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ECONOMIC SITUATION AND ECONOMIC REFORM IN EASTERN EUROPE

Introduction

The 1989 revolutions in Central and Eastern Europe started a progressive and irreversible move towards political pluralism and parliamentary democracy, private enterprise and a market economy open to international trade and investment. The transition was made harder by the major problems inherited from the old system: macroeconomic imbalances (monetary overhang and related shortages, over-full employment, external deficits and debts) and a capacity structure inappropriate to domestic and foreign demand, to the state of technology and to environmental protection. Thus systemic change was accompanied by macroeconomic stabilisation programmes supported by the international community, and by attempts at capacity restructuring.

Because the various countries and sectors set out from different starting positions, and because the complex process of transformation has progressed at different speeds, achievements to date have also differed. In general, stabilization has been relatively fast and successful, normalising the state of markets and hardening domestic currencies often to the point of convertibility. Transition has been slower than initially expected, especially as a result of technical and political delays in privatization. Restructuring has hardly begun.

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Poland, Hungary and the CSFR, now connected by the Visegrad Treaty of February 1991 that led to a free trade area from June 1992, have made the most significant progress. The Polish stabilization programme of January 1990 provided a shock therapy prototype for the rest of the area. Hungary was in a better macroeconomic position and did not need it, but intensified price and trade liberalization along the same lines in 1990-91. The CSFR was favoured by an even better macroeconomic position, offset by harder tasks of institutional change (no private sector, monopolies) and industrial restructuring (away from metallurgy, armaments, and an over-sized and excessively diversified machine building sector). Their systemic transition has, necessarily, been more gradual than their stabilization and liberalization, but has achieved the transformation of a monolithic banking system into a multi-level system of central and commercial banking, the development of financial markets, some privatization of state assets and the growth of new private enterprises, the opening of their economies and the redirection of foreign trade.

The achievements of these three countries have been matched by closer ties with the European Community, through the so-called Europe Agreements which came into force on an interim basis in March 1992. The agreements provide for ongoing political dialogue through 'Association Councils' and aim at implementing a free trade area within ten years (except for agriculture) in two stages, with all trade barriers on these countries' exports to the Community to be removed within a year (except for sensitive products, which represent less than half of their exports). Accession to full membership will naturally depend on further EC developments and on potential members' willingness and ability to implement the 'acquis communautaire'.

The progress of the CSFR has been handicapped by the split between the Czech and Slovak republics. Nationalism and national disintegration have characterized transitional countries, but Czech and Slovak separation is set for an amicable solution, to the point of preserving a common currency. Nationalist, ethnic and religious strife has exploded into a gruesome civil war in Yugoslavia, dissipating stabilization efforts and freezing effective transition except for Slovenia. Romania and Bulgaria, though behind the Visegrad three, have made significant progress. In Albania, stabilization and reform are a long way behind.

Since the disintegration of the Soviet Union at the end of 1991 the individual republics have pursued stabilization and transition at differing paces. Probably Russia and the Baltic states have advanced more than the others, while armed conflict in Armenia, Azerbaijan and Georgia, and chaotic situations in Moldova and Tadjikistan, have prevented them from making any headway. For all the former Soviet republics disintegration has created additional costs of disrupted trade flows and great confusion over the role and management of the rouble, which are still unresolved and are major obstacles in the way of further progress.

All the countries of Central and Eastern Europe and the former Soviet Union have suffered serious and protracted recession, as witnessed by rapid decline of national income, industrial output, investment, living standards, and the rapid appearance of large scale unemployment. These phenomena are partly overemphasized by the statistical procedures, through former achievements grossly overstated by exaggeration and the complete lack of market verification, and through underrecording of current growth of the private sector, but are still significantly large. Partly they are the manifestation of already existing problems (such as overmanning, negative value added activities, subsidization, bad loans) which have only been able to surface under the new system and are not due to it. Partly — for the net importers of energy — they are due to the delayed oil shock of importing at world prices. Another major factor was the collapse of CMEA, which ended in September 1991; this was the unavoidable consequence of Soviet intransigence, though in any case trade would have collapsed following Soviet decline.

There is now an increasing awareness that to some extent the recession may have been due to specific features, or dosages, of stabilization measures and reform policies, such as: the high transitional costs of freeing trade ahead of structural change; initial overshooting of monetary and credit squeezes; currency under- and over-valuation; delays in privatization and, meanwhile, neglect of the still large state sector.

All the recessionary factors listed above either have once-and-for-all effects, which should have been absorbed by now, or are factors rectifiable by policy changes. Thus one should expect the decline to come to an end in 1993, at least for the countries which were early starters. In fact the decline has slowed down, and in Poland and the CSFR by mid-1992 the first signs have appeared of bottoming out.

The international community has played a leading role in assisting transitional economies, with loans obtained through membership of the IMF, the World Bank and the EBRD, balance of payments assistance, funds backing exchange rate stability and convertibility, emergency aid, grants, guarantees, technical assistance. The Community PHARE programme, promptly initiated in 1990 for Poland and Hungary, has been extended to another eight countries.

Everywhere, however, new problems have also emerged, which can be eased by international resources and technical assistance but cannot be resolved without determined government action and sacrifices by the citizens of the countries concerned. Indeed there is a strong case for international assistance being made conditional on domestic commitment to tackle these problems.

First, there is a widespread fiscal crisis, caused by inflation lags and by profitability falls, by a reduced size of the state sector and the tax privileges of the private sector, by the cost of unemployment and by often over-generous social welfare provisions. There is a need to modernize the tax system and its administration, and to implement budgetary discipline so as to contain deficits within reasonable and prefixed limits. This is vital, especially in countries with still undeveloped domestic financial markets and with limited access to international finance, where therefore deficits above a small percentage of national income are necessarily financed by monetary expansion and so crowd out investment.

Second, the transition from a passive to an active monetary policy typically has created a boom in inter-enterprise debts, many of which are bad loans. These, together with the build-up of enterprise arrears towards banks, and added to the stock of bad loans inherited from the old system, threaten the financial stability of transitional economies. There is a need to clean up the balance sheets of financial institutions, to recapitalize enterprises and banks, to enforce liquidation and bankruptcy procedures, and to proceed with privatization.

Third, there is a recrudescence of wage-push inflation, resulting from pent-up aspirations, impatience, indulgence in populist tendencies. A formal or informal social pact appears necessary to give legitimacy to necessary austerity policies otherwise avoided by weak governments and fragmented parliaments for fear of social unrest and electoral backlash.

Last but not least, after decades of high though misdirected capital accumulation, there is now underinvestment, with respect to the requirements of capacity restructuring and the resumption of growth. Barring further cuts in living standards, higher investment can only be funded from foreign capital, including operations of debt restructuring and relief. Private investment inflows have been disappointing, apart from Hungary, though Polish prospects have been improving recently. Public international funds can go some of the way to fill the gap but ultimately it is up to the transitional countries to create the legislation, incentives, domestic economic climate, credible and stable policies, capable of inducing higher levels of foreign investment and savings. Growth, once resumed, should be able to feed and sustain itself, justifying the more optimistic predictions of acceleration in the second half of this decade; however, this virtuous circle is not yet in motion and will not be, by any means, automatic.

Albania

Albania, with its population of 3.3 million, is a predominantly agricultural economy, whose level of economic development is the lowest in Europe. Until early 1991, Albania was a remarkably pure example of a centralized command economy: no private property, all economic decisions taken centrally in the five-year plans, a virtually flat income distribution, and autarky as an ideal. This policy increasingly starved the country of foreign inputs and technology. As a result, the physical and human infrastructure became grossly inadequate, technology became increasingly backward and output growth decelerated gradually over the past few decades. Combined with one of the highest population growth rates in Europe (over 2% per annum) this meant that output per capita in 1990 was 10% lower than a decade earlier.

The political events of 1990 and 1991 have had a catastrophic effect on the economy. The central planning system has stopped working, and nothing has yet been put in its place. Whereas in other East European countries systemic inertia kept much of the economy going in the early stages of the transition, the collapse in Albania was immediate and very deep. GDP is estimated to have fallen by 30% in 1991 and by a further 11% during the first half of 1992. Industrial output in 1991 fell to almost half its 1990 level, and has continued to decline during the first part of 1992. The upheaval which followed the privatization of agriculture seriously disrupted the planting of crops in the autumn of 1991 and led to a collapse of the spring 1992 harvest, thus making the country almost entirely dependent on food aid. Unemployment has reached 70%, the workforce is demoralized, discipline is low and absenteeism high. Frequent strikes have exacerbated the downturn.

The general government budget developed an increasing deficit in recent years (20% of GDP in 1990, 47.5% in 1991 and an estimated 50% during the first half of 1992). Tax revenues, which are virtually all drawn from the ailing enterprise sector, declined from 42% of GDP in 1990 to 28% in 1991 and to 16% in the first half of 1992. Furthermore, in an effort to prevent a complete social breakdown, the government decided to continue paying redundant workers 80% of their previous wages. The exploding budget deficit was met by printing money. The government that was formed following legislative elections in March 1992 has replaced the 80% scheme with a social assistance system which will provide a subsistence income to the unemployed. With the exception of 24 items of basic necessity all prices have been liberalized, yet most goods remain scarce. Thus excess liquidity has led to a monetary overhang and spiralling inflation, currently estimated at 10-15% per month.

Economic reform is still in its initial stages. During 1991 private enterprise was legalized and a few other piecemeal measures were taken, such as allowing private car ownership. The privatization of agricultural land was carried out in a fairly chaotic way but is now nearly completed; all collective farms were broken up and the land was distributed to private farmers. A two-tier banking system has been created, consisting of an independent central bank and three competing commercial banks. The liberalization of foreign trade, the privatization of those state enterprises deemed to be viable, gradual moves towards currency convertibility and the drafting of several important pieces of legislation, including a commercial code, a company law and a bankruptcy law, have been announced.

The currency has been twice devalued since September 1991, but this is of little relevance, since trade has collapsed and the external position of the country has become extremely grave. The 1990 current account in convertible currencies recorded a deficit of close to US$ 91 million, which was financed by foreign credits and, to a lesser extent, by a drawing down of international reserves, which are now less than $5m. The situation further deteriorated in 1991, with hard currency exports falling to $73m compared to $123m in 1990 (−40.4%) and hard currency imports declining to $201m compared to $228m in 1990 (−11.9%). The drop in total trade was even more pronounced because of the abandonment of all clearing agreements with East European countries during 1991 and the resulting collapse of non-convertible trade. New credit from foreign banks is unlikely to be forthcoming, as Albania is confronted with a huge outstanding external debt of over US$ 500 million. Over 70% of this debt is due in the form of arrears on short-term credits with some fifteen European commercial banks. A committee of creditor foreign banks has been formed; the National Bank of Albania has asked for a debt rescheduling, but foreign banks are requiring an agreement with the IMF on an economic stabilization and restructuring programme as a condition for negotiations.

ALBANIA

Area (1000 sq km)	27.5			
Population (millions)	3.3			
Population density (per sq km)	120			
Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	−13.1	−30.0	−11.0	Jan-June
Agricultural production (a)	−7.4			
Industrial production (a)	−7.5			
Consumer price index (b)				
Unemployment rate, in % (c)	8.6	50.0	70.0	June
Budget balance, % GDP (d)	−20.0	−47.5	−50.0	Jan-June
Trade balance, $ bn (e)	−0.1	−0.2		
Current account, $ bn (e)	−0.1	−0.3		
Gross foreign debt, $ bn (c)	0.35	0.55		
Debt-export ratio, % (f)	284	753		

(a) Percentage increase over (the same period of) the previous year.
(b) Reliable data not available.
(c) End of period.
(d) Consolidated state budget deficit, accrual basis.
(e) In convertible currencies.
(f) Gross hard-currency debt as a percentage of hard-currency exports.

The new government reached provisional agreement with the IMF in July 1992 on an economic and financial programme, which could be supported by a 12-month stand-by arrangement from the Fund. The main elements of the programme are: the abolition of most remaining price controls; a wage policy designed to ensure a decline in real wages; a sharp reduction in the budget deficit, to be achieved mainly by lowering expenditure; substantial monetary tightening; and liberalization of the foreign exchange regime.

Baltic States

The three Baltic republics (Latvia, Estonia and Lithuania) were forced to accede to the USSR in 1940, so beginning a 50-year period of Soviet domination. They formally regained full independence in August 1991. This was the culmination of moves towards independence that had begun in the late 1980s as the political climate in the then USSR became more tolerant.

All three Baltic states were granted limited economic autonomy by the Supreme Soviet of the USSR with effect from 1 January 1990. Although this included the right to set up their own central and commercial banking system and established a two-tier fiscal system of state and local budgets, the individual republics' budgets remained tied to the central Union system. Furthermore, the Soviet Union remained an economic and monetary union, with monetary, exchange rate and trade policy controlled from the centre. Responsibility for the central planning and supply system

was devolved to the republics for the agricultural sector and most of the industrial sector, but the defence, chemical, energy and transport sectors continued to be planned from the centre. Moreover, the highly specialized and monopolistic Soviet production structure continued to be a check on independent economic policy.

The Baltic republics are among the smallest of the former Soviet Union in terms of land area, population and the economy. In 1990 Estonia totalled 0.6% of the total USSR population, while Latvia accounted for 0.9% and Lithuania for 1.3%. Lithuania has the largest economy of the three, which accounted for 1.4% of USSR Net Material Product in 1988, while the figure for Latvia was 1.1% and for Estonia 0.6%. Nevertheless, these economies are relatively more prosperous than other former Soviet republics. Estimates of net output per capita for 1988 show Latvia 19%, Estonia 17% and Lithuania 10% above the average for the USSR as a whole. Moreover, the Baltic republics appear to have avoided the gradual downturn in economic activity that began elsewhere in the USSR in the mid-1980s, although sharp declines were recorded in 1990 and 1991.

The three economies were highly integrated within the Soviet economic structure, previously deriving over 80% of their imports from inter-republic trade. Trade with western partners and former CMEA members is small. The decline in the Russian economy, in particular, has denied the Baltic states much of their main export market. Moreover, the Baltic republics' relative prosperity within the Soviet Union reflected a sizeable inter-republic trade deficit, which was financed by intra-union transfers. Under independence this deficit, if sustained, would translate into a substantial external trade deficit which could not be financed. The move to world prices and hard currency trading has had a negative effect on the Baltic states' terms of trade. The main reasons for this are that previously they were supplied with Russian oil and energy products at below world prices, and in return exported relatively low-value manufactured products. This worsening of the terms of trade only serves to compound the external payments problem. Nevertheless, the withholding of supplies by other republics, particularly Russia, during 1991 resulted in a decline in imports and hence in trade being close to balance in all three countries.

The three republics are progressing at varying paces towards establishing a market economy and reorienting trade towards the West. Stabilization policy is now beginning, and all three Baltic republics became members of the IMF in April/May. The countries are in the process of discussing their economic stabilization programmes with the IMF. Monetary policies have been exceptionally tight because of the failure of Russia to deliver roubles. Each of the three countries has now left or is in the process of leaving the rouble zone. It is expected that by the time the stabilization programmes are in place, all three countries will have their own currency, and therefore be responsible for their own monetary policy.

The budget was broadly balanced in both Estonia and Lithuania in the first half of 1992, but in Latvia a deficit amounting to 3.5% of GDP emerged. Revenues are likely to be depressed in the second half of the year, largely as a result of shortfalls in tax payments by enterprises facing a build up of domestic and inter-state payments arrears.

Estonia

During 1991 Estonia's GDP is estimated to have fallen by 11% in real terms following a 4% decline in 1990. The deterioration in trading conditions was the root cause. This trend continued into the first half of 1992 as industrial output fell by 38% compared to the same period in 1991.

Unemployment has yet to reach significant levels in Estonia, despite the reduction in economic activity throughout 1990 and 1991. Enterprises have been reluctant to shed labour, and unemployment in July 1992 stood at only 5,635, although this represented a big increase over the June figure. The continued contraction in output expected during 1992 is likely to result in more widespread job losses.

The adverse trading climate in 1991 reduced import volumes by more than export volumes, and export prices rose faster than those of imports because price liberalization proceeded more rapidly than in other Soviet republics. However, these terms of trade gains are expected to be wiped out in 1992, as Russia raises its export prices, in particular for fuels. The emergence of a significant trade deficit has only been prevented by the lack of finance; the current account was roughly in balance in the first half of 1992.

In response to the decline in output and the corresponding fall in tax revenues in 1990 and 1991, the government reduced expenditure and achieved budget surpluses in both these years. For 1992 a budget was initially set only for the first half of the year, in anticipation of the introduction of the new currency (the kroon), which took place on 20 June. The government achieved a balanced budget for the first half of 1992, and a balanced budget is also planned for the full year. However, the growth in inter-enterprise arrears has led firms to delay tax payments, which has recently started to affect the budget.

ESTONIA

Area (1000 sq km)	45.1			
Population (millions)	1.6			
Population density (per sq km)	35			

Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	−3.6	−10.8	−30.0	Q-1
Agricultural production (a)	−3.2			
Industrial production (a)	−5.6		−38.0	Q-1
Consumer price index (a)	17.2	260.0	1 156.0	Q-2
Unemployment rate, in % (b)			0.7	July
Budget balance, % GDP (c)	3.1		0.0	Jan-June
Trade balance, $ bn (d)	−0.1	−0.1	0.0	Jan-June
Current account, $ bn (d)			0.0	Jan-June
Gross foreign debt, $ bn (b)		0.4		
Debt-export ratio, % (c)		685.3		

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Consolidated state budget deficit, accrual basis.
(d) In convertible currencies.
(e) Gross hard-currency debt as a percentage of hard-currency exports.

Price liberalization has progressed well in Estonia. Goods whose prices continue to be controlled include sugar, bread, electricity, fuel and rents, while milk, cereals and energy continue to be subsidized. The higher general price level that resulted in Estonia in 1991 was seen by the government as a means of encouraging imports from, and discouraging exports to, other republics. In the second quarter of 1992 the cost-of-living index was over 1000% higher than in the second quarter of 1991, and 58% higher than in the first quarter of 1992. Although the second quarter figure is high, it represents a slowing in the rate of price inflation.

A two-tier banking system has been established. The central bank (Bank of Estonia) was founded in 1990, and took on full central banking responsibilities at the beginning of 1992, when it absorbed the Estonian branch of Gosbank. The private commercial banking sector comprised 20 banks at the end of 1991.

Macroeconomic stabilization is beginning to receive serious attention, now that Estonia has left the rouble zone and has its

own currency. The Bank of Estonia now has genuine responsibility for monetary policy. The kroon is pegged to the DM and is internally convertible. The currency is backed by about $120m-worth of reserves of hard currency, gold and forestry assets held by the central bank. A currency board system has been established which strictly limits the issue of money to the amount of reserves held. The adoption of the currency board system will set a limit to monetary expansion. The Estonian authorities are negotiating for additional reserve support from the IMF, which would allow the Estonian authorities greater freedom of manoeuvre in the conduct of monetary policy.

Budgetary reform began in 1990 by separating central and local government budgets, requiring both to be balanced. Progress was made in 1991 towards the creation of a tax system consistent with that of a market economy.

Privatization has shown less progress. Up to the end of 1991 little over 100 enterprises had passed into private ownership. The privatization of municipal housing has proceeded by the distribution of vouchers to residents. The main impediments to further progress appear to be the issue of citizenship and rights to ownership, and the additional complications introduced by the restitution law.

Latvia

GDP fell by 7.6% in real terms in 1991, the main areas of contraction being construction of dwellings, services and freight transport. Industrial output remained unchanged, while agricultural output fell by about 4%, mainly because of poor crop yields and fodder shortages for cattle production. Enforced import contraction from former Soviet trading partners, particularly the Russian republic, resulted in an unprecedented surplus in trade with these partners in 1991. This compares with regular deficits in internal trade balances throughout the previous decade.

During 1990 new institutions were established, including a new tax system, which from 1991 enabled an independent fiscal policy to be pursued. Provisional estimates of the Latvian budget show a substantial surplus in 1991 (about 8% of GDP). This compares to a planned deficit of about 0.5% of GDP. The large unanticipated surplus was mainly the result of price liberalization, which had a positive effect on tax revenues through receipts from the turnover tax and enterprise profits. In addition, adjustments were made throughout the year to cover previously unforeseen expenditures.

LATVIA

Area (1000 sq km)	64.5			
Population (millions)	2.7			
Population density (per sq km)	42			

Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	−0.2	−7.9	−30.9	Jan-June
Agricultural production (a)	−17.2	−3.6		
Industrial production (a)	7.4	0.0		
Consumer price index (a)	10.5	172.2	700.0	June
Unemployment rate, in % (b)			1.6	June
Budget balance, % GDP (c)	2.1	8.0	−3.5	Jan-June
Trade balance, $ bn (d)	−0.2	−0.2	0.0	Jan-June
Current account, $ bn (d)			0.0	Jan-June
Gross foreign debt, $ bn (b)		0.8		
Debt-export ratio, % (e)		520.4		

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Consolidated state budget deficit, accrual basis.
(d) In convertible currencies.
(e) Gross hard-currency debt as a percentage of 1990 hard-currency exports.

The 1992 budget plans initially covered only the first half of the year, and a balanced budget had been envisaged. However, the difficulties faced by the enterprise sector resulted in the accumulation of tax arrears, and an actual budget deficit of about 3.5% emerged. The government has been forced to finance the deficit by borrowing from the central bank. The budget package for the second half of the year aims to reduce the deficit as a proportion of GDP. This will be difficult, in view of the fact that unemployment, which stood at 23,000 in June, is expected to increase as the year progresses. Measures to reinforce the tax collection system have been initiated, and a decision to introduce a tax-based incomes policy has been taken.

Following the declaration of independence in mid-1990 the reform programme proceeded with the establishing of the Bank of Latvia, which subsequently took over the functions of the Latvian branch of Gosbank, as well as the state commercial banks. The private banking sector has expanded; 17 banks had been created by the end of March 1992.

The central bank will issue and manage the new currency (the lat), which it envisages pegging at parity with the ECU. It is planned to make the lat immediately convertible for current account purposes. However, the immediate problem of securing sufficient roubles from Gosbank in Moscow led the authorities to introduce a temporary parallel currency in May — the Latvian rouble. Furthermore, on 20 July, the Latvian authorities left the rouble zone by replacing all remaining Russian roubles with Latvian roubles. Since then the Latvian rouble has been the only legal tender and will remain so until the introduction of the lat, possibly as early as September. A clearing arrangement for trade has been established with Russia.

Price liberalization has proceeded at a steady pace in Latvia since January 1991. These initial measures freed prices mostly for non-food items, while other goods were subject to price ceilings or maximum profit margins. At the end of 1991 farm procurement and all retail food prices were liberalized. Industrial goods prices were further liberalized in January 1992. More recently, farm support prices for all products except grains have been abolished, and maximum profit margins for food processors and retail traders have been removed. Retail prices have risen strongly, but have moderated in recent months. In June 1992 the index of retail prices was 700% higher than in the same month in 1991.

Privatization so far has progressed only slowly in Latvia. This is partly due to the provisions for restitution, which set the end of 1993 as the deadline for the submission of claims. So far the programme has mainly been confined to agricultural co-operatives, small shops and service establishments. No firm plans exist yet for privatization of large-scale enterprises.

Lithuania

NMP is estimated to have declined by about 13% in 1991, following a decline of about 5% in 1990. This came about mainly because of the deterioration in the trade situation. Trade with Russia continues to be hampered by obstructive banking and clearing arrangements in Moscow and by Russian enterprises reneging on supply agreements. The Lithuanian authorities estimate that Russian enterprises owe some 8bn roubles to Lithuanian counterparts.

Industrial output in the second quarter of 1992 was 41% down on the same period in 1991, while agricultural output declined by 18% over the same period. Further declines are anticipated as the year progresses, particularly in the agricultural sector, which has

been severely affected by the drought in the region. Unemployment stood at 20,308 in May 1992.

Price liberalization progressed in 1991, although controls remain for food, oil and rents and monopoly products (communications, transport, energy and pharmaceuticals). About 70% of GDP is estimated to be under a liberal price regime; the remaining 30% is regulated by the state, directly or indirectly.

LITHUANIA

Area (1000 sq km)	65.2			
Population (millions)	3.7			
Population density (per sq km)	57			

Main Economic Indicators	1990	1991	1992	latest
NMP at constant prices (a)	−5.0	−12.8	−35.0	Jan-June
Agricultural production (a)	−11.5	−8.0	−18.0	Q-2
Industrial production (a)	0.3	−1.3	−41	Q-2
Consumer price index (a)	8.4	224.7	1 000.0	June
Unemployment rate, in % (b)			1.1	May
Budget balance, % GDP (c)	−2.9	3.0	0.0	Jan-June
Trade balance, $ bn (d)	−2.0	−0.1	small +	Jan-June
Current account, $ bn (e)				
Gross foreign debt, $ bn (b)		1.0		
Debt-export ratio, % (f)		442.7		

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Consolidated state budget deficit, accrual basis.
(d) In convertible currencies.
(e) Invisibles balance not available.
(f) Gross hard-currency debt as a percentage of hard-currency exports.

Estimates suggest that price inflation rose as high as 275% in 1991. The trend had slowed until November, when the latest liberalization law came into effect. Prices continued to rise at an increasing pace in early 1992, mainly fuelled by real wage growth. Inflation in the first half of 1992 exceeded 1000% at an annual rate.

Provisional data show a significant decline in imports from other Soviet republics in 1991, resulting in a trade surplus with these republics. A small overall trade surplus was recorded in the first half of 1992.

The 1991 budget was broadly balanced, and this continued into the first half of 1992. However, a substantial budget deficit is anticipated for the full year in 1992. The deficit is expected both because of increased expenditures, related largely to subsidies to compensate for price increases, and because of depressed revenues resulting from the weakened financial situation of state enterprises. This last factor has been exacerbated by the build-up of inter-enterprise arrears, a problem which the central bank has sought to alleviate by injecting credits into the banking system.

Monetary reform is to be based on the new currency (the litas), and the central bank will be responsible for monetary policy. The insufficient supply of roubles from Russia has led the government to introduce coupons, issued as a proportion of social benefits (pensions, student grants and other benefits). The Lithuanian authorities estimated that these vouchers accounted for about 60% to 70% of money transactions in June.

Stabilization policy has yet to get under way. The government is currently negotiating a programme with the IMF. The introduction of the new currency will allow more scope for the control of inflation, which will also depend to some extent on the exchange rate policy adopted. Indications from the central bank are that the litas will be allowed to float, possibly with a flexible link to the ECU, and that the degree of convertibility will be limited. Stabilization will also entail steps to reduce the size of the projected budget deficit in 1992.

Privatization in Lithuania is based on a voucher system. The privatization of residential property began in 1991, with 50% to 60% of apartments transferred to private ownership. In the enterprise sector sales have proceeded by auction for small-scale enterprises and a public share subscription system for larger firms. Some 48,000 farms are also said to have been privatized. The introduction of a stock market is planned for later this year.

Little progress has been made in reforming the banking system. Twenty branches have been separated from the central bank, but it retains ten commercial branches, through which it continues to engage in commercial activities. Further progress is being hampered by uneasy relations between the central bank and the government.

Bulgaria

Bulgaria started its far-reaching economic reform in February 1991 under exceptionally unfavourable conditions. The legacy of central planning included an excessively developed heavy industrial sector, based in part on artificially cheap energy and lax regulation of pollution, and systematic neglect of the traditionally competitive agricultural sector. From 1990, the country also encountered a number of serious external shocks: first, the collapse of trade with the CMEA, and in particular the USSR, on which Bulgaria was particularly dependent; second, the need to import energy at world prices to replace cheap Soviet supplies; third, the lack of access to commercial credit as a result of the unilateral moratorium on external debt declared in March 1990; and fourth, the effect of international embargoes on Iraq and, recently, Serbia.

The February 1991 reform package contained a series of liberalization, stabilization and structural reform measures. Most prices were freed at one stroke, in order to eliminate the increasingly pervasive shortages and the very substantial overhang of unwanted savings. The foreign trade regime was significantly liberalized. A new exchange rate system was put in place, providing for a single floating exchange rate. Fiscal policy was aimed at simultaneously reducing the share of public spending in GDP, and cutting the deficit. Subsidies were slashed from 14.9% of GDP in 1990 to 4.0% in 1991. The budget was, however, caught in a 'debt trap': the full cost of interest due on internal and external debt amounted to 17.5% of GDP in 1991. Only by not servicing external debts could the cash deficit be limited to 3.6% of GDP; on an accrual basis it was 14.9%. Monetary policy was extremely restrictive, with both credit ceilings and positive real interest rates. This was supplemented by a very tight tax-based incomes policy.

Structural change has been slower than planned. Budget constraints on enterprises remain too soft, partly because no bankruptcy law exists yet. In the financial sphere, progress has been made with the restructuring of the banking system and the enactment of modern banking legislation. A large proportion of bank assets consist of bad loans to enterprises, however; the government has started a process of gradual recapitalization, but this is hampered by its budgetary cost. Privatization has long been stalled because of political difficulties.

Only in 1992 was structural reform speeded up, mainly by the adoption of several major pieces of legislation. In January 1992, a liberal foreign investment law was passed. For large industrial enterprises, a privatization law was adopted in April. The restitution of small shops and businesses is well under way. The law on privatization of agricultural land was finally revised in April 1992; effective implementation is expected to start by late summer.

The economic results since the start of reform have been substantially worse than initially expected. After declining by 11.8% in 1990, real GDP fell by another 22.9% in 1991. Output trends in early 1992 are still sharply negative, even if the pace of decline appears to be slackening. The retail price level jumped by 277% during the first quarter of 1991, and has since then continued to increase at a 4-6% monthly rate. The collapse of Bulgaria's traditional foreign markets and the decline in domestic output led to a sharp decrease in exports. This, plus the acute shortfalls in external financing, forced a very rigorous contraction of imports in 1991 (by 62% in hard currencies) — which in turn exacerbated the domestic contraction.

BULGARIA

Area (1000 sq km)	112.5			
Population (millions)	9.0			
Population density (per sq km)	80			

Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	−11.8	−22.9		
Agricultural production (a)	−6.7	−13.2		
Industrial production (a)	−16.3	−27.5	−17.5	Q-1
Consumer price index (a)	21.6	333.5	112.8	Jan-June
Unemployment rate, in % (b)	1.7	10.2	12.5	May
Budget balance, % GDP (c)	−9.1	−14.9		
Trade balance, $ bn (d)	0.8	0.0	0.2	Q-1
Current account, $ bn (d)	−1.2	−0.9	−0.1	Q-1
Gross foreign debt, $ bn (b)	10.0	11.4	12.0	April
Debt-export ratio, % (c)	299	271		

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Consolidated state budget deficit, accrual basis.
(d) In convertible currencies.
(e) Gross hard-currency debt as a percentage of hard-currency exports.

The cost of adjustment has largely been borne by wages and the labour market. Real wages fell by 42% during 1991. Public sector labour-shedding has been very substantial at around 900,000 jobs (over 20% of the labour force), both in the state administration and in the state enterprise sector. Unemployment rose from negligible levels at the start of 1991 to 12.5% in May 1992.

In April 1991 Bulgaria obtained an arrangement with the Paris Club which recommended deferral and rescheduling of all debt servicing payments to official creditors, including arrears on short-term credits. However, the greater part of the debt — about 80% of the total $12 billion — is owed to commercial banks. Although the initial reaction of the banks was not positive, the talks are continuing.

Commonwealth of Independent States

Russia

The radical economic reform programme launched in January 1992 has suffered severe setbacks in recent months. Macroeconomic stabilization in particular proved to be politically unfeasible, in part because no real control is being exercised over money and credit creation in the rouble zone (cf. section on CIS below). Discussions with the IMF on a stand-by arrangement, a necessary condition for the release of $24 billion in Western aid, have run into delays as a result. Russia is now clearly on the brink of hyperinflation, and output continues to decline sharply.

A radical reform programme was launched on 2 January 1992. Most prices were freed immediately. Fiscal policy aimed to be very restrictive, with drastic spending cuts and an overhaul of the tax system. A 28% VAT was introduced as one of the main sources of revenue. After some confusion about the Central Bank's support for the government's policy, monetary policy turned very tight.

This policy package was not sufficiently comprehensive to ensure stabilization, however. The main weaknesses were exchange rate policy and wage policy. The exchange rate regime remained excessively fragmented and distorting, with a multitude of rates ranging from 5.4 roubles/$ to a grossly undervalued auction rate of 230 roubles/$; the latter oscillated around 140 from March onwards as a result of the Central Bank's interventions in the very thin foreign exchange market. These interventions were stopped in July, and the rate depreciated to over 160 by the end of the month. Enterprise wages have not been controlled, as would have been desirable in view of the underdeveloped state of the credit and banking system.

As a result, prices shot up by 250% in January; thereafter the rate slowed down but remained very high at between 15 and 25% per month. A serious shortage of bank notes emerged, which held down consumer price inflation somewhat, but further strengthened the trend towards barter, and fostered popular discontent as employers were frequently unable to pay wages on time. The consequences of the Central Bank's high interest-rate policy are being circumvented in part by the explosive growth of inter-enterprise credits, which fuels wholesale price inflation. The new VAT is proving difficult to collect, leading to sizeable state revenue shortfalls. The government has reported only a small budget deficit for the first quarter, but there has been substantial slippage since then. Economic decline continues unabated: compared to the same period of 1991, industrial output fell by 13.5% during the first half of the year, and investment by 46%. A very large share of the population was pushed below the poverty line.

RUSSIA

Area (1000 sq km)	17 075.4			
Population (millions)	147.4			
Population density (per sq km)	9			

Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	0.4	−9.0	−14	Q-1
Agricultural production (a)	−3.6	−4.7		
Industrial production (a)	−0.1	−8.0	−13.5	Jan-June
Consumer price index (a)	5.0	90.4	875	Jan-June
Unemployment rate, in % (b)		0.1	0.2	March
Budget balance, % GDP (c)		−20		
Trade balance, $ bn (d)	2.4	7.3	0.5	Jan-June
Current account, $ bn (d)	−1.1	3.4		
Gross foreign debt, $ bn (b, c)	38.0	40.1	43.4	May
Debt-export ratio, % (e, f)	148	162		

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Notional balance for 1991 includes assumed share of Union budget.
(d) In convertible currencies.
(e) Russia's share in debt contracted by the former USSR is 61.34%. In practice it might assume a higher burden. For the debt/export ratio calculation a share of 80% has been assumed.
(f) Gross hard-currency debt as a percentage of hard-currency exports.

The trade surplus, which in 1991 was still substantial ($7.4 billion), all but disappeared during the January-June period ($0.5 billion), as officially recorded exports declined more steeply (−35%) than imports (−24%). Trade with former CMEA partners fell even more, and was nearly halved compared to January-June 1991. Since the end of 1991, Russia has been unable to service its foreign debt; in the following months it reached temporary agreements with public and private creditors for a deferral of principal repayments. However, substantial arrears have been incurred since then (reported by official Russian sources at $8.5 billion by July, of which more than $1 billion were interest arrears), indicating that a longer-term solution to the debt problem is urgently needed.

From late February onwards, the government worked in consultation with the IMF, to which it formally acceded in June, on a much more comprehensive strategy for the rest of the year. A

preliminary version of this plan was submitted to, and endorsed by, the IMF Board and formed the basis of the G7's conditional aid pledge of $24 billion made at the beginning of April and reiterated during the July summit in Munich. The main elements of this second package were reinforced fiscal and monetary tightness, a staged increase in domestic energy prices, unification of the exchange rate system and an early move to current-account convertibility, and more control over wages.

Discussions with the IMF on this package could not yet be concluded, however, as the government ran into serious opposition from Parliament and from the powerful lobby of large state enterprises. Progress was made in some areas. Energy prices were raised somewhat (although they remain far below world market levels); a simplification of the exchange rate system was implemented in July; an import tax of 5% was introduced (to be raised to 15% in September) for budgetary reasons. However, in other respects planned measures were deferred and initial targets were relaxed. State enterprises got substantial additional access to credit. Pensions and minimum wages were increased sharply, wage arrears were 80% indexed, and no progress was made in getting wage developments under control. Earlier attempts to master inflation by curtailing the number of bank notes in circulation were stopped, and large amounts of new high-denomination bills are to be released. Although the government in principle committed itself to limiting the budget deficit for the second half of the year to 5% of GDP, it is unclear how this is to be achieved.

These developments prompted the IMF to review its strategy for supporting Russia and to conceive a staged approach comprising: (i) a transitional 'first credit tranche arrangement', (ii) a traditional stand-by arrangement conditional upon stricter monitoring and (iii) a further arrangement, including activation of the rouble stabilization fund. The implementation of this strategy started in early August, when the IMF approved the first arrangement providing for the use of $1 billion, to be purchased at one stroke.

There are manifest divisions within the government — to which President Yeltsin has appointed more representatives from the state enterprise sector — over the course and pace of reform. Central bank chairman Matiukhin was replaced by former USSR Gosbank governor Gerashenko, with the support of industrial leaders. By July, those arguing against rapid and comprehensive macro-stabilization, even at the risk of losing access to western support, were clearly in the ascendancy.

Ukraine

In Ukraine, a country of roughly the same area and population as France, the collapse of the Soviet empire has implied the abandonment not so much of central planning but of centralized decision-making from Moscow. The thrust of economic policy design has been determined mainly by nationalist forces intent on asserting independence from Moscow. At present, the nationalists and the old communist nomenklatura seem to have joined forces to ensure that change does not go beyond independence. The goal of a separate Ukrainian currency and reservations about an important role for the CIS should also be seen in this context.

Since Ukraine declared its sovereignty in August 1991, some remarkable results in economic policy have been achieved. Price liberalization (although forced by developments in Russia) narrowed the gap between demand and supply for consumer goods. The introduction of Ukrainian coupons as a complement, and later as a substitute, for roubles helped to overcome a shortage of banknotes in a time of exploding demand for transaction cash, although initially severe managerial shortcomings threatened to discredit the Government's ability to run macroeconomic policy.

Finally, the economic reform programme of March 1992 is a positive factor, despite the fact that it has so far had little impact on Ukrainian economic policy design. It has, however, been transmitted to the IMF and could serve as a basis for the international community to urge that a comprehensive reform strategy be pursued.

Like the economies of Central and Eastern Europe, the Ukrainian economy is subject to major disruptions and a major slump in output following the collapse of old structures. The Ukrainian economy has already been hit by two severe shocks: (i) the consequences of disintegration and the struggle for independence from the old Soviet system, with the associated deterioration in the terms of trade and (ii) the consequences of a sudden and unprepared liberalization of regulated and centrally fixed prices in an economy where restructuring of inappropriate capacity is a particularly daunting task. Two more shocks may be coming: (i) the introduction of a separate, convertible currency in the absence of appropriate currency reserves at a time of large-scale macroeconomic imbalances and a lack of capability and willingness to steer a sound and sustainable fiscal and monetary policy and (ii) the transition from a command economy to a market economy.

Price liberalization in Russia, which led to a steep price rise for goods of Russian origin, took the Ukrainian authorities by surprise. To avoid its adverse impact on Ukrainian enterprises' balance sheets (as a result of higher input prices) and to avoid an explosion of cross-border shopping by Russian consumers (as a result of inter-republic price differentials), the Ukrainian Government had to follow Russian price deregulation for tradables. The first steps to lift price controls were taken in January 1992; further steps followed in February and April. Price liberalization was introduced without preparation and on an ad-hoc basis, and a price-wage-price spiral was initiated, which has already had strong negative repercussions on economic activity. Prices have increased by a factor of 16 (industrial wholesale prices) and 8 (consumer retail prices) over the last year. This has not led to an immediate collapse of real consumption, as wages and transfer income were partially indexed.

UKRAINE

Area (1000 sq km)	603.7			
Population (millions)	51.7			
Population density (per sq km)	86			
Main Economic Indicators	1990	1991	1992	latest
NMP at constant prices (a)	−3	−10	−18	Q-I
Agricultural production (a)	−7	−4	−20	Q-I
Industrial production (a)	−1	−13	−15	Q-I
Consumer price index (a)	4	84	775	Q-I
Unemployment rate, in % (b)	0	0	0	Q-I
Budget balance, % GDP (c)	−1	−14	−2	Q-I
Trade balance, % GDP (d)	−1	2		
Current account, % GDP (e)				
Gross foreign debt, $ bn (e)				
Debt-export ratio, % (e)				

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Consolidated state budget deficit, accrual basis.
(d) Excluding inter-republic trade, in world market prices.
(e) Reliable data not available.

The sharp decline in output which has occurred since mid-1991 has not yet affected the labour market, as enterprises have allowed productivity to fall. Indeed, while registered unemployment has remained close to zero, overemployment, which was estimated to be about 15 to 20 per cent in the mid-1980s, may have reached 30 per cent at prevailing levels of output.

The impact of economic disintegration and price liberalization on fiscal and monetary policy has been enormous. In fiscal policy, the government was obliged to set up a new structure of taxation and of revenue collection, while on the expenditure side provisions had to be made for emerging hyperinflation. Furthermore, fiscal policy is still dominated by the struggle between the legislative and executive power and the struggle to shield consumers and workers from feeling directly the costs (and benefits) of economic reforms. This has led to several postponements of the adoption of a budget law for 1992. Until early July, the President was implementing a provisional budget, in which expenditures were partially indexed to inflation while revenues fell short of what was needed to cover expenditure growth. When a budget law was finally adopted in early July, its figures had already been overtaken by events: for example, the deficit foreseen for the whole of 1992 was already reached by the end of May. The true fiscal position is probably worse still, since financial burdens may be concealed by off-budget operations, for example, allowing (state) enterprises to borrow on a large scale.

Monetary policy still suffers from the failure to reform the banking and financial sector and from the lack of a definite and workable assignment of monetary competences. At present, it is the Central Bank in Moscow and the Ukrainian Ministry of Economy which issue legal tender in Ukraine (roubles and coupons respectively). Also the Ukrainian Central Bank's role and instruments for controlling the banking sector's activities have not been finalized.

Moreover, the Ukrainian Central Bank's philosophy still sticks to old-fashioned centrally planned money-growth management by having both tight and loose monetary policy at the same time. While the Central Bank tries to limit consumer-price inflation by artificially limiting the issue of new banknotes, it allows large-scale borrowing by the (state) enterprise sector. This approach can be implemented by maintaining an artificial split of monetary circulation (cash and non-cash transactions). However, such a policy is not sustainable in the medium term and is detrimental to an efficient banking and financial sector and to the plans for introducing a separate currency.

CIS

The Commonwealth of Independent States (CIS), initially heralded as the Soviet Union's successor, so far is only a declaration of intent to maintain economic, political, and military co-operation among eleven of the remaining twelve ex-Soviet republics. No institutional framework has yet been defined, and it is doubtful that this will happen soon. Very little co-operation has in fact emerged. One of the few areas in which an agreement was reached was on how to share out ex-USSR foreign debts and assets, but this has to a large extent remained a dead letter, since all republics have defaulted on their debt servicing obligations. The two main economic issues confronting the CIS states now are trade and money.

Inter-republic trade is likely to be progressively adjusted to international prices, even if the rouble remains the main currency for the settlement of transactions or if barter deals are renewed. Russia wishes to reduce its trade surplus with the other republics through a series of inter-state bilateral agreements setting quotas and a compensation system through state orders. Such an initiative is completely at odds with efforts to create a market system. Other republics are also negotiating bilateral trade agreements and are designing their own schemes for export incentives and management of foreign exchange. The most likely result is a further sharp contraction in intra-CIS trade, with serious knock-on effects on domestic activity.

Yet most former Soviet republics are still part of the rouble zone. This implies, in particular, that developments in Russia have major consequences for the other states. Indeed, all of them were forced to follow Russia's lead in price liberalization at the start of 1992, whether they were prepared for this or not. At the same time, Russia alone cannot bring down inflation as long as the other states do not follow adequate monetary and fiscal policies. In the absence of co-operation, some states might be forced into issuing their own currencies before they are ready for this. Already now, several of them have issued multiple-use coupons as rouble substitutes to offset the shortage of bank notes. This poses serious problems for the payments system and for monetary management; it can also lead to these states dumping roubles in other republics and to retaliatory export controls.

During a meeting of ex-USSR central bankers in Tashkent in mid-May, agreement was reached on guidelines for the rouble zone, including credit ceilings, rules on how to issue currency, reserve requirements and refinancing rates. The Russian authorities have refused to ratify the agreement, however. They maintain that any state wishing to remain within the rouble zone should accept that Russia alone sets monetary policy. As long as this issue is not resolved, macroeconomic control cannot be regained in any rouble-zone state, nor can any IMF-supported stabilization programmes be effectively implemented.

Croatia

Croatia was Yugoslavia's second largest republic with a population of 4.7 million. It was second only to Slovenia in terms of economic development, its GDP was 25.4% of Yugoslavias and GDP per capita was 28% above the Yugoslav average. Industry accounts for 41% of GDP, agriculture for 12% and tourism for 5%. Croatia has sizeable oil and natural gas reserves in eastern Slavonia, a region now mostly under Serbian control.

Croatia was Yugoslavia's second most industrialized republic: industrial production was 21.9% of Yugoslavia's in 1988, and approximately 30% of the active population was employed in industry and mining. The bulk of the republic's industry is socially owned. Enterprises tend to be overmanned, technologically backward and uncompetitive by West European standards. Many were on the verge of bankruptcy but have been bailed out by the state through the repayment of non-performing company debts to the banks in the form of government bonds. This operation accounted for the lion's share of Croatia's $0.7bn public debt.

Croatia's output has been declining for the past few years (−0.9% in 1988, −1.4% in 1989 and −10.2% in 1990). The government announced a 23.4% decline in GDP for 1991 caused by the uncertain supply of raw materials, blockades and extensive war damage. Output in the first quarter of 1992 was 25% lower than in the same period of 1991. Industrial production fell by about 39% in 1991 following a 10% decline in 1990. During the first half of 1992 there was a further decline of 28.1% over the same period of 1991. The rate of unemployment was 17.6% in May 1992. Retail prices rose by 15.1% in June 1992 for a year-on year rise of 484%; recently inflation has been on an accelerating trend. The two main sources of monetary expansion are the central bank financing of the budget deficit and the refinancing of credits to the agricultural sector by the central bank. During the first six months of 1992 real wages were 53% lower than in the same period of 1991.

Trade with other Yugoslav republics accounted for 61.3% of Croatia's total external trade flows in 1988. In foreign trade, Croatia had trade deficits of $0.7bn in 1989 (exports: $2.8bn, imports: 3.5bn) and $1.5bn in 1990 (exports: $2.9bn, imports: $4.4bn). However, large surpluses in invisibles gave Croatia a

current account surplus of $1.0bn in 1989 and a $0.6bn deficit in 1990. Earnings on the services account include substantial revenues from tourism, where Croatia accounted for about 50% of Yugoslavia's total official receipts of $2.7bn in 1990. Final foreign trade data for 1991 are not available. The National Bank of Croatia estimates exports of $3.1bn (+7% over 1990) and imports of $3.5bn (−20%). There was a much-reduced positive balance ($88m) in invisibles, resulting in an estimated current account deficit of $766m. Revenues from tourism collapsed in 1991; other invisible receipts were also in sharp decline. During the first half of 1992 exports were reported to be up by 24.8% and imports by 8.6% compared to the first half of 1991. Foreign exchange reserves at the central bank are extremely low ($30m in July 1992).

Economic reforms were at a very early stage when civil war broke out. The privatization process initiated by the last Yugoslav government was fiercely contested by the Croatian authorities, partly in an effort to resist what was regarded as a policy imposed by the federal government but also because 'social ownership' is a concept with deep roots in Croatia and many of the nomenklatura have an interest in retaining elements of the old system. A new privatization law was enacted by parliament in May 1991. Croatia's 3,600 socially owned enterprises were given until end-June 1992 to privatize themselves. About 1,000 submitted proposals to the republic's Agency for Restructuring and Development. Those that did not are to be brought under state control, to be restructured and then privatized by some unspecified date. The law has been heavily criticized both at home and abroad because of the major role accorded to enterprise management and workers in the privatization process and because it excludes the huge agricultural 'combinats'.

CROATIA

Area (1000 sq km)	58.8			
Population (millions)	4.7			
Population density (per sq km)	80			

Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	−10.2	−23.4	−25.0	Jan-Mar
Agricultural production (b)				
Industrial production (a)	−11.3	−39.1	−28.1	Jan-June
Consumer price index (a)	710.0	222.6	484.3	Jan-June
Unemployment rate, in % (c)	9.2	15.4	17.6	May
Budget balance, % GSP (d)		−4.8		
Trade balance, $ bn (e)	−1.5	−0.4	0.2	Jan-June
Current account, $ bn (e)	−0.6	−0.8		
Gross foreign debt, $ bn (c)		2.6		
Debt-export ratio, % (f)		119		

(a) Percentage increase over (the same period of) the previous year.
(b) Data not available.
(c) End of period.
(d) Consolidated state budget deficit, accrual basis.
(e) In convertible currencies.
(f) Gross hard-currency debt as a percentage of hard-currency exports.

Croatia is in the process of establishing an independent monetary system, to be achieved in two stages. The Croatian dinar, planned as a temporary currency, was introduced in late December 1991. It will be replaced by the crown when Croatia is ready to introduce full current account convertibility in two to three years' time. In the mean time the National Bank of Croatia has pegged the dinar to the DM, but, since it has no foreign exchange deposits to defend this parity, the dinar has been repeatedly devalued in recent months, from 55 per DM at end-December 1991 to 158 per DM in mid-July 1992.

Since the outbreak of the war, the government budget has run a significant deficit, which it has attempted to finance by raising taxes, selling dinar and DM-denominated bonds, and selling state-owned housing to the public. The real value of tax revenues was greatly reduced in 1991 because of the collapse in output and consumption. This trend is expected to continue in 1992 and, along with rising war-related costs, will result in a much higher budget deficit.

Czechoslovakia

Czechoslovakia embarked on the transition to a market economy in late 1990/early 1991 under better macroeconomic conditions than other countries in transition. Thanks to a conservative fiscal and monetary policy over the past decade, inflation had never emerged as a serious problem, the monetary overhang was relatively small, hard-currency debt was less than 15 % of GDP, and net government debt was negligible.

The country was disadvantaged, however, compared to Poland and Hungary, for example, with regard to the structure of the economy and the legal framework and basic institutions: concentration in industry was much higher, the private sector was very small, and exports were heavily biased towards East European countries and towards heavy industrial goods and armaments. Furthermore, frictions between the different levels of government and the need to deal with growing tensions between the Czech and Slovak republics, and the Slovaks' struggle for more independence put additional burdens upon the reform process.

The first steps to reform the economic and institutional structure were taken in 1990, when the commercial and non-commercial exchange rates for the koruna were unified, the koruna was devalued, a two-tier banking system was created, and a mixed system of centralized and decentralized prices was introduced. However, fundamental economic reforms started in earnest only in 1991. Cornerstones of these reforms were the complete liberalization of prices and external trade, large-scale privatization and a rigorous macroeconomic stabilization policy. About eighteen months later, remarkable successes in macroeconomic management have been achieved, with prices stable, and the government and external accounts close to balance. Also privatization seems to be well under way. Small-scale privatization got off to a quick start in early 1991; and large-scale privatization, which started in May 1992, seems to be on track. About 30% of shares offered in approximately 1400 large enterprises were sold in the first round of a multiple-round voucher privatization scheme. But output has fallen sharply and structural reform is proving to be slow and difficult.

CZECHOSLOVAKIA

Area (1000 sq km)	130			
Population (millions)	15.6			
Population density (per sq km)	120			

Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	0	−16	−15	Q-I
Agricultural production (a)	−2	−14		
Industrial production (a)	−4	−21	−22	Jan-May
Consumer price index (a)	10	58	6	June
Unemployment rate, in % (b)	1	7	5	July
Budget balance, % GDP (c)	0	−2	1	Jan-June
Trade balance, $ bn (d)	−0.8	0.9	0.2	Q-I
Current account, $ bn (d)	−1.1	1	0.3	Q-I
Gross foreign debt, $ bn (b)	8.1	9.3	9.1	Q-I
Debt-export ratio, % (e)	135	91		

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Consolidated state budget deficit, accrual basis.
(d) In convertible currencies.
(e) Gross hard-currency debt as a percentage of hard-currency exports.

Czechoslovakian output has suffered a serious setback since early 1991 as a result of several factors, not all linked to the domestic reform process. On the external side, the fall in exports to former CMEA countries reduced total demand for Czechoslovakian products, while the switch of CMEA trade to a convertible currency base implied a significant deterioration in the terms of trade. On the internal side, the pace of the reallocation of resources (rapid decline in output in existing branches and a slow and hesitant start in building new structures), as a result of the move to a market system and the change in relative prices, contributed to a negative output shock. Also, restrictive monetary and fiscal policy in response to the (unexpectedly high) price surge in early 1991 contributed to the overall contraction of supply. Finally, domestic demand, especially investment expenditures, was driven down by substantial uncertainty concerning future institutional developments, the structure of relative prices and the consequences of privatization.

All in all, real GDP declined by 16% in 1991, and both in the Czech republic and in Slovakia the decline in industrial production reached more than 20%, and output in construction shrank by about one third. According to official statistics, public consumption stagnated, but personal consumption fell by one third, and net investment even became negative from the third quarter.

In mid-1992, some indications are emerging that the economic decline is about to taper off, with production in traditional sectors stabilizing and output and employment growth in new sectors gaining momentum. Inflation seems now to be under control, public finances show no alarming developments, interest rates have come down somewhat, and the exchange rate remains stable. Furthermore, the trade balance is in surplus and the gross hard-currency debt is no longer rising.

The redirection of trade away from the former CMEA bloc has continued, and these countries now account for less than one fifth of total CSFR exports. The authorities intend to maintain a fixed exchange rate for the koruna, so as to hold domestic prices and wages within reasonable bounds. The Czechoslovak government is likely to allow full repatriation of both local and hard-currency profits before the koruna becomes fully convertible.

However, major structural adjustment is still to come, and will probably have significant negative repercussions on the labour market and on enterprises' balance sheets. Although registered unemployment rates edged down in early 1992 (partly as a result of changed registration methods), large-scale labour-shedding seems unavoidable to improve the competitiveness and profitability of enterprises, as the alternative (a further significant decline in real wages) is politically less feasible. Major risks are also hidden in the enterprises' accounts, as liabilities are accumulating and debt servicing may endanger the necessary modernization of the capital stock. This may lead to significant pressure to bail out the enterprise sector.

The economic success story of Czechoslovakian reforms, which has resulted from favourable macroeconomic starting conditions, comprehensive and rapid economic policy reform and good macroeconomic demand management is, however, increasingly overshadowed by political developments. Since 1990, growing tensions between the Czech republic and Slovakia have already slowed down the reform process. Since early 1992 reform-related legislation has come to a standstill and is unlikely to resume before the future of the Czech and Slovak Federal Republic is settled.

Hungary

1992 is a test year for the Hungarian economy, which is now operating under the nearly completed legal and institutional market framework. However, with the breakdown of the CMEA trading system, the transition to a market economy has been more painful than expected and one of the challenges for economic policy in 1992 is to resume positive growth.

After declining by 10.2% in 1991, GDP is not expected to grow in 1992: projections for the growth rate lie between − 3 and 0%. The uncertainties surrounding the 1992 outcome relate to the possibility that export growth will level off; the likelihood that private consumption will fall by more than expected, which is indicated by the increasing propensity of households to save; and, on the positive side, an upsurge in investment.

Industrial production is not recovering: it fell by 18.9% in the first 4 months of 1992, compared to 19.1% in 1991. Large companies, which were more dependent on exports to the Soviet Union, are primarily affected. The official statistics, which do not fully take into account the expanding private sector, overestimate the recession. In 1991, industrial companies employing less than 50 employees, the category where the private sector is concentrated, increased their production by 50.1%, compared to a fall of 21.5% for companies with more than 50 employees. In 1992, the contribution of the private sector to GDP is expected to increase from 25 to 33%.

HUNGARY

Area (1000 sq km)	93.6			
Population (millions)	10.3			
Population density (per sq km)	110			
Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	−5.0	−10.2		
Agricultural production (a)	−4.0	−3.0		
Industrial production (a)	−10.5	−19.1	−18.9	Jan-Apr
Consumer price index (a)	28.9	35.0	19.6	Jan-June
Unemployment rate, in % (b)	1.7	8.5	10.1	June
Budget balance, % GDP (c)	−0.8	−4.6		
Trade balance, $ bn (d)	0.3	0.2	0.6	Jan-May
Current account, $ bn (d)	0.1	0.3	0.5	Jan-Apr
Gross foreign debt, $ bn (b)	21.3	22.7	21.6	Apr
Debt-export ratio, % (e)	46	29		

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Consolidated state budget deficit, accrual basis.
(d) In convertible currencies.
(e) Gross hard-currency debt as a percentage of hard-currency exports.

The number of registered unemployed reached 547,000 by the end of June 1992, corresponding to 10.1% of the workforce. The Ministry of Labour has predicted that unemployment might approach 12% by the end of 1992. Real per capita income shrank by 9.8% in 1991, and by 3.6% if transfers and interest payments are included. In 1992, a further deterioration of households' income is not foreseen, since real wages have fallen only slightly so far. Hungarians have responded to the deterioration in their living conditions by increasing savings: the savings ratio increased from 6.8% in 1990 to 14% in 1991. Partial data for 1992 indicate that this trend is continuing. The fall in private consumption is now becoming the main driving factor in the recession.

Since January 1991, when consumer prices increased by 7.5%, monthly price increases have overall decelerated resulting in an inflation rate of 35% in 1991. Inflation is further slowing down in 1992, with a projected annual rate of 20 to 25%. Since April 1992, monthly price increases have not exceeded 1.5%, so that for the first six months of 1992 consumer prices have increased by 19.6% compared to the same period last year. With the completion of price liberalization, prices are now influenced by changes in taxes, profit margins and the import content. Industrial producer prices are rising at about half the rate of consumer prices.

For the second consecutive year, the recession is undermining the fiscal stabilization undertaken by the Hungarian government. In 1991, the deficit target was overshot by one percentage point of GDP. In June 1992, the fiscal deficit amounted to Ft108bn, exceeding its annual target of Ft70bn. The target had thus to be revised and has now been set at Ft160-180bn, corresponding to about 4% of GDP. All components on the fiscal revenue side are recording losses, reflecting the fall in households' income and the increasing difficulties of Hungarian companies. Overall, in June 1992, revenues were 12% lower than expected. Spending on the other hand, was kept within the budgetary limits.

The positive external performance is one of the unexpected features of the Hungarian transition. In 1991, the current account in convertible currency recorded a surplus of $267 million, a result in sharp contrast with the original forecast of a deficit of $1.2bn. In 1992, in view of a trade surplus of $590 million at the end of May, it is now believed that the trade and current accounts will again end up with a surplus, although a trade deficit between $300 and $500 million was originally projected. However, this good result has been achieved at lower levels of exports and imports than last year. This trend is not confirmed by customs data which are increasingly diverging from balance of payments data: the customs data show a smaller surplus for the first six months, of about $113 million for transactions involving cash, with exports growing by 16.5% and imports 6% lower than last year. Hungary is progressing further in reorienting its trade towards the EC, which in mid-1992 represented 49.4% of Hungarian exports. In 1992, trade with the ex-CMEA partners is recovering: in the first half of the year, Hungarian exports to the zone increased by 23% and imports by 34%.

International reserves in foreign currencies expanded from $1.1bn at end-1990 to $5.1bn at the end of May 1992, having increased by $1bn over the first five months of 1992. They now cover about 6 months' imports. Gross external debt in convertible currencies is stabilizing, reaching $22.2bn at the end of May 1992, compared to $22.7bn at the end of last year. Foreign direct investment, which reached $1.45bn in 1991, well above the expected $550m, is progressing at the same rate in 1992: by the end of April, $660 million had come in to the country.

The Forint has been devalued twice in 1992, in March by 1.9% against the dollar-ECU basket and in June by 1.6%. These devaluations make up for about two thirds of the inflation gap between Hungary and its main trading partners. But given the good balance of payments performance, the Hungarian government thinks that the economy can cope with an appreciation of the Forint. On 1 July 1992, an inter-bank market was set up and the foreign exchange regulations were further liberalized. To begin with, the central bank will intervene on the market to limit fluctuations of the Forint vis-à-vis the main currencies to, initially, 0.25%.

In 1992, the changes affecting the company sector are accelerating. In 1991, 11% of state assets were sold, yielding total income close to Ft40bn, of which 85% was hard currency cash. In 1992, in the first five months alone, privatization income amounted to Ft35bn, with a lower foreign participation. However, up to now, the strong growth of the private sector has been due less to the privatization of state-owned companies than to the rapid expansion of new enterprises, aided by sizeable infusions of foreign capital. The main uncertainty in the recent developments is the impact of bankruptcy and liquidation on the economy: following the application of the new 1991 legislation, 381 companies are being examined for bankruptcy, and liquidation proceedings have been started for 440 companies. The government is trying to mitigate the deterioration of the business climate through various measures: new legislation on state contracts has been adopted which gives priority to Hungarian firms; debt relief financed out of last year's privatization proceeds is being offered to key companies. A step has also been taken on the financial side to reduce the cost of borrowing with a decrease of interest rates by 2%, but the weak financial situation of companies still restricts their ability to borrow. Consequently, commercial banks will continue to finance the public deficit and to hold excess liquidity.

The programme of structural reform proceeds. Key legislative acts were passed in 1991: the central bank act, the banking law, the investment funds act, the compensation law, the employment act. These were followed by the company tax law and the act on the social security fund in 1992. Draft bills on public finance and the tax system are being prepared.

Poland

The declining trends which were strongly evident in the Polish economy during 1989 were exacerbated by the radical stabilization measures introduced on 1 January 1990. The stabilization programme provided for: price liberalization and an end to most subsidies; a devaluation of the zloty and the introduction of convertibility for current transactions; strict control of wage rises above stipulated levels; a reduction in the state budget deficit to 1 per cent of GDP.

The stabilization programme helped to reduce hyper-inflation from 640% in 1989 to 249% in 1990 and 60.4% in 1991. During the second half of 1991 inflation had stabilized at a monthly rate of 2-3%. In the first six months of 1992 prices increased by 22.3%, the June figure representing a 39.0% increase on the same month a year ago. The recent slowing of inflation prompted the National Bank to lower the key interest rate from 40% to 38% in June 1992.

Stabilization has resulted in significantly lower levels of economic activity for two years, but there are signs now that the recession is ending. GDP declined by 12% in 1990 and is reported by the statistical office to have declined by 7% in 1991. The rapid expansion of the small private sector, which grew by about 25% in 1991, could only partially compensate for the slump in the economy's state sector. Industrial production in 1991 was 14.2% lower than in 1990 and 35% lower than in 1989. Gross agricultural production in 1990 increased by 2.5% over 1989 but fell by 2% in 1991. Output continued to decline in the first two months of 1992, but has since shown some recovery. Unemployment rose from negligible levels at the start of 1990 to 2.3 million in June 1992 (12.6% of the workforce). Moreover, substantial variations in unemployment have emerged, with the rate ranging from just over 5% in Warsaw to over 20% in some northern regions.

The pronounced decline in economic activity resulted in a large deficit for the state budget in 1991 ($2.7bn or 3.5% of GDP, compared to the $0.4bn deficit originally approved for the full year). This was mostly due to the poor financial condition of many state enterprises, which resulted in their tax liabilities exceeding their profits on aggregate by 22%. Consequently industry owed over $2bn to the state coffers in unpaid taxes.

The 1992 budget envisages a deficit of 65.5 trillion zloty ($4.8bn). This package keeps the deficit within the limit agreed with the IMF, of 5% of GDP, and includes plans to introduce charges for some health services, to limit public sector wage and pension rises and gradually to remove subsidies on transport and energy prices. Although parliament approved the budget, the Constitutional Court has recently ruled against cuts in public sector pay and pensions. This entails an additional outlay of 28,100bn zloty, but the government still hopes to stay within the IMF's limit by delaying the expenditure until 1993.

POLAND

Area (1000 sq km)	318.3			
Population (millions)	38.2			
Population density (per sq km)	120			
Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	−11.6	−7.0		
Agricultural production (a)	−2.2	−2.0		
Industrial production (a)	−24.2	−12.9	7.6	June
Consumer price index (a)	249.3	60.3	39.0	June
Unemployment rate, in % (b)	6.3	11.8	12.6	June
Budget balance, % GDP (c)	0.4	−3.4		
Trade balance, $ bn (d)	2.2	0.1	0.9	June
Current account, $ bn (d)	0.7	−1.4	0.3	June
Gross foreign debt, $ bn (b)	46.6	46.9		
Debt-export ratio, % (e)	430	370		

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Consolidated state budget deficit, accrual basis.
(d) In convertible currencies.
(e) Gross hard-currency debt as a percentage of hard-currency exports.

Both tax revenues and government expenditures were below target for the first half of the year, the net result being a deficit of 25.7 trillion zloty. Although the deficit is below the target for the first half of the year, the prospects of meeting the target for the full year are less likely. Recently approved state sector wage rises and delays in the reduction of subsidies on some household items are expected to result in rapid growth in expenditures in the second half of the year, and there is little prospect of significant increases in tax revenues over the coming months. However, the new government's ability to respond quickly to budget problems, should they emerge, will have been enhanced by the recent parliamentary approval of the 'small constitution'. This clarifies the role of the Presidency, and allows the government to act more independently of the parliament.

Trade results were markedly worse in 1991 as a result of higher energy prices, the shift to hard currency settlement of trade with other East European countries, the real appreciation of the zloty, the loss of markets in the former East Germany and the collapse of exports to the USSR. Exports in convertible currencies reached $12.8bn in 1991 (up 17.5% on 1990) while imports rose to $12.7bn (up 47%), resulting in a small trade surplus of $51m compared to a surplus of $2.2bn in 1990. Reserves declined by $1.2bn in 1991. This trend has been reversed in the first half of 1992, with exports increasing by 12.5%, and imports falling by 8% over the same period of 1991. This led to a trade surplus of $946m for the period.

For the first 16 months of the stabilization programme the government maintained a stable exchange rate. However, the need to improve competitiveness and offset the effects of domestic inflation led to a 14.4% devaluation in May 1991. Higher customs tariffs on most imports were introduced in August 1991 to improve further the terms of trade, and in October 1991 a 'crawling peg' policy was adopted, which entails a 1.8% devaluation of the zloty each month against a basket of five Western currencies. In addition, a 12% devaluation of the zloty, against the same basket, was announced on 25 February 1992.

Poland had been unable since 1981 to service fully its external debt, which in February 1991 stood at around $48.5bn, of which about $32bn was owed to 17 of the Paris Club of government creditors. In March 1991 Poland reached an agreement with the Paris Club, which envisages a reduction of the net present value of the debt by fifty per cent. As of the end of April, some 13 bilateral arrangements had been reached with western creditors. The agreement is formally dependent on successful implementation of an IMF-approved three-year economic programme. Poland failed to meet the IMF performance criteria relating to its budget deficit, inflation rate and foreign reserve level for June 1991. From September 1991 onwards, all remaining IMF credits to Poland were suspended. Negotiations are under way to revise the performance criteria for 1992, with a view to resuming lending. However, further progress in reaching an agreement hinges on the implementation of the budget. The Polish government has also been carrying out negotiations on the $10.6bn owed to commercial banks, plus $1.5bn of overdue interest. Talks are due to resume as soon as a new IMF agreement is in place.

Popular support for the stabilization programme has weakened because of the protracted recession and the sharp decline in real wages. Profound structural adjustments still need to be implemented, including large-scale privatization and legislation which will complete the institutional framework of a free market economy. A large number of small and medium-sized enterprises have already been privatized through a system of direct sales by auction, but the privatization programme for large enterprises has progressed at a slow pace. The government aims to transfer to the private sector about half of Poland's 8,000 large enterprises during the next two years.

The privatization process is complicated by the absence of a sound commercial banking system. A two-tier banking system has been created, and the liberal licensing policy has resulted in the creation of about sixty new private banks, half of which are privately owned while the rest belong to state enterprises. A number of small co-operative banks have also been established or revamped; these are particularly active in rural areas. However, the commercial banks have been beset with problems of bad loans, exacerbated by the recession. Some steps have been taken towards financial liberalization. The National Bank of Poland has built up the domestic money market and has introduced new credit instruments. The government is in the process of preparing a comprehensive body of general bank legislation in line with EC directives.

A thorough reform of the country's public finances is under way. The tax system is being overhauled, with the aim of increasing tax revenues from the rapidly expanding private sector in order to make up for falling revenues from unprofitable state enterprises. Personal income tax was introduced from 1 January 1992 and applies to all physical persons except farmers. There are three rates, the highest being 50%. Value added tax is now scheduled to be introduced in 1993. However, the government is experiencing difficulties in improving tax administration.

Romania

The conditions under which Romania embarked on economic reform were particularly difficult. The country had no net foreign debt, but this was achieved at a substantial human and economic cost. During the last years of the Ceaucescu regime imports were kept very low; for a decade virtually no western machinery was imported. Exports (most notably of agricultural goods) were stimulated, but they were made possible by repressed consumption at home. A deliberate policy was followed of holding down services and high technology in favour of heavy industry and manual labour. Moreover, significant resources were squandered on prestige projects. As a result, Romania's industrial infrastructure is among the most backward in Europe, and its workforce is particularly demoralized and badly trained.

Most economic indicators worsened significantly in 1991 and early 1992. Real GDP is estimated by the National Bank of Romania to have declined last year by 13%. Industrial production during the first five months of 1992 was 17.6% lower than in the same period

of 1991, but agricultural production remained stable. Consumer prices were 222% higher in January-May 1992 compared to a year earlier, following price and currency liberalization. Average real incomes have fallen by more than 30% since 1989. Unemployment was 5.4% in May 1992.

After the revolution the government halted food exports and sharply raised imports to improve domestic supply. This, together with the disintegration of the CMEA and the fall in domestic production, led to a deficit of $1.7bn in the hard currency trade account in 1990. Since the invisibles account was in balance, the current account also showed a deficit of $1.7bn. A similar pattern emerged in 1991, with a deficit of $1.4bn on both the trade and the current account. During the first six months of 1992, trade liberalization pushed exports sharply higher to $1.9bn (+28.5% over the same period in 1991), while imports fell slightly to $2.6bn (−4%). In the same period rouble trade has collapsed, with exports dropping from 662m roubles in 1991 to 53m in 1992 and imports from 476m roubles in 1991 to 120m in 1992. Foreign debt is low at $3.2bn, or $141 per capita.

ROMANIA

Area (1000 sq km)	232			
Population (millions)	23.2			
Population density (per sq km)	100			

Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	−7.4	−13.0		
Agricultural production (a)	−3.0	−5.0		
Industrial production (a)	−17.4	−18.7	−17.6	Jan-May
Consumer price index (a)		344.5(f)	222.0	Jan-May
Unemployment rate, in % (b)		2.9	5.4	May
Budget balance, % GDP (c)	1.1	2.1		
Trade balance, $ bn (d)	−1.7	−1.4	−0.7	Jan-June
Current account, $ bn (d)	−1.7	−1.4		
Gross foreign debt, $ bn (b)	0.3	1.9	3.2	
Debt-export ratio, % (e)	8	54		

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Consolidated state budget deficit, accrual basis.
(d) In convertible currencies.
(e) Gross hard-currency debt as a percentage of hard-currency exports.
(f) Dec. 1991 compared with Oct. 1990, when the new CPI was introduced.

Economic reform in 1990 and most of 1991 moved at a slower pace than elsewhere in Eastern Europe. Prime Minister Roman's government initially hesitated to take painful measures. Later the government obtained parliamentary authorization to implement much more radical economic reform by decree, but the programme was flawed both in its conception and in its presentation to the public. In September 1991, renewed civil unrest led to the resignation of the government. The new government of Prime Minister Stolojan carried out the previous government's plan to make the currency convertible, and took the highly unpopular measure to raise energy prices, aligning them with international levels. Presidential and legislative elections are due to be held at the end of September 1992.

Price liberalization started in November 1990, but major controls remained, as well as exemptions for basic goods, rents, etc.; the announcement of further increases in January 1991 led to vociferous public protests and to delays; under IMF pressure further rounds of increases were implemented in April, July and November. Well over 80% of prices are now free, but the staged approach and the associated announcement effects have led to unnecessarily high inflation. Subsidies on staple foods and electricity were cut by 25% in early May 1992, leading to sharp price rises. A further 25% reduction is scheduled for September 1992, and the government plans to eliminate all subsidies by the end of 1993. The government also raised minimum monthly wages and announced a series of pay rises and cash handouts, which were meant to compensate for about half the new price rises. However, some enterprises have circumvented wage guidelines and granted nominal wage rises equal to the rate of inflation.

A series of very sharp devaluations were carried out between November 1990 and November 1991, at which point current account convertibility for residents was introduced, in a dual foreign exchange market. On the one hand, the central bank operates a managed float in a daily inter-bank market, although it is constrained by limited foreign exchange reserves ($0.3bn in April 1992). On the other hand, individuals have access to foreign exchange through exchange offices; the exchange rate here is not managed. Although all export proceeds must be repatriated immediately, Romanian legal persons may hold hard currency accounts, and exporting firms are allowed to keep all their hard currency revenues.

Budgetary policy has been restrictive. In 1991 the budget deficit was higher than originally forecast, at slightly above 2% of GDP. This was due to shortfalls in revenue; spending was well under control. The 1992 budget projects a deficit of Lei 89bn (less than 2% of GDP). Monetary policy, on the other hand, suffered severe setbacks in 1991; money growth targets were exceeded by a sizeable margin, in part because of a decision by the Parliament that the central bank should inject liquidity into the debt-ridden enterprise sector. This has contributed to fuelling inflation.

Recently the government embarked on a new economic strategy, designed with the assistance of the IMF, with the aim of stabilizing the economy. The new strategy is intended to halt the decline in production, limit annual inflation to 40% by the end of 1992, contain the 1992 budget deficit to 2% of GDP, build up reserves to $500m by the end of the year (roughly equivalent to one month's imports) and limit the current account deficit to $1.3bn in 1992. These targets are to be achieved by implementing tight fiscal policies, introducing positive real interest rates -- the central bank has raised interest rates from 28 to 80 per cent -, establishing ceilings on the growth of money supply and domestic credit (89% and 69% respectively) and introducing a flexible exchange rate policy.

After a slow start, the implementation of structural reform measures has been accelerated. In April 1991, Parliament adopted a fairly liberal framework law on foreign direct investment. It allows wholly foreign-owned companies to be set up in all sectors of the economy, and grants significant tax and import duty relief to investors; all profits may be repatriated in hard currency after the payment of a 10% tax. Foreign investments are granted full protection by the constitution.

Privatization of small plots of farmland is nearly complete, with 82% of land in private ownership at present. Also, by mid-1991 some 50% of the housing stock and, by early 1992, a third of retail trade had been privatized. Large privatization is just getting under way. According to a July 1991 law, about 6,200 firms, or 55% of state sector equity, will be privatized; a 30% share in these firms is being distributed to the population through a system of free vouchers, and the rest will be held by the state and will be gradually privatized over the next seven years. There are plans to set up a stock market by the end of 1992.

The government has already made several adjustments to the tax system over the past two years, mainly to broaden its base and streamline its operation. It plans a comprehensive modernization of the system, including the introduction of VAT in 1993 and personal income tax in 1994.

Slovenia

Slovenia, with a population of 1.9 million, was Yugoslavia's most developed republic. Its GDP was 18.2% of Yugoslavias in 1989, and GDP per capita was 121% above the Yugoslav average. Industry accounted for 46% of GDP, while agriculture accounted for only 6%. Slovenia's economy was the most export-oriented of the Yugoslav federation; exports accounted for 30% of the republic's GDP in 1990.

Slovenia was also Yugoslavia's most industrialized republic. The most important branches of industry are electrical machinery, metalworking, textiles and machine building. However, much of Slovenia's basic industry is in urgent need of modernization and restructuring, and the country's infrastructure, including most transport and telecommunications, is largely obsolete. On the other hand, Slovenia has the advantage of a comparatively high-quality work force.

Slovenia's output has been declining in recent years, having fallen by 2.9% in 1988, 0.5% in 1989 and 8.3% in 1990, the sharp fall of 1990 being mostly due to the deep recession which occurred in Yugoslavia as a result of the stabilization programme. Even though Slovenia was spared the heavy damage inflicted on other parts of the country by the civil war, the resulting economic dislocation accentuated already existing supply problems arising from production bottlenecks and lack of foreign exchange, and caused a fall in output in 1991 estimated at 12%. Industrial production, having stagnated throughout the late 1980s, fell by about 12.4% in 1991 and by 16% during the first half of 1992 over the first half of 1991. Retail prices during the first seven months of 1992 were 277% higher than in the same period of 1991, although the monthly rate declined from 25% in October 1991 to 2% in July 1992. The Bank of Slovenia has raised interest rates to 25% per month and hopes to reduce inflation drastically by the end of 1992. Slovenia had traditionally been a full-employment society, but in early 1991 the number of registered unemployed began rising sharply, and reached 10.8% of the labour force in May 1992.

The disintegration of the Yugoslav federation has created some problems for Slovenia's economy. Trade with other ex-Yugoslav republics, which formerly accounted for about 60% of the country's total trade, has fallen to 15% in recent months. Thus Slovenian exporters have been forced to seek new markets abroad. In foreign trade, following a surplus of $0.2bn in 1989, Slovenia recorded a $0.6bn deficit in 1990 (exports: $4.1bn, imports: $4.7bn), which was mostly due to higher imports brought about by the over-valued dinar and extensive trade liberalization. The turbulent situation which prevailed in 1991 brought about a contraction of trading activity, with exports of $3.9bn (−6.4% compared to 1990) and imports of $4.1bn (−12.3%). The steeper relative decline of imports resulted in the shrinking of the trade deficit to $0.3bn. The invisibles balance suffered in 1991, because of the drop in receipts from tourism and emigrants' remittances; there was a $0.2bn current account surplus for the year compared to $0.7bn in 1990. During the first half of 1992 exports rose by 2% and imports fell by 20% over the same period in 1991. Slovenia's share of Yugoslavia's foreign debt is estimated at approximately $1.8bn, or 43% of the value of the country's exports in 1991.

Slovenia was the most reform-minded republic of Yugoslavia; since independence the parliament has adopted legislation which has liberalized foreign exchange operations, deregulated the banking sector and liberalized prices. However, much remains to be done. The government has also promoted the rapid privatization of many state-owned enterprises, but its ambitious plans in this area have been delayed by the civil war and by internal disagreement on the best way to proceed. A series of bills has now been presented to Parliament but none has been adopted to date.

SLOVENIA

Area (1000 sq km)	20			
Population (millions)	2.0			
Population density (per sq km)	100			
Main Economic Indicators	1990	1991	1992	latest
GDP at constant prices (a)	−8.3	−12.7		
Agricultural production (a)	−2.8	1.5		
Industrial production (a)	−10.5	−12.4	−16.0	Jan-June
Consumer price index (a)	550.0	118.0	277.0	Jan-July
Unemployment rate, in % (b)	6.9	10.1	10.8	May
Budget balance, % GDP (c)				
Trade balance, $ bn (d)	−0.6	−0.3	−0.3	Jan-June
Current account, $ bn (d)		0.4	0.4	Jan-Apr
Gross foreign debt, $ bn (b)		1.8		
Debt-export ratio, % (e)		46		

(a) Percentage increase over (the same period of) the previous year.
(b) End of period.
(c) Data not available.
(d) In convertible currencies.
(e) Gross hard-currency debt as a percentage of hard-currency exports.

Slovenia introduced its own currency, the tollar, in October 1991. For a brief period dinars could be exchanged for the new currency at a one-to-one rate. Since then the tollar has been allowed to float, its rate freely determined by the foreign exchange market. There is full convertibility for current account transactions while there still remain some exchange controls on capital account transactions. Foreign currency reserves have more than quadrupled to reach $980m in July 1992. There is no organized market for cross-border tollar-dinar transactions.

Slovenia has completely restructured its fiscal system. The multitude of taxes and contributions which previously existed were abolished and a progressive income tax system was introduced, consisting of four rates ranging from 19-46%. A corporate tax system was put in place, with a uniform 30% rate applied on corporate profits for 1992. A turnover tax came into effect on 1 February 1992 with rates of 5-32% on all goods and services; a value-added tax is scheduled to be introduced in 1994.

15 September 1992

Principal economic policy measures — July/August 1992

Community (EUR-12)

3.7 Social Dialogue Summit adopts texts on both the future development of the dialogue and on the new cooperation strategy for growth and employment.

13.7 Ecofin Council: The Council carried out the multilateral surveillance exercise envisaged under the convergence decision of March 1990.

13.7 Ecofin Council: The convergence programme presented by the Netherlands was given a strong endorsement by the Council.

Belgium (B)

16.7 The central bank increases its seven-day loan rate by 0.15 of a percentage point to 9.45%. This rise is in line with similar decisions taken by the Bundesbank and the Nederlandsche Bank.

3.8 The government presents the draft budget for 1993. The 1993 budget is an element of the multiannual fiscal adjustment programme for the years 1993-1996, which lists the measures to be taken to meet the objectives set in the convergence plan (released in June). The draft budget involves a savings package of about BFR 130 billion (1.7% of GNP): BFR 117 billion for the national government budget and BFR 13 billion for the social security budget. The government estimates that, if other levels of general government (regions, communities and local authorities) meet the objectives set for them in the convergence programme, this would cut the general government deficit from 5.7% of GNP in 1992 to 5.2% in 1993.

Denmark (DK)

None.

Germany (D)

16.7 The Bundesbank raises its discount rate to 8.75% (from 8.0%), with effect from 17 July.

Greece (GR)

1.7 By decision of the Bank of Greece, the compulsory investment by commercial banks in Treasury bills is reduced from 25% to 20% of the increase in their deposits. In addition, compulsory funds reserved for the financing of handicraft are reduced from 8% to 7%.

7.8 The government announces a package of tax increases aimed at containing the budget deficit. The revenue impact has been estimated at DR 138 billion (0.9% of GDP) for the remainder of 1992 and DR 465 billion (2.8% of GDP) for 1993. The package includes an increase in the tax on fuels (the retail price of gasoline going up from DR 145 to 195 per litre (+34%)) and that of diesel from DR 100 to 130 per litre (+30%), an increase in the tax on interest income on bank deposits from 10% to 15%, and an increase in the tax on cars (effective from 1.1.1993); at the same time, the highest VAT rate of 36% on electronics and luxury goods is abolished and the excise duty on tobacco products is raised pari passu to offset the revenue losses.

Spain (E)

21.7 The government approves a package of budgetary measures designed to help correct the undesirable fiscal developments that may undermine efforts to achieve the objective of the convergence programme. These measures include a rise in revenue of PTA 130 billion and a reduction in current and capital expenditure of PTA 195 billion.

23.7 As part of its regular intervention, the Bank of Spain increases the money market rate from 12.4% to 13%.

30.7 The Treasury increases by 0.56 of a percentage point the interest rate on twelveonth securities, bringing it to 12.72%.

27.8 Further increase of 0.25 of a percentage point in the interest rate on one-year government securities, bringing it to 12.97%.

France (F)

2.7 Parliament passes legislation concerning apprenticeships.

18.7 Unemployment insurance contributions are increased by 0.8%, with effect from 1 August. The conditions for beneficiaries become more restrictive.

20.7 A four-year plan is adopted in favour of farmers, with effect from 1 July 1993.

1.8 The financial support for firms putting employees on short-time working rather than making them redundant is renewed till the end of this year.

5.8 In order to increase part-time jobs, the corresponding social security contributions paid by employers are reduced by 30%, with effect from 1 September.

Ireland (IRL)

None.

Italy (I)

31.7 The government, the trade unions and the industrial employers' association sign a joint document (Protocol on Incomes Policy, the Fight against Inflation and Labour Costs). The main points are the following:
- the indexation clause (known as 'scale mobile'), the latest form of which had expired at the end of 1991, has definitively ceased to exist. For the period 1992-1993, a separate payment of LIT 20 000 (ECU 13.3) per month has been agreed upon, to be effected starting from January 1993 and to be incorporated subsequently into the normal wage. For the same period, the parties will refrain from firm-level agreements or unilateral concessions resulting in wage increases;
- further negotiations on the reshaping of the wage-bargaining framework, expected to be concluded by mid-september, will take place;

  the government signals its commitment to a course of action aimed at:
  - regulating administered prices, and particularly public fees and charges, in a way consistent with the achievement of the stated inflation targets (3,5% in 1993, 2,5% in 1994, 2% in 1995);
  - avoiding further tax increases by focusing on the reduction of tax evasion and tax expenditure;
  - pursuing an active labour policy also by speedily implementing the provisions of the reform enacted in July 1991.

Luxembourg (L)

16.7 Parliament approves the bill reforming health insurance funds and the public health system. The bill provides in particular for:
- the restructuring of the Union of Health Insurance Funds (the funds will be given greater independence, particularly in drawing up the budget and in setting contributions and the proportion to be paid by those insured);
- a central government contribution to the future financing of additional payments;
- central government to be responsible for the deficit accumulated up to the end of 1992 (LFR 700 million) and for that to be incurred under the 1993 budget (LFR 300 million);
- an increase in the contributions of those insured from 4.7% to 5%, with effect from 1 August 1992.

3.8 The government outlines its draft 1993 budget. It anticipates a rate of GDP growth, in volume terms, of 3.5% and an inflation rate of 3.6%. Gross revenue is forecast to total LFR 124.6 billion, i.e. an increase of 5.5% compared with the 1992 budget. Gross expenditure is expected to amount to LFR 126.2 billion, i.e. a rise of 6.4% compared with the 1992 budget. There will therefore be a budget deficit of LFR 1.6 billion. In order to cover that deficit, the central government will have to borrow approximately LFR 3.5 billion per year between 1993 and 1995. According to the draft 1993 budget, public investment (mainly earmarked for road infrastructure) will rise by almost 11%. In 1993 the Grand Duchy's budget deficit will be less than 1% of GDP, while its debt will not exceed 2.9% of GDP.

Netherlands (NL)

16.7 The Nederlandsche Bank increases its special loan rate by 0.2 of a percentage point to 9.5%. This rise is in line with similar decisions taken by the Bundesbank and the Banque Nationale de Belgique.

31.7 The Nederlandsche Bank increases its special loan rate by 0.1 of a percentage point to 9.6%. This decision was taken in response to some weakness in the guilder vis-à-vis the German mark.

Portugal (P)

13.8 The Bank of Portugal announces the gradual phasing-out of restrictions on capital inflows by the end of the year and a reduction in interest rates. The end of the requirement to lodge a non-interest-bearing deposit with the central bank of 25% of the amount of any borrowings abroad is set for 31 August, while the abolition of the ban on non-residents purchasing floating-rate bonds is scheduled for 31 October.

United Kingdom (UK)

22.7 Government cuts interest rates on savings instruments from 10.34% to 9.67% to try to forestall mortgage-rate increases induced by competition for funds.

22.7 Government announces major restructuring of public expenditure planning and control aggregates effective from the 1994-95 financial year.

22.7 Government reconfirms the UKL 244.5 billion 'planning total' for expenditure in the 1993-94 financial year despite cyclical (and departmental) pressures to relax it.

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