UNITED
NATIONS

E

Economic and Social Council

Distr.
GENERAL

E/1997/42
16 April 1997

ORIGINAL: ENGLISH

Substantive session of 1997
Geneva, 30 June-25 July 1997
Item 10 of the provisional agenda*

REGIONAL COOPERATION

Summary of the economic survey of Europe, 1996

EXECUTIVE SUMMARY

Economic growth varied considerably in 1996 throughout the region of the Economic Commission for Europe (ECE) - Europe, the Commonwealth of Independent States (CIS) and North America. In the market economies, growth in western Europe (1.9 per cent) was fairly modest and weaker than in 1995, but it was much stronger in the United States (2.4 per cent), and, unexpectedly, stronger than in 1995. In eastern Europe fairly high growth rates were maintained in most of the leading reform countries of central Europe (5 per cent) and there was solid recovery in the Baltic States (3.4 per cent). The long decline in GDP continued in Russia (-6 per cent) but there were recoveries in many of the other members of the CIS.

There were serious setbacks to the transition process in south-eastern Europe last year. The most dramatic were in Albania and Bulgaria, but many of the factors behind those crises are present in other countries in the region and in the CIS, and many are rooted in history and the difficult initial conditions in which those countries began to construct market economies. (These issues are discussed separately below.)

---

* E/1997/100.

The outlook for 1997 is not radically different from the experience of last year. In western Europe GDP growth is expected to improve moderately (to perhaps just under 2.5 per cent), not enough to make much difference to current levels of unemployment. The outcome could possibly be weaker than forecast, given the efforts being made to meet the Maastricht criteria and keep inflation at or below 2 per cent. After seven years of expansion, short-term indicators and forecasts in early 1997 were still pointing to a further slight acceleration in United States GDP growth, to 2.5 per cent for the year as a whole. In eastern Europe, the average growth rate is expected to slow somewhat to 3.5 per cent in 1997 (against 4 per cent last year). This slowdown mainly reflects developments in south-eastern Europe where tough stabilization programmes are expected to produce falls in GDP in Bulgaria and Romania. (Falling output in Albania also seems highly probable, with or without a stabilization programme.) Relatively strong rates of growth (4-6 per cent) are expected to be maintained in the Czech Republic, Poland, Slovakia and Slovenia; and growth should pick up in Hungary after a successful stabilization programme. The recovery in the Baltic States is also expected to continue and strengthen, with growth rates in the region of 3.5-5 per cent.

Assessing the short-run economic outlook for Russia still remains extremely difficult. The Government and some independent forecasters expect a modest (2 per cent) upturn in output in 1997, but there are still many Russian economists who think that even zero growth - i.e., bringing the seven-year decline to an end - might be the best to hope for. Much depends on whether the problem of arrears can be dealt with in a non-inflationary way. In Ukraine, the economy is still in deep depression, but the economy could at least bottom out in 1997, although the Government hopes for growth of 1.7 per cent. In the other CIS member countries the recovery seen in many of them last year is expected to continue, even if some Governments' assumptions about their own growth appear rather optimistic.

CONTENTS

I. EASTERN EUROPE, THE BALTIC STATES AND THE COMMONWEALTH OF INDEPENDENT STATES

A. Economic growth

1. In many respects 1996 was a disappointing year for the transition economies. Economic growth in eastern Europe averaged 4 per cent, less than in 1995 and generally less than expected; in Russia the slump in output deepened rather than bottoming out; the expected boost to activity resulting from the ending of economic sanctions against Yugoslavia has been slow to materialize; there were major economic setbacks in Bulgaria and Romania; and in Albania an economic crisis developed into a state of political and social chaos in which the Government lost control of large parts of the country.

2. But the transition economies are a very heterogenous group, and despite the many setbacks of the last year, there was also notable progress in many areas. Growth remained relatively strong among the leading reformers and especially in Poland, where 6 per cent growth was more or less as forecast, and in Slovakia, where at nearly 7 per cent it was more than forecast. Growth was also sustained in the Czech economy although it was markedly lower than in Poland and a little below expectations. There was also a return to significant growth in all three Baltic States (between 2.5 and 4.0 per cent); and for the first time since the break-up of the Soviet Union and despite the continued fall in Russian output, there was positive growth in a majority of the 12 members of the CIS. The fall in output also ended in all the Central Asian Republics except Tajikistan.

3. The slowdown in eastern Europe as a whole in 1996 was greater than expected at the start of the year. Some deceleration had been expected in those economies that had been growing relatively fast in 1995 (the Czech Republic, Poland, Romania and Slovakia), and this in fact occurred, except in Slovakia; but it was also expected that this would be offset by faster growth in Bulgaria and the countries formerly constituting Yugoslavia, and that growth, albeit fairly modest at 2 per cent, would be maintained in Hungary. In the event, a persistent failure to implement a coherent programme of structural reform finally came to a head in Bulgaria in the spring of 1996 with a massive financial and economic crisis which has still to be resolved; instead of growing by a forecast 3 per cent, Bulgarian GDP actually fell by 10 per cent. This was one of the principal factors behind the slowdown, but growth in the Hungarian economy was also weak, below the rate in 1995 and well below earlier forecasts. Although the measures introduced in 1995 to restore internal and external balance to the Hungarian economy have made considerable progress in this direction, their impact on domestic demand and especially on household consumption has been more severe and more long-lasting than expected. Economic growth in Slovenia also continued to slow down in 1996, despite earlier forecasts of an acceleration. An important reason for this was the weakness of industrial production which was affected by the weaker demand abroad for exports.

4. In the other countries of south-eastern Europe (Albania apart) output increased (for the first time in the former Yugoslav Republic of Macedonia since 1989) but generally by much less than was forecast - or, in some cases, hoped for - at the start of the year. The Croatian economy is still suffering from

the economic effects of the war and the break-up of ties with the other countries of the former Yugoslavia; tight monetary and fiscal policies, together with an appreciating exchange rate, all targeted at preventing any rekindling of inflation, has had a restraining effect on the recovery of output. The Yugoslav economy started to grow after economic sanctions had been lifted, but, given the low level to which activity had fallen, the recovery has been very slow and far below the Government's expectations. Sustained recovery of the Yugoslav economy will be highly dependent on imports, but its export capacity has been considerably reduced as a result of the war and sanctions. Although a large trade deficit has been financed so far largely by foreign currency accounts held abroad, these are most unlikely to be able to sustain output for very long.

5. In most of the transition economies economic growth in 1996 was sustained by domestic demand, both private consumption and fixed investment, with net exports making a negative contribution. A striking feature is the boom in fixed investment in some of the leading transition economies such as the Czech Republic, Poland, Slovakia and Slovenia. In the Czech Republic this is concentrated on the non-financial business sector; in Poland it is broadly based, while in Slovakia and Slovenia it has largely been made in infrastructure (roads, telecommunications etc.).

6. The revival of a sustained rate of fixed investment is one of the most positive features of recent developments in these countries, as it demonstrates that domestic (and foreign) investors are now more firmly confident about the longer-run economic prospects of their economies. There has also been a somewhat weaker recovery, so far, in fixed investment in Estonia and Latvia; and it was beginning to pick up in Bulgaria before last year's crisis. In contrast, the rapid decline in fixed investment in Russia continued in 1996, a predictable consequence of the continuing uncertainty over the political and economic outlook.

B. Employment and unemployment

7. One consequence of the slowdown in eastern European growth was that the hesitant improvement in the level of employment during 1995 came to a halt in the first three quarters of 1996. There were some increases in the numbers employed in some of the faster growing economies - the Czech Republic, Poland, Slovakia - but these were much smaller than the gains in 1995. There was, however, an increase in Lithuania (of 1.2 per cent), the first since independence and following three years of positive growth. But everywhere else, and including all the members of the CIS, total employment continued to fall. In industry, where investment and productivity have been rising in most of eastern Europe and the Baltic States, the decline in employment continued in virtually every country for which data were available (for the first three quarters of 1996). Despite the rise in eastern European output since 1993 (GDP up 14 per cent and industrial output up by 23 per cent between 1993 and 1996), there was virtually no change in total employment. The recovery of output has in fact been accompanied by continued labour shedding in some countries, and productivity in industry has grown rapidly: in addition to the gains from restructuring output and investing in new equipment, the recovery from low levels of capacity utilization greatly increased the productivity of those

already employed. Also reserves of "excess employment" probably still exist in some of the remaining large, state-owned enterprises in eastern Europe. The recovery in output will thus have to proceed much further before there is a significant net increase in the number of new jobs. (The problem of "excess employment" is probably very much greater in the CIS, where the fall in aggregate output between 1989 and 1996 was four times larger than that in the level of employment.)

8. The slowdown in growth rates has also checked the decline in the number of people unemployed in eastern Europe. This had peaked at about 7.5 million people in early 1994 and declined slowly to 6 million in the third quarter of 1996; but in the last quarter there was an increase of nearly 120,000 nearly two thirds of them in Bulgaria. Unemployment levels have continued to rise steadily in the CIS, and at the end of 1996 the number registered as unemployed was just over 8 million. (This figure is almost certainly a considerable underestimate of the numbers unemployed according to the standard definition of the International Labour Organization.) Altogether, there were at least 14 million people unemployed in all the ECE transition economies at the end of 1996.

9. High levels and extended periods of unemployment tend to "discourage" some workers even trying to find another job, and they therefore tend to drop out of the labour force. This effect seems to be the main explanation for the continuing slight fall in unemployment rates in 1996. Nevertheless, the average rate in eastern Europe remained high, at 11.8 per cent at the end of last year, and for most individual countries it ranged between 6.3 per cent in Romania and over 20 per cent in the former Yugoslav Republic of Macedonia. The rate remained exceptionally low in the Czech Republic, at 3.5 per cent at the end of 1996, although it had also risen from 2.7 per cent in the second quarter.

10. Unemployment rates in the Baltic States and in the CIS are generally much lower than those in eastern Europe, but this is largely a reflection of shortcomings in the coverage of the figures for registered unemployment. Estimates based on the more comprehensive labour force surveys, which are not yet being conducted in all countries, suggest that the true unemployment rates in these countries all tend to fall within the range quoted above for eastern Europe.

11. Apart from sharing similar high rates of unemployment, the composition of the unemployed in eastern Europe and the Baltic States is also similar in a number of respects to that in western Europe. First, unemployment rates for women are generally much higher than for men - the exception being Hungary - and women also tend to account for more than half of the numbers unemployed in most of the transition economies (including Russia). Secondly, young people (under the age of 25) also have high unemployment rates and generally account for between a quarter and one third of all persons unemployed (in Romania their share was nearly 50 per cent). And, thirdly, large numbers of people have now been unemployed for longer than one year: labour force survey data in 1996 indicate that the long-term unemployed account variously for some 30-60 per cent of all the unemployed. Given the characteristics of the relationship between economic recovery and job creation, described above, the prospects for a significant reduction in unemployment rates in the near future are not very

good, and as the experience of western Europe suggests, that implies that the prospects for reducing the number of long-term unemployed are probably even worse. The presence of a large pool of long-term unemployed, many of them young people, is a potential source of social instability. In the short run, active labour-market policies and reasonably effective social safety nets can provide some temporary relief, but effective solutions depend on a sustained revival of fixed investment. Investment promoting policies should therefore be central to efforts to deal with the problem of unemployment.

C. Falling inflation rates and rising cost pressures

12. Rates of inflation generally continued to fall in 1996, with particularly marked improvements in the Baltic States, in Russia and all of the other members of the CIS except Kyrgyzstan.

13. In eastern Europe, however, progress was less striking and less general than in 1996. First, in Albania, Bulgaria and Romania there were major reversals, especially in Bulgaria where consumer price inflation rose 311 per cent in the 12 months to December 1996 (compared with 33 per cent in 1995). Although much lower than in Bulgaria, the inflation rate virtually tripled in Albania and more than doubled in Romania. Secondly, the reduction in inflation rates elsewhere in eastern Europe was quite small and often less than the targets that Governments had set for 1996. Although in several countries rates are now in single digits, only two or three approached the prevailing average rate (less than 3 per cent) in western Europe. In Hungary and Poland progress remains slow and inflation remains in the neighbourhood of 19-20 per cent, although their current budget programmes assume reductions in 1997 to 15 per cent and 13 per cent, respectively.

14. In the Baltic States inflation over the year was in the range of 13-15 per cent, half the rates in 1995, while in the second half of 1996 it was in single digits in Estonia and Lithuania and significantly lower than in most of the more advanced reforming countries of eastern Europe. Tight control of monetary and fiscal policies, together with significant real exchange rate appreciation, were the major factors behind this outcome.

15. There was also a major reduction in the rate of inflation in Russia and most of the other CIS countries: from typically 4- and 3-digit rates of increase in 1994 and 1995, the annual rate fell to within a range of 18-40 per cent in more than half of them. Most of the CIS members have been pursuing more effectual macro-policies, especially monetary, with the assistance of the international financial institutions. But the considerable deceleration in the Russian inflation rate has also been important for the other CIS members, given their still high degree of dependence on the Russian economy. In Russia the rate of inflation over the 12 months to December 1996 was just under 22 per cent, compared with over 130 per cent in 1995. The maintenance of a tight monetary policy throughout the year and a large real appreciation of the rouble in the first half were important factors behind this performance, but there was also an element of suppressed inflation as well: large arrears of payments for wages and pensions helped to dampen domestic demand, and increases in administered prices, not necessarily unwisely, were deliberately held below

the average inflation rate. (The large drop in the inflation rate in Belarus, unlike most of the other CIS countries, was largely achieved through governmental price subsidies, cheap credit and de facto price controls.)

16. One of the main factors behind the slow fall in rates of inflation in eastern Europe has been the rapid growth in real wages, which has generally outpaced the growth in productivity, even in countries such as Poland where both output and productivity have been rising quite rapidly. The pressures here come from a variety of sources. In the first place there is probably a strong desire on the part of wage earners to make up for the considerable loss in real wages that they suffered in the early years of the transition, and the recovery of output gives them at last the opportunity to attempt to do so. Moreover, the underlying trend in productivity is still uncertain in many countries: fixed investment in infrastructure as well as in machinery and equipment is clearly rising strongly in a number of countries (Poland, the Czech Republic, Slovakia and Slovenia) and this should lead to larger improvements in productivity over the medium run; but in many other countries, the rise in output per head is still heavily influenced by the recovery of output from very low levels of resource privatization. The process of restructuring large state-owned (or formerly state-owned) enterprises is still fairly slow, and in several countries the privatization process has also been hesitant and lacking in direction: these factors tend to discourage fixed investment (foreign and domestic) and to hold back improvements in productivity. Thus, increases in unit labour costs are generally high and tending to accelerate in most of eastern Europe.

17. The pressure for high nominal wage increases is also influenced by two other factors. The first is that many Governments are still in the process of liberalizing prices, and this is still tending to give periodic shocks to the consumer price index (CPI) (a 1 per cent rise in the Czech Republic in July, more than a quarter of the annual increase in Slovenia). Price deregulation is also moving into a number of sensitive areas in many countries, such as housing rents, utility prices (including public transport), and energy. How far these changes can be contained as one-off increases in the consumer price index will depend partly on careful timing (the increase in Czech energy prices and rents last summer was partly cushioned by the seasonal fall in food prices) but even more on whether they can be absorbed by real wage increases supported by productivity growth.

18. Another pressure for higher average nominal wages comes from the expansion of the service sector in most of the transition economies. In general, prices in the service sector have tended to rise faster than non-food prices and in 1996, as in previous years, they made the largest contribution to the rise in consumer prices. This partly reflects the increasing concentration of administered price liberalization in this sector, but it also arises from the general tendency for service-sector productivity to grow more slowly than in the rest of the economy and from its relatively greater insulation from foreign competition. In a market economy intersectoral or interindustry differences in wage increases tend to be much less than the variance in their rates of productivity growth. Consequently, prices will tend to rise more quickly in sectors with lower productivity growth and little competition from abroad. In this respect the eastern European economies are now little different from the western ones. But a crucial aspect of this so-called Scandinavian model of

inflation is which sector sets the pace for the increase in wages. If the scope for increases is set by productivity growth in the tradeables sector (plus or minus any change in world market prices), price increases in the service sector will still outpace those in the rest of the economy, but the profitability and competitiveness of tradeables will not be eroded. If, however, the model goes into "reverse", as appears to have happened in several western European economies in the 1970s and 1980s, and wage increases in the non-tradeable sectors outpace those in the rest of the economy, the profitability of export- and import-competing production will diminish.

19. It is difficult to say whether such a "reverse" mechanism is currently at work in the eastern European economies: part of the increase in relative service prices reflects the one-off adjustments of price liberalization and the resurgence of a sector artificially suppressed under the former central planning system, and there are still limitations to the availability of data by sector. But in most eastern European economies, nominal wages and unit labour costs in industry have been rising faster than producer prices over the past year, implying a sharp squeeze on gross operating profits and profit margins. The main exception to this tendency last year appears to be Hungary. In general, producer prices rose much less than consumer prices last year, and their deceleration from 1995 was also much greater. To a large degree this probably reflects the effect of real exchange rate appreciation, which not only helps to dampen the cost of imported inputs but also sharpens competition from imports at the factory gate. (The higher rate of consumer price increases reflects the role of services mentioned above, but relatively weak (uncompetitive) distribution systems probably also play a role in sustaining relatively larger increases, especially when consumer demand is rising strongly.) Too much reliance on real exchange rate appreciation as an anti-inflationary device, however, can be a dangerous strategy if pursued for too long. It can weaken the competitiveness not only of exporters, but of all producers in the tradeables sector.

20. Whether these pressures will actually result in higher rates of inflation will depend on the stance of macroeconomic policy and the effectiveness of the instruments of monetary and fiscal policy. The stance of macroeconomic policy in nearly all the transition economies has been clearly aimed at eliminating internal and external imbalances and especially attenuating the effects of price liberalization. Considerable progress has been made towards establishing macroeconomic equilibrium, but the experience of 1996 underlines many of the difficulties still faced by the Governments of the transition economies in trying to pursue their goals with a range of policy instruments which is still limited by the standards of the western market economies and which do not always have the effects predicted by textbook models, based on the experience and institutions of mature market economies. Thus, in the transition economies the demand for money appears to be unstable and there is only a weak correlation, if any, between changes in the money supply and subsequent changes in consumer prices. This appears to be due to weak or still missing institutions and to the relative thinness or absence of a full range of financial markets. Nevertheless, a number of countries (Czech Republic, Hungary, Poland, Slovenia and Croatia) have achieved significant success in lowering and controlling their inflation rates; but one consequence of this success is that they have been attracting large and rapid inflows of foreign capital which threaten to

destabilize domestic monetary control and to push up the exchange rate, thereby further weakening the competitiveness of the tradeables sector. Various measures have been introduced to deal with this dilemma, the most common being a widening of the fluctuation bands in which the exchange rate is allowed to fluctuate, but they have also been accompanied by a tightening of monetary policy (in the Czech Republic, Hungary, Poland, Slovakia, for example). The monetary authorities in these countries are thus increasingly having to pursue a narrow path between trying to check surges in foreign capital inflows, on the one hand, and trying to avoid a tightening of policy to the point at which it would threaten the recovery of output and fixed investment, on the other.

21. Apart from the difficulties of implementing stabilization policies in a transition economy, another major factor in determining whether inflationary pressures actually translate into higher prices is whether Governments can resist the pre-election temptation to loosen policies in an attempt to boost their share of the vote. In Albania and Romania an excessive loosening of monetary policy in the run-up to elections played a role in the deterioration of their economies in 1996, and similar developments occurred elsewhere (for example, in Slovenia) but with less severe consequences. The temptation to try to boost household incomes before an election is particularly strong in countries where the long transition process has so far yielded meagre results for large numbers of voters. The recent increase in the number of strikes and street demonstrations against the effects of tough stabilization policies and restructuring programmes, not least in some of the more advanced reforming countries, will intensify the pressures on Governments to soften their policy stance. Advice and warnings from the international financial institutions and others to resist seems to have little effect in this context.

D. Deteriorating external accounts

22. Prior to 1989 most of the countries of eastern Europe and the former Soviet Union were in surplus for most of the time on their merchandise trade. But from 1990, more and more of them moved into deficit, as trade liberalization and the transformation process got under way, and by 1995 all the eastern European and Baltic States were in deficit. In contrast, about half of the CIS countries were still in surplus, the outstanding case being Russia, with a large and rising surplus.

23. In 1996 trade deficits deteriorated quite considerably in most of eastern Europe and the Baltic States and in most cases at an accelerating rate in the second half of the year - they doubled in Poland and Yugoslavia, sextupled in Slovakia, and elsewhere increases of 50-70 per cent were common. The main exceptions to this development were a few countries where domestic adjustments forced a reduction in imports (Bulgaria, where imports fell over 20 per cent, and to a lesser extent, Romania and Slovenia). Altogether the aggregate of eastern European and Baltic trade deficits increased from $23.6 billion in 1995 to just over $37 billion in 1996.

24. Most of the CIS countries also moved into deficit, although on a much smaller scale than eastern Europe: except for Ukraine, most of the deficits were less than $1 billion. But all of them were dwarfed by another increase in

the Russian surplus, from $31 billion in 1995 to over $37 billion, or 9 per cent of GDP, in 1996. (Allowing for unrecorded trade, however, the Russian surplus is estimated at some $29 billion in 1996.)

25. The proximate reasons for the deterioration in eastern Europe and, to a lesser extent, in the Baltic States were a sharp deceleration in the growth of export values (from 25 per cent in 1995 to just over 1 per cent on average for eastern Europe, and from 36 to 16 per cent for the Baltic States); and a continuing strong growth of imports (11 per cent in eastern Europe, 24 per cent in the Baltic States), although these increases were also smaller than those in 1995.

26. The slowdown in export growth appears to be due to a number of external and domestic factors. Slower growth in western Europe was an obvious factor, with the increase of import demand falling by nearly two thirds between 1995 and 1996. This refers to the decline in the volume growth of merchandise imports. However, this affected the eastern countries differently, and some of them (Poland, Hungary, Estonia and Latvia) were still able to achieve export volume growth of 6-9 per cent, more than the growth of world trade and despite their now considerable dependence on the much weaker western European market.

27. As suggested above, in the summary of price developments, a number of domestic factors have moved in the direction of weakening the international competitiveness of the tradeable goods sectors. Rising unit labour costs and appreciating foreign exchange rates (especially against the deutsche mark) have been squeezing exporters' profit margins and increasing the competitiveness of foreign suppliers on the eastern markets. And delays in restructuring industrial enterprises, especially the larger ones - many of which, but not all, remain under state control - have led to smaller than expected gains in productivity. Another factor is that much of the slack in export capacity created by the collapse of domestic and Council for Mutual Economic Assistance (CMEA) demand in the immediate aftermath of the shocks of 1989 has now been taken up, and a continued rapid growth of exports will depend increasingly on the creation of new capacities and the upgrading of existing ones. This would also suggest that, in present circumstances, devaluation of the exchange rate might not be very effective in boosting exports. Moreover, both eastern European exports as well as the restructuring process itself have a high import content, and so devaluation could prove to be a two-edged sword. Devaluation may sometimes be appropriate, as decided in Hungary last year, if the exchange rate is estimated to be significantly above its equilibrium value (invariably a fragile and controversial calculation) and if there is spare productive capacity. But both from the point of view of reducing the underlying rate of inflation and improving external balance, manipulating the exchange rate cannot be a substitute for structural changes in the real economy.

28. A question that will increasingly preoccupy policy makers in eastern Europe and the Baltic States is whether the growing external imbalances can continue to be financed easily or whether they are likely to become a constraint on growth. Since most of the eastern European and Baltic countries are in surplus on transfers and services (remittances from citizens working abroad and tourism being among the most important sources of net income), their current account deficits are less dramatic than those for trade. Nevertheless the deterioration

on current account was still considerable, in aggregate from $7.7 billion in 1995 to $13.5 billion in 1996 for eastern Europe, and from $0.8 billion for the three Baltic States to over $1 billion (full year data for 1996 are not yet available for the latter).

29. Russia's current account surplus is much smaller than its trade surplus, partly because of a huge deficit on foreign travel, and it increased less than the trade surplus, from $9.3 billion in 1995 to $10.2 billion in the first three quarters of 1996. Data for the other CIS members are limited, but Belarus, Moldova and Ukraine were all in current account deficit in 1996, although only in the first two was this a significant proportion of GDP (8 and 11 per cent respectively).

30. Despite the deterioration in eastern European and Baltic current accounts in 1996, so far there has been no problem in financing them, mainly from private sources. The foreign capital inflow into eastern Europe last year is estimated at just over $15 billion which was sufficient to finance the deficits without adding to aggregate reserves. (In 1995 the inflow had been $24 billion, and several Governments considered the addition to reserves to have been excessive.) Foreign direct investment (47 per cent) and medium- and long-term borrowing (22 per cent) are the most important sources of financing, while portfolio and short-term funds account for some 16 per cent. However, if "errors and omissions" are assumed to contain mainly short-term flows, the short-term component (i.e., including portfolio and capital identified as short-term) is not insignificant (31 per cent).

31. When current account deficits rise above 5 per cent of GDP for any length of time, it is conventionally taken as a warning signal for corrective policies to be introduced. All the Baltic States and many of the eastern European countries have now passed this threshold, several by a large margin, and current forecasts suggest a further deterioration in some of them in 1997 (Croatia, Czech Republic, Poland, Slovakia, for example). Does this mean that Governments will be forced to take action to check the rising external deficits and as a result cut back their growth rates? Like all rules of thumb, however, the 5 per cent signal is only a first warning to pay more attention to what may be happening and the possible risks involved.

32. The sustainability of current account deficits (or foreign borrowing) basically rests on whether foreign investors believe a country will eventually be able to generate a stream of net export earnings sufficient to service and repay its debts. If foreign investors do believe that, then they will continue to sustain a country's deficit - and there are many examples of countries running deficits of over 5 per cent of GDP for many years (including Ireland and Israel among the ECE member countries). The key points here are whether the country has plenty of investment opportunities and whether the domestic environment is favourable to investors taking advantage of them. A recent study[1] has stressed that a current account deficit of more than 5 per cent is likely to become a problem only when a range of conditions apply: when the export sector is small, debt service is large, domestic savings are low, and the financial sector is weak and dominated by banks subject to weak regulation.

33. As far as the fast-reforming eastern European and Baltic economies are concerned, their performance according to all these criteria is mixed but by no means bad. In the first place, they do have considerable investment opportunities, and fixed investment, both domestic and foreign, is rising strongly in some of them and in several cases more rapidly than consumption, especially in central Europe. It should also be stressed that the available data do not suggest that eastern European current account deficits are being used to finance a boom in imports of consumer goods. In 1995, capital goods accounted on average for about 27 per cent of total imports and manufactured intermediate goods for another 40 per cent; manufactured consumer goods accounted for about 19 per cent.[2] Between 1993 and 1995 manufactured, final consumer goods accounted for only 17 per cent, on average, of the rise in total imports. While the greatest importance is often attached to imports of capital goods, it should be stressed that imports of manufactured intermediates also play a major role in the modernization of production structures, upgrading the quality of output, and generating positive spillovers to the rest of the economy.[3] The import structure of the eastern European transition economies thus appears to be consistent with efforts to restructure their economies.

34. On the other criteria mentioned above, most of the eastern European and Baltic economies are open, with relatively large export sectors: in relation to GDP, the share of exports ranged from 19 per cent (in Poland) to just under 50 per cent (in Slovakia and Estonia) in 1996. The smallest export sectors were in Albania (8 per cent of GDP) and Yugoslavia (13 per cent). As far as foreign indebtedness is concerned, eastern Europe is now classified as a comparatively low debt area, with gross debt to export ratios averaging about 100 and net debt to export ratios much lower, at about 56 per cent. In the Baltic States the ratios are very much lower. The ratios of the most highly indebted countries - Albania, Bulgaria, Hungary and Poland - have fallen considerably in the past few years, although there was a deterioration in Bulgaria last year and there has also been a sharp rise in those for the former Yugoslav Republic of Macedonia. Thus existing levels of foreign debt and debt servicing are not problematic for the majority of eastern European and Baltic countries.

35. The financial system, however, is another matter, and it is now widely recognized that this is one of the most fragile foundations of the whole transition process. The crises of the past year or so in Albania and Bulgaria have highlighted the issues in a dramatic fashion, but many of the constituent elements of the problems in those countries - low quality of banks' asset portfolios, "cosy relationships" between banks, state-owned enterprises and ministries, weak or non-existent regulation, and a widespread, popular mistrust of the banking system - are present in varying degrees elsewhere in eastern Europe and in the CIS. If the confidence of foreign investors is to be maintained, then the Governments of transition economies will have to be seen to be making progress in reforming their financial and banking systems as well as restructuring their productive capacities. If this can be done - and it might also help if Governments were to set out their medium-term programmes for the eventual (and inevitable) conversion of current account deficits into surpluses - then balance of payments crises, with sudden and painful cuts in domestic absorption, can probably be avoided. It also needs to be emphasized that, unlike the western European countries in the late 1940s and 1950s which benefited from Marshall aid and other official support for financing their

current account deficits over a number of years and thus sustaining growth and reconstruction, the transition economies are largely dependent on private financial flows which are much more nervous and fickle than official commitments. It is therefore all the more vital that the programmes for reform and adjustment be kept on track and that they be perceived to be coherent and transparent by those financing the deficits. Any signs that reforms are being stalled or that demand management is being relaxed - for electoral reasons, for example - could quickly reduce the net inflow of funds and compromise the country's investment grade status on the international capital markets.

E. South-eastern Europe

36. The two major crises that broke out in Bulgaria and Albania in 1996 - and which are still unresolved, although progress has been made in Bulgaria - underlined in a dramatic fashion the fragility of the transition process in some countries and demonstrated how misleading and dangerous it can be to focus on changes in a few macroeconomic variables such as indicators of progress and success. The growth rate in Albania of 9 per cent and more between 1993 and 1995 and the reduction in the inflation rate from nearly 200 per cent in 1992 to 6 per cent in 1995 were naturally seen as impressive; inflation in Bulgaria remained much higher but still fell from over 300 per cent in 1991 to 33 per cent in 1995 while GDP was rising modestly at some 2 per cent between 1993 and 1995. However, reducing inflation from 3-digit rates to 2 digits or raising output rapidly from the depths of an exceptional slump is the relatively easy, although still very important, part of the recovery process. But bringing about a sustained recovery in a market economy presupposes that the basic institutional framework required to support market-based activity is in place and functioning effectively. The immediate events that triggered the crises, as well as the more general context in which they occurred, obviously differed substantially in each country. But both crises originated essentially in the "institutional hiatus" that arose between the speedy destruction of the former system of economic organization and the much longer time required to build the new institutions required to support a market-based system of coordination. Developing this new system takes time, and this helps to explain not only why the transitional recession was so deep and long in most transition economies but also why rent-seeking, corruption and criminal activities have flourished in the vacuum. The underdevelopment of the financial sector is a particularly important example of this general problem: in the absence of an effective institutional and regulatory framework for banking and other financial activities, credit risks will not be undertaken on the basis of a commercial evaluation of risks and returns, and this lack of financial discipline leads to the financial sector being an obstacle rather than a support to sustained economic growth and the creation of a modern capitalist economy. This lack of progress towards the creation of an effectual framework for sustained development also means that the effects of stabilization tend to be short-lived: some of the macroeconomic conditions for growth are put in place, but growth does not ensue. For the majority of the people, the costs of adjustment are prolonged and the promised benefits are postponed, except for the minority which is enabled to enrich itself through non-market activity. This is an obvious recipe for social unrest and political instability.

37. Because the Bulgarian and Albanian crises were so extreme - and especially the latter, in its consequences - there is a natural temptation to set them aside as special cases. But most of the basic elements of these crises are present in one form or another in all the transition economies and especially in some of the other countries in south-eastern Europe - the successor States to the former Yugoslavia (except Slovenia) and Romania - as well as most of the CIS. In the central European countries, especially the members of the Central European Free Trade Agreement (CEFTA), there are still problems with certain missing or ineffective or underdeveloped institutions, but their general institutional and economic development has advanced to a degree where the risks of a serious breakdown is now fairly low and considerably less than in south-eastern Europe.

38. The timing and form of any particular crisis always comes as a surprise, but the dangers and risks created by the existence of the "institutional hiatus" have been pointed out in earlier issues of the Survey,[4] and warnings that a "two-speed" transition process was emerging in eastern Europe, with countries such as Albania, Bulgaria and Romania in the slow lane, were being made from the end of 1991.[5] These countries all had much greater difficulties than the CEFTA countries in breaking with their communist past, in establishing the democratic legitimacy of their Governments and in getting effective programmes of reform and stabilization under way.[6] It was tempting then - and is tempting now - for many commentators to say that these failures simply reflect a lack of commitment to reform and policy discipline on the part of Governments. That may be true in a proximate sense, but it begs the question of why Governments do not persist with policies that they - and their electorates - often believe to be necessary for their future well-being.[7] At least part of the answer lies in the ex ante uncertainty of individuals as to whether they, personally, will actually benefit from reform even if they still believe that the majority will do so.[8] Such individual uncertainty may actually be greater the poorer people are, simply because they are closer to the borderlines of penury than the better-off. The bias towards the status quo is therefore stronger in such countries.

39. The countries of south-eastern Europe are generally very much poorer than the other transition economies of eastern Europe, although one of the results of the former socialist systems is that on many development indicators (such as life expectancy and literacy), there is no significant difference between the two groups,[9] and even the poorest countries of south-eastern Europe have considerably higher values for those indicators than most other countries at similar levels of income per head. But in terms of nominal GDP per head, the five CEFTA countries were nearly three times better off than the south-east in 1994, and although the difference is reduced to 1.6 times when adjusted for purchasing power parity, there still remains a significant[10] difference in their levels of income per head.

40. The transitional slump in output in the poorer countries of south-eastern Europe was much deeper than that in central Europe: in Albania, Bulgaria, Croatia, Romania, The former Yugoslav Republic of Macedonia and Yugoslavia, the average fall in GDP between 1989 and 1992 or 1993 was nearly 40 per cent,[11] compared with an average of about 18 per cent for the five CEFTA countries. The slump in output in south-eastern Europe, although not as bad as in the Baltic States, was closer to that of the CIS than to the rest of eastern Europe.

41. The other "initial conditions" from which most of the south-eastern countries embarked on the construction of market economies were also more unfavourable than those facing the CEFTA countries. Bulgaria's dependence on trade with the Soviet Union was much greater than that of other eastern European countries, and this not only worsened the slump in output but presented relatively greater difficulties in adapting production and export structures to meet demand in the western market economies. Albania's long period of isolation from the rest of the world also left it with considerable problems of adaptation, and Albania, Bulgaria and Romania all had relatively unfavourable export structures (high shares of agricultural products and/or of "sensitive products") for taking advantage of the new markets of western Europe. Bulgaria also started the transition with high levels of debt, and quite early in the process all the countries in the region were hit, to varying degrees, by economic sanctions imposed on Iraq and on Yugoslavia. In addition to the economic shocks, the legacy of communist rule in these countries was probably much more unfavourable than in central Europe: more ruthless regimes ensured that there was little, if any, reform before 1989, and there was little opportunity for the emergence of opposition parties which might have developed coherent alternative programmes when eventually presented with the opportunity of taking over Government.

42. Very little special allowance was made for this historical legacy when the international community first responded with assistance for the transition economies. The relations of the south-eastern countries with the international financial institutions were slow to develop,[12] and they lagged behind the other transition economies in obtaining more open markets in the western economies. In the early 1990s pledges of assistance to Albania, Bulgaria and Romania not only frequently fell short of International Monetary Fund (IMF) estimates of their short-term financing needs for the current account, but agreed amounts were often delivered behind schedule, thus creating liquidity shortages and leading to unnecessary cuts in essential imports.[13] The explanations for these delays usually focused on the slow pace of reform and doubts about even the commitment of the various Governments to both economic and democratic reform. Although there were certainly foundations for these doubts, they ignored the dangers of countries falling into a transition trap due to the "institutional hiatus": the old institutions were discredited and unable to perform, but the domestic forces for reform were still too weak to establish viable alternatives. The rent-seekers and vested interests, criminal and non-criminal, who were able to exploit the institutional incoherence thus made it even more difficult for the transition process to move forward.

43. The transition process in the south-eastern economies is now in a very vulnerable position. A significant degree of liberalization of trade and prices, including interest rates and credit allocation, has been achieved in several of them, but the institutional structure required for these newly released market forces to operate in a socially optimal manner is still highly deficient in many crucial respects. Extensive legal reforms have been implemented in most countries, but their administration and judicial enforcement is often weak; small-scale privatization has proceeded rapidly and extensively, but the transfer of large state-owned enterprises to private ownership has been very slow, and there has been little effort made to break up and restructure dominant enterprises. Competition policies are still embryonic, and there are

widespread restrictions on new entrants to different markets. All these problems are common to most transition economies, but they are generally more severe in the south-east than in central Europe.[14]

44. One of the most crucial institutional weaknesses, however, lies in the banking and financial systems. The financial "pyramid" schemes in Albania were only exceptional in the scale on which the population invested in them and in the dramatic and widespread economic, social and political consequences of their collapse. But essentially they were a symptom of the "institutional hiatus" - the lack of sound financial institutions and instruments for the placement of savings and a lack of effective regulation designed not only to proscribe certain types of financial practice but also to limit the systemic effects of financial failure. The naive and the credulous willing to gamble their savings on promises of gain which exceed all reasonable degrees of probability are not concentrated in south-eastern Europe; they are to be found not only in all the transition economies but in all the western market economies as well.

45. The banking problems in Bulgaria are similar to those in most of the countries of south-eastern Europe, including Yugoslavia. Most of them are burdened with bad debts (non-performing loans), and many are insolvent by western banking standards; loans continue to be made to loss-making enterprises in the state sector, partly under political pressures or on the basis of personal relationships but also to prevent balance-sheet problems from emerging into the open; and there is generally inadequate regulatory and supervisory powers in the hands of the central banks. In addition, there is widespread distrust among the general population of financial instruments and institutions - this is of long standing in some of the States of the former Yugoslavia where foreign currency deposits were frozen in the early 1990s, but the credibility of financial institutions and the banks has clearly worsened as a result of last year's crises. Incapable of playing a constructive role in the transition process, the banking system in much of south-eastern Europe is actually a major obstacle to progress.

46. Reform of the financial system is thus at the top of most programmes for reform and the financial and technical assistance programmes of the international financial institutions (including the EBRD). But the fragility of the banking and financial systems is closely bound up with the slow development of the private sector and the lack of other institutions required to support the market economy. Action will therefore be needed on a wide front, and reforms will need to fit together in a coherent framework. And, in addition, urgent measures are required to restore macroeconomic stability. The question therefore arises as to whether the traditional responses of the international community will be sufficient to ensure success this time. Romania has already reached four standby agreements with IMF since April 1991, and all of them were suspended because the Fund's conditions could not be met by the Romanian Government. The difference now is that there is a new Government in power, elected by a popular vote in favour of reform. However, while the electorates will be keen for quick results, the development and transition problems of Romania and the other countries of south-eastern Europe are considerable and cannot be solved quickly - the crucial institutional changes cannot be brought about through "shock therapy".

47. Recent developments have highlighted not only the lack of mechanisms and institutional safeguards to deal with serious shocks and upsets but also the danger that, in the absence of such safeguards, setbacks in the economy can rapidly degenerate into a broader social and political crisis which is extremely difficult to control. The two open crises of the past year raise important issues not only for policy makers in all the transition economies[15] but also for those countries and institutions in a position to provide assistance. These transition failures in south-eastern Europe also bring again to the forefront of public debate a number of questions related to the goals and methods of providing assistance to countries that still face considerable problems not only in escaping from the transition trap but also in nurturing democratic institutions and forms of Government.

48. Overcoming these problems requires concerted action and long-term commitment on the part of both policy makers in the transition countries themselves and of the international community. It will also require a more generous, better focused, and much speedier delivery of assistance - technical and financial - which is not available domestically. Speedy assistance is likely to be more effective in helping Governments with their stabilization policies, while aid delayed can actually have perverse effects.[16] Effective assistance may also help to reduce the ex ante uncertainty of individuals which can be a break on the reform process. Such assistance should not be regarded as an act of generosity subject to the fiscal restraints imposed in the western European and other economies but rather a form of public investment guided by enlightened self-interest. Among the future returns to the donors of prompt and appropriate assistance should be increased economic and political stability in Europe and the ECE region as a whole. Without such assistance, the results of further crises may be even more chaos and destruction, with severe spillover effects on neighbouring countries, in the first instance, and eventually on the rest of Europe.

II. WESTERN EUROPE AND NORTH AMERICA IN 1996

49. Economic growth in western Europe strengthened during the course of 1996, but for the year as a whole, the average rate of increase of just under 2 per cent was still much lower than that in 1995. Allowing for revisions in the 1995 national accounts data, the outcome was a little bit better than expected last year. Of the four large European economies, only the United Kingdom, which has been cyclically detached from mainland Europe since 1993, maintained a significant rate of expansion, although growth in many of the smaller economies was some way above the western European average. Although most of the data are still provisional, the recovery in continental Europe appears to have lost momentum in the last quarter of 1996, while in the United Kingdom there was an acceleration in the closing months of the year.

50. The main source of western European growth last year was rising exports, mainly to regions outside Europe such as the United States, the transition countries of eastern Europe, and the developing countries. Many countries benefited from the competitive advantages resulting from the appreciation of the dollar and the stronger growth of demand in countries such as the United States. But the impulse from net exports was not strong enough to give a significant

boost to domestic demand. In general private consumption expenditure in western Europe rose slightly more than 2 per cent, not much more than in 1995, and still restrained by modest growth in wages and salaries and in employment. Government consumption expenditure increased very little (1.4 per cent on average, the only large increase among the larger economies being in Germany) as a result of the continuing efforts to meet the Maastricht criteria for entry into the European Union.

51. As part of the same efforts at fiscal retrenchment, fixed investment by Governments actually fell quite sharply in a number of countries and for the second year in succession in France, Germany and the United Kingdom. Business fixed investment showed little buoyancy, and investment plans were cut back during the year as a response to expectations of relatively weak output growth. What investment did take place appears to have been focused more on rationalization than on expanding capacity. The total volume of fixed investment rose by just 3 per cent in 1996 and was only 2.5 per cent higher than in 1990 (only 1 per cent if Turkey is excluded). The weak performance of fixed investment is a matter of some concern since it implies some slipping behind in the technological modernity of the European economy and, ultimately, a slowdown in the creation of new jobs. Since costs of capital have fallen and rates of return have risen, the main restraint on investment would appear to be the weak prospects for economic growth.

52. In sharp contrast to western Europe, the United States economy continued to expand for the sixth successive year (the present upswing began in early 1991). Growth actually strengthened through the year and for 1996 was about 2.5 per cent higher than in 1995. The expansion was broadly based, but rising employment, higher real incomes, and rising consumer confidence meant that households' expenditure (up 2.5 per cent) was the main support. Nevertheless, business investment also rose strongly, encouraged by high capacity utilization, rising profits and confident expectations of continued growth. In contrast to western Europe, American business was also expanding its productive capacities as well as spending heavily on new technology. Strong domestic demand in the United States also gave a boost to the world economy in 1996, imports of goods and services rising nearly 6.5 per cent and creating a slight net drag on the domestic growth rate.

53. In many ways the performance of the Canadian economy last year was closer to that of western Europe than that of the United States: annual growth averaged some 1.5 per cent, rather less than in 1995; relatively weak labour markets and increased taxes held back the growth of personal disposable income, although consumption picked up to a large extent because of a steep fall in the savings ratio; and business fixed investment is also more concerned with rationalization than expanding capacities.

54. Despite the tighter labour markets and strong consumer demand in the United States and the United Kingdom, inflation rates in both countries remain subdued, and there were only sporadic signs of incipient inflationary pressures, although in late March 1997 the Federal Reserve considered that these were sufficient to justify a small increase in the federal funds rate. In continental Europe, inflation rates have continued to decelerate, and this development led to an easing of monetary policy in a number of countries; subsequent expectations

about the likely movement of interest rates in favour of United States and United Kingdom assets strengthened the dollar and the pound sterling against the continental currencies during much of the year, improving the export competitiveness of the continental economies. European rates of consumer price inflation continued to fall through most of 1996, and the average rate for the year as a whole was just under 2.5 per cent, its lowest rate in more than 30 years. Little change is expected in average rates of inflation in the near future: some slight increases might occur in the United States and the United Kingdom, but in the rest of Europe, a further deceleration would seem more likely than a rise.

55. Low rates - and weak expectations - of economic growth in western Europe have meant there was virtually no increase in the average level of employment. There was some creation of new jobs in the United Kingdom, especially in the second half of the year, and in some of the smaller economies, but in general the increases were less than in 1995. Most of the new jobs that were created were in services. But whereas in Europe the numbers in employment increased by just 0.3 per cent on average, in the United States job creation was still robust, rising by 1.4 per cent, despite still larger increases in the previous three years. Employment has also been rising more strongly in Canada than in Europe over the past three years, and last year the increase (1.3 per cent) was close to that of the United States, even though Canadian GDP growth was significantly lower.

56. Weak output and employment growth in western Europe mean that little progress has been made in reducing the persistently high rates of unemployment throughout the region. The average rate in 1996 was 10.3 per cent, somewhat higher than in 1995 and about the same as in 1993. In the four large economies it varied in 1996 from 8.2 per cent in the United Kingdom, the only one of the four where the rate fell, to 12.3 per cent in France. There were a few small reductions in some of the smaller economies, where unemployment rates ranged from 3 per cent in Luxembourg to over 20 per cent in Spain.

57. Despite the considerable deregulation of European labour markets in recent years, the weakness of demand and output growth continue to hold back any significant reduction in unemployment. The major exception to this is the United Kingdom where output has grown relatively strongly since early 1993. However, the prospects for any significant improvement in European unemployment are still rather poor. The stance of economic policy is dominated by concerns to meet the Maastricht criteria for general governmental budget deficits, and this implies tight fiscal policies in the coming year. Although monetary policy was loosened somewhat in 1996, it can still be expected to be kept relatively tight, given the ambitious targets for inflation now being set, as shown by the Bundesbank's decision to lower its target rate to 1.5 per cent. It may therefore still be some time before western European growth can rise again to rates that would bring about a significant reduction in unemployment.

Notes

[1] G. M. Milesi-Ferretti and A. Razin, "Sustainability of persistent current account deficits", NBER Working Paper No. 5467 (Cambridge, 1997).

[2] Based on trade data from the Commodity Trade Statistics Database of the United Nations Statistics Division (COMTRADE) for Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovakia, prepared for an ongoing study by the ECE secretariat. The analysis is based on the data for the exports of 19 OECD countries to their eastern European partners.

[3] D. T. Coe, E. Helpman and A. W. Hoffmaister, "North-south R&D spillovers", The Economic Journal, vol. 107, No. 440 (January 1977), pp. 134-149. Essentially, imports of capital and intermediate goods provide the importing country with access to the benefits of research and development in the country of origin. The more imports are sourced from high research and development countries and the higher the level of the human capital stock in the importing country, the greater these spillovers are likely to be.

[4] For example, ECE, Economic Survey of Europe in 1989-1990 (United Nations publication, Sales No. E.90.II.E.1), chap. 1; and Economic Survey of Europe in 1992-1993 (United Nations publication, Sales No. E.93.II.E.1), chap. 1.

[5] ECE, Economic Bulletin for Europe, vol. 43 (1991), pp. 9-10, and subsequent issues.

[6] ECE, Economic Survey of Europe in 1990-1991 (United Nations publication, Sales No. E.91.II.E.1), chap. 4.5, "Late starters": Bulgaria, Romania, pp. 164-168.

[7] D. Rodrik, "Understanding economic policy reform", Journal of Economic Literature, vol. XXXIV (March 1996), pp. 9-41.

[8] ECE, Economic Survey of Europe in 1992-1993, op. cit., p. 12.

[9] Life expectancy in five south-eastern European countries (Albania, Bulgaria, Romania, the former Yugoslav Republic of Macedonia and Croatia) in 1994 averaged 72 years, and in five CEFTA economies (Czech Republic, Hungary, Poland, Slovakia and Slovenia), 72.2 years. However, the difference between all the transition economies and the average for western Europe (76.8 years) is significant (on the basis of a t-test at the 5 per cent level of significance). Basic data taken from World Bank, World Development Report 1996 (Washington, D.C., 1996), table 1.

[10] That is, the difference between the means was significant at the 5 per cent confidence level for the t-test. The basic GDP data were also taken from World Bank, World Development Report 1996 (Washington, D.C., 1996), table 1. On the World Bank's classification, Albania falls in the category of "low income" countries in 1994 and is situated between the Central African Republic and Ghana; Bulgaria, the former Yugoslav Republic of Macedonia and Romania are all in the bottom half of the "lower-middle" income group and fall between Bolivia and Ecuador; Croatia is in the upper half of the "lower-middle"

income group and ranks above Poland and Slovakia; Bosnia and Herzegovina and Yugoslavia are not classified.

[11] Excluding Croatia and Yugoslavia, affected by the war, only reduces the average to 35 per cent.

[12] Although Romania had been a member of the International Monetary Fund since the 1970s.

[13] ECE, Economic Bulletin for Europe, vol. 43 (1991), pp. 9-10; and vol. 44 (1992), p. 8 and pp. 99-100; and ECE, Economic Survey of Europe in 1992-1993 (United Nations publication, Sales No. E.93.II.E.1), pp. 249-251.

[14] For a useful survey of progress in these areas, see European Bank for Reconstruction and Development Transition Report 1995 (London, 1995), table 2.1; and Transition Report 1996 (London, 1996), table 2.1, pp. 11-13.

[15] The warnings have not been ignored in the CIS. In Moldova, Deputy Prime Minister Ion Gutu has warned that in today's statistics Moldova resembles Bulgaria a year ago and stressed the need to undertake necessary reforms over the "next few months" (OMRI, Daily Digest, 26 March 1997). Prime Minister Larzarenko of Ukraine has also been quoted as saying that "the terrible Bulgarian lesson will not be repeated in Ukraine" (Financial Times, 13 March 1997).

[16] A. Casella and B. Eichengreen, "Can foreign aid accelerate stabilization?", The Economic Journal, vol. 106 (May 1996), pp. 605-619.
