ***Political Factors***

The Republic of Serbia is ruled in accordance to a constitution, which was adopted by a referendum in October 2006. The Serbian parliament is the lawmaking body of the country. The political risk associated with doing business in Serbia is still high compared to other countries from the region. The primary issues of concern in Serbia revolve around the stability of the weak coalition government in Serbia and its response to Kosovo's declaration of independence on February 17, 2008.<sup>1</sup>

### **Historical Overview**

Before the fall of the socialist regime, Serbia was a part of the Federal Republic of Yugoslavia. In 2003, the F.R.Y. parliament adopted a new Constitutional Charter establishing the state union of Serbia and Montenegro. In 2006, the Republic of Montenegro declared independence and the parliament of Serbia stated that the Republic of Serbia was the continuity of the state union, rendering the two republics independent and sovereign countries.

The end of the 1990s was marked by the authoritarian regime of the Yugoslav President Slobodan Milosevic and his party - Socialist Party of Serbia. In 2000 mass street protests forced Milosevic to concede defeat and was replaced by Vojislav Kostunica (Democratic Opposition of Serbia) together with the Democratic party of Serbia. However, those reforms did not stabilize the situation in the country. Organized crime escalated and led to the assassination of the Prime Minister Djindjic in 2003. The chaos was not tamed until the election of the new president Boris Tadic in 2004, who was reelected for a second mandate in 2008.

### **Ruling Party**

In the beginning of 2007 a new governing coalition was elected - Democratic Party (DS), the Democratic Party of Serbia (DSS), and the G17+. It collapsed in March 2008. The elections that took place in May 2008 formed a new government, which won parliamentary approval by a slim margin on July 7th. It contains as many as seven parties and holds 128 out of the 250 parliamentary seats. Leading the new cabinet will be the Serbian President Boris Tadic's Democratic Party (DS) and the Socialist Party of Serbia (SPS). DS official and former Finance Minister Mirko Cvetkovic will be the new prime minister. The opposition will include former Prime Minister Vojislav Kostunica's Democratic Party of Serbia and the far-right Serbian Radical Party, which have 108 MPs combined.

According to the prime minister, this cabinet will focus on Serbia's European future, rejection of the independence of Kosovo, strengthening of the economy, fulfillment of social obligations and stronger crackdown on corruption and crime.

### **Kosovo**

In 1998 violence flared in the autonomous province of Kosovo in Serbia. The Kosovo Liberation Army, supported by the majority ethnic Albanians, came out in open rebellion against Serbian rule. NATO launched air strikes in Kosovo and Serbia in March 1999. The UN took over administration of the region after Serbian forces had been driven out. Kosovo declared independence on 17 February 2008 after the failure of UN-brokered talks on the status of the province.

### **Foreign Relations**

Serbia, as a successor state of the F.R.Y., has its seat in international organizations, such as the Organization for Security and Cooperation in Europe (OSCE) and the UN. It is actively participating in International Monetary Fund and World Bank projects. In 2003, Serbia was admitted to the Council of Europe. Serbia has also indicated its desire to join the EU and NATO's Partnership for Peace. It

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<sup>1</sup> [http://www.buyusa.gov/serbia/en/doing\\_business.html](http://www.buyusa.gov/serbia/en/doing_business.html)

signed the Stabilization and Association Agreement with the EU on April 9<sup>th</sup>, 2008, overcoming one of the key initial hurdles for EU membership. Serbian President Boris Tadic has stated that Serbia is now seeking to become an official candidate for EU membership.

However, no EU states will ratify the treaty, nor will Serbia start receiving any trade and VISA benefits, or financial and economic incentives that come with the SAA until it is seen to be fully co-operating with the International Criminal Tribunal for Yugoslavia (ICTY).<sup>2</sup> In 1993 the UN Security Council established the ICTY to try those responsible for violations of international humanitarian law on the territory of the former Yugoslavia since 1991. Since the fall of Milosevic, EU and US foreign aid has steadily increased although there are congressional restrictions based on Serbia's need to meet its international obligations to the ICTY. In that sense+ subject Serbia has already made some significant progress. On July 21<sup>st</sup>, 2008 Radovan Karadzic, accused by the Tribunal for war crimes against humanity and genocide during the Milosevic authoritarian regime, was arrested by the local authorities.

## VISAs

Since 1 January 2008, Serbian citizens enjoy the benefits of a VISA facilitation agreement with the European Union. This agreement provides simplified conditions for VISAs, including a waiving of a VISA fee for a broad range of categories of citizens including students, sportsmen and sportswomen, cultural workers, journalists, people visiting family members living in the EU, people in need of medical treatment, economic operators working with EU companies, etc. Up to 80% of the Serbian citizens can currently be exempt of a VISA fee. People who pay for VISA are charged the special reduced rate of EUR 35 instead of EUR 60. On May 7<sup>th</sup>, 2008, European Commission (EC) vice-president Jacques Barrot officially presented a roadmap on VISA liberalization with Serbia. The roadmap outlines the steps that Serbian authorities need to take, so as to achieve VISA-free travel for Serbian citizens. It sets clear requirements for the reforms to be implemented in key areas, such as security of documents, border management, fight against illegal migration, fight against organized crime and corruption, and fundamental rights.<sup>3</sup>

## Financial Incentives – Regulations

The Serbian state is trying to provide favorable investment atmosphere. State grants are offered for Greenfield and Brownfield projects in all industries, except for trade, tourism, hospitality and agriculture. Eligible companies are those involved in manufacturing activities, internationally marketable services sector, and research and development. Favorable tax policy is implemented, including 10% corporate profit tax, exemption from corporate profit taxes for period of 10 years in some cases (investment over EUR 7,5 million or at least 100 employees on indefinite contracts). VAT tax is 18% standard and 8% lower rate (for basic food stuffs, daily newspapers, utilities etc).<sup>4</sup>

## Trade Partners and Agreements

As a party to the Central European Free Trade Agreement, Serbian exports enjoy preferential trade access also to OECD countries under their various Generalized System of Preferences schemes. CEFTA integrates the countries of the South East Europe, thus creating a possibility for companies to place their goods customs free to a market of close to 30 million people. Such access is granted also to other Eastern European and Central Asian countries under bilateral trade agreements. Serbia is the only country outside the CIS that has a free trade agreement with Russia, providing access to another market of 150 million people.

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<sup>2</sup> <http://www.marketresearch.com/map/prod/1793154.html>

<sup>3</sup> <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/717&format=HTML&aged=0&language=EN&guiLanguage=en>

<sup>4</sup> [http://www.siepa.sr.gov.yu/site/en/home/1/brief\\_guide/serbia\\_on\\_your\\_location\\_list/tax\\_system/](http://www.siepa.sr.gov.yu/site/en/home/1/brief_guide/serbia_on_your_location_list/tax_system/)

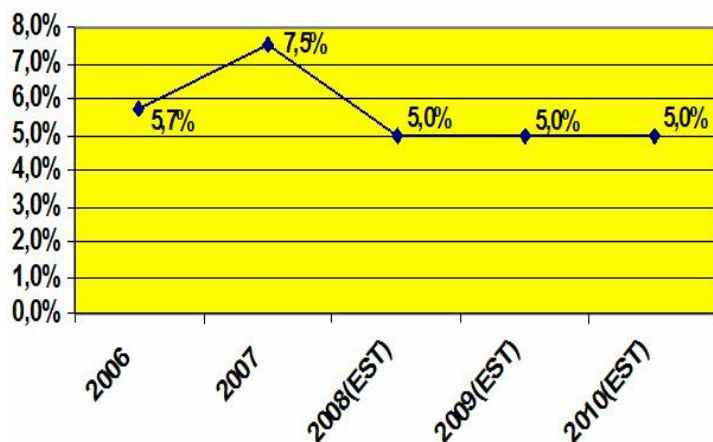
Preferential status in trade with EU and USA is an additional incentive for investors as they can freely export to these markets.<sup>5</sup> The Stabilization and Association Agreement with the European Union would grant reciprocal preferential market access, but its effectiveness is suspended for political reasons.<sup>6</sup> Serbia is expected to become a member of the World Trade Organization by the end of 2008.

The major foreign trade partners in export during 2007 were the following: Italy - 12.4%, Bosnia and Herzegovina - 11.8%, Montenegro - 10.8%, Germany - 10.6%. The major foreign trade partners in import during 2007, on the other hand, were the Russian Federation - 14.3%, Germany - 11.8%, Italy - 9.7%, and China - 7.3%.<sup>7</sup>

## Economic Factors

### Economic Growth

In 2007 the Serbian economy managed to continue its positive performance by reaching 7.5% growth for the year. This number marks a significant increase of 1.8% in comparison to the 5.7% growth in 2006.<sup>8</sup> The steady increase in the GDP of the country has been a trend ever since 2001 after the periods of stagnation in the 1980s, decline in the 1990s amid the FRY breakup, and collapse and hyperinflation in the 1999-2000 period.



However, according to the Vienna Institute for International Economic Studies, Economic growth in Serbia will slow down to 5% this year and this pace will continue in the next two years.<sup>10 11</sup> The main contributors to the \$44 billion GDP for 2007 were transportation, trade, financial mediation, and processing industry. Industrial production rose by an estimated 4.6% in 2007. Significant growth was achieved in the sectors of construction, as well as in retail trade.<sup>12</sup>

Figure 1. GDP of Serbia – real change in % against previous year (2006-2010)

### GDP Based on Purchasing Power Parity

According to IMF estimates, the purchasing power parity (PPP) in Serbia has been growing in a moderate pace in the 2004-2008 period.<sup>13</sup>

<sup>5</sup> [http://www.siepa.sr.gov.yu/site/en/home/1/investing\\_in\\_serbia/liberalized\\_trade/](http://www.siepa.sr.gov.yu/site/en/home/1/investing_in_serbia/liberalized_trade/)

<sup>6</sup> <http://info.worldbank.org/etools/wti2008/docs/brief165.pdf>

<sup>7</sup> [http://www.siepa.sr.gov.yu/site/en/home/1/importing\\_from\\_serbia/foreign\\_trade\\_data/foreign\\_trade\\_by\\_countries/](http://www.siepa.sr.gov.yu/site/en/home/1/importing_from_serbia/foreign_trade_data/foreign_trade_by_countries/)

<sup>8</sup> <http://uk.reuters.com/article/topNews/idUKL033537920080203>

<sup>9</sup> <http://www.imf.org/external/np/ms/2006/062706.htm>

<sup>10</sup> <http://www.limun.hr/en/main.aspx?id=305693>

<sup>11</sup> [http://www.wiiv.ac.at/pdf/FC2\\_presse\\_eng.pdf](http://www.wiiv.ac.at/pdf/FC2_presse_eng.pdf)

<sup>12</sup> [http://www.buyusa.gov/serbia/en/doing\\_business.html](http://www.buyusa.gov/serbia/en/doing_business.html)

<sup>13</sup> <http://www.imf.org/external/>

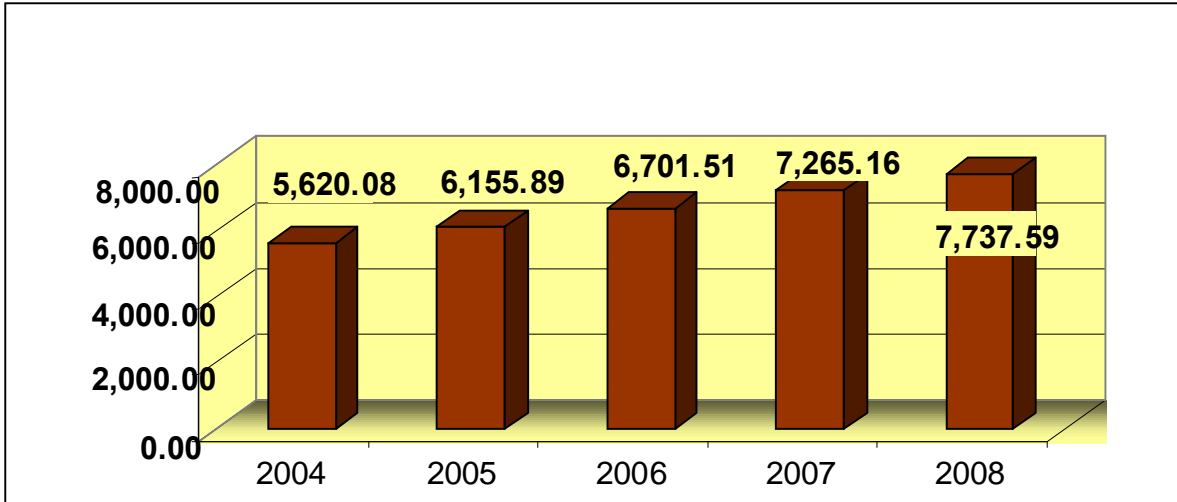
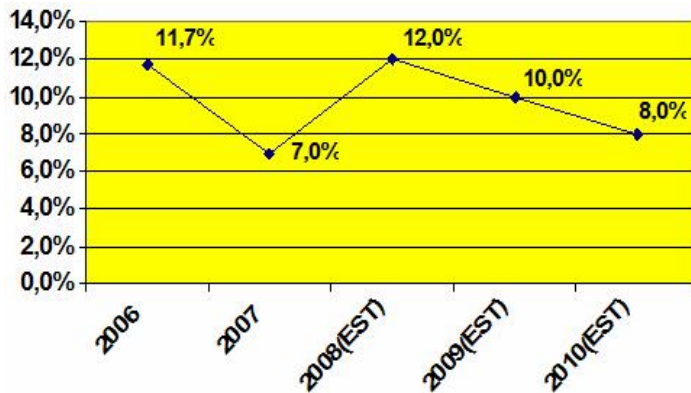


Figure 2. GDP based on purchasing-power-parity per capita in Serbia in USD (2004-2008)

### Inflation

Serbian inflation is high in comparison to other countries from the region. This sends a clear message to the domestic and foreign investors that the country still experiences macroeconomic disorder.<sup>14</sup> According to the Vienna Institute for International Economic Studies, this year's inflation in Serbia will



amount to 12% if there are no sharp price increases on the global market and will drop to 8% annually by 2010.<sup>15</sup> The consumer price index rose by 6.1% for the first half of 2008 which refutes the government's economic plan predicting a rise in inflation of 6.5% for the whole year.<sup>16</sup> Inflation in Serbia in June 2008 was 1%. The highest price increase was recorded in industrial non-food products which amounted to 2.2%, driven mainly by the rise in fuel prices.<sup>17</sup>

Figure 3. Consumer prices in Serbia – change in % against previous year (2006-2010)

<sup>14</sup> <http://www.imf.org/external/np/ms/2006/062706.htm>

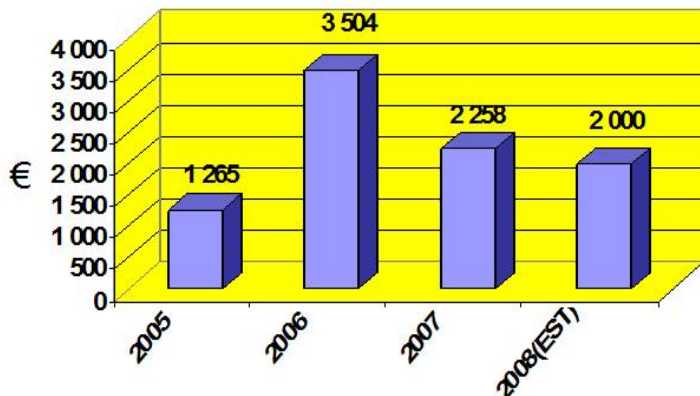
<sup>15</sup> <http://www.limun.hr/en/main.aspx?id=305693>

<sup>16</sup> <http://www.sseeurope.net/?q=node/15982>

<sup>17</sup> <http://www.sseeurope.net/?q=node/15982>

## FDI

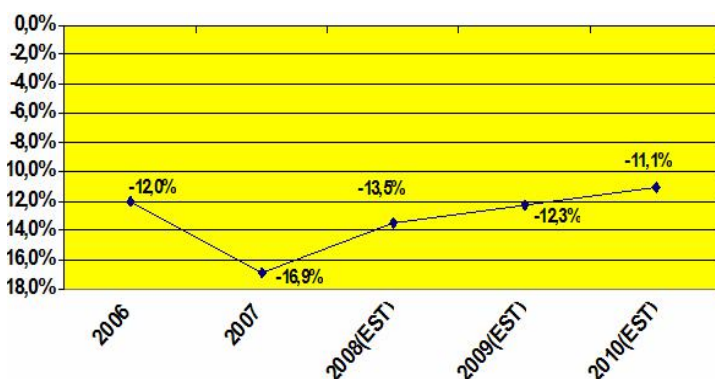
After attracting EUR 3.5 billion of FDI in 2006, the cumulative level of FDI in Serbia sharply decreased to EUR 2.2 billion in 2007. This drop in FDI was due to a slower pace of privatization following Parliamentary elections at the beginning of 2007 and a six-month delay in forming the government.



According to the European Bank for Reconstruction and Development (EBRD), even with the lower number, Serbia is ranked fourth in Southeast Europe, after Bulgaria, Romania and Croatia and before Bosnia, Montenegro, Albania and Macedonia in total 2007 FDI. FDI counted for roughly 10% of Serbia's GDP in 2007.<sup>18</sup> The leading foreign investors in the country are blue-chip companies and banks, such as Telenor, Philip Morris, Mobilkom, Banca Intesa, InBev, and many others.<sup>19</sup>

Figure 4. FDI in Serbia (2005-2008)

## Current Account Deficit



Despite the obvious improvement in the country's economy, Serbia's chronic current account deficit remains a great concern.<sup>20</sup> That is mainly due to the high prices as the country is obliged to pay for importing energy and food.<sup>21</sup> FDI is covering 135% of the shortfall as of 2007. However, the continued uncertainty and growing risk aversion in international markets could lead to a change, which can have devastating effect on the Serbian economy.<sup>22</sup>

Figure 5. Current account deficit of Serbia in % of GDP (2006-2010)

## Interest Rates

In response to mounting inflationary pressures, the National Bank of Serbia raised the key policy rate three times in Q1 in 2008. After two revisions by 75 basis points, the key policy rate was raised by 300 basis points to 14.5% p.a. by the end of March.<sup>23</sup>

Higher interest rates on the EU capital market lead to higher interest rates for credits in EUR in Serbia. The European Central Bank has increased the reference interest rate from 4% to 4.25%.

<sup>18</sup> [http://www.buyusa.gov/serbia/en/doing\\_business.html](http://www.buyusa.gov/serbia/en/doing_business.html)

<sup>19</sup> [http://www.siepa.sr.gov.yu/site/en/home/1/investing\\_in\\_serbia/strong\\_fdi\\_figures/](http://www.siepa.sr.gov.yu/site/en/home/1/investing_in_serbia/strong_fdi_figures/)

<sup>20</sup> <http://www.businessmonitor.com/businessforecasts/serbia.html>

<sup>21</sup> [http://www.wiwi.ac.at/pdf/FC2\\_presse\\_eng.pdf](http://www.wiwi.ac.at/pdf/FC2_presse_eng.pdf)

<sup>22</sup> <http://www.businessmonitor.com/businessforecasts/serbia.html>

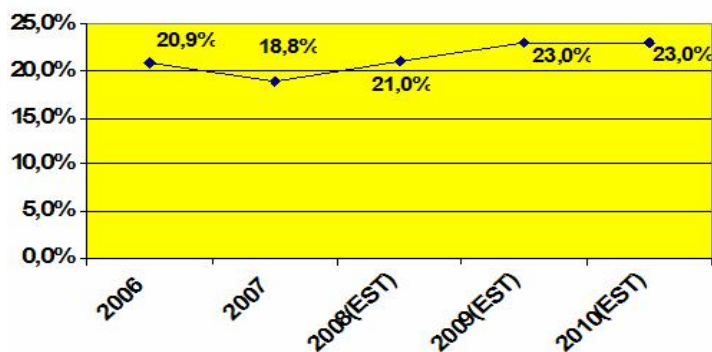
<sup>23</sup> [http://findarticles.com/p/articles/mi\\_hb6465/is\\_200806/ai\\_n25744936](http://findarticles.com/p/articles/mi_hb6465/is_200806/ai_n25744936)

European banks include this measure in their interest rates, which will also be reflected in the interest rates for domestic loans (as Serbian citizens mainly incur debt in EUR). At the moment it can be expected that banks will increase their interest rates, mainly for housing loans and short-term loans in EUR with variable interest rates.<sup>24</sup>

## Employment Growth

The economic transition in Serbia has brought deep changes in the structure of the job market. The current unemployment rate is about 20% and this number is not expected to change dramatically in the years to come.<sup>25</sup> This forecast is backed up by the latest data which shows that during the period January-April 2008 there was a decrease in the number of employees by 0.8%.<sup>26</sup>

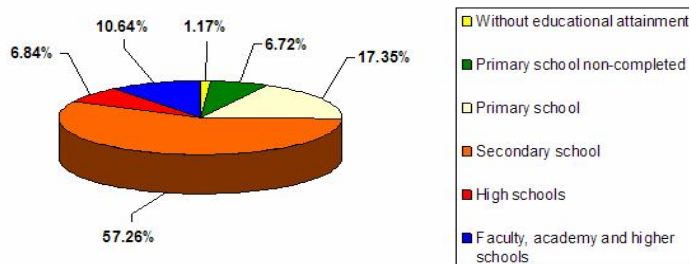
According to the International Monetary Fund, labor market institutions discourage employment, which continues to fall even as output rises strongly.<sup>27</sup> Almost two-thirds of the employment is now in



the private sector, where labor turnover is on average much higher than in the public sector. Serbia still has large potential labor supplies because only about 50% of the working-age (15-64) population is employed. Employment rates are low according to the Organization for Economic Co-operation and Development standards for most demographic groups, especially youths, women and the elderly.<sup>28</sup>

Figure 6. Unemployment in Serbia (2006-2010)

## Employed Persons by Education Attainment



The main part (about 58%) of the labor force employed in the country of Serbia has secondary education attained.

However, a lot needs to be done in order to improve the labor force quality. For instance, only 4% of the already employed receive any kind of additional qualifications on a regular basis.<sup>29</sup>

Figure 7. Employed persons by education attainment

<sup>24</sup> <http://www.limun.hr/en/main.aspx?id=305694>

<sup>25</sup> [http://www.wiiv.ac.at/pdf/FC2\\_presse\\_eng.pdf](http://www.wiiv.ac.at/pdf/FC2_presse_eng.pdf)

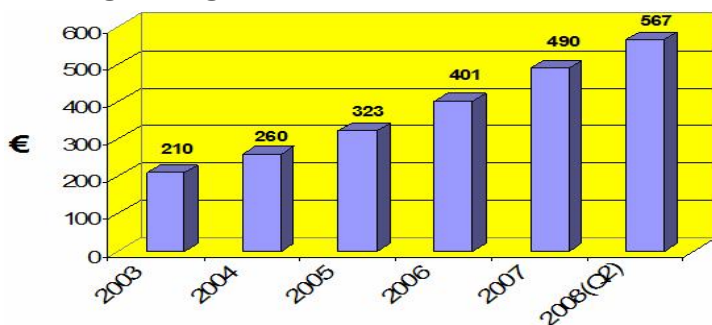
<sup>26</sup> [http://www.razvoj.sr.gov.yu/SED/2008/Maj/SED\\_0805\\_e.htm](http://www.razvoj.sr.gov.yu/SED/2008/Maj/SED_0805_e.htm)

<sup>27</sup> <http://www.imf.org/external/np/ms/2006/062706.htm>

<sup>28</sup> <http://www.oecd.org/dataoecd/48/59/40841888.pdf>

<sup>29</sup> [http://reports.aiidatapro.com/SSI/Statistical\\_Yearbook\\_2007.pdf](http://reports.aiidatapro.com/SSI/Statistical_Yearbook_2007.pdf)

## Average Wages



The consequence of the positive performance of the Serbian economy can be seen fully in the sharp increase in the wages in the country. During the period Jan-Apr 2008 positive tendency towards deceleration of the rise in average net earnings continued - a real rise in net earnings stands at 5.5% in comparison to the same period last year.<sup>30</sup>

Figure 8. Average gross wages and salaries in Serbia (2003-Q2 2008)

## Economic Ratings

Standard & Poor's revised Serbia's outlook to stable from positive in November due to fiscal policy loosening, but affirmed its "BB-" long term and "B" short term foreign and local currency sovereign credit ratings. Fitch kept its rating at BB- with stable outlook in November, but noted that political risk "remains a material constraint on Serbia's sovereign rating."<sup>31</sup>

## Privatization of Property and Land

The privatization of property and land in Serbia is still continuing at a low pace. The constitutional laws dating from the Communist era are still in force, forbidding private ownership of building land. Although these constitutional provisions have already been modified, there are still no appropriate regulations to implement them.<sup>32</sup>

## Banks and Lease Financing

In 2007 there were 36 banks operating in Serbia, 22 of which were foreign banks together controlling more than 75% of the market. The top five banks enjoyed a 44% market share. The fact that cars, buses and trucks in Serbia are an average of 15 years old and that over 31,000 new vehicles are imported every year means that heavy demand for lease financing can be expected in future. The Serbian Government also intends to make greater use of PPP financing for infrastructure projects in the future. Market demand for operating leasing for real estate is buoyant, and the potential is expected to increase.<sup>33</sup>

## Social Factors

### Population, Language, Ethnic Composition

The following chart (Figure 9) represents the ethnic composition of the population of the Republic of Serbia. It is diverse, which is a result of the country's turbulent past. The majority of the population of Serbia is Serbs. Yet, other 37 ethnicities live on country's territory. All citizens have equal rights and responsibilities and enjoy full ethnic equality.

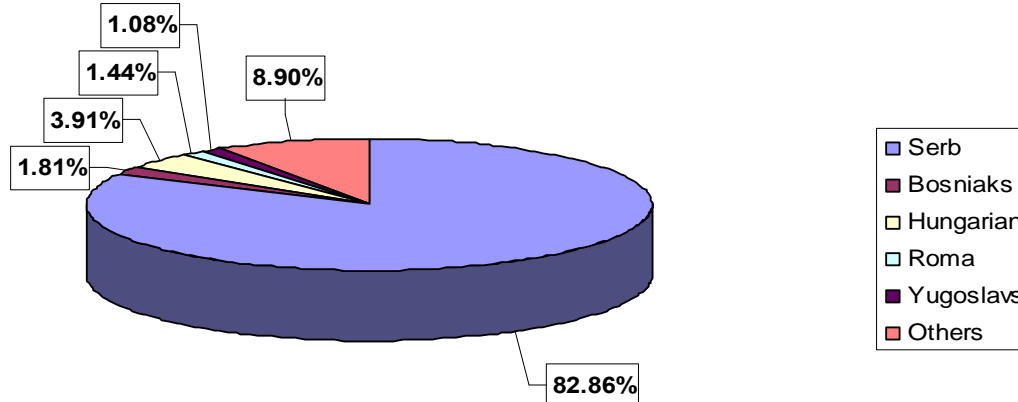
<sup>30</sup> [http://www.razvoj.sr.gov.yu/SED/2008/Maj/SED\\_0805\\_e.htm](http://www.razvoj.sr.gov.yu/SED/2008/Maj/SED_0805_e.htm)

<sup>31</sup> <http://uk.reuters.com/article/topNews/idUKL033537920080203>

<sup>32</sup> <http://www.wieninternational.at/en/node/6597>

<sup>33</sup> <http://www.hypo-alpe-adria-bank-annualreports.com/2007/page.953.htm>

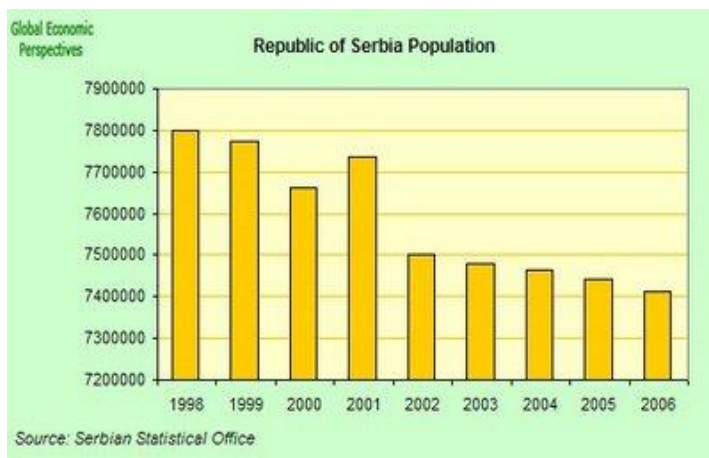
**Ethnic composition of Serbian Population**



**Figure 9. Ethnic composition of the Serbian population**

The official language in Serbia is Serbian and the script in official use is Cyrillic. Latin script is also used. In the areas inhabited by ethnic minorities, the languages and scripts of the minorities are in official use, as provided by law.

The main religion in Serbia is Christian Orthodox. Beside the Christian Orthodox population, there are other religious communities in Serbia: Islamic, Roman Catholic, Protestant, Jewish, and others.<sup>34</sup>



As demonstrated in Figure 10 (to the left), the population of Serbia has been declining constantly since 2001. As of 2007, the estimated population in Serbia is 7, 269, 703 with growth rate of 0.1%, birth rate of 12.1/1000 and infant mortality rate of 12.3/1000. The life expectancy is 75.1 years.<sup>35</sup> The median age has been rising quite rapidly in the recent years and is 37.5 years (2008 est.) The reason for Serbia's rising median age is threefold: low fertility, increasing life expectancy, and substantial out migration of people in younger age groups.

**Figure 10. Republic of Serbia population (1998 – 2006)**

Some indication of the extent of Serbian out-migration can be obtained from the remittances flows, which were estimated by the World Bank to be running at a rate of 17.7% of the GDP in 2006. Back in 2002, according to the statistics office, there were roughly half a million Serbs working abroad, about 100,000 of those being in Germany. In that year there were 2 billion dollars worth of remittances coming back. In 2006 there were roughly 4.7 billion dollars coming in, so we could estimate that the number of those working abroad has more or less doubled to near a million over these years.<sup>36</sup>

<sup>34</sup> <http://www.srbija.sr.gov.yu/pages/article.php?id=36>

<sup>35</sup> <http://www.infoplease.com/ipa/A0108157.html>

<sup>36</sup> <http://globaleconomydoesmatter.blogspot.com/2008/05/serbia-must-what-goes-up-really-come.html>



## Income, Expenditure, Households

In the 2002 - 2007 period a significant growth in household income and expenditure was recorded. The nominal growth in income of 95.4% and in expenditure of 113.9% corresponds to the real growth in income of about 14% and expenditure of about 25%.<sup>37</sup> Most households live in houses, then apartments in residential buildings, while only an insignificant number of households live in premises not intended for living. Ownership over residential dwellings is widespread in Serbia - 90.4%. The average number of rooms per family member is 1.2 and the average surface area per member is 30.3 sq.m. Only one tenth of the housing stock is rented.<sup>38</sup>

Below is a table with information about the change in the average household size in 2003 and 2007.

	2003	2007
Single	17,5	18,6
Two members	24,7	23,8
Three members	19,8	19,3
Four members	21,7	20,2
Five and more members	16,4	18,2
<b>Total</b>		<b>100 percent</b>

**Table 1. Household size**<sup>39</sup>

Improvement in liquidity and better performance of the domestic economy led to a 63.5% increase in corporate deposits during 2007. Higher standard of living and restored confidence in the banking system resulted in the record rise of 45.6% in household savings deposits. Household deposits came to RSD 428 billion, 90% of which are foreign currency savings deposits.<sup>40</sup>

## Technological Factors

### Research and Development

Traditionally, a significant level of research was undertaken in research institutes and universities. These institutes had linkages with a wide range of industrial sectors and also had an extensive experience of research cooperation with camps in Western Europe, USA and Canada. Many of the activities of these institutes have now been privatized through spin-off of separate self-financing companies. The universities are also developing separate campus based initiatives to foster entrepreneurship and develop closer cooperation with foreign industry on research and product development. These institutions, companies and campus initiatives have developed internationally traded expertise and prototype systems in areas such as Radio Frequency Identification, remote data acquisition, expert process control systems, communications software and embedded systems.<sup>41</sup>

### Industry Developments

The Serbian government has announced that it is to assign USD 43 million from the National Investment Plan for a project to set up an integrated electronic network covering state organizations. According to a recent announcement, the administration has set out a program for rapid development of electronic government, with the schedule providing for the network to be established at both the

<sup>37</sup> [http://reports.aiidatapro.com/SSI/Living\\_standard\\_Measurement\\_Study\\_2002-2007.pdf](http://reports.aiidatapro.com/SSI/Living_standard_Measurement_Study_2002-2007.pdf)

<sup>38</sup> [http://reports.aiidatapro.com/SSI/Living\\_standard\\_Measurement\\_Study\\_2002-2007.pdf](http://reports.aiidatapro.com/SSI/Living_standard_Measurement_Study_2002-2007.pdf)

<sup>39</sup> [http://reports.aiidatapro.com/SSI/Living\\_standard\\_Measurement\\_Study\\_2002-2007.pdf](http://reports.aiidatapro.com/SSI/Living_standard_Measurement_Study_2002-2007.pdf)

<sup>40</sup> [http://www.serbia-business.com/serbia-business/index.php?option=com\\_content&view=article&id=78%3Aserbia-financial-sector-performance-in-2007&Itemid=69](http://www.serbia-business.com/serbia-business/index.php?option=com_content&view=article&id=78%3Aserbia-financial-sector-performance-in-2007&Itemid=69)

<sup>41</sup> <http://www.siepa.sr.gov.yu/attach/ITS.pdf>

national and local level within a four-year period. The initiative is in line with the government's policy objective of modernizing local government and of public procurement procedures.<sup>42</sup>

### **Architectural Quantum Leap in Belgrade**

A growing number of real estate investors are discovering Belgrade as an attractive boom market in the Balkans. Construction is taking place virtually throughout the city: from blocks of flats, prefab renovation and new apartments to sports facilities, shopping centers, business parks, logistics centers and entire new factories. Even a modern marina and an aqua park are under construction to compensate for the fact that Montenegro's independence means that Serbia no longer has access to the Adriatic, and thus no longer has a coastline. Now that affordable mortgages have become available, residential construction and the business of renovating old prefabricated buildings are booming. The image of older districts in the city centre has already changed dramatically. At the same time, prices everywhere are exploding. And the trend is still rising.<sup>43</sup>

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<sup>42</sup> <http://researchreport.wordpress.com/2008/02/25/information-technology-report-serbia/>

<sup>43</sup> <http://www.wieninternational.at/en/node/6597>