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Wirtschaftsentwicklung in ausgewählten mittel- und osteuropäischen Ländern 1998/99

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Gutachten

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Die vorliegende Analyse wird im Frühsommer 1999 zusammen mit den Beiträgen anderer deutscher Forschungsinstitute veröffentlicht. Dort wird über die Wirtschaftslage und den Stand der Reformen in 27 Transformationsländern in möglichst vergleichbarer Form berichtet.
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Vorwort

Die vorliegenden Berichte wurden im Auftrag des Bundesministeriums für Wirtschaft und Technologie erstellt. Redaktionsschluß für die Bearbeiter der Berichte war der 9. April. Später veröffentlichte Daten konnten im Regelfall nicht mehr berücksichtigt werden.

Die vom Osteuropa-Institut erstellten Berichte werden durch Berichte zu Rußland, Weißrußland, den baltischen und zentralasiatischen Staaten ergänzt, die von anderen Instituten erstellt, und später gemeinsam vom Bundesministerium für Wirtschaft und Technologie veröffentlicht werden.

Bei den Prognosen konnten die möglichen Folgen der Balkankrise noch nicht abgeschätzt werden, daher wurden noch die Prognosen von vor der offenen Krise aufgenommen, die aber für die Balkanstaaten überholt sind. Solide Prognosen für den Einfluß der Krise auf das Wachstum können aber allenfalls nach Abschluß der Kämpfe gemacht werden.

Um dem Leser auch Anhaltspunkte über die Entwicklung in den anderen Transformationsländern an die Hand zu geben, haben wir in diesem Jahr erstmals Übersichtstabellen, die in der gemeinsamen Veröffentlichung ebenfalls erscheinen werden, sowie einige Tabellen der EBRD beigefügt.

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Summary

Poland

Although, in the wake of the crises in Russia and Asia, the growth rate Poland recorded in 1998 (4.8%) was two percentage points lower than in the previous year, the economic situation and the results of reform are still to be regarded as positive. The GDP in 1998 was about 20% higher than it was in 1989, the year before the transition recession, and the private sector attained a share in the employed workforce of approx. 70%. In view of the economic slowdown particularly in Europe, the prospects for growth in 1999 (4%) must be expected to be somewhat less encouraging.

The country's positive overall development is essentially the outcome of a sound macroeconomic policy. The budget deficit has gradually been reduced over the years (reaching 2.5% of the GDP in 1998). A cautious monetary policy has created the foundation for declining inflation rates (11.9% in 1998, 8.6% on the basis of a December-to-December comparison). This macroeconomic environment made it in turn possible for the central bank to lower the interest rates in the second half of the year. However, the real interest rate remained at a high level due to a declining increase in prices and lower expectations of inflation. Consequently, the interest rates were reduced again in January 1999, but further reductions are hardly to be expected in the short term on account of an acute weakening of the zloty in February 1999.

The slackening of the remarkable economic dynamism that has been observed over the years is due to internal and external factors. While a more restrictive macroeconomic policy had its effect in the first half of the year, the crises in Russia and Asia had a negative impact on the country's economic development in the second half of the year. With regard to the domestic demand components, gross investments in equipment (20%) and private consumption (4.9%) attained high growth rates that were similar to those of the previous year. In spite of mounting exports (+ 11%) the increasing demand for imports (13%) resulted in a large deficit in the balance of trade amounting to 13.6 bn USD (and even more than 20 bn USD according to the customs statistics). Nevertheless the current account deficit was maintained in the relatively safe range of 4.3%.

Czech Republic

The Czech growth crisis of recent years has developed into a deep recession. As the continuous decline of domestic demand growth contributions, observable over the past years, could no longer be matched by an increase in foreign demand, real GDP declined by 2.7% in 1998. Although this constellation helped to contain the current account deficit within just 1.9% of GDP, the labor market was hit hard by the recession, at the end of February 1999 the unemployment rate reached 8.3%.

While domestic demand will at best stagnate in 1999, the continuous real appreciation of the Czech crown (only temporarily interrupted by the nominal de facto devaluation of May 1997) and poorer growth prospects for the country's main trading partners (Slovakia and the EU) will result in a seriously weakening foreign demand. 1999 should therefore bring another decline in real GDP of up to 1%, zero growth is forecast only for the year 2000. The unemployment rate might reach 10% until the end of this year.

The currently gloomy economic situation and outlook may have its roots in past structural policy decisions as well as in recent monetary policy conduct. Privatization, formally executed years ago, has yet to become effective in large parts of industry which are still ineffectively controlled by a state-dominated, unstable banking sector, resulting in a continuously declining competitiveness. While in addition monetary policy has appeared overly restrictive at least during the first half of 1998, by failing to anticipate inflationary developments correctly, the banking sector's overwhelming bad debt problems have seriously hampered the effectiveness of a looser monetary policy since the second half of 1998. The social democratic minority government of Premier Zeman, in office since June 1998, seeks a way out of the current crisis by relying on a mix of economic policy measures: A state budget deficit, in combination with the looser monetary policy of the independent central bank, aims at strengthening domestic demand; the privatization of large banks is gaining speed, and a "revitalization" program is currently being designed in order to restructure highly indebted industrial enterprises; the most promising variant of the latter program plans to break with the past of an exclusively Czech way of transition by aiming at effectively incorporating know-how and capital of international financial organizations into Czech industrial restructuring.

Slovak Republic

Slovakia's "economic miracle", brought about by a strong expansion of domestic demand which produced the highest growth rates in the region over the last few years, is nearing an abrupt end. Although in 1998 real GDP increased by yet another impressive 4.4%, the economy showed clear signs of a slow-down during the last quarter. Due to the strong growth contribution of domestic demand the current account deficit rose to more than 10% of GDP for the third year in a row. Responsible for this situation is an unrestricted fiscal expansion resulting in an official state budget deficit of 2.7% of GDP, while the true figure, taking additional account of all public budgets and extrabudgetary funds and activities, should exceed 5%. Colliding with the National Bank's stability oriented monetary policy this resulted in a crowding out of private investment and an increasing unemployment rate that reached 15.6% at the end of 1998.

Under strong speculative pressure the National Bank on October 1, 1998 terminated the fixed exchange rate arrangement that had tied the Slovak crown to a basket of DM and USD for almost eight years, the crown was allowed to float and has lost about 20% in value since. With gross external debt standing at almost 60% of GDP the external situation remains extremely unstable in spring 1999. For this year, growth is forecast to at least considerably slow down, real GDP is expected to increase by about 2%.

The results of the September 1998 general elections paved the way for a political re-start. The previous oppositon parties now forming the new prime minister Dzurinda's government coalition hold a more than 60% majority in parliament sufficient for constitutional changes. Among the economic policy tasks most urgent are the containment of the double deficit in public and external budgets and the reduction of still existing institutional barriers to a workable market economy. Early in 1999 the new government announced cuts in public infrastructure investment, a pay freeze in the public sector, and increases in consumption taxes to diminish public and external deficits during this year by half. Also, the new government intends to introduce an effective privatisation of the banking sector with foreign investors' participation. This is to be preceded by an already proposed, though still insufficient looking, scheme to clean up banks' balances that are amassed with bad credits to industry.

Hungary

With the help of the stabilisation programme of 1995 and through a vigorous policy of privatisation and structural reforms, Hungary has created a solid basis for a sustained economic upswing. The economic growth of 4.6% that began so discernibly in 1997 was even surpassed in 1998 (approximately 5%), which is all the more remarkable in the light of the Russian crisis and the resulting shortage of exports. Nevertheless there was a slight slowing of growth in the second half of the year, which continued in the early months of 1999. The higher budget deficit of 6.5% of the GDP and the negative current account of 4.2% of the GDP both pose problems. Economic growth in 1999 must be expected to be lower at approximately 4% and will carried in the main by domestic demand components.

The successful process of privatisation in Hungary (with a privatisation quota of approximately 80%) is reflected in large productivity increases, which up until 1997 were solely responsible for the economic dynamism. In 1998 growth was accompanied, for the first time, by an increase in employment so that the number of jobless fell slightly (9.1% at the end of 1998). There are only a few more privatisation projects planned for 1999 so that foreign direct investments (1998: influx of 1.8 bn USD) must go primarily into the establishment of new enterprises. Of the central eastern European countries Hungary has made the most progress in terms of deregulation and privatisation of the energy, banking and telecommunications sectors. The drastic need for a rehabilitation of the Hungarian Postbank underlines the necessity to improve supervision in the banking sector. Following the reform of the pension system which began in 1998, structural reforms in the health system are also urgently required.

Slovenia

In spite of delays in the reform process owing to the political situation, Slovenia recorded two major successes in 1998. On the one hand, it withstood relatively well the turbulence of the emerging markets and particularly the financial crisis in Russia. On the other hand, it made substantial progress towards achieving its target of joining the EU. Negotiations for admission commenced at the end of 1998, the EU Agreement came into force in February 1999 and the EU's Enlargement Report states that the country is basically equipped for admission.

The generally criticised restrictions on the movement of capital which Slovenia still imposed in 1998 protected the country against the negative effects of the current financial crisis. The measures that had been taken to lower the interest rates were not negatively affected. The stock market, which leads a phantom existence, remained largely untouched by the negative external influences.

Slovenia's small national economy, which is closely integrated in the world economy, was not able to extricate itself from the downward economic trend in Europe. Almost two-thirds of the country's trade is with the EU. The extremely dynamic economic development at the beginning of the year began to slow down again. On account of the sustained endeavours for stabilisation, domestic demand only increased at a slow rate and could not replace demand from abroad as the growth engine. Moderate increases in incomes and stagnating employment and unemployment rates were characteristic of the development.

In spite of many administrative prices being raised, the endeavours aimed at stabilisation continued to be successful. Nevertheless, the inflation rate, which is around the 8% mark, is the only Maastricht criterion that Slovenia has not met to date. There was only a slight deficit in the budget again and the current account was largely balanced. The problem of a two-fold deficit, which many of the transition states have to contend with, is unknown in Slovenia. The areas that benefited most from the decline in interest rates in the course of the year were the interest-oriented areas like housing. Capital investments were also maintained at a high level with a growth rate approaching 8%. The savings and investment rates are at 24%. As Slovenia also enjoys by far the highest per capita GDP among the transition states and has already attained the same level as the poorest states of the EU, it has a stable foundation on which further growth can be based.

In 1997 Slovenia had attracted more foreign direct investments per capita than any of the other transition states apart from Hungary. But this figure was cut by half in 1998. This is problematical not so much in terms of the resulting shortage of capital as in terms of technology transfer and the improvement of corporate governance. Although the conversion of the enterprises from state-owned property into other forms of ownership was largely completed, this has resulted in the formation either of enterprises in which the state continues to hold a very large share or of private enterprises which, on account of the large proportion of management and employee buyouts, have difficulty in solving their structural problems. This has a severe effect on the operating efficiency of the enterprises themselves and consequently on the competitive strength of the Slovenian economy as a whole. In view of the relatively high level of wages and the large reliance on foreign trade, however, these factors will play a central role in the country's further development.

An additional problem that has to be solved is the unemployment rate, which is stagnating at a relatively high level. Alongside the influences of the economic situation in Europe as a whole, investments are the decisive instruments for maintaining the relatively high level of income. Without further substantial institutional reforms, which have also been specified by the EU as conditions for entry, the employment rate will not increase. Parliament should therefore abandon its unproductive internal skirmishing and issue the statutory regulations that are necessary for accelerated structural transition and for harmonisation with the EU standards. A start has been made in this direction in the form of the liberalisation of the movement of capital and banking legislation. If Slovenia is to succeed in gaining admission to the EU in 2002, it will need to speed up the measures considerably in this respect.

Slovenia will only be able to attain the optimistic growth rate of 4% if there is a substantial improvement in the European economic situation. The successes already achieved in terms of stability are not in any danger. The budget and the current account will continue to be largely balanced. As the economic structure does not present any major problems, Slovenia has an extremely favourable chance of being one of the first countries to gain entry to the EU.

Romania

In 1998 the Romanian economy again failed to find its way onto the road to consolidation. The GDP shrank further by 5.5%. On the other hand, the government pursued a restrictive monetary policy, which succeeded in bringing inflation down to 40.6%. The reforms on the microeconomic level were delayed further by the political instability of the country. On account of the bickering within the government coalition, the prime minister was replaced in the early part of the year, but this did not prove to be a durable solution to the altercations either. The reform surge that had been generated by the new government began to stall again as a result. It was not until the end of the year that some success was recorded in the privatisation of large state-owned enterprises and in the banking sector. The scope for further reforms is now limited by the increasing social dissatisfaction among the population, where the willingness to support the reform process, is visibly flagging.

Economic development was characterised by continued de-industrialisation, which was reflected in a decline in industrial output of 17%. The general slackening of economic activity also stamped its mark in the services section, where there was a slump of 18.8%, and even in the agricultural sector, which was therefore unable to consolidate the positive result it had achieved in the previous year. The foreign economy also failed to produce any signs of positive tendencies. The balance of trade is characterised by a decrease in the volume of exports on a broad front. The mounting volume of imports largely served the purpose of consumption, as the substantial increase in the imports of food products and luxury goods demonstrate. Protectionist measures were taken to combat the deterioration in the balance of trade, which resulted in a setback in the process of liberalisation pursued in the preceding years. The deficit in foreign trade dominates the current account, which with a deficit of 7.2% of the GDP represents a considerable strain on the country. International rating agencies therefore lowered the country's credit standing several times in the course of 1998, with the result that borrowing is more expensive for Romania. To cover the deficit, the foreign currency holdings of the central bank had to be drawn on, which had thus dwindled to 1.6 bn. USD by the end of the year.

This means that in 1998 Romania again failed to catch up with the other transition countries in the reform process so that the gap between Romania and the countries which have reached an advanced stage in transition has become even greater. The EU has made it clear that Romania does not meet the requirements for admission. Consequently, in its endeavours to establish connections with western alliances, Romania has also failed on the economic level after its exclusion from the first round of Nato extensions.

For the coming year, the ministry of finance forecasts a 2% decrease in the GDP, which would mean economic shrinkage for the third year in succession. The forecasts additionally anticipate a slight budget deficit of 2%. This can only be achieved, however, if the slowing pace of reforms is accelerated again and the decision makers in the political domain really do maintain the austerity programme. This will be problematical in 1999, the year before the next general elections, on account of the mounting social and political tensions.

Bulgaria

The political situation has stabilised since the Kostov government assumed office in May 1977. Support for market-oriented reforms has grown. The government is apparently determined – not least in view of the municipal elections coming up in the autumn – to adhere to its programme of reforms.

Despite a distinct improvement since mid-1977, the overall economic development presents a contradictory picture. While there have been some successes in the area of macroeconomic stabilisation, economic development in real terms has fallen short of the optimistic forecasts. Although the basis for structural reforms was established, these were only slowly implemented in the course of 1998.

This is also basically the gist of the latest progress report published by the EU Commission. For this reason, Bulgaria does not reckon with the assumption of concrete talks on admission before the year 2001. The crucial part of the government's stabilisation policy is a strict currency board regime, and this is now functioning successfully. On a December-to-December basis, the inflation rate decreased dramatically from 578% (1997) to 1% in 1998. The consolidated budget in 1998 recorded a surplus of 0.9% of the GDP instead of the originally planned deficit of 1.7%. These figures are put into perspective, however, by the increase in the overall liabilities of state and communal enterprises to a total of 7.1 bn DM (September 1998), which corresponds to a good 30% of the probable GDP. An all too positive impression is also presented by the provisional figures regarding the growth of the GDP, which show a 4.5% increase. This increase is, to a large degree, the result of the catastrophic development in the corresponding period of 1997, when the GDP declined by 6.9%. The recession of 1997 deepened even further particularly in the industrial sector. This, together with the altogether disappointing development of exports, worsens the picture. In the early part of 1998, the trade surplus that had been a familiar feature in the previous years changed into a deficit, and this has been mounting continually ever since.

External factors such as the Russian financial crisis and the revaluation of the DM are only part of the explanation for the absence of economic recovery. The main reason for the country's dwindling competitive strength is the insufficient progress that has been made in terms of privatisation and restructuring and the resulting problems in attracting urgently needed foreign direct investments into the country.

As a result, Bulgaria has to rely on external support. This is available for the time being at least, following the signing of an EFF agreement with the IMF in September 1998 for a loan totalling 840 million USD over a period of three years and promises of loans amounting to roughly the same figure from the World Bank, the EU and the G-24. The allocation of these loans is linked, however, to the fulfilment of certain conditions, primarily connected with privatisation and restructuring. Above all, it will depend upon the decisiveness of the government in these areas as to whether it will be possible to meet the envisaged macroeconomic targets – economic growth of 4–5% in the coming years (adjusted downwards in the meantime to 3.7% for 1999), an inflation rate of 6.3%, and a limiting of the current account deficit to below 3% of the GDP. Further delays could also have the effect of undermining the stability of the currency board.

Croatia

The incorporation of Croatia in the process of European integration failed to make significant progress in 1988. In a recently published report the OECD issued the criticism that Croatia was still inadequately meeting its obligations towards the community of states, not only in terms of the right to vote and the media but also in terms of the return of refugees and the judiciary. In 1999 it should be possible to integrate Croatia in the PHARE programme and hence provide support for the democratic process. Beyond that, however, it is difficult to see at present whether there will be a resumption of the negotiations between the EU and Croatia on a trade and co-operation agreement which were suspended in 1995.

The economic impetus slackened markedly in 1998. The revised economic data now show an increase in the GDP of 3% for the year under review after an average annual growth rate of over 6% in the period from 1994 to 1997. This lower rate is attributable to declining growth in industry and tourism. Domestic demand returned to a more sustainable level following the boom in 1997 which had led to a corresponding influx of imports. This decline in domestic demand, combined with a sustained restrictive monetary and fiscal policy and increasing exports, reduced the extraordinarily large deficit in the current account (1997: 12.5% of the GDP) to 7.5% of the GDP in the year under review (provisional figures).

Nevertheless, in view of the more difficult and more expensive access to the international capital markets and the drying up of influxes of capital, the current account deficit must be reduced further by the repatriation of savings in order to make sure that the deficit can be financed and to avoid the possibility of a currency crisis. For the necessary increase in the country's competitive strength, the Croatian government backs the principle of further structural reforms in order to correct the structural failings in the economy which are at the root of the current account deficit. The central aspect of these reforms is the consolidation of the banking system, which is fraught with liquidity and solvency problems. Under the leadership of the central bank, sickly banks are to be examined and rehabilitated or wound up altogether. In the enterprise sector, following the conclusion of coupon privatisation, large state enterprises in the infrastructure and public utility sectors are to be included in the process of privatisation as well.

In the current year, the central bank will continue to maintain a monetary policy oriented towards the exchange rate as a means of safeguarding price stability. The exchange rate, which has established itself in the Croatian public's minds as the decisive indicator of economic stability, is to be kept stable by and large in order to contain expectations of inflation. The central bank has forecast an inflation rate of 3% to 4%. The deficit in the current account is to be reduced to 5.5% of the GDP. With less fiscal political leeway – the draft budget is based on the assumption of a balanced budget in 1999 – growth will continue to decline in the current year. After a sustained phase of stagnation in the first half of 1999, the central bank expects a growth rate of 1.5% to 2% for the year as a whole.

Bosnia-Herzegovina

The process of economic recovery in Bosnia-Herzegovina continued in 1998. As expected, the very high growth rates of 54% and 34% achieved in 1996 and 1997 respectively could not be emulated. For 1998 an increase in the GDP of approximately 20% is expected. The growth rates are declining in the industrial sector too, which only attained a level of 21% in the first half of 1998. This reflects, among other things, the structure of the foreign capital flowing into the country. It is dominated by international aid for rebuilding, whereas foreign direct investments are no longer of any significance. The degree to which the two entities, the Bosnian-Croatian Federation and the Serbian Republic, benefit from this international assistance, differs extremely, with the result that the there is a large disparity in the development of the two parts of the country as well. It was not until 1997 that aid began flowing into the Serbian Republic (RS) as well. And since then, it has received only about 20% of the total volume of funds that have been made available. As the domestic economy's absorption capacity is limited, only about half of the 4.4 bn USD that has been made available so far (of the 5.1 bn USD held out in prospect) has actually been taken advantage of.

The split economy is also reflected in the labour market. Unemployment in the RS is much higher than in the Federation, where it is estimated to be about 35%. Net wages in the Federation were the equivalent of 308 DM in December 1997, whereas in the RS they came to only 133 DM. This is also due to the different economic structures. In the RS the economy is dominated by the agricultural sector with its low incomes, whereas in the Federation 60% of the GDP is produced by the services sector. This is the sector that benefits most from the international financial assistance and the presence of about 12,000 reconstruction helpers in Sarajevo alone.

Privatisation, which will begin in 1999, is also expected to generate a greater influx of foreign direct investments. Although the legal basis for privatisation was established in both entities in the summer of 1998, it did not actually get off the ground because of difficulties in the production of the opening balance sheets that are required. In the Federation the privatisation of large enterprises is now scheduled to begin in the second half of the year. In the course of privatisation the state is to settle its obligations towards the population which have accrued as a result of the secession from Ex-Yugoslavia and the war. These payments are to take into account lost savings (2.4 bn DM in the Federation and 1 bn DM in the RS), outstanding payments to soldiers (7 bn DM) and pensioners (1 bn DM) as well as any restitution claims that may be made. The voucher privatisation which has been planned for this purpose requires that at least 35% of the purchase price must be paid in cash. A solution to the problem of privatisation in both entities was found. The banks were excluded from voucher privatisation and their shares are to go preferably to strategic investors.

The winner of the presidential elections in the Serbian Republic was the nationalistically-minded Poplasen. He has torpedoed the establishment of joint institutions and destabilised the political situation in the RS by refusing to commission the moderate Dodik with the formation of the government again. Through the close connections with the FR Yugoslavia, development in the Serbian Republic is also influenced by the effects of the current Kosovo conflict and this will also have an effect on the Federation. Economic setbacks can therefore not be ruled out.

Yugoslavia

Economic development in 1998 was impaired by the military conflict in Kosovo and the resulting sanctions imposed by the international community of states. To all intents and purposes, then, FR Yugoslavia was already a war economy even in 1998. In addition, the tension between the part-republics of Serbia and Montenegro escalated. Economic growth became less and less dynamic in the course of the year and at 2.6% fell far short of the target of 10% which the country had set itself. Industrial output in the first half of 1998 was 11.2% higher than in the corresponding period of the previous year, but owing to the intensification of the international sanctions it only reached an average of 3.8% for the year as a whole. The industrial stagnation in the second half of the year was made worse by a decline in agricultural production of approximately 6%. The prohibition of investments was having its effect. Investments came to a standstill, which, in view of the weak capital stock, further reduced the country's competitive strength. And even the industrial resources that were available were only working at 35 to 40% of their total capacity.

The official employment figures do not represent the complete extent of the economic misery. The official unemployment rate of 27.1% does not include those employed persons who are on unpaid leave or have been sent home at reduced pay. Consequently the actual unemployment rate is more likely to be around the 50% mark. In order to finance the two-fold deficit in the balance of payments and the budget, wages and pensions are paid out with a delay of several months. The arrears in pension payments alone amounted to about 1.7 bn DM at the end of the year. The "inflation tax" also contributed an estimated figure of approximately 2 bn USD towards financing the budget deficit. Inflation increased again in comparison to 1997 and reached an average of around 30% for the year as a whole, with a noticeably rising tendency in the second half of the year. One reason for this renewed emergence of inflation was the devaluation of the dinar in April. Nonetheless, on the black market the rate had returned to eight dinars to one DM at the end of the year. A further devaluation in 1999 seems inevitable, and this will lead to inflation accelerating even further.

As expected, the devaluation of the dinar in April 1998 only produced a modest improvement in the balance of trade. According to provisional estimates, the trade deficit in 1998 was just under 2 bn USD, compared with 2.15 bn USD in the previous year. Germany's trading surplus with Yugoslavia climbed to 400 million DM.

The political indications for economic development in 1999 are extremely unfavourable. At the beginning of the year a modest growth rate of 2 to 3% was still expected even on the basis of the sanctions being maintained. The Nato air strikes against Yugoslavia have meanwhile dimmed the prospects even further, so that an economic collapse is to be expected in 1999. The interest in Yugoslavia that foreign investors had just begun showing again in 1997 was already negated by the crisis in Kosovo. Even when the current hostilities come to an end, it will take some time before foreign direct investments begin flowing into the country again, and without them there does not seem to be any likelihood of an economic upswing. Market economy reforms will certainly be throttled in their earliest stages. Consequently, 1999 will be yet one more year lost in the process of economic transformation.

Macedonia

In 1998 Macedonia recorded, for the third year in succession, a positive growth rate in the economy, which is now firmly on the road to recovery. But the growth rate of 4% in 1998 was again lower than had been expected.

The reason for the result not being better was the Kosovo crisis. The conflict in Kosovo is also likely to prevent Macedonia from achieving the growth rate of approx. 5% that was originally expected for 1999. Growth rates of such dimensions, however, are not sufficient to ease the pressing problem of unemployment in the medium term. Industrial output increased by 5.5% after having reached a level of approximately 10% in the first half of the year. Economic development continues to be borne by financial aid from the international financial institutions and other creditors. An upswing that is capable of sustaining itself has not yet been set in motion. Nevertheless, the attraction of foreign direct investments can be interpreted as a step in this direction. Hope now rests on the creation of a common market between Macedonia and all its neighbouring countries bringing a decisive increase in Macedonia's attractiveness for foreign direct investments. It remains to be seen whether this is still realistic in the present situation.

A striking feature of the macroeconomic data is the stability of prices. The inflation rate fell to 0.8% on an annual average. And a comparison of the figures on a year-end basis even reveals a deflationary development. One of the reasons for this is the increase in wage payment arrears, which led to demand being subdued. Devaluation in 1997 did not reduce the deficit in the balance of trade in 1998 to any material extent. Changes in the structure of trade give cause for concern: imports of equipment, which are needed for a restructuring of production and consequently for an increase in the country's export strength, continue to decrease.

The statistical office no longer publishes unemployment figures. Estimates of the unemployment rate in Macedonia have a tradition of being very wide-ranging. The decline in employment is estimated to be at least 2%, which, if applied to the official figures, would result in an average unemployment rate for the year of over 32%. In the first ten months of the year, net wages rose by 2.8% to the equivalent of approximately 300 DM. The current wave of refugees from Kosovo presents the country with considerable problems since these large numbers of people seeking protection have to be fed in addition to those without work. What is more, the possibility of the conflict spreading across the border cannot be ruled out.

The forces that emerged as winners from the parliamentary elections in October are oriented towards a market economy. The new government coalition with the conservative-national Democratic Party (VMRO-DPNME) as its leading force sees one of the main aspects of its work in increasing employment. It backs the principle of promoting small and middle-sized businesses although as yet it has not introduced any concrete measures in this direction. However, the closure of twelve large loss-making enterprises which is envisaged if they have not been rehabilitated by July 1999, will first push up unemployment even further. Also, the examination of privatisation, which the present government has branded as a form of enrichment for the nomenclature, will probably lead to considerable unrest among the workforce in the enterprises. Nevertheless, a departure from the previous government's stability policy is not to be expected as this would jeopardise the support of the IMF and the World Bank upon which Macedonia's future development depends.

Albania

After the collapse of law and order in 1997, the political situation in Albania remained extremely fragile in 1998. In September the tension exploded once again in political unrest. Prime minister Nano was forced to resign. But the situation was brought back under control relatively quickly. The government was again formed by the five-party coalition. Pandeli Majko, who, like Nano, belongs to the Socialist Party, was elected prime minister. Apart from the minister of finance, all those responsible for making decisions on economic issues remained in office and the course adopted by the Nano government on the lines of the agreement with the IMF was maintained.

After the serious crisis that followed as a consequence of the financial pyramid systems collapsing at the beginning of 1997, the Albanian economy had recovered well by September 1998, although the influx of about 20,000 refugees fleeing out of Kosovo as a result of the repressions against the Albanian population in the spring and summer of 1998 made the political situation within the country even more unstable. Confidence in the country's ability to achieve economic development was therefore severely impaired and substantially reduced the willingness of both domestic and foreign investors to invest in the country.

In spite of all these difficulties, the country still managed to increase its GDP by more than 8%. This must be rated as a success, even if it largely involved the restoration of capacity that had been destroyed during the period of unrest in 1997. The industrial and constructional engineering sectors recorded above-average rates of growth. But since agriculture still accounted for over 50% of the GDP, its growth rate in excess of 3% was one of the determining factors for the overall economic development. In this extremely poor country, agriculture continues to act like a sponge, absorbing the workers that are made redundant and helping to ensure the physical existence of the population by virtue of the large subsistence economy.

Taking into account the disaster in connection with the financial pyramids in 1997, the achievement of reducing inflation from 42% to just above 8% is to be seen as a significant success. A decisive factor in this success was the rigorous financial policy and the strict monetary policy. The budget deficit was lowered substantially and the increase in the supply of money was reduced significantly without this involving any threat to the positive real interest rates. The foreign economic position was strengthened, which is reflected in the renewed increase in currency reserves and the stable rate of exchange. Although it was not possible to reduce the large foreign trade deficit under these circumstances, the flow of money transferred by Albanians living abroad recovered more rapidly than expected, with the result that the current account deficit was maintained within narrow limits.

The achievement of such successes cannot, however, hide the fact that Albania continues to be the poor house of Europe. For this reason, and in spite of some positive decisions, the structural reforms that had got somewhat bogged down after the events of September, need to be speeded up again considerably if the successes that have been recorded in terms of stabilisation and growth are to be consolidated. This alone will generate the confidence that is necessary for the investment process to be accelerated by both domestic and foreign capital.

This makes the burdens that Albania has to face as a result of the Kosovo conflict and the surge of refugees all the more problematical. The country will not be able to cope with these burdens under its own strength alone, either economically or politically. Internal political reconciliation and the solution of the Kosovo conflict, both of which are closely connected with the development of the economy, are crucial and they alone will have a stabilising influence on the country and the region as a whole. In the medium term, however, building up the economy is a process that must be incorporated in an overall concept for the entire region, including Macedonia and Serbia. This must be implemented immediately after the hopefully swift end to the military conflict and the reversal of ethnic cleansing in Kosovo as well as Serbia's return to a constructive political policy in the region.

Ukraine

The increasing gravity of the financial and debt crisis, which was mainly due to the failure to take fundamental structural reforms, was the most important feature of the economic situation in Ukraine in 1998. As a result, the economic decline that has continued ever since independence could not be arrested. The signs of growth that were beginning to appear in some sectors (industry, construction, services) in the first half of the year disappeared again in the course of the year on account of the decrease in demand from abroad (caused among other things by the crisis in Russia) and the worsening of the domestic financial situation. The decrease in the GDP (1.5% compared with 1997) was less dramatic than in the previous year (3.2%) but was accompanied by an emerging exhaustion of the growth potential.

The overall economic stability, which in 1997 had still been considered largely secure thanks to the rigorous monetary and currency policy adopted the Ukrainian central bank, was put in great jeopardy in 1998 by substantial structural shortcomings and the resulting debt crisis. Increasing imbalances became apparent in the course of the year both in the budget and in the current account. The budget deficit, which had increased steeply during the run-up to the parliamentary elections (in the early part of 1998), was reduced to 2% of the GDP partly by a further increase in payment arrears and partly by drastic cuts in spending. However, this did not bring any relief to the financial situation because the sources of financing largely dried up – not least as a result of the loss of confidence in the government on the international capital market. The foreign economic imbalance was generated on the one hand by a decline in exports and on the other by the dramatic increase in debt servicing.

A further risk factor was the government's imminent insolvency, which could only be averted temporarily by a rescheduling of short-term government securities, a measure that was also accepted by the creditors themselves. Nevertheless, the financial and currency crisis that had already been looming in 1997 could no longer be averted. The hryvnia had to be devalued. A further deterioration in the exchange rate could only be prevented by administrative currency market restrictions.

Ukraine has evidently entered a new phase in the transition crisis. It was just possible to prevent a financial meltdown in 1998. But in 1999 debts amounting to over 2 bn USD (including 680 million owed to the IMF) have to be serviced in due time without putting the overall economic stability in jeopardy at the same time. This will not be possible without the assistance of the international financial organisations. After important structural measures had been taken at the beginning of 1999 (including the adjustment of municipal rates and the reform of the state administration), the IMF resumed its supply of loans under the EFF programme, which it had suspended in the autumn of 1998. This means that there are again prospects of loans from other international creditors as well (particularly the World Bank and the EU).

For 1999 the government expects a slight slowdown in economic performance (1% lower than in 1998). Inflation should be maintained at 19%. The budget passed by parliament provides for a further reduction in the deficit to 1% of the GDP. The rehabilitation of the budget appears very unlikely before the presidential elections (at the end of October 1999). Judging by past experience, the substantial arrears in the payment of pensions and wages will be reduced in the period before the elections. The implementation of a rigorous policy of reform will also be prevented by the sustained resistance coming from parliament and even from within the government itself. The formation of new enterprises continues to be obstructed by increasing bureaucracy, widespread corruption and an unstable legal environment. But if the government does not overcome the resistance being shown at present and fails to push through measures designed to remedy the structural imbalance, it will be impossible to stabilise the financial situation in Ukraine and avert a new economic setback.

Moldova

In 1998 the economic development of Moldova was mainly influenced by the financial crisis in Russia. At the beginning of the year a positive growth rate was still forecast for the GDP, which then finally decreased by 8.6% in the course of the year. For Moldova 1998 was already the second year in which an anticipated positive development of the economy could not be realised. In 1996 a poor harvest had caused an unexpected decline in the GDP of 8%.

Agricultural production declined last year by 7%, industrial output by 11%. The agricultural sector, including the food industry, is a major factor in the Moldovan economy. It generates around 60% of the GDP and employs 46% of the workforce. For 1999 the government forecasts a growth rate of 1% for the GDP. In contrast, the IMF anticipates a further decline of 3%.

Inflation increased to 18.2% during the year under review, compared with 11.2% in 1997.

The major challenges for Moldova continue to be the reduction of the internal and foreign debt, the foreign trade imbalance, accelerated restructuring and privatisation of the main state-owned enterprises. The unwavering continuation of the agricultural reform programme is needed just as much as the institutional entrenchment of the market economy.

On the political level, the parliamentary elections, which took place on 22nd March, were the main issue. The electoral participation was 69.1%. As expected, the leadership of the renegade region of Transnistria refused to participate in the elections. The most surprising aspect of the election was not the strong result of the Communist Party (30%) but the crushing defeat of the governmental party (Democratic Agricultural Party of Moldova) and the co-operating bloc, Socialist Unity. The new reform government headed by prime minister Ion Ciubuc, a non-communist Alliance for Democracy and Reform has been in office since May.

One of the essential obstacles to the further development of the state and the economy in Moldova is the political separatism in the eastern part of the country. The chances of reunifying the two parts of the country depend not only on Moldova becoming more attractive economically but also on the political willingness of the Russian government to solve the conflict in Transnistria.

At the beginning of February 1999 prime minister Ciubuc resigned. It is not yet clear whether his former substitute and present successor, Ion Sturza, will be more successful as far as the challenge of consolidating the Moldovan economy is concerned. The return of the International Monetary Fund (IMF), which had suspended its support temporarily in 1997, might prove helpful. The IMF announced at the beginning of this year that a credit tranche of 35 million USD will be released. As a result of the IMF's renewed engagement, the World Bank and other financial institutions expressed their willingness to offer credits to Moldova. An extremely important aspect of the IMF's return is the implicit signal of increased credit standing to foreign investors and banks, which is of vital interest to Moldova.

Armenia

1998 was a successful year for the Armenian economy. According to the provisional figures, the country achieved a sturdy economic growth of 7.2% and thus surpassed the growth rates of past years. With a slight reduction in consumer prices of 1.3%, the price development pointed in a direction that is unusual for a transition country. In spite of the change in the political leadership in the early part of the year, fiscal policy remained restrictive so that the budget deficit at the end of the year will probably be no more than 2% of the GDP.

The successes achieved by the country in terms of stabilisation must, however, be examined critically. The high rate of growth is due above all to a particularly positive development in the agricultural sector (13.2%). Industrial output on the other hand was 2.5% down on the previous year and has thus returned to a level that is not even half as high as it had been before the commencement of transition. This means that, parallel to the growth in the economy as a whole, there is a process of de-industrialisation taking place. At the same time the subsistence economy is growing, which sheds a completely different light on the aggregate result.

Armenia's reliance on foreign creditors proved to be one of the crucial factors of the year under review. Loans from international financial organisations which had been firmly planned into the budget arrived at a later time or at a lower level than expected. Furthermore, the transfers of money back home by the some 1.6 million Armenian guest workers in Russia were reduced by more than half at the onset of the Russian crisis. This shortfall put a strain on the budgets on which these transfers depended, as well as on the balance of payments. The strain on the balance of payments was relieved by foreign direct investments, the volume of which increased by a factor of more than three as a result of the sale of some large enterprises to strategic investors. The balance of trade on the other hand was completely dominated by the Russian crisis. The 3.9% decline in exports over the year as a whole does not reflect in full the collapse from September onwards. The open trade policy combined with the meagre competitiveness of Armenian products had the effect that the country again recorded a deficit even in what has now become its main area of trade, i.e. with non-CIS countries, in which the EU is its largest trading partner.

As before, Armenia remains one of the poorest of the transition countries with a per capital income of 450 USD. The official statistics do not provide an accurate picture of the population's true social circumstances, as between 30 and 70% of the GDP is generated in the shadow economy. According to surveys of households, wages, which are still at a catastrophically low average level of around 36 USD, account for less than a quarter of the overall income of the households, which is a further indication of the large subsistence economy, although this is likely to have reached its upper limits in the meantime. Nevertheless, there is no doubt that unemployment is far higher than the official rate of 9.5%. The actual figure is three to four times as high.

Armenia achieved encouraging progress in terms of privatisation, which in response to the poor results of the voucher method had been geared more directly to foreign large investors and channelled income of a good 6% of the GDP into the treasury. With the support of the international finance organisations, Armenia has also assumed a vanguard role among the transition countries as far as reforms in the banking sector are concerned. The positive results achieved in the year under review were the result of the desire to institute reforms on the one hand and the support received from abroad on the other. The fragile nature of the political situation appears to have been overcome, but for Armenia "abroad" continues to be a factor that is unpredictable and largely impossible to influence.

Azerbaijan

In the presidential elections that took place in October 1998, the 75-year-old Heidar Aliev was, as expected, re-elected for another five years, although – according to the OECD – the elections were accompanied by blatant irregularities. The president's illness and his hospitalisation at the beginning of the year generated speculation about a possible successor. In particular the numerous international crude oil companies, which have concluded production agreements for terms of up to twenty years, are worried about how secure their contracts might be in the event of Aliev resigning. The four powers that have a particular interest and influence in the region, Russia, Turkey, Iran and the USA, were already apprehensive. In this difficult period of transition, strong political leaders are for many of the former Soviet republics a guarantee of political stability and continuity.

Azerbaijan's economic development in the year under review turned out to be more favourable than had at first been expected. In the years to come, however, economic growth will in all probability be slower. And for this reason alone it is important to initiate structural reforms quickly and to promote the development of other sectors of the economy in addition to the crude oil sector. Structurally broader growth is also essential as a basis for reducing the mounting unemployment rate, which is quoted to have been 24% in 1997, even though only 1% of those out of work actually receive unemployment benefits.

Azerbaijan has attained a remarkable level of macroeconomic stability in recent years. Inflation has already been brought down below the 10% mark and the increase in the money supply has also been maintained within a reasonable range. State budgets have not yet been brought entirely under control, however. In the year under review, the consolidated budget deficit increased at a higher rate than in the previous year and reached 4.3% of the GDP. As cuts in spending will hardly be possible in the near future, income must be strengthened by an increase in the relatively low tax ratio.

The increasing production and export of crude oil will in the years to come – particularly before the backdrop of the new OPEC agreements on increasing the prices – lead to a balance both in the budget and in foreign trade. However, a healthy development of the economy as a whole, which will also produce an improvement in the standard of living for broad sections of the population, will depend largely on whether the country succeeds in channelling foreign investments into other sectors of the economy as well and thus accomplishes diversification in the economic structure.

Georgia

Georgia's reform policy has achieved undeniable success in terms of macroeconomic stabilisation. The next step involves the implementation of important structural and institutional reforms. In spite of what continues to be a positive trend, overall economic growth has become less dynamic. Nevertheless, compared with standards in most of the other CIS countries, a high growth rate of 8% p.a. is expected in the coming years. This growth will continue to be carried by the agricultural sector, which will be joined to an increasing extent by trade, constructional engineering as well as the transport sector, because of the anticipated rise in domestic demand.

On account of the natural environment with which the country is blessed and its cultural heritage, tourism is a sector with an important role to play in the future. But this will depend upon the conflicts in the autonomous regions (Abkhazia, South Ossetia and Ajaria) being brought to an end. Besides having a positive effect on the labour market and income, a circumspect tourist trade policy can perform a not inconsiderable function in terms of reducing foreign economic imbalances. The current account deficit in 1998 had extended to 607 million USD (10% of the GDP) on account of mounting imports.

A sign that confidence in the country's reform policy is growing abroad may be seen in the continuing increase in foreign direct investments since1994 (1998: 255 million USD). Georgia's entry into the WTO this year would send out further positive signals. Private law reforms that have just come into force (mercantile law and bill of exchange and cheque transaction law) make the legal environment more dependable for domestic and foreign investments. The cabinet reshuffle undertaken by President Shevardnadze last July was a signal for a more demonstrative fight against the corruption that is still widespread in all areas of politics and society.

In spite of the evident successes achieved by the government's financial policy, the state budget must finally be released from its reliance on central bank credits and external financing. One of the principal targets of financial policy will continue to be raising the tax ratio. According to provisional figures, the budget deficit was reduced to 1.5% of the GDP through further cuts in spending and increases in tax receipts.

Inflation in 1998 was brought down to an acceptable 6.5%. The falling inflation rate and the controlled floating of the exchange rate raised confidence in the national currency. The government must now take appropriate measures with the aim of mellowing the effects that floating the currency will have on the social sector.

The informative value of the labour market statistics is very restricted on account of the high percentage of people employed in the informal sector and by concealed unemployment. Given the corresponding supporting measures, like those recommended by the EU, however, the very large proportion of self-employed persons in the workforce could represent the basis for developing a sustainable small-business sector. In some public areas overstaffing is still conspicuous. The expenditure for wages and salaries in 1998 placed a strain on the budget amounting to 2.3% of the GDP.