

CHAPTER 4

THE TRANSITION ECONOMIES 1989-1999: FOREIGN TRADE AND PAYMENTS

4.1 Overview of current account developments

(i) Summary of recent developments

During much of 1999, most of the transition economies faced weak foreign demand. Russian imports remained depressed, and west European demand grew relatively slowly (although the pace picked up in the second half of the year). This situation and rising oil prices led to expectations of larger current account deficits. Concerns persisted about the availability of external financing, due to the continuing nervousness of the international markets and, in some cases, questions about the feasibility of national financial plans. In several countries constraints on access to external finance did tighten, causing national currencies to weaken. This and/or tight macroeconomic policies generally caused imports of goods and services to decline (more than that of exports), thus reducing current account deficits. In the European transition economies, the smaller current account imbalances and diminished capital inflows were generally associated with faltering output growth, especially in the first half of 1999.

Two major exceptions to this general picture are the unexpectedly large current account deficit in Poland, which raised the aggregate deficit of eastern Europe to \$20 billion (5.5 per cent of GDP), and the Russian current account surplus which is estimated to have reached a record of \$23 billion (table 4.1.1). The trade surplus surged as imports fell sharply, while export revenues stabilized thanks to the rebound in the international price of oil.

In the three *European CIS* members (Belarus, the Republic of Moldova and Ukraine), the scarcity of foreign funds caused a sharp contraction in their merchandise trade deficits (table 4.1.2)³²⁸ which swung their current accounts from deficit to surplus in 1999. Sizeable falls in exports, mainly to the Russian market, made this adjustment particularly painful. In *south-east Europe*, the already severe financing problems in several countries were compounded by the Kosovo conflict.

Initially this shock was expected to widen external imbalances and to deter foreign investment.³²⁹ Although the impact varied considerably, in most countries merchandise exports fell and service balances tended to deteriorate, with tourism in Croatia being especially affected. However, overall, the losses were smaller than had been feared and, in most cases, current account deficits actually declined (as did capital inflows).³³⁰ Bulgaria suffered the same external shocks, but unlike other countries in this group, its current account deficit increased substantially.³³¹ Albania and The former Yugoslav Republic of Macedonia earned higher revenues from services, presumably because of spending by Kosovar refugees and international relief workers. However, in Albania the current account deficit surged at the end of the year because of sharply reduced private transfers (although official transfers rose, as they also did in The former Yugoslav Republic of Macedonia).³³² In The former Yugoslav Republic of Macedonia revenues from services and official transfers, reflecting aid from the international community, rose considerably. Yugoslavia does not seem to have published its balance of payments for two years. Data for merchandise trade flows (table 3.1.2) suggest the persistence of trade deficits of around \$2 billion in 1998-1999, but it is not clear how they would have been financed.³³³

In *central Europe*, the anti-inflationary stance of macroeconomic policies tended to curtail current account deficits, which in general were easily financed. However, Hungary's deficit was halved, despite faster output growth, thanks to accelerating export growth. In Poland and Slovenia, buoyant internal demand resulted in much larger current account deficits, that of the former

³²⁹ UN/ECE, *Economic Survey of Europe, 1999 No. 2*, chap. 1.

³³⁰ On balance, the current account balances of Albania and The former Yugoslav Republic of Macedonia may even have benefited from the conflict.

³³¹ The increase in the current account deficit may be linked to the rise in domestic investment. In 1999, Bulgaria was assured of official funding, and FDI was buoyant despite the adverse external conditions.

³³² Official estimates indicate that the current account deficit of The former Yugoslav Republic of Macedonia also rose sharply at the end of 1999, but the components are not yet available.

³³³ Traditionally Yugoslavia has run a surplus on services, but not so large as to offset the merchandise trade deficits. However, China extended a \$300 million loan in 1999. Foreign exchange reserves are thought to have been exhausted for some time.

³²⁸ This section is based on national balance of payments statistics. Merchandise trade balances based on customs statistics are presented in section 4.2 and table 3.1.2.

TABLE 4.1.1
Current account balances of the transition economies, 1996-1999
(Million dollars, per cent)

							Per cent of GDP				
	1996	1997	1998	January-September		1999	1996	1997	1998	Jan.-Sept.	
				1998	1999					1999	1999
Eastern Europe^a	-13 498	-15 021	-17 468	-10 055	-12 498	-20 122	-3.8	-4.3	-4.6	-4.7	-5.5
Albania	-107	-272	-45	-79	-77	-155	-4.0	-11.9	-1.5	-2.9	-4.3
Bosnia and Herzegovina	-748	-1 060	-1 097	..	-1 341 ^b	..	-26.9	-31.7	-26.1	-39.7	..
Bulgaria	16	427	-61	161	-401	-663	0.2	4.2	-0.5	-4.5	-5.5
Croatia	-1 148	-2 343	-1 551	-901	-687	-1 443	-5.8	-11.5	-7.1	-4.5	-7.2
Czech Republic	-4 292	-3 211	-1 336	-549	-167	-1 058	-7.4	-6.1	-2.4	-0.4	-2.0
Hungary	-1 678	-981	-2 298	-1 336	-1 288	-2 076	-3.7	-2.1	-4.9	-3.6	-4.3
Poland	-1 371	-4 312	-6 858	-3 878	-7 994	-11 628	-1.0	-3.0	-4.4	-7.2	-7.5
Romania	-2 571	-2 137	-2 968	-1 818	-634	-1 303	-7.3	-6.1	-7.2	-2.9	-3.8
Slovakia	-2 098	-1 952	-2 059	-1 542	-791	-1 074	-11.2	-10.0	-10.1	-5.6	-5.7
Slovenia	39	37	-4	51	-431	-581	0.2	0.2	-	-2.9	-3.0
The former Yugoslav											
Republic of Macedonia	-288	-276	-288	-163	-28	-140	-6.5	-7.5	-8.2	-1.1	-4.1
Yugoslavia	-1 317	-1 837	-1 700*	..	..	..	-8.2	-9.3	-10.2*	..	..
Baltic states	-1 400	-1 890	-2 489	-1 693	-1 444	..	-8.1	-9.5	-11.1	-8.8	..
Estonia	-398	-563	-478	-376	-138	..	-9.1	-12.2	-9.2	-3.6	..
Latvia	-279	-345	-713	-419	-461	..	-5.4	-6.1	-11.1	-9.7	..
Lithuania	-723	-981	-1 298	-898	-845	..	-9.2	-10.2	-12.1	-10.8	..
CIS	6 497	-2 233	-5 273	-10 070	12 991	..	1.2	-0.4	-1.4	6.7	..
Armenia	-291	-307	-390	-240	-184	-247	-18.2	-18.8	-20.6	-14.7	-13.4
Azerbaijan	-931	-916	-1 365	-945	-728*	..	-29.2	-23.1	-33.1	-25.4	..
Belarus	-516	-788	-862	-719	-30	-80 ^c	-3.8	-5.9	-7.5	-0.4	-0.7 ^c
Georgia	-275	-375	-416	-264	-10*	..	-6.6	-7.6	-8.5	-0.5	..
Kazakhstan	-751	-794	-1201	-667	-420	-286	-3.6	-3.6	-5.4	-3.4	-1.8
Kyrgyzstan	-425	-138	-371	-233	-104	-210 ^c	-23.7	-7.8	-23.2	-12.1	-17.3 ^c
Republic of Moldova	-198	-285	-347	-293	-10	-40 ^c	-11.9	-14.8	-20.4	-1.2	-3.5 ^c
Russian Federation	12 116	3 924	2 056	-4 438	14 579	23 000*	2.9	0.9	0.7	11.2	12.7*
Tajikistan	-70	-56	-107	..	-54	-29	-6.7	-6.1	-8.1	-7.5	-2.7
Turkmenistan	2	-580	-934	-805	-550*	..	0.1	-21.6	-34.2	-24.4	..
Ukraine	-1 184	-1 335	-1 296	-1 467	767	1 200 ^c	-2.7	-2.7	-3.1	3.3	3.9 ^c
Uzbekistan	-980	-584	-39	..	-265	..	-7.1	-4.0	-0.3	-2.4	..
Total above^a	-8 401	-19 145	-25 230	-21 818	-951	..	-0.9	-2.1	-3.2	-0.2	..
Memorandum items:											
CETE-5	-9 400	-10 420	-12 555	-7 254	-10 671	-16 418	-3.3	-3.7	-4.2	-4.9	-5.6
SETE-7^a	-4 098	-4 602	-4 914	-2 800	-1 827	-3 704	-5.7	-6.4	-6.0	-3.6	-5.1
Asian CIS	-3 721	-3 750	-4 824	-3 153	-2 315	..	-7.6	-7.1	-9.1	-7.0	..
Three European CIS ^d	-1 898	-2 408	-2 505	-2 480	727	1 080 ^c	-3.2	-3.7	-4.6	2.3	2.5 ^c

Source: National balance of payments statistics; press reports; IMF, UN/ECE secretariat estimates.

^a Excludes Bosnia and Herzegovina and Yugoslavia.

^b The methodology of the central bank of Bosnia and Herzegovina may differ from that used by the IMF for its 1996-1998 estimates.

^c Extrapolation of January-September trends.

^d Belarus, Republic of Moldova and Ukraine.

rising to nearly \$12 billion.³³⁴ A fall in exports seems to have checked the *Baltic states'* rapid economic expansion, which in turn led to sharply reduced imports. In consequence the persistent growth of their current account deficits slackened. Thus, for the time being, the

question whether the long-term appreciation of real exchange rates (at least in Latvia and Lithuania) has encouraged the growth of current account deficits has receded. Current balance of payments data for the *Asian CIS* have only recently started to become available and they still remain fragmentary. Together with customs trade data they suggest a general fall in current account deficits in 1999.

In 1999, improvements in the current account balances of most east European and Baltic countries were generally due to the fall of *merchandise trade* deficits, which stemmed from sharp declines in imports. In

³³⁴ Much of the worsening in the current account deficit of Poland is due to the \$2.3 billion reduction in the surplus generated by "unclassified current account items". These net receipts are associated with unrecorded cross-border trade and the conversion of the remittances of Poles working abroad at local exchange bureaux. Losses from the former item reflect in part the financial difficulties in the CIS and the strong depreciation of the Russian rouble after August 1998.

TABLE 4.1.2

Current account balances, by country group and composition,
1990-1999
(Billion dollars)

	1990	1993	1995	1997	1998	1999 ^a
Eastern Europe^b						
Current account	-6.2	-7.9	-1.7	-15.0	-17.5	-20.1
Merchandise	-5.8	-10.5	-14.6	-28.4	-29.9	-27.5
Services	1.5	3.0	5.4	6.6	5.2	3.2
Income	-5.8	-5.3	-3.1	-3.3	-4.3	-4.3
Transfers	3.3	2.7	3.5	4.1	5.5	4.9
Unclassified ^c	0.6	2.2	7.2	6.0	6.0	3.6
CETE-5						
Current account	0.5	-6.3	1.8	-10.4	-12.6	-16.4
Merchandise	0.6	-7.3	-9.2	-20.7	-21.7	-21.0
Services	1.5	2.2	4.7	5.0	3.6	1.5
Income	-5.1	-4.8	-2.4	-2.7	-3.4	-3.4
Transfers	3.0	1.4	1.5	1.9	3.0	2.8
Unclassified ^c	0.6	2.2	7.2	6.0	6.0	3.6
SETE-7^b						
Current account	-6.7	-1.6	-3.5	-4.6	-4.9	-3.7
Merchandise	-6.4	-3.2	-5.4	-7.7	-8.2	-6.5
Services	0.0	0.7	0.6	1.6	1.6	1.6
Income	-0.7	-0.5	-0.7	-0.7	-0.9	-0.9
Transfers	0.3	1.3	2.0	2.2	2.5	2.1
Baltic states						
Current account .....	..	0.4	-0.8	-1.9	-2.5	-2.2
Merchandise .....	..	-0.3	-1.9	-3.1	-3.8	-3.2
Services .....	..	0.3	0.8	1.1	1.1	1.1
Income .....	..	-	-	-0.3	-0.3	-0.4
Transfers .....	..	0.3	0.3	0.4	0.5	0.4
CIS						
Current account .....	..	10.7	4.7	-2.2	-5.3	20.6
Merchandise .....	..	12.5	16.5	9.1	9.2	30.8
Services .....	..	-1.0	-9.1	-3.1	-3.0	-2.2
Income .....	..	-2.4	-4.1	-9.6	-12.7	-9.9
Transfers .....	..	1.6	1.3	1.3	1.3	1.9
Three European CIS^d						
Current account .....	..	-1.4	-1.7	-2.4	-2.5	1.1
Merchandise .....	..	-2.4	-3.4	-5.9	-4.3	-0.7
Services .....	..	0.9	1.6	3.2	1.8	1.9
Income .....	..	-0.1	-0.5	-0.7	-0.9	-1.0
Transfers .....	..	0.2	0.6	1.0	1.0	0.9
Asian CIS						
Current account .....	..	-0.8	-1.4	-3.7	-4.8	-3.5
Merchandise .....	..	-0.7	-0.5	-2.3	-3.9	-2.7
Services .....	..	-0.5	-1.3	-1.6	-1.4	-1.3
Income .....	..	-0.1	-0.2	-0.4	-0.2	-0.3
Transfers .....	..	0.5	0.7	0.6	0.7	0.8
Russian Federation						
Current account	-6.3	12.8	7.7	3.9	2.1	23.0*
Merchandise	-0.3	15.6	20.5	17.4	17.4	33.2
Services	-2.0	-1.4	-9.4	-4.6	-3.3	-2.0*
Income	-4.0	-2.3	-3.4	-8.5	-11.6	-8.5*
Transfers .....	..	0.9	0.1	-0.4	-0.4	0.2*

Source: National statistics and direct communications from national statistical offices to UN/ECE secretariat.

^a Reported full year data for eastern Europe. Extrapolation of January-September trends for the other areas.

^b Excludes Bosnia and Herzegovina and Yugoslavia.

^c Poland: unclassified current account transactions.

^d Belarus, Republic of Moldova and Ukraine.

central Europe the surplus on *total services* fell because of the near doubling of the deficit on "other services", mostly business services related to the marketization of the transition economies (see below). By contrast, in Russia the deficit in services continued to decline in 1999, thanks to higher net earnings from transport and a smaller deficit on other services. There was little change in the deficits of *investment income* except for a sharp increase in the Baltic states and a \$3 billion fall in net payments reported by Russia. *Transfers* generally decreased in 1999, in contrast to their more or less steady growth in previous years.

(ii) Current account balances since 1990

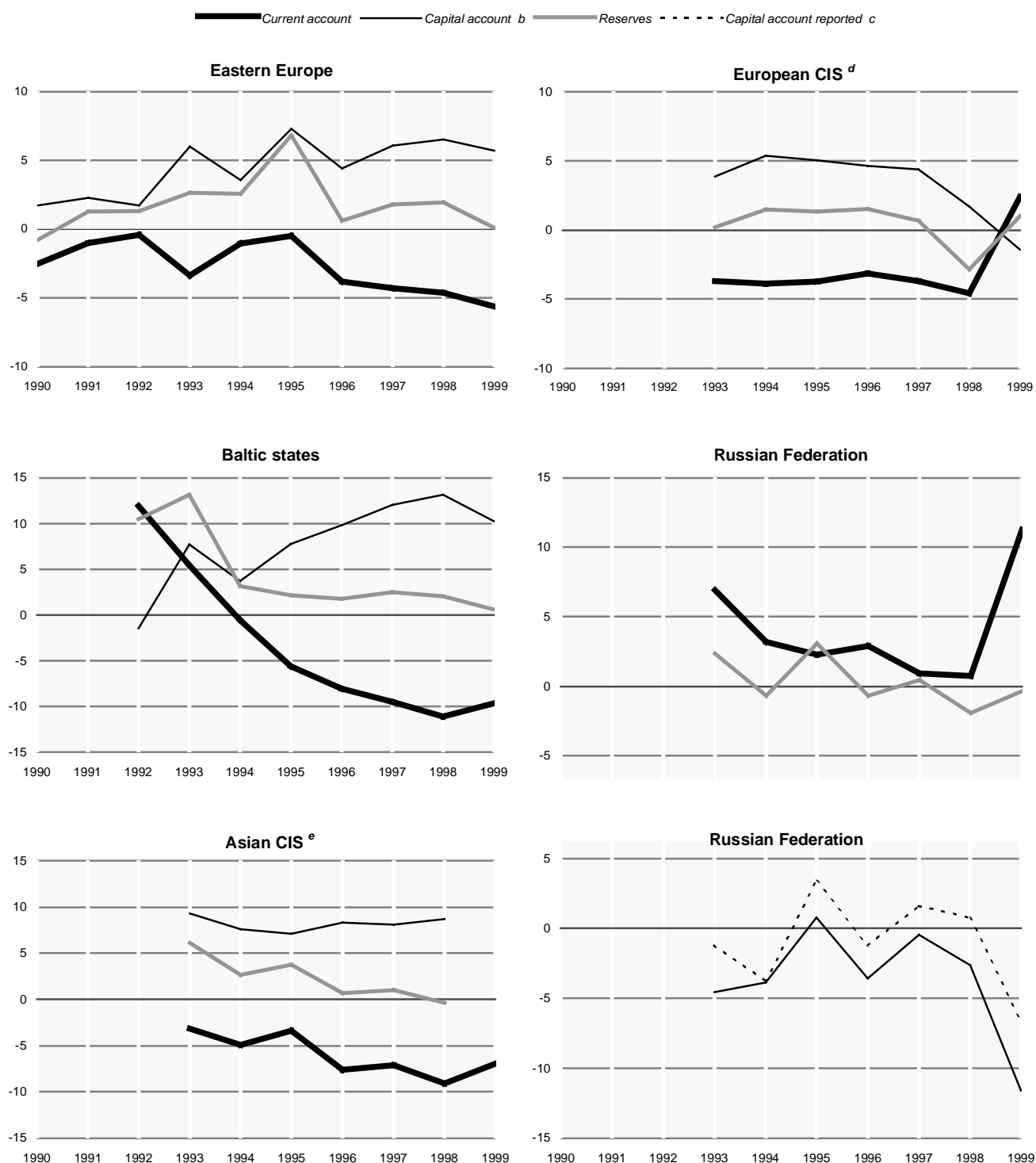
Except for Russia, the aggregate current account balances of the groups of transition countries have deteriorated more or less steadily since the early 1990s (chart 4.1.1 and table 4.1.2). While the main reason has been the growth of merchandise trade deficits, imbalances have also increased on the income account, a consequence of rising indebtedness and profit repatriation. In most cases services have been in surplus (but not in the Asian CIS). In broad terms, the development of trade in services partly reflects the "normalization" of this sector after its neglect under the centrally planned system and the lifting of restrictions on cross-border activities. In central and south-east Europe the surplus on services increased during most of the decade, boosted by higher earnings from tourism and transport.³³⁵ However, in central Europe this upward trend was reversed in 1998, due to rising expenditures on various business services (other services) associated with deepening marketization. Early in the 1990s the central European countries ran a substantial surplus on this item, but since 1996 there has been a growing deficit. These changes suggest that central Europe can no longer count on additional net earnings from services to partially offset any further increases in their merchandise trade deficits. The Baltic states have benefited from transit trade and increased tourism (including "shopping tourism"). Transfers, mainly of workers' remittances and official aid, have been positive in virtually all the transition economies and in some cases remain a major source of financing.

The steady growth of the aggregate current account deficit in eastern Europe reflects the interaction of long-term growth and structural factors, external shocks and domestic policies. West European import demand has been largely supportive of the transition economies' export growth (except, especially, in 1993 and in 1996). On the other hand, structural domestic factors seem to explain the frequent cases of disappointing export performance,³³⁶ while trade liberalization has promoted the growth of imports of goods and services. The rapid

³³⁵ This reflects the development of tourism in the Czech Republic and Hungary and the recovery of the sector in Croatia and Slovenia.

³³⁶ This is reflected in the persistently weak export performance of several countries, even in periods when external market conditions have been favourable.

CHART 4.1.1
Balance of payments of the transition economies, 1990-1999 ^a
(Per cent of GDP)



Source: UNECE secretariat, based on national balance of payments statistics.

^a January-September.

^b Including errors and omissions.

^c Excluding errors and omissions for the Russian Federation.

^d Belarus, Republic of Moldova and Ukraine.

^e Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan.

expansion of expenditures on business services, an area in which the transition economies have only recently started to build capacity, is a case in point. In several cases, macroeconomic policies have temporarily exacerbated imbalances, with corrections eventually being made as a result of policy measures and/or adjustments triggered by crises.³³⁷ However, except for Poland (since 1996), no country has experienced a sustained deterioration of the current account.

In the early 1990s the current account deficit of eastern Europe was small (chart 4.1.1), the result of falling domestic economic activity, real exchange rate devaluations engineered at the beginning of the transition and shortages of external finance (section 4.5). In 1996 there was a major deterioration in the current account balances of most countries (including the Baltic states). In part it is explained by the slowing of western import demand, but there was no correction when the pace picked up in 1997. The worsening of imbalances was particularly acute in the Czech Republic,³³⁸ Poland, Romania and Slovakia. The large current account deficits which emerged in several countries around 1996 continued until the correction in 1999.

The current account deficits of the *Baltic states* had grown steadily during the decade, peaking at 11 per cent of GDP in 1998. Among the explanations for this development are real exchange rate appreciation³³⁹ and, in the case of Lithuania, long-standing expansionary fiscal policies.

These current account deficits have an important bearing on prospects for economic growth and convergence with western Europe (chapter 5). The deficits reflect a net transfer of resources from abroad which has helped to buoy domestic economic activity. In other words, in the absence of the deficits growth would have been even less than it was. The concern is that current account deficits, especially those financed largely by foreign debt may not be sustainable. However, reducing them could lower growth prospects. Deficits can be a normal part of the development process, but the key is to distinguish between good deficits and bad deficits. The former will use foreign borrowing to invest in productive assets which will eventually produce a return to service and pay off the debt – or produce profits for repatriation by foreign direct investors. Bad deficits are used for consumption and lead eventually to default. To reduce the risks of unsustainable current account deficits, foreign

direct investment (largely non-debt creating flows) is preferred to debt finance. Since 1997, the risks associated with development based on short-term finance have become more widely appreciated (although a proportion of it performs useful functions in trade financing, etc.).

In Russia the current account has been in surplus since the beginning of the decade, although for short periods (e.g. when oil prices plummeted in 1998) it has swung into deficit. Typically Russia has run a trade surplus (table 4.1.2), but there have been deficits on the net factor income account (due to large interest payments on an increasing external debt) and in services. The services deficit peaked in 1995 when expenditure on tourism (believed to reflect largely the so-called shuttle trade) soared.

4.2 Merchandise trade

(i) Exports

(a) East European and Baltic economies

In 1999, the dollar value of exports³⁴⁰ from the east European and Baltic countries fell by some 2 per cent, after five years of continuous expansion (table 3.1.2).³⁴¹ In volume, performance was somewhat better: according to ECE secretariat estimates, real exports increased moderately, by some 1-2 per cent above their 1998 level. Dollar unit values of exports declined by 3-4 per cent on average and the terms of trade worsened, partly because the world market prices of major international commodities, except for energy and non-ferrous metals, fell, while the average dollar prices of manufactured goods exported by European countries remained unchanged.³⁴²

The Russian crisis was a significant shock, particularly to the three Baltic states, while the economies of south-eastern Europe were adversely affected by the Kosovo conflict and the blockage of the Danube river. The slump in aggregate demand in a number of transition economies and increased protectionism across the region, particularly in the agricultural and food sectors, depressed intraregional trade.³⁴³ Finally, the slow recovery of import demand in

³⁴⁰ The analysis below is based on customs data for merchandise trade, which differ (considerably in the case of Poland and a few other countries) from the balance of payments statistics of trade in goods.

³⁴¹ It must be emphasized that trade statistics denominated in current dollars tend to understate the export performance of transition economies in 1999 because an overwhelming proportion of their trade is conducted with countries whose currencies depreciated strongly against the dollar in 1999: the euro, for instance, depreciated by some 13 per cent in 1999.

³⁴² In 1999, world raw material prices (*excluding* energy) were some 8 per cent below their 1998 level; food prices shrank by nearly 19 per cent and prices for industrial and agricultural raw materials declined by 2 and 1 per cent, respectively (Hamburg Institute of Economic Research (HWWA), direct communication). In the first nine months of 1999, average export unit values for European manufactured goods were some 0.7 per cent above their level of a year earlier. United Nations, *Monthly Bulletin of Statistics*, Vol. 53, No. 12, December 1999.

³⁴³ The import barriers introduced in some CEFTA and BAFTA states were blamed for shrinking intraregional trade in agricultural products and

³³⁷ For example, in Hungary a strong fiscal stimulus resulted in a large current account deficit in 1993, which was eventually curtailed by a tough austerity programme.

³³⁸ In the Czech Republic and Poland, surges in capital inflows contributed to the worsening of current account balances. In the Czech Republic this process had already emerged in 1993 and continued until the koruna crisis in 1997. UN/ECE, "Surges in capital flows into eastern Europe, 1990-1996", *Economic Bulletin for Europe*, Vol. 49, 1997.

³³⁹ UN/ECE, *Economic Survey of Europe, 1999 No. 1*, pp. 165-178.

western Europe, especially in the first half of 1999, and increased competition in these markets from cheaper imports from the Asian countries, also contributed to the weak export growth of eastern Europe and the Baltic states.

The deterioration of the competitive position of the east European and Baltic exporters on their major markets was quite pronounced. The price and cost competitiveness of Baltic exports was severely affected, and not only in eastern markets. This was particularly true for Lithuania, whose currency (the litas) is pegged to the dollar. According to the respective national banks' estimates, in January-September 1999 the real effective exchange rates of Latvia and Lithuania appreciated by 25-35 per cent (year-on-year), and that of Estonia by 11 per cent. The significant depreciation of the rouble against their currencies, coupled with their still high exposure to CIS markets, played an important part in this large appreciation. In the central European countries with more flexible exchange rate arrangements, often linked to the deutsche mark or the euro, and whose exports are much less exposed to the rouble zone, domestic currencies in general depreciated or remained broadly unchanged in real effective terms as compared with 1998.³⁴⁴ For these economies, the development of unit labour costs became an increasingly important factor in their competitive positions (see chapter 3.4 above). The steady rise in real wages, often exceeding productivity gains, made it increasingly difficult for exporters to price their goods competitively (in spite of favourable exchange rates) without accepting serious cuts in their profit margins.³⁴⁵

Summary statistics on the trade repercussions of these and other factors up to the fourth quarter of 1999 are shown for major subregions and for selected east European and Baltic countries in tables 4.2.1-4.2.4 and charts 4.2.1-4.2.2. These data show a considerable contraction not only in exports to the CIS and other transition economies, but also a notable deceleration of exports to the developed market economies, which in some cases is far greater than the slowdown of overall import demand in these countries (table 4.2.4, chart 4.2.3). Although there was some recovery of exports in the second half of 1999, and particularly in the fourth quarter, in a number of east

European and Baltic countries, as west European demand became stronger and the situation in Russia stabilized, this was not sufficient to offset the losses in the early part of the year (for annual growth rates of major subregions and individual countries, see table 3.1.2 above).³⁴⁶

While poor export performance was characteristic of eastern Europe and the Baltic states, the variance among countries was also substantial (see table 3.1.2 for export value growth and table 4.2.3 for changes in volume in selected countries). Exports increased, albeit by less than a year earlier, in the Czech Republic and Hungary, with distinct pick-ups in the third and fourth quarters of 1999 (their growth would have probably been much stronger if Germany, their major trade partner, had not been so slow to recover). Strong export growth in the last quarter of 1999 helped to raise total export revenues slightly above their 1998 value also in Romania, while in Albania and Bosnia and Herzegovina there was rapid growth throughout 1999.³⁴⁷ In all other countries, exports declined, most notably in Lithuania (by 21 per cent). In the Baltic states, the declines in total exports were due to the large fall in trade with their eastern neighbours, as their exports to the EU grew by 7-8 per cent (wood and base metals accounting for more than half of this increase). Croatia, Poland,³⁴⁸ Slovakia and Slovenia all reported 3-6 per cent declines in total export value, due primarily to substantial falls – of 40-60 per cent – in their trade with the CIS combined with unchanged (or declining) exports to the EU. The poor performance of the latter three countries on the EU markets in the second half of 1999 – particularly if compared with Czech and Hungarian exports – seems to be partly determined by the higher proportion of low value added goods in their exports. For 1999 as a whole Bulgaria's exports fell across the board in value, including trade with the EU, but there was a pick-up in exports to the latter market and an even stronger one to the neighbouring Balkan countries and Slovenia in the second half of 1999. As in Romania, increasing exports of raw materials, fuels and some machinery were behind this end-year recovery; however, the strong Bulgarian lev (currently pegged to the euro), probably slowed somewhat the growth in its exports to the EU as compared to Romania (table 4.2.4).

foodstuffs by the Hungarian Ministry of Economy as well as by Estonian and Lithuanian authorities.

³⁴⁴ An important factor for the level of real effective exchange rates in these countries in 1999, and for their international price competitiveness, was the deepening depreciation of the euro against the dollar. The external exchange rate environment supported an improvement of their competitiveness in relation to trading partners attached to the dollar, but it did little to improve their competitive position with respect to the EU countries. For medium-term trends in the behaviour of the real effective exchange rates, see chart 3.2.3 above.

³⁴⁵ In Poland, for instance, even with the help of a real depreciation of the zloty in terms of changes in unit labour costs, the financial position of exporters in general worsened. At the end of the second quarter, their pre-tax margins had dropped 1.9 points from the corresponding period of 1998. Exporters in manufacturing fared slightly better – a drop of 1.6 points, year-on-year – and enjoyed an improvement in their financial position compared with the previous quarter. National Bank of Poland Monetary Policy Council, *Inflation Report*, III Quarter (Warsaw), December 1999, p. 49.

³⁴⁶ This pick-up in exports in the third and fourth quarters of 1999 was more pronounced on a year-on-year basis because of low export values registered in the immediate aftermath of the Russian default in August 1998. If compared with the average quarterly values in the previous two to three years, east European and Baltic exports in the third and fourth quarters of 1999 remained at nearly the same levels or were even slightly below.

³⁴⁷ Due to frequent revisions and apparent differences in the area coverage used by customs authorities, the reported rates of export value growth (some 30-50 per cent) in these two countries should be regarded with some caution.

³⁴⁸ There are considerable discrepancies between Polish trade data published by the Polish statistical office and the national bank, the latter indicating a much larger decline in merchandise exports (by some 12 per cent), including those destined for the EU markets. In contrast, the mirror data (Eurostat figures on EU imports from Poland) show a steady positive trend in January-September 1999. For a discussion, see SG Warsaw, *Weekly Financial Market Review*, 28 January 2000 and *Rzeczpospolita*, 7 January 2000 (Warsaw).

TABLE 4.2.1
Foreign trade of the ECE transition economies, by direction, 1997-1999
(Value in billion dollars, growth rates in per cent)^a

Country or country group ^b	Exports				Imports			
	Value 1998	Growth rates			Value 1998	Growth rates		
		1997	1998	1999 ^c		1997	1998	1999 ^c
Eastern Europe, to and from:								
World	112.9	5.3	9.3	-2.1	150.4	6.0	9.1	-3.9
ECE transition economies	26.2	6.6	-5.2	-21.4	28.8	0.2	-4.1	-10.4
CIS	3.9	14.3	-24.9	-48.1	8.7	-3.6	-16.9	-14.7
Baltic states	0.4	27.2	9.3	-3.4	0.1	0.3	20.8	41.9
Eastern Europe ^d	16.2	2.2	2.9	-9.4	13.8	3.8	4.6	-8.2
Developed market economies	79.8	6.8	16.8	4.9	107.3	7.7	13.2	-1.8
European Union	73.5	6.5	17.2	4.5	93.9	7.0	14.1	-1.5
Developing economies	6.9	-10.5	-6.6	-4.2	14.3	8.5	9.6	-5.8
Baltic states, to and from:								
World	8.8	23.1	3.4	-13.2	13.8	26.7	7.5	-16.7
ECE transition economies	3.7	19.1	-13.1	-37.8	4.3	14.9	-2.9	-13.6
CIS	2.3	19.4	-23.4	-54.7	2.7	9.2	-11.3	-16.8
Baltic states	1.2	25.1	11.8	-10.3	0.8	23.2	19.8	-9.5
Developed market economies	4.7	26.5	21.0	7.8	8.6	32.8	13.7	-18.0
European Union	4.2	24.5	20.1	8.0	7.4	30.5	12.0	-18.4
Developing economies	0.3	45.4	14.7	-7.7	0.8	48.9	7.0	-20.2
Russian Federation, to and from:								
World	71.3	-0.1	-16.2	-8.2	43.5	15.2	-17.9	-40.7
Intra-CIS	13.7	4.6	-17.9	-29.9	11.3	-2.2	-20.9	-38.9
Non-CIS economies	57.6	-1.2	-15.8	-3.0	32.3	23.2	-16.8	-41.4
ECE transition economies	10.4	6.0	-21.9	-8.7	3.9	34.4	-27.7	-53.7
Baltic states	2.3	17.4	-28.0	4.6	0.7	61.9	-33.4	-63.6
Eastern Europe	8.2	3.0	-20.0	-12.2	3.2	29.2	-26.3	-51.6
Developed market economies	34.6	-0.2	-13.8	-6.7	22.0	24.1	-17.0	-40.9
European Union	23.2	2.4	-17.1	-5.1	15.7	23.4	-19.6	-38.3
Developing economies	12.6	-9.0	-15.8	12.5	6.4	13.0	-7.8	-35.6
Other CIS economies, to and from:								
World	31.6	3.5	-12.9	-10.8	37.2	2.9	-8.7	-22.0
Intra-CIS	13.7	-3.2	-22.0	-30.0	19.1	-3.7	-14.3	-20.9
Russian Federation	10.2	-2.5	-18.6	..	15.2	0.2	-13.3	..
Non-CIS economies	17.9	10.8	-4.4	5.2	18.1	12.3	-1.9	-23.0
ECE transition economies	2.9	-8.3	2.3	..	3.2	13.2	-7.4	..
Baltic states	0.8	-27.4	29.1	..	0.8	27.1	-11.4	..
Eastern Europe	2.1	-1.2	-5.1	..	2.5	9.5	-6.1	..
Developed market economies	8.1	21.5	8.3	..	10.2	22.1	0.5	..
European Union	5.9	23.0	11.8	..	7.6	22.2	2.1	..
Developing economies	6.8	29.6	-18.1	..	3.9	4.4	-5.1	..
ECE transition economies, to and from:								
World	229.1	3.8	-3.4	-5.6	253.7	8.6	0.4	-14.4

Source: National statistics and direct communications from national statistical offices to UN/ECE secretariat; for the Russian Federation, State Customs Committee data; for other CIS economies, CIS Interstate Statistical Committee data.

Note: There were changes in the methodology of foreign trade reporting in several economies in transition in 1996-1998. In 1998, Slovakia began reporting foreign trade flows according to the new methodology (including imports for inward processing and exports after processing). The Czech Republic has recently revised its export and import figures back to 1994. However, these revisions are not reflected in the eastern Europe aggregate above because revised data by destination are not yet available. For details on prior-1998 changes see UN/ECE, *Economic Bulletin for Europe*, Vol. 48, 1996 and Vol. 49, 1997.

^a Growth rates are calculated on dollar values.

^b "Eastern Europe" refers to Albania, Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia. For lack of adequate data, the trade of Bosnia and Herzegovina, The former Yugoslav Republic of Macedonia and Yugoslavia is not covered. The partner country grouping has been revised recently (subsequent changes back to 1980 were made also in appendix table B.13) following the changes in the national statistical sources. Thus, the earlier reported "Transition economies" group is now replaced by "ECE transition economies", which covers the east European countries, including the successor states of the former SFR of Yugoslavia, the Baltic states and the CIS. "Developed market economies" excludes Turkey and includes Australia, New Zealand and South Africa.

^c January-September over same period of 1998. For Slovakia data are derived from export and import data reported according to the new methodology.

^d Including Bosnia and Herzegovina, The former Yugoslav Republic of Macedonia and Yugoslavia.

TABLE 4.2.2
Trade balances of the ECE transition economies, 1994-1999
(Billion dollars)

	1994	1995	1996	1997	1998	January-September	
						1998	1999
Eastern Europe^a							
World	-12.1	-19.9	-31.9	-34.6	-37.5	-25.3	-22.8
ECE transition economies	-2.0	-3.2	-3.9	-2.4	-2.5	-1.1	-3.2
Developed market economies	-9.8	-15.1	-24.1	-26.5	-27.5	-18.7	-14.4
European Union	-5.9	-10.6	-18.0	-19.6	-20.4	-13.5	-10.0
Developing economies	-0.3	-1.5	-3.9	-5.7	-7.5	-5.5	-5.1
Baltic states^b							
World	-0.9	-2.2	-3.2	-4.3	-5.0	-3.7	-2.9
ECE transition economies	-	-0.5	-0.3	-0.2	-0.6	-0.3	-1.0
Developed market economies	-0.8	-1.6	-2.6	-3.7	-3.9	-3.0	-1.6
European Union	-0.4	-1.4	-2.2	-3.1	-3.2	-2.5	-1.2
Developing economies	-0.1	-0.1	-0.3	-0.5	-0.5	-0.4	-0.3
Russian Federation^c							
World	24.6	31.5	39.1	32.0	27.7	16.2	26.8
Intra-CIS	3.8	0.9	1.3	2.4	2.4	1.0	1.5
Non-CIS economies	20.9	30.6	37.7	29.6	25.3	15.2	25.3
ECE transition economies	4.3	5.5	8.6	8.0	6.6	4.5	5.6
Eastern Europe	3.3	4.3	6.6	5.9	5.0	3.5	4.1
Developed market economies	12.8	15.6	18.8	13.6	12.6	7.2	13.0
European Union	6.9	8.4	11.5	8.4	7.5	4.0	8.2
Developing economies	3.8	9.4	10.3	8.0	6.2	3.5	6.6
Other CIS economies							
World	-1.3	-2.1	-4.5	-4.5	-5.6	-4.1	-0.5
Intra-CIS	-2.6	-4.0	-5.1	-4.8	-5.5	-3.4	-3.7
Non-CIS economies	1.3	1.8	0.5	0.3	-0.2	-0.7	3.1
ECE transition economies	0.4	0.1	0.1	-0.7	-0.4	..	..
Eastern Europe	0.2	-0.2	-0.1	-0.4	-0.4	..	..
Developed market economies	-0.6	-0.7	-2.3	-2.7	-2.1	..	..
European Union	-0.3	-0.6	-1.8	-2.2	-1.7	..	..
Developing economies	1.5	2.4	2.5	4.2	2.9	..	..

Source: National statistics and direct communications from national statistical offices to UN/ECE secretariat.

Note: There were changes in the methodology of foreign trade reporting in several economies in transition in 1996-1999. In 1998, Slovakia began reporting foreign trade flows according to the new methodology (including imports for inward processing and exports after processing). The Czech Republic has recently revised its export and import figures back to 1994. However, these revisions are not reflected in the eastern Europe aggregate above because revised data by destination are not yet available. For details on prior-1998 changes see UN/ECE, *Economic Bulletin for Europe*, Vol. 48, 1996 and Vol. 49, 1997.

^a Trade balances as from 1996 are derived from export and import data reported by Hungary according to the new methodology and those for January-June 1998 are derived from export and import data reported by Slovakia according to the new methodology.

^b Trade balances as from 1995 are derived from export and import data reported by Lithuania according to the new methodology.

^c For the Russian Federation: State Customs Committee data for 1994-1999.

There were some pronounced changes in the direction and composition of trade, mainly reflecting developments in external demand in the second half of 1998. However, these are not all captured yet in the available data, and their longevity has yet to be seen. Exports to the EU increased between the second half of 1998 and the fourth quarter of 1999 both in absolute terms and as a share of total exports of the region, but growth in dollar value terms was rather sluggish and much less than in 1998.³⁴⁹

³⁴⁹ In the third quarter of 1999, the EU accounted for 70 per cent of the total exports of central European countries (CETE-5) and some 57 per cent of those of the south-east European region and of the Baltic states. The structure of Baltic exports changed considerably (an 11 percentage point gain for the EU) which, however, largely reflected the considerably diminished exports to the CIS (a loss of 14 percentage points). Currently, Hungary, Poland and the Czech Republic are the most dependent on the

Thus the gains in the EU market share in the first half of 1999 (based on the "mirror" statistics reflecting extra-EU imports) was marginal (table 4.2.4). At the same time, the value and the share of exports going to Russia and other CIS countries fell as a result of the falling rouble and the recession in that region; moreover, many east European and Baltic food exports were crowded out of the Russian market by subsidized food supplies from the EU and the United States, in part under special food-aid agreements with the Russian authorities.³⁵⁰ Exports to

EU market: 76, 70 and 69 per cent, respectively, of their total exports going to the EU.

³⁵⁰ In January-October 1999, for instance, the share of meat and meat products delivered by the EU and the United States under these agreements accounted for 20 per cent of total meat imports in Russia from non-CIS countries. Over the same time, the meat and meat product

TABLE 4.2.3
Changes in the volume of foreign trade in selected transition economies, 1996-1999
(Per cent)

	Exports						Imports					
	1996	1997	1998	1999 ^a			1996	1997	1998	1999 ^a		
				Jan.-Mar.	Jan.-Jun.	Jan.-Sept.				Jan.-Mar.	Jan.-Jun.	Jan.-Sept.
Czech Republic	2.7	14.2	14.4	-2.3	4.6	5.7	10.7	7.6	8.5	1.2	3.0	2.9
Hungary	4.6	29.9	22.1	12.1	11.3	12.9	5.5	26.4	24.9	12.6	12.2	12.5
Transition economies	-0.2	25.2	4.7	-21.2	-20.3	-14.6	2.8	5.3	12.1	1.7	3.6	3.6
European Union	5.7	33.6	24.1	16.9	16.1	17.4	4.0	29.7	23.8	15.9	13.6	13.7
Poland ^b	9.7	13.7	2.3	-7.4	-3.7	-2.1	28.0	22.0	14.3	-2.2	-0.6	0.6
Transition economies	29.0	35.8	-5.0	-33.1	-27.5	-20.1	19.3	13.5	12.6	0.1	4.0	4.8
European Union	5.7	11.9	8.5	0.7	3.9	3.3	27.3	25.2	16.2	-1.1	-0.1	0.6
Slovenia ^c	-1.1	11.9	8.1	5.8	3.6	3.8	0.3	10.5	11.3	2.6	5.8	8.5
Estonia	6.7	51.1	9.6	-10.0	-8.6	-4.0	..	..	9.5	-17.6	-20.0	-18.1
Latvia	8.8	20.1	10.2	-8.2	-8.6	-4.9	..	..	21.3	-5.4	-6.4	-4.9
Russian Federation	0.1	1.8	-0.3	18.1	17.2	14.1	-1.9	21.1	-11.0	-37.5	-29.0	-21.9
Non-CIS	3.6	1.8	-0.6	25.4	21.3	15.9	-0.1	31.7	-8.4	-39.1	-30.4	-24.6
CIS	-15.6	1.9	0.8	-6.3	1.5	7.4	-6.2	-1.8	-18.4	-32.7	-25.8	-14.2

Source: UN/ECE secretariat calculations, based on national foreign trade statistics.

^a Over same period of 1998.

^b Changes in volumes for 1998 are based on growth rates of trade value according to the previous customs declaration system.

^c Changes in annual volumes for Slovenia are calculated on the basis of export (import) unit values indices and trade value growth as reported in *Statistical Yearbook 1999* (Ljubljana), p. 371. For cumulative periods of 1999, as reported in IMAD, *Slovenian Economic Mirror*, Vol. V, Nos. 4, 7 and 10 (Ljubljana), 1999. January-May instead of January-June in 1999.

other transition economies also fell in both relative and absolute terms, as did exports to the developing countries (table 4.2.1, chart 4.2.2). However, east European exports to China and to other Asian countries with centrally planned economies grew by some 60 per cent, albeit from low levels.

The commodity composition of east European and Baltic exports has also changed. Chart 4.2.3 (the linear part, with the scale on the right-hand side) illustrates the dramatic fall of some commodity groups in 1999 and the prevalent growth trends of 1992/93-1998. In January-September 1999, as compared with the same period of 1998, central European and Baltic exports of food and agricultural products (SITC 0, 1 and 4) were down by some 20 and 35 per cent, respectively, after average annual growth rates of 5 and 15 per cent over the 1992/93-1998 period. Exports of chemicals and intermediate goods (SITC 5 and 6) also fell (by 8 to 20 per cent), after a steady expansion over the past five to six years. Only exports of the broadly defined group of consumer manufactures (SITC 8 and 9) grew across eastern Europe and the Baltic states, whereas exports of machinery and equipment (SITC 7) from central Europe expanded further but shrank from the south-east European and Baltic countries, from the latter region quite considerably.

These dramatic changes in the performance of different commodity groups strongly reflect the prevalent duality of the composition of exports destined for the

“western” and “eastern” markets (chart 4.2.4). By 1999, food products and intermediate goods dominated the structure of exports going to the transition economies, and in particular to the crisis-ridden CIS markets; hence, the recent dramatic fall in exports of these commodities. In contrast, consumer manufactures and, in the case of the central European economies, machinery and equipment, are predominant in exports going to the west. The concentration of individual commodities on particular export markets thus makes the exports of transition economies very vulnerable to changes in particular markets.

(b) *The dual structure of exports and the influence of FDI in eastern Europe and the Baltic states*

The duality in the commodity composition of exports destined to the west and to the east has long been noted as a characteristic of east European and Baltic trade.³⁵¹ However, in the first years of transition the two structures were almost the inverse of that observed recently: foods and intermediate goods were “over-represented” in exports to the west, whereas consumer manufactures and machinery and equipment predominated in exports to the east, with the latter accounting for 40-60 per cent of “eastern” exports in 1990. In 1994-1996 this feature seemed to be fading, as the transition economies rapidly expanded total exports

imports from non-CIS countries diminished by 46 per cent in dollar value and by 40 per cent in volume. *Ekonomika i zhizn'*, No. 50 (Moscow), December 1999.

³⁵¹ M. Landesmann and I. Szekely (eds.), *Industrial Restructuring and Trade Reorientation in Eastern Europe* (Cambridge, Cambridge University Press, 1995). See also UN/ECE, *Economic Survey of Europe in 1995-1996*, chap. 3.5.

TABLE 4.2.4

Influences on the foreign trade performance of selected east European and Baltic economies, 1998-1999
(Changes in per cent against same period of the previous year, shares in per cent)

	Demand conditions						Price competitiveness				Outcomes					
	Domestic demand ^a		Partners' demand ^b				Real effective exchange rate ^c		Export unit value ^d		Export volume growth by markets ^e				Share in extra-EU imports ^f	
			Western market economies		Transition economies		Jan.-Sept.	Jan.-Sept.	Western market economies		Transition economies		Jan.-Jun.			
	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999	1998	1999		
Bulgaria	8.6	10.7	6.2	3.8	1.0	-2.5	16.8	-1.0	..	..	..	..	..	..	0.31	0.29
Croatia	7.5	-3.6	7.6	5.1	7.2	2.9	1.6	-4.7	..	..	..	..	..	..	0.26	0.25
Czech Republic	-2.5	6.1	8.2	6.3	8.8	0.3	8.2	-0.3	1.1	-3.7	22.0	13.6	1.8	-15.4	2.07	2.15
Hungary	11.5	4.3	8.4	6.4	4.1	-	-1.3	0.7	-1.4	-4.9	25.5	17.1	4.7	-20.3	2.05	2.24
Poland	6.6	4.7	8.3	6.0	3.4	-2.9	5.7	-4.1	0.3	-3.0	8.5	2.3	-5.0	-29.0	2.27	2.32
Romania	-6.7	-5.4	7.2	4.9	6.6	3.0	29.0	-15.0	..	..	..	..	..	..	0.72	0.73
Slovakia	6.1	-7.3	8.0	5.8	9.3	3.6	-2.2	-6.5	..	..	..	..	..	..	0.75	0.83
Slovenia	5.5	6.5	7.8	5.5	1.9	-2.1	3.9	-1.5	-0.3	-6.9	11.1	5.6	0.2	-6.1	0.73	0.72
Estonia	6.6	-5.1	8.9	4.4	3.1	-8.8	10.4	11.4	0.6	-0.1	21.6	5.2	-6.7	-32.3	0.25	0.24
Latvia	6.7	-3.5	8.7	5.9	2.5	-8.2	8.2	24.5	-1.7	-1.0	29.0	11.2	-15.4	-28.8	0.20	0.19
Lithuania	15.8	..	8.3	5.5	4.1	-6.2	26.2	34.5	-9.1	-2.2	27.3	5.9	-7.2	-21.5	0.20	0.21
Russian Federation	-8.1	..	7.6	6.0	6.3	0.5	-11.5	-36.4	-15.3	-21.9	-0.6	21.3	0.8	1.5	3.24	3.05

Source: UN/ECE secretariat calculations, based on national statistics. Figures for 1999 are estimates unless otherwise noted.

^a Growth of final domestic demand in exporting country (consumption + gross fixed capital investment).

^b Aggregation of the import volume growth rates of individual western and transition countries, respectively, weighted by their share in the exports of each transition country. The import data refer to goods and services on a national accounts basis, except for a few CIS countries where, for lack of real import data, GDP growth rates are used as a proxy. Western market economies include western Europe, North America, Turkey and Japan; transition economies include CETE-5, Bulgaria, Croatia, Romania, the Baltic states and CIS.

^c Calculated on the basis of quarterly indices reported by IMF, *International Financial Statistics* (deflated by changes in CPI); for Slovenia, Estonia, Latvia and Lithuania, as reported by national banks. For Romania, estimates as in chart 3.2.3.

^d Changes in dollar unit values calculated from reported changes in export unit values in national currencies and respective exchange rates.

^e For Hungary and Poland as reported by national statistics; for the other countries calculated on the basis of changes in average export unit values and export values by partners.

^f Computations based on EU import data as reported by Eurostat, Intra- and Extra-EU Trade, CD-Rom No. 11, 1999.

and increased both the variety of destinations and exportable goods.³⁵² This was especially true for the central European countries, which at that time started to lose their comparative advantage in clothing and footwear exports under outward processing trade (OPT) arrangements and to diversify their exports of industrial products, not only in trade with the western partners but also among themselves. In the Czech Republic, Hungary and Poland, the degree of commodity concentration of

exports in 1995 was distinctly lower than in 1993 both as regards total trade and trade with major partner groups.³⁵³ In the Baltic states, too, the commodity concentration fell, indicating a widening of the export base, but this occurred somewhat later than in the central European countries.

However, in the past few years, the duality of the structure has re-emerged rather strongly, accompanied by an increased commodity concentration of exports. In 1998, the *similarity index* for the commodity structures of the region's exports to the east and to the west did not exceed 50 per cent, with much lower values if one compares exports of individual east European and Baltic countries to Germany and Russia, respectively. In Hungary, for instance, the similarity index for the latter pair of export structures was only 18 per cent in 1998, and in the Czech Republic and Poland it was 38-39 per cent.³⁵⁴

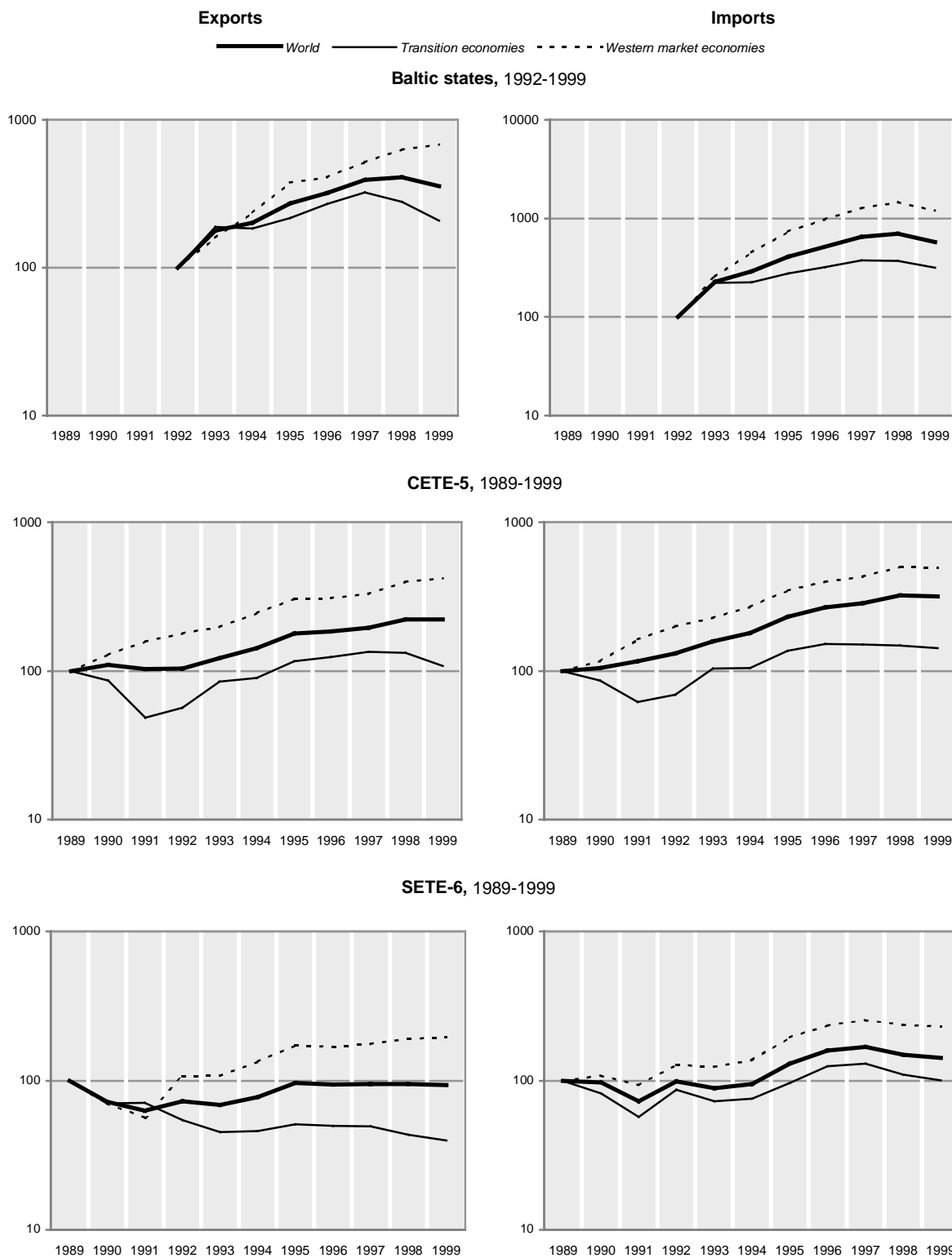
³⁵² The increasing diversification of exportables from east European and Baltic countries and changes in their revealed comparative advantages as indicators of ongoing "despecialization" in their trade during 1994-1995 were widely discussed in the economic literature, including previous issues of this *Survey*. However, the main empirical findings were almost exclusively based on mirror data and covered the region's trade only with its west European partners (usually the 12 EU countries). For more recent studies in this field, see M. Freudenberg and F. Lemoine, *Central and Eastern European Countries in the International Division of Labour in Europe*, CEPII, Document de travail, No. 99-05, (Paris), 1999; V. Kaitila, *Trade and Revealed Comparative Advantage: Hungary, the Czech Republic, and the European Union*, BOFIT Discussion Papers, No. 8 (Helsinki), 1999; C. Aturupane, S. Djankov and B. Hoekman, "Horizontal and vertical intra-industry trade between eastern Europe and the European Union", *Weltwirtschaftliches Archiv*, Vol. 135, No. 1 (Kiel) 1999; F. Lemoine, "Integrating central and eastern Europe in the regional trade and production network", in J. Zysman and A. Schwarz (eds.), *Enlarging Europe: The Industrial Foundations of a New Political Reality* (Berkeley, University of California, 1998).

³⁵³ Measured by the normalized Hirschman coefficient, calculated on SITC 3-digit level national data reported to the United Nations COMTRADE Database; UN/ECE secretariat calculations.

³⁵⁴ Measured by the Finger-Kreinin similarity index for exports at the 3-digit level of the SITC. UN/ECE secretariat calculations, based on national data reported to the United Nations COMTRADE Database.

CHART 4.2.1

Export and import growth in eastern Europe and the Baltic states, 1989-1999
 (1989=100, log scale; 1992=100, log scale)

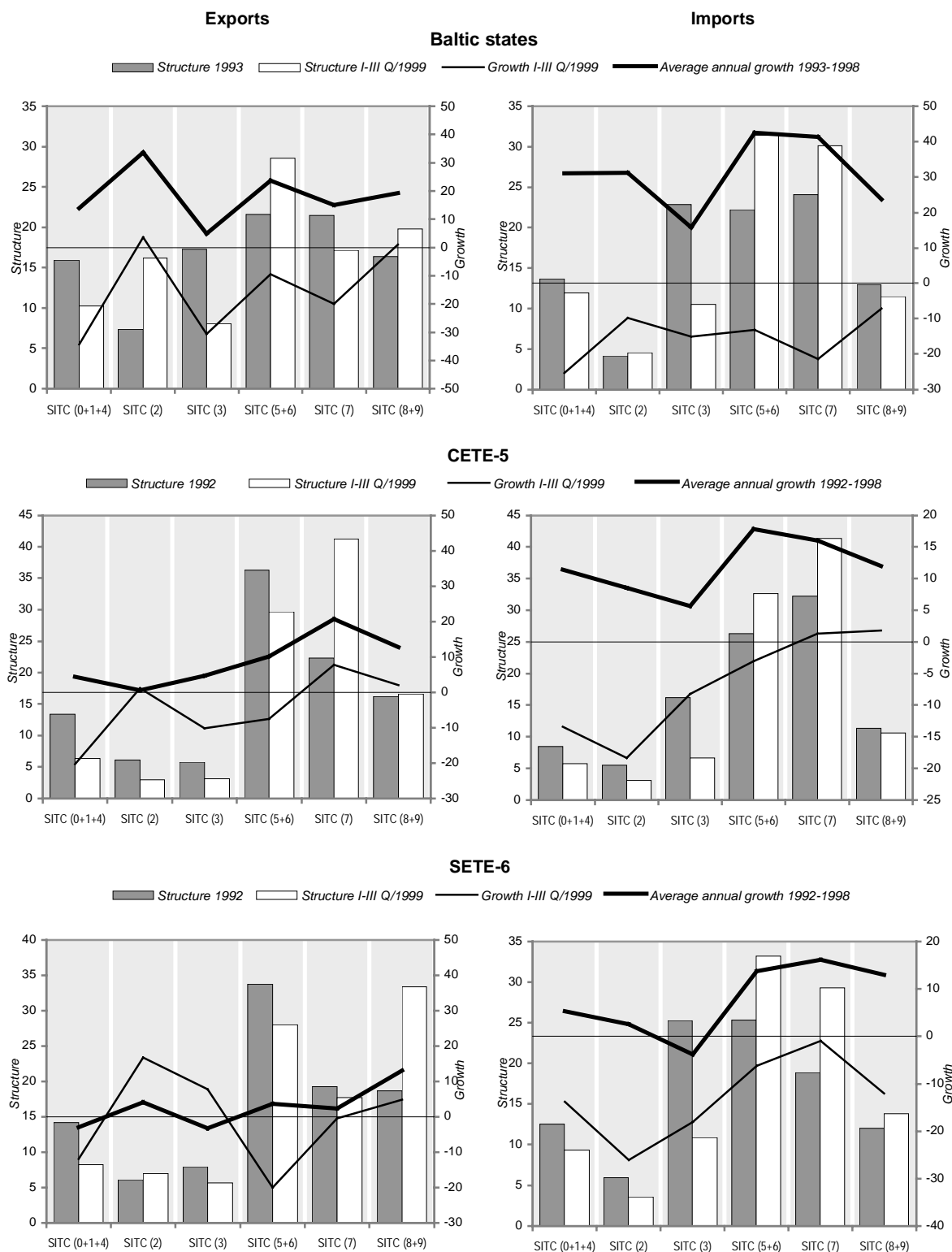


Source: UN/ECE secretariat calculations, based on national statistics and direct communications from national statistical offices.

Note: Growth rates (year-on-year basis) are calculated on the dollar values of exports. CETE-5 includes the Czech Republic, Hungary, Poland, Slovakia and Slovenia (for 1989-1992, Czechoslovakia). SETE-6 includes: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania and The former Yugoslavia Republic of Macedonia (for 1989-1992, SFR of Yugoslavia minus Yugoslavia).

CHART 4.2.2

Growth and commodity structure of exports and imports of transition economies, 1992-1999
(Per cent)

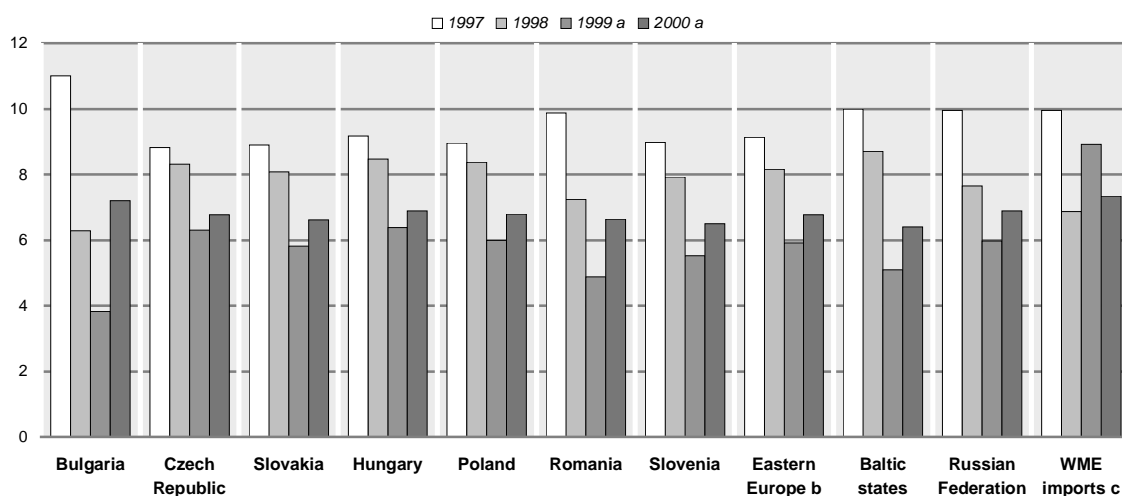


Source: UN/ECE secretariat calculations, based on United Nations COMTRADE Database, national statistics and direct communications from national statistical offices. Commodity groups are Sections of the United Nations Standard International Trade Classification (SITC Rev. 3): (0+1+4) – Food, beverages, agricultural products; (2) – Raw materials except fuel; (3) – Mineral fuels; (5+6) – Chemical products and intermediates; (7) – Machinery and transport equipment; (8+9) – Other manufactured goods.

Note: As for chart 4.2.1, *mutatis mutandis*.

CHART 4.2.3

Specific western demand for selected transition economies' exports, 1997-2000
(Annual percentage change in volume terms)



Source: UN/ECE secretariat calculations: aggregation of the import volume growth rates of individual western countries weighted by their share in the exports of each eastern country. The western import data refer to goods and services on a national accounts basis. Data for 1998 are preliminary.

a Preliminary estimates for 1999 and forecast for 2000.

b Seven countries shown.

c Western market economies (WME) include western Europe, North America, Turkey and Japan.

In general, among the 15 most important commodities (3-digit level SITC) exported by individual central European economies to Germany and Russia, respectively, there are only two to four matches, and in comparisons of exports to CEFTA partners and to the EU, only five to six. At the same time, the *commodity concentration index* for total Hungarian exports increased from 10 to 15 per cent between 1995 and 1998, while for exports to Germany it rose from 9 to 22 per cent, and to Russia from 16 to 20 per cent. There were changes of a similar magnitude in Slovakia, while in the other central European countries they were more modest. The commodity concentration of exports from the Baltic states increased by some 3-4 percentage points between 1995 and 1998.

These developments were greatly influenced by the increasing integration of the transition economies into the manufacturing and distribution networks of western enterprises, mainly transnationals. The central European, Baltic and south-east European countries, one after the other, became strongly engaged in clothing and footwear exports under OPT arrangements with EU producers who recognized the former's comparative advantage in cheap and qualified labour.³⁵⁵ As under these arrangements the foreign contractors did not incur any fixed capital costs, they could easily move to other countries whenever

labour costs in the initial location began to evolve unfavourably. Thus an initially strong comparative advantage in the sectors such as clothing, footwear, furniture and bedding, etc., was often not sustained. The engagement in OPT of the east European and Baltic economies was also reflected in an increased degree of commodity concentration of their exports to the west (in 1990-1993 in the central European countries, and in 1994-1996 in the Baltic states and south-eastern Europe).

In the following years, the rapid growth of FDI gradually reshaped the pattern of comparative advantages and thus of exports, especially in the Czech Republic and Hungary which were the first to acquire sizeable levels of FDI per capita, and later in Poland, Slovenia and Estonia. The major greenfield investments and the manufacturing facilities acquired via privatization by western investors were concentrated in just a few sectors.³⁵⁶ At the very beginning, the food-processing sector (including beverages and tobacco) was targeted, with the aim of capturing local and neighbouring markets which were still largely protected.³⁵⁷ The resulting increase in the

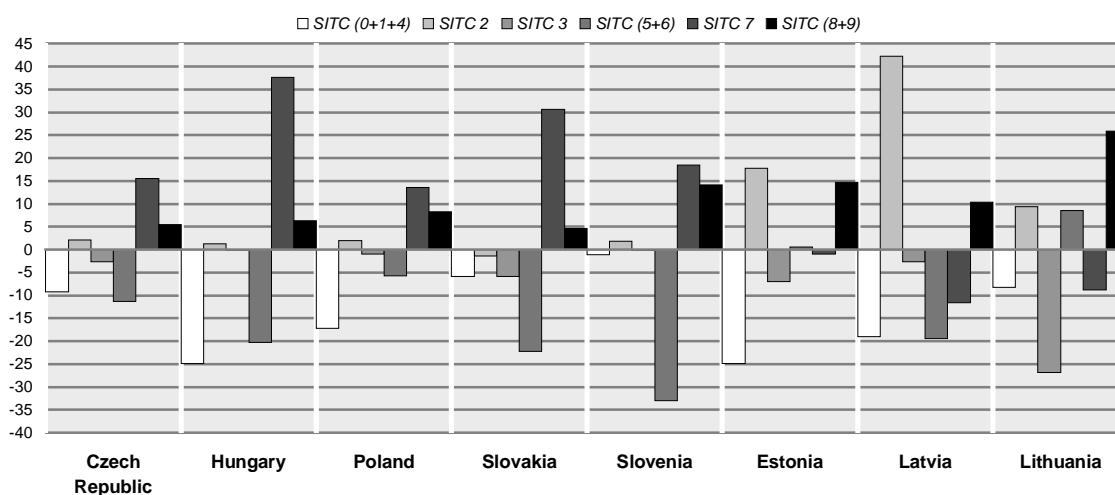
³⁵⁶ See for instance, H. van Hastenberg, *Foreign Direct Investment in Hungary* (Budapest, Elinkwijk, 1999), chap. 3; A. Eltető, *The Impact of FDI on the Foreign Trade of Four Smaller CEE Countries*, Hungarian Academy of Sciences, Institute of World Economics, Working Paper, No. 96 (Budapest), 1998; G. Hunya, *Foreign Direct Investment and Its Effects in the Czech Republic, Hungary and Poland*, WIIW Reprint Series, No. 168 (Vienna), June 1997.

³⁵⁷ The gaining of local market access, as compared with factor cost advantages, as a principal motive for foreign investment early in the

³⁵⁵ For more detail see, UN/ECE, *Economic Bulletin for Europe*, Vol. 47, 1995, chap. 5; Vol. 48, 1996, chap. 3; Vol. 49, 1997, chap. 2; and *Economic Survey of Europe 1996-1997*, chap. 3.5.

CHART 4.2.4

Differences in the structure of exports to transition economies and to the European Union, 1998
(Percentage points)



Source: UN/ECE secretariat calculations, based on United Nations COMTRADE Database.

Note: Export structure differentials, by aggregated SITC Rev. 3 groups, are measured here as the difference between commodity groups' percentage shares in exports to the ECE transition economies and to the European Union. The differentials have a positive value if a commodity group is "over-represented" in the European Union trade, and a negative value if it is "over-represented" in trade with ECE transition countries. A value of zero indicates equal shares in both export structures.

potential of these industries spilled over into an increasing share of foodstuffs, beverages and tobacco in exports, but mainly to the CIS markets and CEFTA, as western markets remained difficult to enter, not only because of their (mainly non-tariff) barriers but also because of the difficulties of competing with their highly subsidized agri-food sector.

Shortly after (or in parallel, in the case of the Czech Republic and Hungary), there was a rapid rise in FDI in the car and engineering (mainly electronic equipment and power) industries. This was prompted not only by lower factor costs in the recipient countries, but also by their proximity to major markets.³⁵⁸ These inflows of FDI flows, widely regarded as strengthening comparative advantages and providing a range of skills and initiatives in support of economic growth, also enjoyed some

transformation process was regarded by some economists as one of the major reasons why the impact of FDI on restructuring in general fell short of expectations in many of these countries. M. Rojec, *The Development Potential of Foreign Direct Investment in the Slovenian Economy*, WIIW Research Report, No. 235 (Vienna), April 1997.

³⁵⁸ Much of the FDI by multinational enterprises was actually prompted by the prospect of integration with the EU, and not least by early attempts to create regionally integrated areas in eastern Europe and the Baltics (the Visegrad agreement, followed by CEFTA expansion, the Baltic Free Trade Area, etc.). This supports the view that multinational enterprises seem to pursue strategies of regional integration, which expands intraregion intra-firm trade, rather than global integration, and that, within regions, intra-firm trade is usually associated largely with vertical integration. D. Greenaway, "Intra-industry trade, intra-firm trade and European integration", in *Journal of Common Market Studies*, No. 26, 1986. See also K. Schmidt, *Motives of Large Multinationals Investing in Small Transition Countries: A Literature Review*, Kiel Working Papers, No. 668 (Kiel), January 1995.

preferences in a number of east European countries, including tax allowances and subsidies for greenfield investments.³⁵⁹ It took some time, however, before these investments accumulated the necessary weight to have an impact on structural change. But by 1997-1998, their influence in reshaping both the commodity and the geographical structure of exports had become evident (charts 4.2.1, 4.2.2 and 4.2.4 and appendix table B.13). However, more detailed figures on the booming exports of the car industry reflect the change more strongly.³⁶⁰ According to national statistics, the central European countries have not only doubled or tripled their exports of vehicles, but have also become important suppliers of engines and other parts for the European automobile industry: by 1998, some 11 per cent of Hungary's exports to the EU consisted of engines for cars and other motor vehicles, and for Slovakia and Slovenia exports to the EU of road motor vehicles and their parts accounted for some 15 per cent of total exports. In the Czech Republic, nearly 15 per cent of total exports came from the car industry. In 1998-1999, these shares increased even further as Audi, Volkswagen and some other car manufacturers put new manufacturing facilities into operation in Hungary, Poland and Slovakia.

³⁵⁹ Hungary, for instance, still attracts most of the FDI going into the eastern car industry despite its rapidly increasing labour costs, partly because it maintains various subsidies to the car manufacturers. Recently, the DM650 million investment that was launched in 1999 by Audi, a German car manufacturer, received special tax allowances. BBC Monitoring, *Summary of World Broadcasts*, 3 February 2000.

³⁶⁰ See also UN/ECE, *Economic Bulletin for Europe*, Vol. 49, 1997, chap. 2.1, box 2.1.2.

(c) CIS

The dollar value of exports of the CIS countries have been shaped by large movements in commodity prices and the delayed effects of the Russian financial crisis. Total CIS exports declined by 9 per cent in the first nine months of 1999, somewhat less than the fall in 1998 (table 3.1.2). The recent decline reflects a divergence of export performance with little change in the dollar value of CIS exports to non-CIS countries and a fall of nearly one-third in intra-CIS trade (table 4.2.5).

Primary commodities dominate the exports of the CIS countries making their export revenues highly sensitive to changes in commodity prices. Azerbaijan, Kazakhstan and Russia depend significantly on foreign sales of crude oil, natural gas and oil products. Exports of base and ferrous metals are important to Kazakhstan, Russia, Tajikistan and Ukraine while cotton and gold sales are important for the exports of central Asia. In the first three quarters of 1999 commodity prices were generally lower.³⁶¹ The price of cotton was down by almost 20 per cent, gold by 7 per cent and various metal prices were either flat (zinc) or fell by as much as 10 per cent (copper). Unit value prices of Russia's natural gas exports declined by over 20 per cent in the first three quarters of 1999.³⁶² The two significant exceptions were crude oil (and oil products) and nickel. Crude oil prices increased by more than 20 per cent and nickel by 12 per cent in the first nine months of 1999 (year-on-year). Moreover, the prices of these two commodities have continued to rise – increasing since the third quarter by about 50 and 65 per cent, respectively, by mid-March 2000.

The Russian financial crisis and particularly the weakness of the Russian rouble, has continued to affect CIS countries by making their products less competitive in the Russian market.³⁶³ Belarus, Kazakhstan, the Republic of Moldova and Ukraine – countries with the highest export exposure to Russia – continued to be most affected.³⁶⁴ While data constraints, administrative intervention in foreign exchange markets and the prevalence of settlement in kind make analysis difficult, the dynamics of exchange rate adjustments in CIS countries against the Russian rouble have varied.³⁶⁵ In Azerbaijan, Georgia and Uzbekistan, real exchange rates have not only appreciated against the Russian rouble but have since stayed above their pre-crisis level. In

Kazakhstan, Kyrgyzstan, the Republic of Moldova and Ukraine, the initial real appreciation has already subsided somewhat and their currencies are now returning to pre-crisis levels.³⁶⁶ It should be noted that in all cases CIS currencies have depreciated in real terms against the dollar making non-CIS markets relatively more attractive to CIS exporters.

In the first nine months of 1999, the overall weak export performance of the CIS region disguised the usual variance among individual countries. Export growth in Azerbaijan, Georgia, Tajikistan, Turkmenistan and Uzbekistan ranged between 4 per cent and 102 per cent while the exports of the other countries fell, often by large amounts (table 3.1.2). Nearly all countries report an increase in the value of exports to the non-CIS area, in part also because of the improvement in international market conditions (table 4.2.5). On the other hand, for most countries there were declines in their exports to the CIS area where the deeply depressed Russian import demand made sales more difficult.

In spite of a devalued currency and rising crude oil prices, the dollar value of Russia's exports declined by 8 per cent in the first three quarters of 1999. The overall volume of exports grew by 14 per cent (table 4.2.3) although there was little change in the quantities of a number of key exportables (crude oil, natural gas and nickel).³⁶⁷ On average, export prices fell because the effect of rising prices of crude oil was more than offset by lower prices for other commodities, especially those of natural gas. Preliminary data for 1999 as a whole show virtually no change in the value of exports from 1998. The marked improvement in the last quarter of the year reflects the continuing surge in international oil prices, which helped to raise the merchandise trade surplus to a record \$33 billion.³⁶⁸

Despite this windfall gain, Russia's ability to generate revenues from crude oil and natural gas³⁶⁹ exports continues to be limited by low investment, transport bottlenecks and the recent increases in export tariffs.³⁷⁰

³⁶¹ Compared with the corresponding period of 1998.

³⁶² Calculated from Russian customs trade statistics.

³⁶³ In volume terms, CIS countries' exports to Russia declined by 14 per cent.

³⁶⁴ A typical, defensive policy response was to weaken national currencies. For example, Kazakhstan devalued the tenge in April 1999 and the Ukrainian government announced in February 2000 that it would allow its national currency to float by dismantling administrative restrictions and eliminating a trading range.

³⁶⁵ P. Westin, "The domino effect of the Russian crisis", *Russian Economic Trends*, December 1999, pp. 3-11.

³⁶⁶ Preliminary 1999 fourth quarter exports data in value terms indicate dramatic, year-on-year improvement (up by over 50 per cent) in Azerbaijan's and Kazakhstan's exports to Russia and declines of 6-8 per cent in Belarus and Kyrgyzstan.

³⁶⁷ Flat export volumes of crude oil and natural gas were consistent with production. In the first three quarters of 1999 (year-on-year) production of crude oil and natural gas was up by 0.1 and 0.5 per cent, respectively, while nickel production increased by 6.2 per cent. *Sotsial'no-ekonomicheskoe polozhenie Rossii* (Moscow), January-September 1999, pp. 21-22 and 26.

³⁶⁸ *Sotsial'no-ekonomicheskoe polozhenie Rossii*, No. 1 (Moscow), January 2000, p. 82.

³⁶⁹ Gazprom recently signed an agreement to purchase 20 billion cubic meters of gas from Turkmenistan (payment will be 40 per cent in cash and the rest in kind), reportedly to make up for significant unauthorized "transit leakages" which the company claims occur in Ukraine.

³⁷⁰ In December 1999, the Russian government doubled the oil export tariff to €15 per tonne, the tariffs on nickel, copper and zinc also doubled to 10 per cent, and other metal tariffs were raised to 6.5 per cent.

TABLE 4.2.5
CIS countries' trade with CIS and non-CIS, 1997-1999
(Value in million dollars, growth rates in per cent)

	Exports			Imports			Trade balances				
	Value 1997	Growth rates		Value 1997	Growth rates		1997	1998	January-September		
		1998	1999 ^a		1998	1999 ^a			1998	1999	
Armenia											
Non-CIS	138	1.4	25.1	593	13.3	-8.5	-455	-552	-387	-320	
CIS	95	-14.8	-43.6	299	-23.0	-8.0	-204	-150	-72	-90	
Azerbaijan											
Non-CIS	403	-7.2	64.1	443	51.7	9.7	-40	-299	-286	-209	
CIS	378	-38.6	-24.2	351	15.3	-19.1	27	-173	-112	-100	
Belarus											
Non-CIS	1 922	-0.7	25.1	2 872	4.3	-25.3	-949	-1 085	-961	-44	
CIS	5 379	-4.1	-34.6	5 817	-4.5	-30.6	-438	-394	-236	-321	
Georgia											
Non-CIS	102	-16.7	37.0	600	2.3	-44.8	-498	-592	-431	-190	
CIS	138	-21.7	-4.8	340	-21.7	-10.2	-203	-274	-98	-84	
Kazakhstan											
Non-CIS	3 515	-7.9	9.9	1 969	13.8	-14.6	1 547	999	888	1 366	
CIS	2 982	-29.6	-52.0	2 332	-14.2	-30.4	650	99	237	-221	
Kyrgyzstan											
Non-CIS	285	-0.5	-4.0	274	46.5	-18.1	11	-118	-75	-32	
CIS	319	-27.8	-17.4	436	1.1	-38.7	-117	-210	-126	-40	
Republic of Moldova ..											
Non-CIS	266	-23.6	11.6	567	3.0	-52.8	-301	-381	-359	-87	
CIS	608	-29.5	-57.4	605	-27.2	-53.0	4	-11	49	6	
Tajikistan											
Non-CIS	473	-16.7	0.5	268	-1.2	-35.1	205	129	67	138	
CIS	273	-25.7	54.8	482	-7.5	2.2	-209	-243	-192	-116	
Turkmenistan ^b											
Non-CIS	300	47.3	33.4	531	-0.2	77.7	-231	-88	-8	-158	
CIS	451	-66.3	311.1	653	-26.8	-19.4	-202	-326	-272	133	
Ukraine											
Non-CIS	8 646	-2.4	-4.5	7 249	-6.5	-37.6	1 398	1 657	829	2 594	
CIS	5 586	-24.8	-31.1	9 879	-20.1	-13.5	-4 294	-3 695	-2 537	-2 776	
Uzbekistan ^c											
Non-CIS	2 689	-9.8	5.7	3 047	-26.0	3.7	-358	169	27	59	
CIS	1 338	-40.7	-0.8	1 139	-23.7	2.2	199	-75	-29	-48	
Total above											
Non-CIS	18 738	-4.4	5.2	18 412	-1.9	-23.0	326	-161	-696	3 118	
CIS	17 546	-22.0	-30.0	22 333	-14.3	-20.9	-4 786	-5 452	-3 388	-3 655	
Russian Federation ...											
Non-CIS	68 412	-15.8	-3.0	38 805	-16.8	-41.4	29 607	25 343	15 232	15 261	
CIS	16 624	-17.9	-29.9	14 234	-20.9	-38.9	2 390	2 391	955	1 502	
CIS total											
Non-CIS	87 150	-13.3	-1.1	57 217	-12.0	-35.2	29 933	25 182	14 536	28 379	
CIS ^d	34 171	-20.0	-30.0	36 567	-16.9	-28.0	-2 396	-3 061	-2 433	-2 153	
<i>Memorandum item:</i>											
Russian Federation ^e ...											
Non-CIS	69 959	-15.8	-2.1	39 364	-16.7	-41.0	30 595	26 146	5 000	19 900	
CIS	16 668	-18.4	-28.1	14 203	-20.5	-39.3	2 465	2 314	200	1 400	

Source: CIS Statistical Committee; direct communications to UN/ECE secretariat; CIS Statistical Committee, *Statistical Bulletin*, 21(229) (Moscow), November 1999; for the Russian Federation, State Customs Committee data.

^a January-September over same period of 1998.

^b *Sotsial'no-ekonomicheskoe polozhenie Turkmenistana*, January-October 1999; *Turkmenstatprognoz*, Ashgabat, 1999.

^c Interfax News Agency, *Statistical Report*, 20 January 2000 and UN/ECE secretariat calculations.

^d Note that the values of total intra-CIS exports and imports are not identical as they should be. The reported aggregate intra-CIS imbalances reflect the same statistical discrepancy.

^e Adjusted for non-registered trade; for 1996 and 1997, Russian Federation Goskomstat, *Sotsial'no-ekonomicheskoe polozhenie Rossii*, No. 1 (Moscow), 1998. For 1999, *Sotsial'no-ekonomicheskoe polozhenie Rossii*, No. 10 (Moscow), 1999. Note that the two series may not be directly comparable as the 1998 and 1999 statistics are revised to be compatible with balance of payments data.

TABLE 4.2.6

Russian Federation's export and import volumes by selected commodities, January-September 1998-1999
(Growth rates in per cent)

	Industrial production	Exports (volume)			Imports (volume)		
		QI	QII	QIII	QI	QII	QIII
Minerals (HS25-27)	1.9	0.7	8.1	-6.4	-44.6	-38.7	-7.1
Chemicals (HS28-40)	20.3	67.6	30.9	0.2	-36.3	-21.6	7.7
Wood & paper (HS44-49)	14.5	27.3	41.4	27.6	-43.3	-39.8	-18.0
Metals (HS72-83)	10.0	12.5	17.2	20.5	-37.2	-13.2	23.6
Food and agriculture products (HS1-24)	9.9	-20.1	-20.4	-14.9	-41.1	-13.0	16.9
Textiles (HS50-67)	8.4	2.6	18.4	10.4	-26.4	0.7	16.9
Machinery and equipment (HS84-90)	13.1	21.7	10.9	55.5	-38.8	-29.9	-35.2

Source: Russian Federation State Customs Committee, *Tamozhennaya statistika vneshej trgovli Rossijskoi Federatsii* (Moscow), various issues. *Sotsial'no-ekonomicheskoe polozhenie Rossii* (Moscow), January-September 1999.

Note: Industrial production data: January-September 1999 over same period in 1998; export and import volume data: 1999 quarterly data over same period in 1998. Commodity groups are Chapters of the Harmonized Commodity Description and Coding System (HS).

Several non-mineral industrial sectors in Russia, however, have been able to take advantage of the rouble devaluation in August 1998 and significantly increased their exports while reducing imports (table 4.2.6). Export sectors such as chemicals, wood and paper, and metals all reported higher export volumes and increased production in the range of 10-20 per cent. Others – more import-substituting industries – also increased their output. In particular, food and agricultural products and machinery and equipment increased output with food largely destined for domestic consumption and machinery for both domestic and foreign markets.

In the other *European CIS countries* – Belarus, the Republic of Moldova and Ukraine – the dollar value of exports fell in the first nine months of 1999, largely as a result of shrinking exports to other CIS countries. The economic situation in Belarus, which has continued to face severe macroeconomic imbalances, has now been aggravated by unfavourable changes in its terms of trade. Because of rising crude oil prices and hard currency shortages, Belarussian exporters must now sell an additional 10 per cent (40 per cent in total) of their hard currency earnings at the overvalued official exchange rate. To reduce the hard currency shortage, exports are being increased to non-CIS markets. In addition, the reluctance of Russia and other CIS countries to accept barter arrangements have also contributed to reducing the share of exports to other CIS (for example, Belarus' exports of machinery and textiles were down by over 25 per cent each). The Republic of Moldova's exports of food, alcohol and tobacco (down by 57 per cent) continued to be affected by weak import demand in Russia. Ukrainian exports also fell because of declining CIS trade with decreased earnings from metals and chemicals leading the decline.

In the *Caucasian countries*, strong export sales to the non-CIS area outweighed declining shipments to the

CIS countries. This offsetting pattern of trade resulted in more or less unchanged exports in value in Armenia, but considerable (12 per cent and 22 per cent) year-on-year increases in Georgia and Azerbaijan. Armenia's exports of machinery and equipment declined but this was partly offset by growing exports of paper and food products. In Azerbaijan, large increases in exports, as well as the second highest rate of GDP growth among the CIS countries, were a reflection of a 64 per cent increase in the value of exports to non-CIS countries. Specifically, a 42 per cent increase in the value of crude oil exports was the result of increased shipments via the Baku-Supsa pipeline that became fully operational in April 1999.³⁷¹

In *central Asia*, export performance was mixed – in Kazakhstan and Kyrgyzstan exports declined³⁷² but in Tajikistan and Turkmenistan they increased. Kazakhstan's exports to the CIS area halved, largely because the Russian devaluation made its goods uncompetitive on the Russian market. Exports to non-CIS countries increased in value terms by 10 per cent, due to higher prices as well as volumes. Kyrgyzstan's increased sales of electricity and agricultural commodities were more than offset by weaker sales of gold, processed foods and manufacturing goods. Exports from Tajikistan and Turkmenistan increased on the strength of higher volumes of aluminium and natural gas sales, respectively. Turkmenistan doubled its exports by exporting nine times more natural gas than in the first nine months of 1998, but exports of crude oil, oil products and cotton products also increased significantly. Uzbekistan's exports were flat, partly as a result of weaker gold prices and lower cotton sales following unfavourable growing conditions in the spring and low cotton prices.³⁷³ To lessen the adverse impact of low prices, the government has decided to barter some of the cotton crop for Ukrainian steel products.

(d) *The changing composition and direction of CIS trade*

The long-standing dependence of the CIS on commodity exports is shown in chart 4.2.5. The increasing share of fuel exports in the Caucasian countries (Azerbaijan) since 1994 stands out, while on the import side, declining shares of fuel (HS V) in all the CIS regions are evident (owing to either lower import prices, lower energy consumption or the development of domestic energy sources). The rebuilding and modernization of the physical capital stocks in the CIS economies is reflected in the increased share of machinery and equipment in total imports (HS XVI-XVIII).

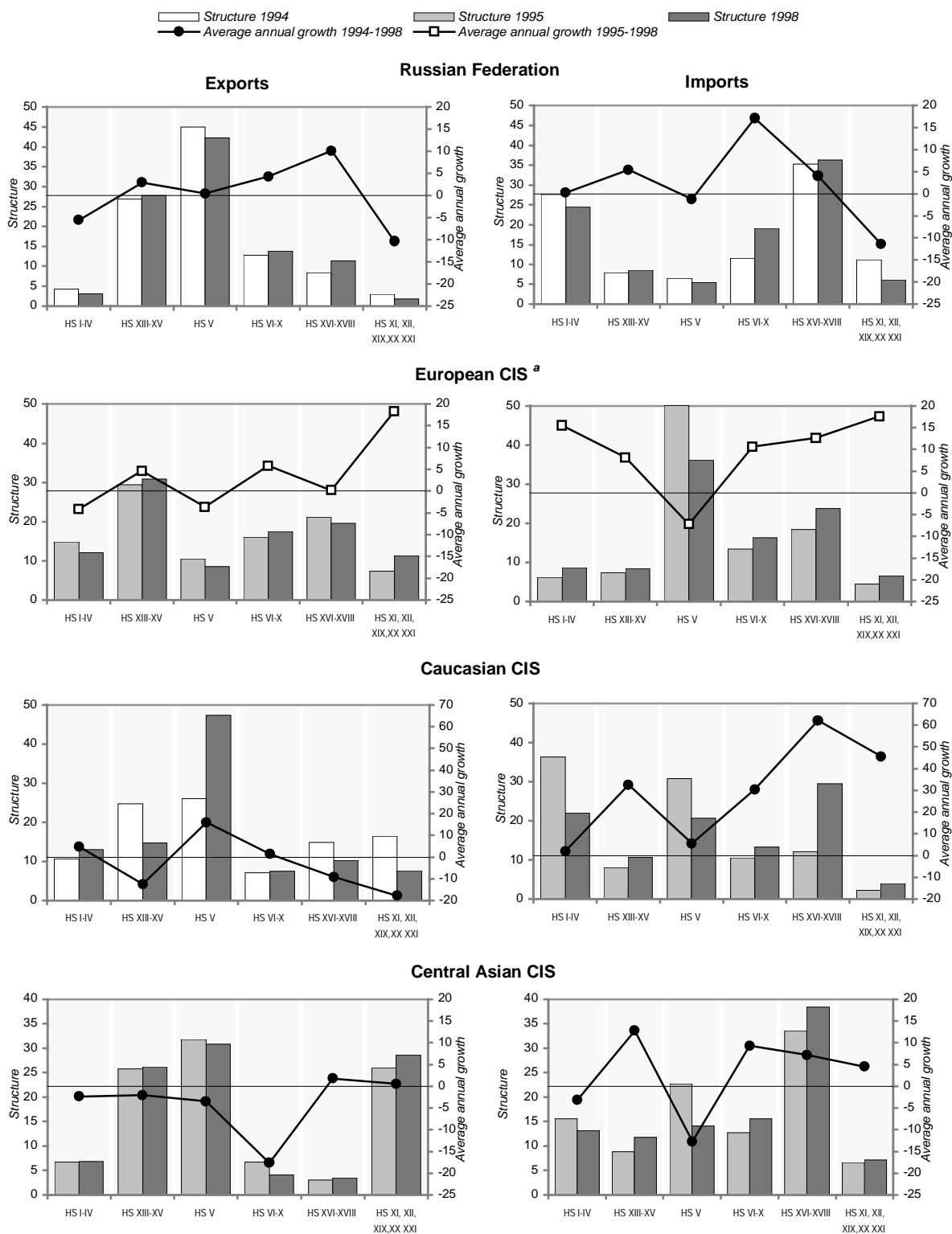
³⁷¹ Exports of crude oil and oil products in the fourth quarter of 1999 were more than double their level of a year earlier.

³⁷² Kazakhstan's mineral products and metal exports fell in value by 19 and 8 per cent, respectively, in the first three quarters of 1999. However, fourth quarter 1999 exports of fuels and metals show a remarkable improvement with fuel exports rising 2.5-fold and metal exports by almost 60 per cent in dollar terms (year-on-year).

³⁷³ The government of Uzbekistan estimates that raw cotton production in 1999 will be up by 16 per cent compared with 1998.

CHART 4.2.5

Growth and commodity structure of exports and imports of CIS economies, 1994-1999
(Per cent)



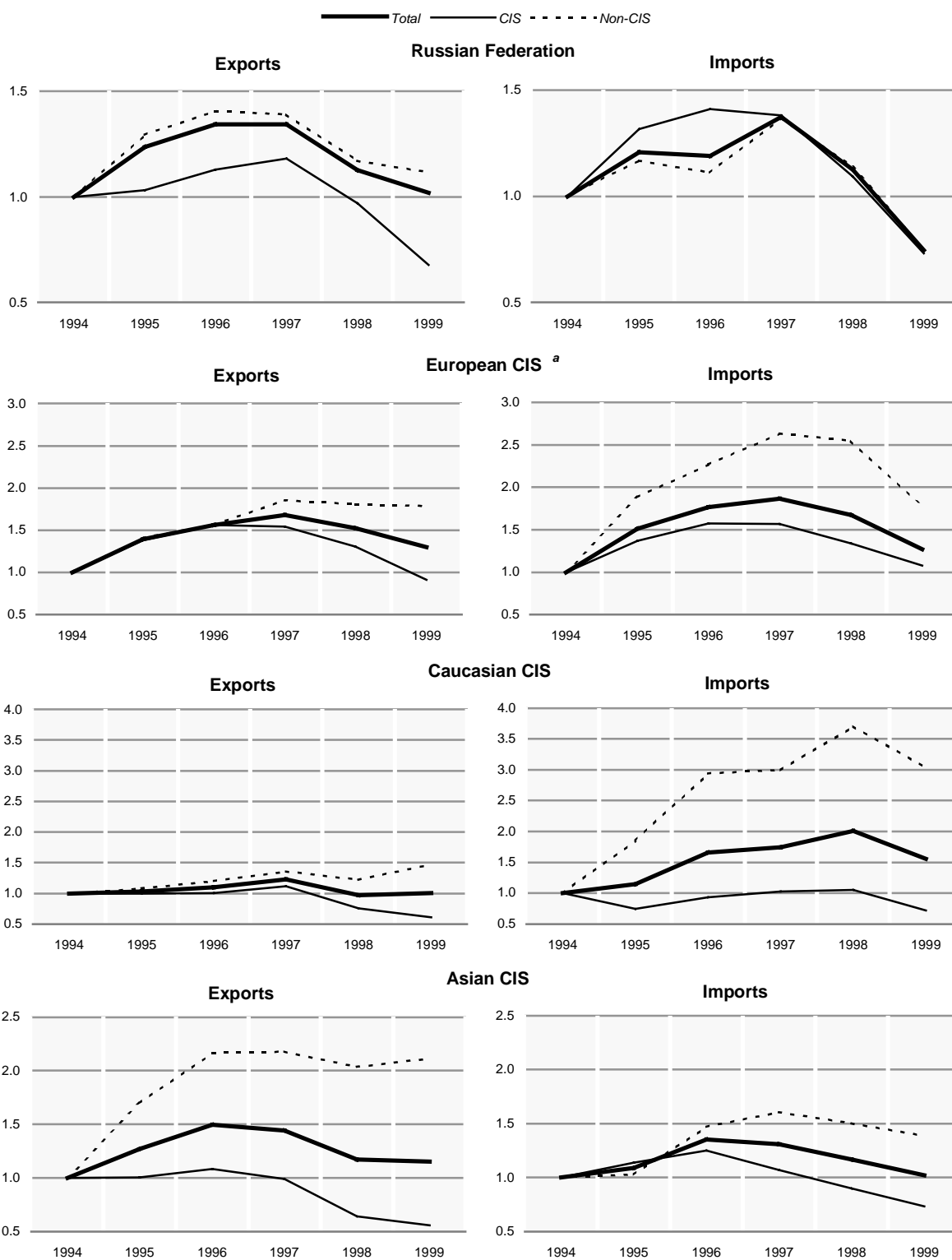
Source: National statistics and CIS Statistical Committee.

Note: HS are sections of the Harmonized Commodity Description and Coding System and roughly correspond to the United Nations SITC Rev. 3; see source in chart 4.2.2.

^a Excludes Russian Federation.

CHART 4.2.6

Export and import growth in the CIS, 1994-1999
(1994=1.0)

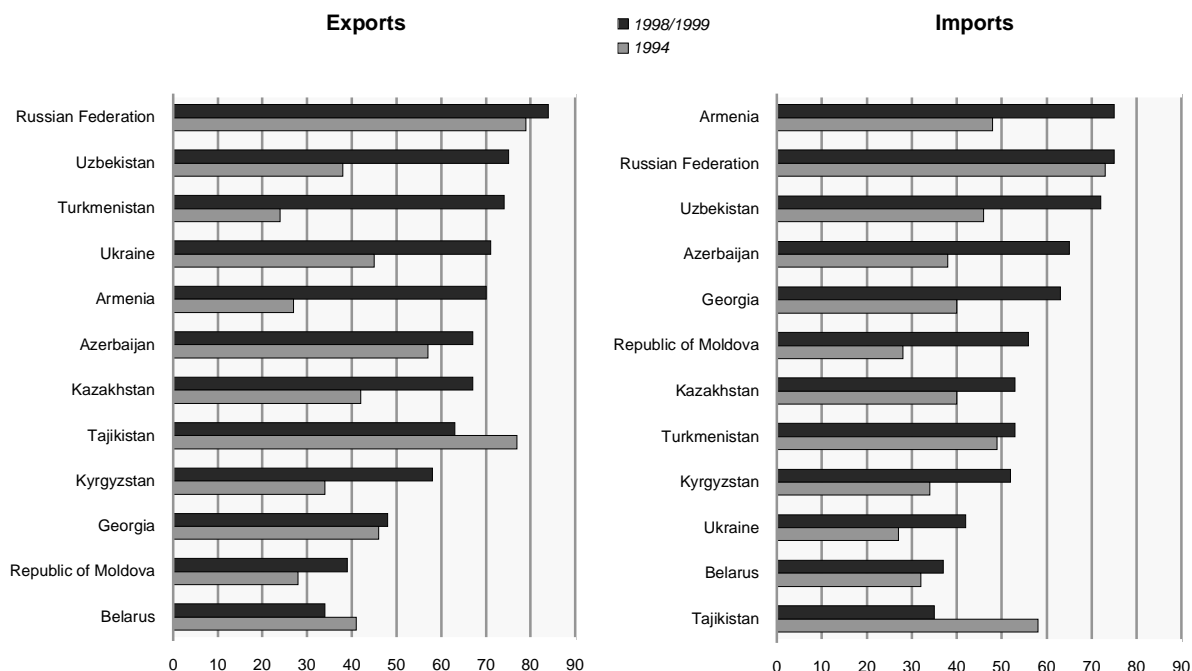


Source: National statistics and CIS Statistical Committee.

Note: Data for 1999 are estimates.

CHART 4.2.7

Trade with non-CIS economies, 1994-1999
(Shares in per cent)



Source: CIS Statistical Committee, *Statistical Yearbook*, various issues and *Statistical Bulletin*, 18(226), October 1999 (Moscow).

Note: 1998/1999 refers to unweighted average of 1998 and first half of 1999.

In parallel with these changes, the CIS countries have redirected their trade away from “traditional partners” since the breakup of the Soviet Union (chart 4.2.6). Although the accuracy of the statistics for 1991-1993 is suspect,³⁷⁴ they show the share of non-CIS countries in the total trade of the CIS increasing sharply between 1994 and 1999. Currently, all the CIS countries, except Belarus, Georgia and the Republic of Moldova, direct more than 50 per cent of their exports (in value) to non-CIS destinations (chart 4.2.7). Of the three exceptions, both Georgia and the Republic of Moldova have raised the non-CIS shares, while Belarus’ exports have increasingly been directed to Russia.³⁷⁵ The share of imports from non-CIS countries has shown a similar trend for all CIS countries (except Tajikistan).

While the direction of CIS trade has switched towards non-CIS markets, trade flows in value terms provide only a partial description of this adjustment. Thus, the share of the CIS in Russian exports, in value, has stabilized at about 20 per cent while the volume of exports of natural gas, crude oil and oil products to the

CIS has declined (chart 4.2.8).³⁷⁶ Similarly, fluctuating crude oil prices have masked the importance of growing export volumes to the non-CIS area from Azerbaijan and Kazakhstan. In both countries large FDI inflows have had a direct impact on the volume and destination of oil exports.³⁷⁷ Falling prices of gold and cotton – two easily marketable commodities – also somewhat obscure the rapid reorientation of Uzbek exports. In contrast, exports from a relatively new gold mine in Kyrgyzstan now represent about 60 per cent of the country’s non-CIS exports, perhaps exaggerating the country’s reorientation towards non-CIS countries. Finally, Turkmenistan’s intermittent exports of natural gas to Ukraine and other non-paying CIS customers make it difficult to separate the underlying change in structure.

Ferrous metals have remained a key source of export earnings in the CIS area. However, CIS exporters have been facing an ever-increasing number of anti-

³⁷⁴ For details of statistical difficulties see C. Michalopoulos and D. Tarr (eds.), in *Trade in the New Independent States* (Washington, D.C., The World Bank/UNDP, 1994).

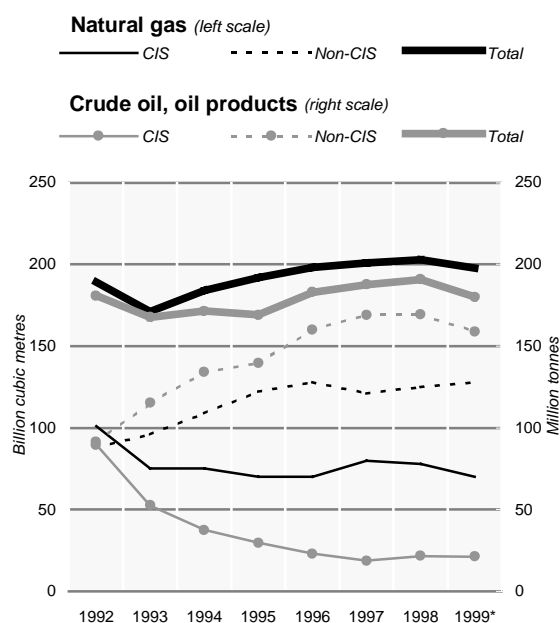
³⁷⁵ In 1990, only Belarus, Russia, Tajikistan and Ukraine shipped more than 10 per cent of the value of their exports to non-CIS destinations, and then largely to other centrally planned economies.

³⁷⁶ In addition, they could have declined more had it not been for exports of natural gas to Belarus and Ukraine in payment for their transit to west European markets.

³⁷⁷ The importance of foreign involvement is also evident in the metal industry in Kazakhstan. The country exports virtually all of its copper and zinc to non-CIS countries, while in 1994 it still shipped 25 per cent (in volume) to the CIS. A similar pattern – linked to foreign financing – is also apparent in Tajikistan’s exports of cotton – virtually all of its cotton fibre is now exported to non-CIS countries whereas in 1992 three quarters went to CIS markets.

CHART 4.2.8

Russian Federation exports of natural gas,
crude oil and oil products, 1992-1999
(Million tonnes, billion m³)



Source: Goskomstat, *Russian Statistical Yearbook*, various issues.

dumping investigations by importing countries. In 1999, Russia, Ukraine and Kazakhstan were the most frequently affected; the majority of anti-dumping cases involved steel products although fertilizers and aluminium foil have also been affected.³⁷⁸ While some CIS products allegedly trade below cost, triggering anti-dumping action, raising prices also provokes retaliation. Recently, reacting to Russia's imposition of a 15 per cent export duty on steel scrap and waste, the EU's Economic Commission decided to retaliate by reducing import quotas for some Russian steel products by 20 per cent.³⁷⁹

³⁷⁸ Historically, some countries have excessively targeted exports from "economies in transition". Also, most of the countries with the highest proportion of affirmative outcomes in anti-dumping investigations are "economies in transition". J. Miranda, R. Torres and M. Ruiz, "The international use of anti-dumping", *Journal of World Trade*, Vol. 32, No. 5, October 1998, pp. 5-71.

³⁷⁹ The European Commission stated that "the purpose and effect of the duty is to restrict exports of the products concerned, thus helping to increase the upward pressure on the international prices of scrap, which directly harms the Community steel industry". "Commission proposes measures against Russian Federation for failure to observe agreement on trade in steel products", *European Commission*, IP/00/78, 26 January 2000 (internet website). On the other hand, since 1994 exports of scrap metals have increased 135 times for aluminium, 61 times for nickel, and exports of ferrous scrap metals have increased six-fold. Furthermore, the attractiveness of exports has depleted Russian companies' access to these raw materials and has stimulated theft. RECEP, *Russian Economic Trends*, Vol. 8, No. 3, 1999, p. 51.

(ii) Imports

(a) East European and Baltic economies

The 3 per cent fall in the dollar value of aggregate imports into the east European and Baltic economies in 1999 was a reversal (if only brief) of an import boom that had begun in the early 1990s (table 3.1.2 and charts 4.2.1-4.2.2). Imports had already lost momentum in the last quarter of 1998 and slipped into decline from the beginning of 1999, falling in value by nearly 6 per cent in the first half of the year. In the second half, however, they turned up again in many countries of the region, partly because of higher prices for oil and non-ferrous metals and partly because of increased domestic demand for imported inputs as industrial activity strengthened. The recovery of personal consumption in several countries also gave a boost to imports of consumer goods, although in some of these countries household spending seems to have shifted in favour of housing improvement, which has a relatively small import content.³⁸⁰ The *volume* of aggregate imports remained virtually flat, as import unit values (in dollars) for much of 1999 were lower than in 1998, edging up only late in the year.

Although weakening in general, the changes in imports differed considerably among individual countries. There were not only large falls, at double-digit rates in the Baltic states, Romania and Slovakia, The former Yugoslav Republic of Macedonia and Yugoslavia, but also large increases, at double-digit rates in Albania and Bosnia and Herzegovina and by 9-10 per cent in Bulgaria and Hungary. In Hungary, despite strong growth in aggregate demand, import growth was relatively moderate in 1999, as compared with 1998, and in volume terms the increase was smaller than the rise in exports. In Bulgaria import growth accelerated in both value and volume terms, reflecting resumed business activity and much higher gross capital investment. In all other countries imports weakened, in some notably more so than exports, with resulting improvements in merchandise trade deficits.

For most of the countries in the region – the three Baltic states and south-eastern Europe except Bulgaria – depressed aggregate demand and declines in economic activity were the main causes of the import slump. In Slovakia, however, the reduction in domestic and import demand resulted mainly from the austerity measures – including an import surcharge – that were introduced in the middle of 1999. In Romania, imports also plummeted under the impact of the substantial weakening of the leu;³⁸¹ moreover, the government tried to discourage

³⁸⁰ Some aspects of these changes in household consumption in Hungary and Poland are discussed in PlanEcon, *Developments in the Economies of Central Europe and Russia*, *Monthly Report*, Vol. XVI, No. 3 (Washington, D.C.), 25 February 2000.

³⁸¹ From the beginning of the year through the end of September 1999, the leu depreciated in nominal terms by 50 per cent; after a two-

imports by decreeing that public institutions should only buy domestic products when available.³⁸²

In Slovenia, the value of imports remained just below their 1998 level, mainly because of a brief slump after an earlier surge that had anticipated the introduction of the new VAT.³⁸³ The large rise in the volume of imports (table 4.2.3) largely reflected increased imports of investment goods (which also includes some supplies for the car and engineering industries).³⁸⁴ In Poland, with domestic demand rising rapidly, the fall in imports seems to have come to an end already in the second quarter, with an upward trend reasserting itself in the third and fourth quarters. In contrast to Slovenia, however, there was a noticeable tendency in Poland for the share of consumer imports to rise, while that for capital equipment and intermediate supplies remained stable. In the Czech Republic, where domestic demand was rather weak, the dollar value of imports was virtually unchanged although there was a strong pick-up late in the year. Rising oil prices inflated import values in the fourth quarter, and there appears to have been significant stockpiling by the business sector before the end of the year.

In the case of imports, in contrast to exports, the weakening or decline of trade flows affected all the trade partners of the east European and Baltic countries (table 4.2.1 and chart 4.2.1). However, if east European imports from transition economies declined strongly, the fall in purchases from the EU was only slight. In contrast, imports from the EU were affected more than those from the CIS in the case of the Baltic economies; this reflected the rising value of energy imports from the CIS, but also the resumption of counter-trade transactions. In the Czech Republic, Hungary and a few other countries in the region the share of imports from developing countries has increased markedly, most of the rise coming from the Far East, particularly China and the Republic of Korea. In Hungary, for instance, machinery imports from the developing world grew at twice the average rate for that group of goods, and in the first nine months of 1999 accounted for 11 per cent of total machinery imports.

month period of relative stability, it fell again in November as demand for foreign currency increased to pay for the import of fuel for winter.

³⁸² Art. 56 in the 1999 Romanian State Budget stipulates that "the institutions financed out of public funds, subsidized public and national utilities shall buy products of Romanian make, unless it is about the goods that are not being produced in this country". Quoted from *Reuters*, 27 January 2000.

³⁸³ The scheduled introduction of the value added tax in Slovenia led to a significant rise in imports in the immediately preceding months, when the largest trade deficit since 1992 was recorded.

³⁸⁴ The reported 8.5 per cent growth in import volume with flat dollar import value in January-September 1999 in Slovenia implies the sharpest decline in import unit values observed in the region. However, as was pointed out by the National Bank of Hungary, imports of material for processing tend to generate severe problems for the accuracy of customs-based trade statistics in value terms. The importing companies usually record these imports only as intra-firm deliveries in quantity terms; no effective mechanism to test the reliability of the valuation they attach to these quantities is currently in place. National Bank of Hungary, *Monthly Report*, No. 11, 1999, p. 17.

The commodity pattern of imports did not change markedly in 1999. The continued importance of investment in central Europe and in Bulgaria kept the share of machinery and equipment imports (SITC 7) steady or even increased it slightly (chart 4.2.2).³⁸⁵ In the Baltic states, however, these imports declined sharply in 1999 and lost share for the first time since the start of the transition. The slight fall in the share of imports of intermediate goods (SITC 5, 6) was slightly more pronounced in central Europe than in the Baltic countries. Over the period 1993-1998, however, with industrial output improving steadily, imports of these goods had been the fastest growing category of the region.

Imports of manufactured consumer goods fared better than any other commodity group in 1999, not only in central Europe (where Polish imports rose considerably in the second part of the year) but also in the Baltic countries, where personal consumption was helped by the loose fiscal stance in the early part of the year and by the strong real appreciation of the domestic currency which made imports cheaper. However, imports of food and agro-products were down considerably, both in value and share, in all three subregions: this was partly due to the increased supply of locally produced goods, diverted from the CIS and intraregional markets, and partly to the rise in domestic protectionist measures (tariffs, quotas, etc.) which have increased since the end of 1998.

(b) CIS

The contraction of CIS imports accelerated in January-September 1999, their value falling by about one third (table 3.1.2). The decline in imports was roughly equal as between CIS and non-CIS countries (table 4.2.5). The value of imports fell across the board in almost all the CIS countries except Turkmenistan and Uzbekistan. In the first nine months of 1999, all the CIS currencies depreciated against the dollar in both nominal and real terms resulting in declining purchasing power and lower imports from the non-CIS area. With respect to intra-CIS trade, most CIS currencies strengthened against the Russian rouble, and their imports from Russia increased by over 7 per cent in volume (although the dollar value was down). The largest increases in import volumes involved chemicals and machinery, while imports of natural gas and minerals declined. These imports are likely to have helped sustain output growth in the region (all countries except the Republic of Moldova and Ukraine posted positive growth) in 1999. However, falling investment outlays in Belarus, Kyrgyzstan, the Republic of Moldova and Ukraine contributed to lower imports of machinery and equipment, while better harvests increased food supplies sufficiently to reduce the need to import agricultural products.

³⁸⁵ For a discussion of longer-term trends in imports of capital goods in the east European and Baltic countries, see UN/ECE, *Economic Survey of Europe, 1998 No. 1*, chap. 3.6(ii), pp. 136-138.

In the first three quarters of 1999, the dollar value of Russian imports was 40 per cent lower than a year earlier – a reflection of the weak rouble against the dollar and low aggregate demand (table 3.3.8).³⁸⁶ Russian producers were also reportedly less willing to accept barter deals with other CIS countries as evidenced by the decrease in barter trade with Belarus and Ukraine. The volume of imports of consumer durables and non-durable goods were significantly lower across the board. Imports of machinery and equipment declined over 40 per cent in value, despite a reported 7 per cent increase in investment.

As regards the other *European CIS countries*, imports into Belarus fell across the board with fuel and machinery down by over a third in value. Hard currency purchases appear to have been concentrated on critical commodities such as crude oil and grain. The Republic of Moldova's trade deficit and large energy debt led to total imports being cut more than a half, with fuel imports reduced by 37 per cent as a result of voluntary and involuntary reductions.³⁸⁷ Moreover, the Republic of Moldova's shrinking economy led to a 75 per cent decline in imports of machinery and equipment. The dollar value of Ukrainian imports of energy decreased along with dramatic cuts in other commodities, particularly machinery and equipment. In the *Caucasian countries*, Armenia's imports declined, partly because of lower food imports, while Azerbaijan's were roughly unchanged with imports of machinery and equipment for oil and gas exploration slowing down and imports from the CIS area falling.

In *central Asia*, Kazakhstan's imports from Russia were down by 30 per cent because of import restrictions on Russian foodstuffs and consumer goods, with quotas on some goods and tariffs on oil. Negligible GDP growth in the first nine months of 1999 was reflected in a 25 per cent fall in imports of chemicals and a roughly 10 per cent cut in imports of machinery and equipment. Kyrgyzstan's imports fell by a third due to declining import volumes of fuels and chemicals, owing to ongoing difficulties in the industrial sector, while food imports fell as a result of strong growth in agricultural output. Turkmenistan and Uzbekistan were the only two CIS countries increasing their imports. Turkmenistan's rose 26 per cent, with a doubling of imports from the non-CIS area. The country bought more ferrous metals and food from abroad, but less machinery and equipment. The value of Uzbek imports increased modestly despite the continuing effort of the authorities to curb foreign purchases through hard currency rationing and import controls.

4.3 Capital accounts and external financial positions

(i) Total net financial inflows

Although the climate for international financial flows improved in 1999, most European transition economies received less capital in the first three quarters of the year than in 1998 (tables 4.3.1 and 4.3.2). In general, borrowing was facilitated by the stabilization of the financial markets and by better terms. Numerous FDI projects went ahead. However, the reverberations from the triple external shock (the Asian and Russian financial crises and the Kosovo conflict), as well as domestic policy failures, continued to plague many transition economies. Russia and Ukraine, both of which were active in the bond markets in 1998, have since lost their creditworthiness. Most transition economies have failed to gain lasting access to international fund markets (section 4.5), while even some rated as investment grade risks have had to pay high margins.³⁸⁸ In consequence, sovereign borrowing remained modest in 1999³⁸⁹ and was far short of its pre-Asian crisis level. (This is all the more the case for corporate issues.) The after-effects of the "triple shock" also appear to have dissuaded some potential FDI investors. However, in some cases, a reduction in current account deficits in the first part of the year and/or successful privatizations eased financing pressures and helped to restore confidence. For some of these countries, borrowing became easier and terms improved.

In 1999 the generally smaller capital flows into most central European and Baltic countries were still sufficient to finance the evolving current account deficits.³⁹⁰ However, many transition economies were financially constrained to various degrees (some already in 1998), at least during part of the year.³⁹¹ Early in 1999, this *Survey* drew attention to the financing challenges facing several countries in the coming year. Their financing plans often included a mix of bond issues, privatization revenues (involving sales of strategic assets) and official funds. As noted above, some countries were successful in balancing their payment flows as the year

³⁸⁸ For example, in 1999 the bond issues of Latvia and Lithuania were priced at 330-475 basis points over the benchmark bond interest rates, considerably above what they paid for comparable issues in 1997.

³⁸⁹ International issues of bonds by the transition economies totalled around \$7 billion in 1999, compared with \$12 billion in 1998 (when Russia and Ukraine were still able to borrow).

³⁹⁰ There were large periodic capital inflows into the Czech Republic and Hungary in 1999 which raised concerns about exchange rate appreciation and domestic monetary expansion. Similar concerns were provoked by the possible impact of large FDI-related privatizations in the Czech Republic and Poland. As a result, special foreign exchange accounts (at the central bank) were created to receive these privatization receipts and thus circumvent the foreign exchange market.

³⁹¹ In some cases, capital flow figures for the full year, swollen by end-of-year privatization revenues, obscure the relative lack of financing during much of 1999.

³⁸⁶ The volume of retail sales was down 12 per cent.

³⁸⁷ Both Romania and Ukraine reduced electricity deliveries to the Republic of Moldova in 1999 because of payment arrears.

TABLE 4.3.1
Net capital flows into the transition economies, 1996-1999
(Billion dollars, per cent)

	Capital and financial account flows ^a						Changes in official reserves ^b								
	Billion dollars			Capital flows/GDP			Billion dollars			Reserves/GDP					
	1996	1997	1998	Jan.-Sept.		1999 ^c	1997	1998	1999	1997	1998	1999	1997	1998	1999
				1998	1999										
Eastern Europe^d	15.7	21.8	25.4	17.6	14.2	25.3	6.2	6.6	5.3	6.8	7.9	1.7	1.9	2.1	0.7
Albania	0.2	0.3	0.1	0.1	0.2	0.2	13.7	3.5	7.2	-	0.1	0.1	1.9	2.1	4.4
Bosnia and Herzegovina	1.1	1.1	1.0	..	..	..	34.3	24.8	..	0.1	-0.1	..	2.6	-1.3	..
Bulgaria	-0.8	1.2	0.5	-	0.4	1.2	12.0	4.3	4.9	1.6	0.5	-	16.2	3.8	0.3
Croatia	1.6	2.8	1.7	1.0	0.8	1.9	13.6	7.8	5.5	0.4	0.2	0.1	2.0	0.7	0.9
Czech Republic	3.5	1.4	3.3	2.3	0.5	2.7	2.7	5.9	1.3	-1.8	1.9	0.3	-3.4	3.5	0.9
Hungary	0.2	0.8	3.1	1.6	2.6	4.4	1.8	6.6	7.4	-0.2	0.8	1.3	-0.4	1.7	3.7
Poland	5.0	7.9	12.6	9.3	7.6	11.5	5.5	8.0	6.8	3.6	5.7	-0.4	2.5	3.6	-0.3
Romania	2.8	3.8	2.1	1.5	0.7	1.5	10.8	5.1	3.2	1.7	-0.8	0.1	4.7	-2.0	0.3
Slovakia	2.3	2.0	1.5	1.2	1.0	1.3	10.3	7.4	7.0	-	-0.5	0.2	0.2	-2.7	1.4
Slovenia	0.5	1.3	0.2	0.3	0.2	0.5	6.9	0.8	1.7	1.3	0.2	-0.2	7.1	0.8	-1.2
The former Yugoslav															
Republic of Macedonia	0.3	0.3	0.3	0.2	0.1	0.2	8.4	9.4	5.3	-	-	0.1	0.9	1.2	4.3
Yugoslavia .....	..	1.8	..	..	..	..	9.3	..	..	-	-1.7	..	-0.1	-10.2	..
Baltic states	1.7	2.4	2.9	2.2	1.3	..	12.0	13.1	7.9	0.5	0.4	-0.1	2.5	2.0	-0.9
Estonia	0.5	0.8	0.5	0.4	0.2	..	16.4	9.4	4.2	0.2	-	-	4.2	0.2	0.6
Latvia	0.5	0.4	0.8	0.5	0.5	..	7.3	11.7	11.0	0.1	-	0.1	1.2	0.6	1.4
Lithuania	0.7	1.2	1.7	1.4	0.6	..	12.7	15.8	7.9	0.2	0.4	-0.2	2.5	3.7	-3.0
CIS	-8.0	5.1	-1.8	3.8	-12.4	..	0.9	-0.5	-6.4	2.8	-7.1	0.6	0.5	-1.8	0.3
Armenia	0.4	0.4	0.4	0.3	0.2	..	23.3	23.3	12.5	0.1	0.1	-	4.5	2.7	-2.2
Azerbaijan	0.9	1.2	1.3	0.9	0.8	..	29.2	32.7	28.8	0.2	-	0.1	6.2	-0.5	3.4
Belarus	0.6	0.7	0.8	0.6	-	..	5.3	7.1	0.4	-0.1	-0.1	-	-0.6	-0.5	-0.1
Georgia	0.2	0.3	0.4	0.3	0.2	..	6.4	7.8	7.5	-0.1	-	0.1	-1.2	-0.6	7.0
Kazakhstan	1.0	1.3	0.9	0.1	0.5	..	6.0	4.0	4.0	0.5	-0.3	0.1	2.4	-1.5	0.6
Kyrgyzstan	0.4	0.2	0.4	0.2	0.1	..	12.5	22.8	16.8	0.1	-	-	4.7	-0.4	4.6
Republic of Moldova	0.3	0.3	0.1	0.1	0.1	..	17.5	7.3	11.7	0.1	-0.2	0.1	2.7	-13.1	10.5
Russian Federation	-15.0	-2.0	-7.4	0.2	-15.0	..	-0.5	-2.6	-11.6	1.9	-5.3	-0.4	0.5	-1.9	-0.3
Tajikistan	0.1	0.1	0.1	..	-	..	7.8	10.9	4.0	-	-	-	1.7	2.7	-3.5
Turkmenistan	-	0.7	1.0	0.8	0.7	..	25.8	37.6	31.7	0.1	0.1	0.2	4.2	3.4	7.3
Ukraine	2.1	1.7	-	0.2	-0.2	..	3.4	-0.1	-0.9	0.4	-1.3	0.6	0.8	-3.2	2.4
Uzbekistan	1.0	0.1	-	..	0.2	..	0.7	0.3	2.1	-0.5	-	-	-3.3	-	-0.3
Total above^d	9.4	29.3	26.5	23.5	3.2	..	3.2	3.4	0.7	10.1	1.3	2.2	1.1	0.2	0.5
<i>Memorandum items:</i>															
Russian Federation ^e	-5.2	7.0	2.1	9.1	-8.6	..	1.6	0.8	-6.6	1.9	-5.3	-0.4	0.5	-1.9	-0.3
CETE-5	11.6	13.4	20.6	14.7	12.0	20.4	4.8	6.9	5.5	3.0	8.0	1.3	1.1	2.7	0.6
SETE-7^d	4.1	8.4	4.8	2.9	2.3	5.0	11.7	5.8	4.5	3.8	-0.1	0.5	5.3	-0.2	0.9
Asian CIS	4.1	4.3	4.6	2.6	2.7	..	8.1	8.7	8.3	0.5	-0.2	0.4	1.0	-0.4	1.3
Three European CIS ^f	2.9	2.8	0.9	0.9	-0.1	..	4.2	1.7	-0.3	0.4	-1.6	0.6	0.6	-2.9	2.0

Source: UN/ECE secretariat estimates, based on national balance of payments statistics.

^a Including errors and omissions.

^b A positive sign indicates an increase in reserves.

^c Full year data except for The former Yugoslav Republic of Macedonia for which extrapolations of January-September rates were used.

^d Excludes Bosnia and Herzegovina and Yugoslavia.

^e Excluding errors and omissions.

^f Belarus, Republic of Moldova and Ukraine.

progressed, with some new capital covering smaller-than-forecast current account deficits. In other cases, the shortage of finance led to depreciating exchange rates and to sharp adjustments in current account balances. Where there were current account surpluses, official reserves rose, often from very low levels (table 4.3.3).

Romania and Ukraine were among the first countries encountering financial difficulties to be subject to the new IMF policy of "bailing in" foreign investors. In 1999, both faced *ex-ante* current account deficits, heavy repayment schedules and few financing possibilities (following the downgrading of their credit

TABLE 4.3.2

Net capital flows into eastern Europe, the Baltic states and the European members of the CIS, by type of capital, 1997-1999
(Billion dollars)

	Eastern Europe ^a					Baltic states				Three European CIS ^b			
	1997	1998	Jan.-Sept.		1999	1997	1998	Jan.-Sept.		1997	1998	Jan.-Sept.	
			1998	1999				1998	1999			1998	1999
Capital and financial account	17.6	23.3	15.4	13.2	21.4	2.1	2.5	1.8	1.3	3.4	1.7	1.3	0.6
Capital and financial account ^c	21.8	25.4	17.6	14.2	25.3	2.4	2.9	2.2	1.3	2.8	0.9	0.9	-0.1
of which:													
FDI	8.5	13.2	9.2	10.9	16.5	1.0	1.8	1.4	0.7	0.9	1.0	0.7	0.6
Portfolio investment	4.1	4.2	0.6	1.6	2.4	-0.1	-0.1	-	0.4	1.8	-	0.1	-0.1
Medium-, long-term funds	4.9	3.6	2.0	3.6	4.4	1.0	0.5	0.4	0.3	1.5	1.4	1.0	0.9
Short-term funds	-0.1	1.5	3.1	-3.1	-2.2	0.3	0.3	0.1	-0.1	-0.9	-0.9	-0.5	-0.9
Errors and omissions	4.2	2.1	2.2	1.0	3.9	0.3	0.4	0.3	-	-0.6	-0.8	-0.4	-0.7
Memorandum item:													
Short-term investment ^d	8.2	7.8	6.0	-0.5	4.0	0.4	0.7	0.4	0.3	0.3	-1.7	-0.9	-1.7

Source: UN/ECE secretariat estimates, based on national statistics.

^a Excludes Bosnia and Herzegovina and Yugoslavia.

^b Belarus, Republic of Moldova and Ukraine.

^c Including errors and omissions.

^d Portfolio investment, short-term funds and errors and omissions.

ratings in 1998). As a condition for the disbursement of a stand-by credit tranche, the IMF required Romania to raise fresh private loans, although the costs turned out to be prohibitive. Default was only avoided by running down the already modest level of official reserves. Similarly, Ukraine was required to seek a restructuring of the \$2.6 billion external bonds coming due in 2000-2001.³⁹²

In Russia, the capital account continues to reflect the repercussions of the August 1998 rouble crisis. In 1998, recorded net capital imports fell to \$2 billion in 1998, due to the huge outflows toward the end of the year. The latter, which continued in the first three quarters of 1999 (some \$9 billion), reflects the loss of access to the international capital markets, the cessation of portfolio investment in domestic securities, some repayment of external debt (specifically the "new Russian debt"), and the export of various funds (much of which is capital flight). Russia's net outflow of funds is even larger if unrecorded capital outflows (as measured by the negative "errors and omissions" item in the balance of payments) are taken into account.³⁹³ In 1999 capital flight was sustained by an estimated \$23 billion current account surplus (\$15 billion in January-September), of which only about \$2 billion seems to have been channelled into official reserves.³⁹⁴

³⁹² The proposed deal involves the exchange of this debt for new bonds with a seven-year maturity. Early in 2000 Ukraine missed interest payments on two external bonds, essentially placing it in deficit.

³⁹³ Nevertheless, it has been estimated that capital flight from Russia actually declined in 1999 to \$15 billion, from \$25 billion in 1998. The reduced outflow has been attributed to new regulations introduced in mid-1999, according to V. Melnikov, Deputy Governor of the Central Bank of Russia. *Financial Times*, 5-6 February 2000.

³⁹⁴ The official series (foreign exchange plus gold) indicates a smaller change in 1999 because of a change in methodology requested by the

The European transition countries (excluding Russia) have relied heavily on various long-term funds (FDI and medium- and long-term loans) for balance of payments financing (table 4.3.2 and section 4.5).³⁹⁵ Short-term investment flows into the transition economies continued to be sizeable and volatile. In Hungary and Poland large portfolio investments from abroad helped to boost local stock markets to record levels. In south-east Europe alone, total inflows were marginally smaller than in 1998. They were buoyed by FDI (see below) and a reflow of short-term funds. However, medium- and long-term investment were the smallest in years. The difficult financial situation in three European CIS countries is reflected in the fact of declining long-term inflows being totally offset by outflows of short-term funds (probably including some capital flight).

(ii) FDI flows

The European transition economies attracted an estimated \$24 billion in FDI in 1999, a modest increase from the previous year (table 4.3.4).³⁹⁶ Record investments were reported by Bulgaria, Croatia, the Czech Republic and Poland. There does not seem to be a common explanation for these inflows, which reflect various mixes of privatization revenues, follow-on and

IMF. In the second half of the year official foreign exchange data were revised to exclude the central bank's holdings of currency at its overseas subsidiaries, reported to be some \$1.4-\$1.5 billion.

³⁹⁵ On average FDI covered 87 per cent of eastern Europe's current account deficit, but the distribution among countries has been very uneven (table 4.3.3).

³⁹⁶ The Asian CIS are excluded from this discussion because of lack of data. Some fragmentary returns and various projections suggest a drop in FDI flows in 1999.

TABLE 4.3.3
Selected external financial indicators for the transition economies, 1998-1999
(Billion dollars, per cent)

	Gross debt		Net debt		Net debt/exports		Gross debt/GDP		FDI/current account		Official reserves			Ratio to short-term debt ^c
	(billion dollars)		(billion dollars)		(per cent) ^a		(per cent)		(per cent) ^b		(billions)		Months of imports ^a	
	1998	1999	1998	1999	1998	1999	1998	1999	Average 1995/1998	Jan.-Sept. 1999	1998	1999	1999	
Eastern Europe^d	156.2	157.5	93.5	93.8	103	109	41	43	81	87	62.8	63.6	4.4	267
Albania	0.9	0.9*	0.5	0.5	225	143	29	25	58	63	0.3	0.4	4.0	542
Bosnia and Herzegovina	2.9	3.1*	2.5	2.6	211	203	68	68	3	-	0.3	0.4	2.0	574
Bulgaria	10.3	9.7	7.4	6.6	163	161	84	80	-360	114	2.8	3.1	5.3	660
Croatia ^e	8.5	8.9	5.7	5.9	95	106	39	44	26	55	2.8	3.0	3.5	173
Czech Republic	24.3	22.8	11.8	9.9	69	64	44	43	76	2 030	12.5	12.9	4.2	229
Hungary	27.3	29.3	18.0	18.3	98	104	58	60	134	75	9.3	10.9	4.3	222
Poland	56.9	59.9	30.4	35.3	156	190	36	39	164	60	26.4	24.5	6.1	353
Romania	9.8	8.6	8.1	6.7	100	85	24	25	42	108	1.7	1.8	1.8	65
Slovakia	11.9	10.6	9.0	7.2	89	86	58	56	16	19	2.9	3.4	3.0	169
Slovenia ^e	5.0	5.5	1.3	2.3	43	50	25	28	-1 629	5	3.6	3.2	3.3	490
The former Yugoslav Republic of Macedonia ^e	1.5	1.4	1.1	1.0	98	97	41	41	14	75	0.3	0.4	2.6	419
Yugoslavia	15.1	15.1	14.9	14.8	443	628	90	84	13	..	0.2	0.2	0.6	52
Baltic states	5.0	5.4	2.0	2.5	39	48	22	24	60	47	2.9	2.9	2.5	206
Estonia	2.9	2.9	2.1	2.0	67	70	56	56	63	134	0.8	0.9	2.3	101
Latvia	0.4	0.6	-0.3	-0.2	12	21	6	9	106	40	0.7	0.8	2.7	394
Lithuania	1.7	2.0	0.3	0.8	32	45	16	18	41	36	1.4	1.2	2.5	278
CIS	185.9	190.2	171.8	174.7	140	155	48	70	-597	-22	14.2	15.5	1.8	89
Armenia	0.8	0.9	0.5	0.6	179	172	44	47	26	41	0.3	0.3	4.2	801
Azerbaijan	0.5	0.6	0.1	-0.1	52	67	13	15	86	76	0.4	0.7	4.1	3 015
Belarus	2.5	2.5	2.2	2.2	31	39	22	23	16	632	0.3	0.3	0.5	315
Georgia	1.6	1.6	1.5	1.5	196	193	33	60	40	750	0.1	0.1	1.1	636
Kazakhstan	7.3	7.3	5.9	5.8	107	120	33	46	154	167	1.5	1.5	2.7	221
Kyrgyzstan	1.5	1.6	1.3	1.4	243	299	93	132	29	3	0.2	0.2	3.4	590
Republic of Moldova	1.4	1.3	1.2	1.2	154	224	82	118	27	282	0.1	0.2	2.9	469
Russian Federation	152.4	154.0*	144.6	145.5	166	177	55	85	-35	-4	7.8	8.5	1.6	58
Tajikistan	1.3	1.4	1.3	1.3	225	218	100	128	31	28	0.1	0.1	1.0	38
Turkmenistan	1.7	2.1	0.4	0.7	166	196	64	65	34	11	1.4	1.4	8.6	299
Ukraine	11.5	13.0	10.7	12.0	65	83	28	42	43	-45	0.8	1.0	0.8	202
Uzbekistan	3.2	3.8	2.1	2.6	112	153	23	23	25	52	1.2	1.1	5.4	473
Total above^d	347.1	353.0	267.2	271.1	117	127	44	53	127	1 513	79.9	82.0	3.4	192
<i>Memorandum items:</i>														
CETE-5	125.4	128.0	70.6	73.1	101	108	42	43	102	88	54.8	54.9	4.7	278
SETE-7^d	30.9	29.4	22.9	20.7	115	111	38	40	43	86	8.0	8.7	3.2	203
Asian CIS	18.1	19.3	13.0	13.8	129	153	34	42	72	70	5.1	5.5	3.9	351
Three European CIS ^f	15.4	16.8	14.1	15.3	58	74	28	39	33	-78	1.2	1.5	0.8	236

Source: National statistics; IMF, *International Financial Statistics* (Washington, D.C.), February 2000; press reports; BIS press release, "BIS consolidated international banking statistics for end-June 1999" (Basle), November 1999; UN/ECE secretariat estimates.

Note: Net debt equals gross debt less foreign exchange reserves. Debt statistics for 1999 are the latest available at the time of publication, generally September-December. Data for Yugoslavia are for end-1997 as published in World Bank, *Global Development Finance* (Washington, D.C.), 1999.

^a Exports of merchandise and services, and income receipts. Total imports of merchandise and services, and income payments. For Poland, exports exclude net receipts from non-classified current account items. For Tajikistan and Uzbekistan merchandise trade only; for Bosnia and Herzegovina good and services.

^b FDI flows are net. A negative number indicates a current account surplus.

^c Ratio of official reserves to bank debt maturing in one year, June 1999 (per cent).

^d Excludes Bosnia and Herzegovina and Yugoslavia.

^e Allocated debt only for Slovenia. Unallocated debt is included in Croatia and The former Yugoslav Republic of Macedonia; the debt figures of the latter include only medium- and long-term debt.

^f Belarus, Republic of Moldova and Ukraine.

TABLE 4.3.4
Indicators of foreign direct investment in the transition economies, 1998-1999
(Million dollars, per cent)

	FDI flows										Cumulative inflow ^a		
	FDI inflow (million dollars)			FDI abroad (million dollars)		Net FDI (million dollars)		FDI inflow per capita (dollars)		FDI inflow/GDP (per cent)		(million dollars)	(per capita)
	1998	1999 ^b	1999 ^c	1998	1999 ^c	1998	1999 ^c	1998	1999 ^c	1998	1999 ^c	1999	1999
Eastern Europe^d	14 162	11 367	17 245	-952	-707	13 210	16 538	132	162	3.7	4.7	72 056	675
Albania	45	28	41	-	-	45	41	14	13	1.5	1.1	424	138
Bosnia and Herzegovina ...	100	..	60*	-	-	100	60	27	16	2.4	1.3	160	42
Bulgaria	537	459	739	-	-5	537	734	64	89	4.4	6.1	2 228	269
Croatia	873	390	1 332	-93	-43	781	1 290	195	298	4.0	6.6	3 552	793
Czech Republic	2 720	3 535	5 108	-79	-197	2 641	4 912	265	498	4.9	9.6	16 546	1 612
Hungary	2 036	1 117	1 944	-481	-249	1 555	1 695	201	193	4.3	4.0	19 822	1 967
Poland	5 129	4 884	6 757	-163	-127	4 966	6 630	132	174	3.3	4.4	20 402	527
Romania	2 031	691	961	9	-12	2 040	949	90	43	4.9	2.8	5 441	243
Slovakia	508	177	240*	-135	-31	374	209	94	45	2.5	1.3	2 068	384
Slovenia	165	66	83	-11	-44	154	40	83	42	0.8	0.4	1 355	681
The former Yugoslav Republic of Macedonia ...	118	21	40*	-	-	118	40	59	20	3.4	1.1	217	108
Baltic states	1 863	721	981 ^c	-65	-49	1 798	932	247	131	8.3	4.4	5 942	794
Estonia	581	231	361 ^c	-6	-50	575	311	406	256	11.2	7.1	2 019	1 430
Latvia	357	184	270 ^c	-54	1	303	271	147	113	5.6	4.1	1 998	836
Lithuania	926	306	350 ^c	-4	-	921	350	251	95	8.6	3.3	1 925	523
CIS	6 791	4 165	5 539	-1 045	-1 808	5 745	3 732	24	19	1.8	2.0	37 868	133
Armenia	232	75*	100*	-12	..	221	100	66	28	12.3	5.4	436	124
Azerbaijan	1 023	550*	700*	-	..	1 023	700	133	91	24.8	17.5	3 837	499
Belarus	149	192	250 ^c	-2	-1	147	249	14	24	1.3	2.3	722	70
Georgia	265	75*	100*	-	-	265	100	52	20	5.4	3.7	622	124
Kazakhstan	1 158	700*	950*	-8	..	1 149	950	71	58	5.2	6.0	6 738	414
Kyrgyzstan	109	3	5	-1	-	109	5	24	1	6.8	0.4	388	83
Republic of Moldova	86	28	49 ^c	-	-1	86	47	20	11	5.1	4.2	368	84
Russian Federation	2 761	1 976	2 600*	-1 027	-1 800	1 734	800	19	18	1.0	1.4	19 900	135
Tajikistan	24	15	21	..	-	24	21	4	3	1.8	1.9	141	23
Turkmenistan	64	60*	80*	-	..	64	80	15	18	2.3	2.4	781	178
Ukraine	743	353	500 ^c	4	-5	747	495	15	10	1.8	1.6	3 211	63
Uzbekistan	176	138	184*	-	..	176	184	7	8	1.2	1.1	723	30
Total above^d	22 816	16 253	23 765	-2 062	-2 564	20 754	21 202	57	60	2.9	3.6	115 866	291
<i>Memorandum items:</i>													
CETE-5	10 558	9 778	14 133	-868	-648	9 690	13 485	159	213	3.5	4.8	60 193	906
SETE-7^d	3 604	1 589	3 112	-84	-59	3 520	3 053	89	77	4.4	4.2	11 862	295
Asian CIS	3 052	1 616	2 140*	-20	..	3 031	2 140	43	30	5.8	4.6	13 667	191
Three European CIS ^e	978	573	799 ^c	2	-8	980	791	15	12	1.8	1.9	4 301	66
Poland (accrual basis)	6 365	..	..	-316	..	6 049	..	163	..	4.1	..	24 104 ^f	622 ^f

Source: UN/ECE secretariat, based on national balance of payments statistics. FDI in Poland is given first on a cash basis (equity capital and loans) and then on an accrual basis, which also includes reinvested earnings, contributions in kind and loans on a transaction basis.

^a FDI inflows are cumulative from 1988.

^b January-September.

^c Reported full year data except for The former Yugoslav Republic of Macedonia, the Baltic states and several European CIS countries for which extrapolations of January-September rates were used.

^d Excludes Bosnia and Herzegovina and Yugoslavia.

^e Belarus, Republic of Moldova and Ukraine.

^f End 1998.

greenfield investments.³⁹⁷ In the other countries inflows generally stagnated or declined. The impact of the triple external shock is difficult to assess and to separate from purely domestic factors. In the Baltic states the decline in FDI may be partially explained by the postponement or cancellation of projects intended to produce for export to Russia.³⁹⁸ Also, the Kosovo conflict seems to have discouraged some foreign investments in Croatia, Slovenia and The former Yugoslav Republic of Macedonia. However, in Croatia a single large privatization boosted FDI to record levels. There were several exceptional one-off deals in the area in which the strategic interests of the foreign investors prevailed over other considerations.³⁹⁹ In the European CIS, the poor investment climate continues to deter FDI, although in Belarus and Russia there was some increase in the first three quarters of the year. Russia's FDI abroad increased sharply.

4.4 Conclusions about the sustainability of current account balances

In general, the balance of payments of the European transition economies are in the best shape they have been in several years and can be expected to benefit from the improving international economic environment. Prospects are good for a further strengthening of foreign demand for eastern goods due to the ongoing economic expansion in western and central Europe and the more limited recovery in Russian import demand. In most transition economies imports will be rising under the influence of stronger demand and higher international prices for fuels and other commodities. These factors may partially explain the marked worsening of current account deficit in many east European countries in the final quarter of 1999.

According to current official forecasts, most transition economies expect a quickening of output growth (or a recovery from recession) in 2000. For most of them the assumption is one of vigorous export-

led growth since forecasts of current account balances show little change from 1999. Several countries have already reported stronger export growth in the latter months of 1999 and early 2000. Supply side factors continue to be important. For example, the ability to shift goods towards fast-growing markets and to upgrade the value added structure of exports; both of which can be helped by inflows of foreign direct investment. In some countries it is difficult to tell whether lagging export performance reflects a temporary mismatch between the commodity composition of their exports and that of foreign demand, or whether the problem is a more deep-seated one of economic structure (a problem that may be affecting some countries which until now have been relatively successful exporters). A failure of exports to expand as expected would risk larger current account deficits, as would the continuation of rapid domestic demand growth in several countries, although in general government budgets for 2000 reflect a tighter fiscal stance.⁴⁰⁰

The general improvement in financial market sentiment has boosted investors' receptiveness to the sovereign debt issues of creditworthy transition economies and has set the stage for the return of corporate borrowers. Although foreign borrowing gathered pace and terms improved in early 2000, easy market access remains limited chiefly to investment grade risks (and, even for some of these countries, borrowing costs are still above their pre-Asian crisis levels).⁴⁰¹ It is generally believed that current account deficits are more likely to be sustainable if they are funded by FDI inflows. Net foreign direct investment flows already cover a substantial proportion of the transition economies' current deficits. The potential advantage of this structure of financing is that FDI is generally associated with fixed investment rather than consumption, and has proved to be relatively stable.⁴⁰² These potential benefits have become more widely appreciated by policy makers in the transition economies. As a result, current account financing has become a key motive for selling state assets to strategic foreign investors, the anticipated revenues being an important element in many external financing programmes. This is one of the reasons that has prompted many governments to announce the acceleration of their privatization programmes in 2000. Reliance on privatization receipts as a source of

³⁹⁷ For example, according to R. Samek, a spokesperson for CzechInvest: in the Czech Republic the record inflow was due to the privatization of state property (including the \$1.1 billion sale of a stake in Ceskoslovenska Obchodni Banka, CSOB), low asset prices (prices softened during the recession thus attracting investors), the return of Japanese investors and the introduction of new investment incentives for greenfield and brownfield FDI. Bureau of National Affairs (BNA), *Eastern European Reporter*, Vol. 10, No. 1 (London), January 2000.

³⁹⁸ FDI in Estonia was expected to decline because privatization is nearly complete. Similarly, the record 1998 Lithuanian FDI inflow reflects a one-off event, the sale of the telecommunications company. There have been some new, compensating investments designed to orient more exports towards western Europe.

³⁹⁹ The \$840 million received for the sale of a stake in Croatian Telecom boosted otherwise decreasing FDI in 1999. In Bulgaria the record FDI inflow excludes the \$510 million sale of BTC (telecommunications), agreed in 1999 but still awaiting completion in early 2000. Revenues from the sale of the Otkta oil refinery in The former Yugoslav Republic of Macedonia, the largest privatization to date, are also not reflected in the 1999 data.

⁴⁰⁰ It is not clear to what extent declining competitiveness in several transition economies and higher fuel prices are incorporated into the official forecasts.

⁴⁰¹ Declining borrowing costs have been attributed in part to prospective EU membership.

⁴⁰² It should be borne in mind that although the non-debt creating character of FDI is often emphasized, it must eventually result in a reverse flow of repatriated profits; it is also likely to boost imports and thus its longer-run impact on the current account is uncertain. For example, see UNCTAD, *Trade and Development Report, 1999* (United Nations publication, Sales No. E.99.II.D.1), pp. 120-122.

current account financing is a feasible strategy provided that a sufficient stock of assets remains in state hands, which is still the situation in many transition economies. Where this is no longer the case and the aim is still to cover current account deficits with non-debt creating flows, new policy initiatives designed to attract greenfield investments from abroad may be necessary.⁴⁰³

For most of the central European and Baltic economies there should be little difficulty in financing their forecast current account deficits in 2000. However, the continuing deterioration of Poland's external balance (into 2000) is a source of concern, mainly because it is feared that a sharp zloty depreciation could set back the anti-inflation programme. Exports have remained weak while buoyant domestic demand has boosted imports, a situation which has prompted the central bank to tighten monetary policy. Financing is assured since Poland expects a large inflow of privatization-related FDI in 2000, its foreign exchange reserves are large and it has an investment grade credit rating.

The external financial situation in south-east Europe has eased somewhat. In early 2000 Croatia issued a large €500 million bond, and there are hopes that an ambitious privatization programme will go ahead. It is also likely that the new government will restart talks with the IMF, although passage of an acceptable budget remains an issue. Large privatization revenues in 1999 significantly improved the official liquidity position. After the recent financial squeeze, Romania has managed to rebuild its official reserves (although they remain comparatively small). The government intends to accelerate the privatization programme which is expected to raise some \$1.2 billion in 2000. This policy, and reaching an agreement with the IMF, is intended to restore investor confidence and regain access to the international capital markets. Albania and Bulgaria have already secured adequate official financing for the forecast current account deficits this year, which in Bulgaria will supplement another relatively large inflow of FDI.

The recent increases in international oil and other commodity prices are expected to raise Russia's current account surplus to some \$24-\$30 billion in 2000. This range reflects uncertainty about the average price of commodities as well as the pace of recovery in Russia's imports. The surplus should allow the government to meet the \$10 billion foreign debt servicing target set out in its budget (about \$5 billion in interest (reflected in the current account) and a roughly equal amount in amortization). There will be further scope for boosting official reserves, but the actual amount will depend heavily on capital flight. In August 1999, Russia signed a

memorandum on restructuring its Paris Club debt due in 1999-2000, and in February 2000 it concluded a framework agreement with the London Club involving some reduction in debt service.⁴⁰⁴

The balance of payments situation of the three other European CIS, Belarus, the Republic of Moldova and Ukraine, is likely to remain difficult. Their exports should be helped by the expansion of non-CIS markets and by the slow recovery in Russian import demand, but imports are likely to rise under the pressure of increasing fuel prices. Financing the current account deficits will remain heavily dependent on official sources. Several reform conditions, including the privatization of certain state assets, need to be met for the IMF to resume funding to the Republic of Moldova and Ukraine, while no programme is yet in sight for Belarus. So far, privatization involving foreign investors has made little headway in these three countries. They also need to resolve outstanding arrears in their payments for Russian energy supplies.

4.5 Capital inflows into the transition economies since 1989

(i) Introduction

The potential for foreign capital flows to raise economic growth is well recognized: among other things, they can supplement domestic savings, improve the allocation of resources and act as a conduit for new technology and know-how. For the transition economies, burdened by decades of economic backwardness, foreign capital can facilitate the ongoing process of economic reform and restructuring and help to improve international competitiveness. Success in these areas will improve their chances of narrowing the income gap between them and the western market economies (chapter 5).

In subsection (ii) financial conditions in 1990 and the ensuing financial turbulence in the region are discussed; subsection (iii) summarizes some of the key reforms and institutional arrangements which were essential for the development of sustainable, market-determined capital inflows; subsection (iv) overviews the growth and changing composition of financial inflows; and some observations and lessons are drawn in subsection (v).

(ii) Baptism by financial crisis

In 1990, the external financial situation of several eastern countries had become precarious. In the preceding years, external debt had risen and foreign exchange reserves had been drawn down as governments tried to prop up local economies with imports. Poland

⁴⁰³ For example, in Hungary, which is the most advanced transition economy in selling state enterprises, new efforts are being made to promote a broad range of greenfield investments in manufacturing and tourism. BBC, *Summary of World Broadcasts*, 6 January 2000.

⁴⁰⁴ The latter accord calls for a \$13 billion reduction (around 37 per cent) in the face value of the stock of commercial bank debt and an extension of the repayment schedule.

and Yugoslavia had a long history of excessive debt and had defaulted in the 1980s. However, highly indebted Bulgaria and Hungary were considered creditworthy (for some years Hungary had been rated by Moody's Investment Services)⁴⁰⁵ as was Czechoslovakia. The debts of Albania and Romania were low, that of the latter because of the decision to liquidate all foreign debt after the default of 1981.⁴⁰⁶ In Albania, the communist government had adhered to a long-standing policy of avoiding foreign loans.

Increasingly, however, the political upheavals in the region, the collapse of domestic output, and the demise of CMEA trading relationships resulted in a general downgrading of credit ratings (chart 4.5.1). By early 1990, commercial banks had curbed their lending to the area also in part because of reports of Soviet arrears in payments to western suppliers. Furthermore in:

- 1990: Bulgaria declared a moratorium on its foreign payments;
- 1991-1992: the SFR of Yugoslavia broke up and the successor states inherited \$15 billion of foreign debt and the task of independently normalizing their relations with creditors. Over \$5 billion in official reserves vanished leaving the successor states to find their own liquidity;
- 1991: the dissolution of the Soviet Union occurred late in this year. In October, the successor countries of the former Soviet Union effectively defaulted on Soviet debt obligations following the depletion of official reserves. Russia eventually assumed full responsibility for the entire external debt (receiving all assets in return). The successor states emerged from the deal largely debt free but lacking international reserves;
- 1992: Albania defaulted on large amounts of short-term debt obligations, most of which were accumulated as the result of speculation in foreign currencies;
- 1993: in January Czechoslovakia was dissolved, an event anticipated with some concern by investors. Eventually, the country's good credit rating was inherited by the Czech Republic, but Slovakia was marked down.

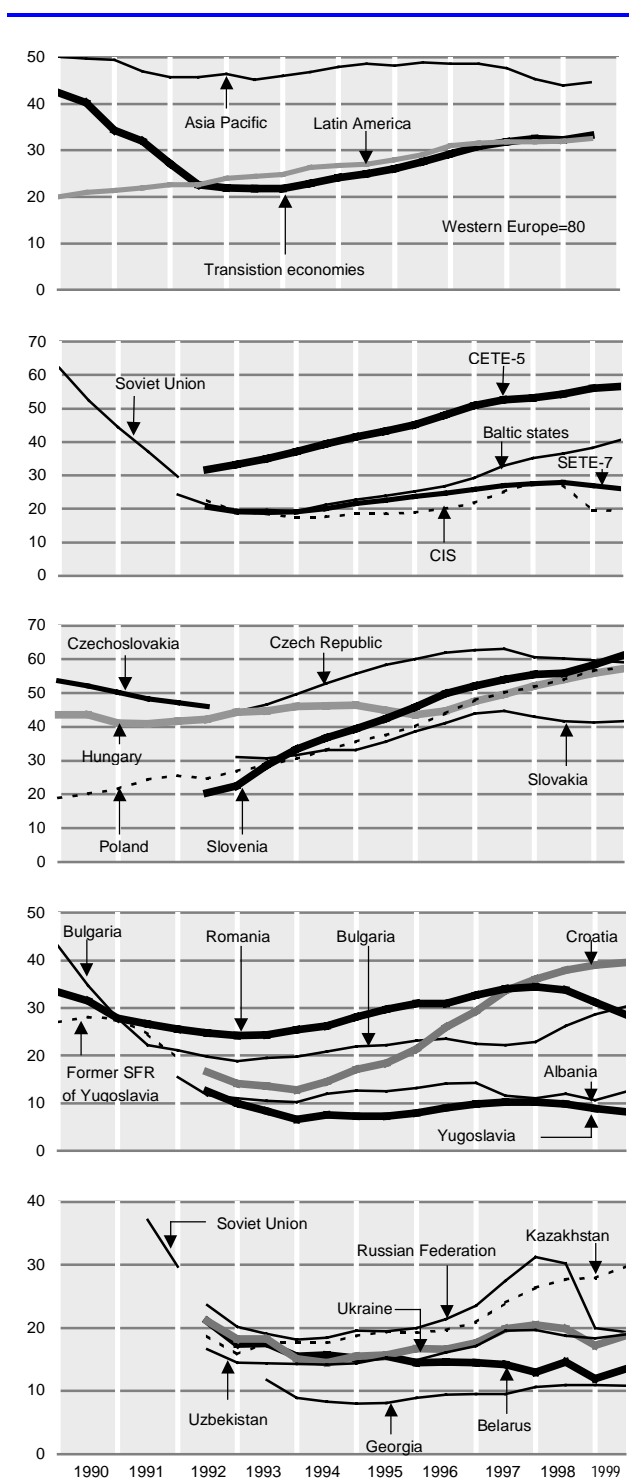
The financial distress of this period, accompanied by bouts of capital flight, triggered adjustments in current account balances (resulting in smaller deficits or higher surpluses), which exacerbated the fall in domestic output. Many of these problems would take years to resolve.

⁴⁰⁵ This was a Ba1 sub-investment grade rating.

⁴⁰⁶ The debt was repaid by draconian cuts of imports and investment, a policy which left the country with an obsolete capital stock and greatly impaired export capacity. This policy contributed to Romania's poor economic condition at the beginning of the transition.

CHART 4.5.1

Credit ratings of selected regions and ECE transition economies, 1990-1999
(Scale 0-100)



Source: Institutional Investor (London), various issues.

Note: SETE-7 excludes Bosnia and Herzegovina and The former Yugoslav Republic of Macedonia. The CIS aggregate reflects only those countries in the lower panel. A country with a grade of 100 stands little chance of default.

(iii) The path to normalcy

More fundamentally, the transition economies were faced with the task of implementing extensive economic and institutional reforms so as to establish the conditions for sustainable market-determined capital inflows and the efficient absorption of resources. Prior to the transition, the eastern economies were unable to attract the full range of market-based foreign capital. Under the centrally planned system, insulated from the international economy, there was no need to develop the necessary market-supporting legal and institutional frameworks. Sovereign borrowing predominated, mainly in the form of syndicated and bilateral loans. Governments also decided the domestic allocation of funds, and foreign investment was prohibited or tightly controlled.⁴⁰⁷ Very briefly, the necessary elements of systemic change involved: allowing resident economic agents to raise capital; the creation of domestic securities markets; privatization (a basis for equity markets); legalization of foreign direct investment; and the partial liberalization of other capital flows (table 4.5.1). These reforms were introduced in parallel with macroeconomic stabilization. Better initial conditions and an early launch of the reforms contributed to central Europe's lead in the creation of a positive investment climate.

Accession to the IMF and World Bank was a priority in order to gain access to financial resources and policy advice, and to reassure foreign investors. An approved IMF programme has been a condition for the release of certain World Bank and various other bilateral funds (below) and, if necessary, for the normalization of creditor relations. Recognizing the particular challenges of transition, the IMF introduced the Systemic Transformation Facility (STF) which provided additional funding under simplified conditions. By 1993, virtually all of the ECE transition economies were IMF members (table 4.5.1) and had drawn on its resources.

For countries in default, the normalization of relations with commercial (London Club) and official (Paris Club) creditors is generally a precondition for re-entering the international credit markets. It also tends to improve foreign assessments of the domestic investment climate. Certain types of investor are legally prohibited from investing in countries in default, if they are not already deterred by a country's balance of payments prospects. The restructuring of debt, which is central to Paris and London Club agreements (table 4.5.1), can provide breathing space for putting an economy in order and upgrading debt servicing capacity. By 1999, only Yugoslavia had failed to conclude such accords. If large debts have rendered a country insolvent, debt forgiveness can improve its chances of regaining creditworthiness. Albania, Bosnia and Herzegovina, Bulgaria and Poland all received debt relief from commercial banks, and

⁴⁰⁷ Yugoslavia was an exception as enterprises had substantial autonomy.

TABLE 4.5.1

Financial milestones in the transition economies

	IMF membership	Debt restructuring		Capital account liberalization ^a	Moody's/Standard & Poor's credit ratings
		Paris Club	London Club		
Albania	Oct.-91	Dec.-93	Jul.-95	16.7	-
Bosnia and Herzegovina ..	Dec.-95	Oct.-98	Dec-97	17.6	-
Bulgaria	Sept.-90	Apr.-91	Jul.-94	35.3	B2/B
		Apr.-94			
Croatia	Dec.-92	Mar.-95	-	44.4	Baa3/BBB-
Czech Republic	Jan.-93			73.7	Baa1/A-
Hungary	May-82			59.5	Baa1/BBB+
Poland	Jun.-86	Apr.-91	Oct.-94	55.3	Baa1/BBB
Romania	Dec.-72			12.5	B3/B-
Slovakia	Jan.-93			23.7	Ba1/BB+
Slovenia	Dec.-92			40.5	A3/A
The former Yugoslav					
Republic of Macedonia ..	Dec.-92	Jul.-95	-	23.3	-
Yugoslavia	-			..	-
Estonia	May-92			..	Baa1/BBB+
Latvia	May-92			..	Baa2/BBB
Lithuania	Apr.-92			..	Ba1/BBB-
Armenia	May-92			..	-
Azerbaijan	Sept.-92			..	-
Belarus	Jul.-92			..	-
Georgia	May-92			..	-
Kazakhstan	Jul.-92			..	B1/B+
Kyrgyzstan	May-92			..	-
Republic of Moldova	Aug.-92			..	B2/
Russian Federation	Jun.-92	Apr.-93	Dec.-92	..	B3/CCC+
		Apr.-96	Sept.-97		
Tajikistan	Apr.-93			..	-
Turkmenistan	Sept.-92			..	B2/
Ukraine	Sept.-92			..	Caa3/
Uzbekistan	Sept.-92			..	-
<i>Memorandum items:</i>					
Czechoslovakia	Sept.-90			..	..
Soviet Union	Jul.-91 ^b			..	..

Source: IMF, *International Financial Statistics and Impact of EMU on Selected Non-European Countries*, Occasional Paper No. 174 (Washington, D.C.), 1998; World Bank, *Global Development Finance* (Washington, D.C.), 1999.

Note: Bold indicates that the debt restructuring agreement also involved debt reduction. In the case of credit ratings, bold indicates an investment grade rating.

^a Index of capital account liberalization, ranging from 0-100 (fully liberalized capital account).

^b Applied for membership.

Bosnia and Herzegovina and Poland from official creditors as well.⁴⁰⁸

In 1989 the international community launched a plan of official assistance intended to provide support for economic reform. Coordinated by the EU, the G-24 programmes pledged grants, emergency aid and new bilateral loans.⁴⁰⁹ They were eventually extended to most

⁴⁰⁸ Poland was accorded special treatment by the Paris Club which included a 50 per cent reduction in the net present value of the stock of eligible debt. The official debt of Bosnia and Herzegovina was reduced as part of the Dayton Accord.

⁴⁰⁹ Included were balance of payments loans (conditional on IMF approval) and, from the EU, European Investment Bank loans. UN/ECE,

east European and Baltic countries. Later, similar programmes of assistance were introduced for the CIS, including a \$24 billion financing package for Russia announced by the G-7 in April 1992. A new institution, the EBRD, was created to help support the transformation with equity investments and loans.

Since the early 1990s most transition economies have strived to improve their creditworthiness, in order to broaden their access to private capital and to obtain lower borrowing costs. Commitment to economic reform, better external financial positions and improved economic performance, as well as debt restructuring agreements (Bulgaria, Croatia, Poland, Slovenia and Russia), seem to explain much of the improvement in credit ratings (chart 4.5.1). The central European countries lead in this respect with a current average rating of 56, still far below the 80 of western Europe. Several countries were downgraded after the Asian and Russian financial crises, often as a consequence of their own policies, but others have improved (Hungary was the latest country to receive an upgrade in February 2000). Currently, six transition economies are rated investment grade risks (table 4.5.1).

(iv) The development of capital inflows since 1990

These economic and institutional changes have paved the way for capital flows into the eastern countries.⁴¹⁰ Early in the decade, net capital flows into *eastern Europe* were modest (chart 4.1.1), inflows of official funds being partially offset by capital flight. The capital surge in 1993 originated in Hungary and the Czech Republic. Hungary borrowed heavily to finance its emerging current account deficit (section 4.1) and privatization-related FDI also rose sharply. In the Czech Republic portfolio investment responded to the opening of the securities markets to foreigners. In both countries, the outflow of short-term funds (capital flight) was reversed. In 1995 the flow of funds into eastern Europe peaked at 7.3 per cent of GDP (chart 4.1.1). This new surge reflected a greater diversity of countries and types of capital. The Czech Republic and Hungary again led the way, the latter reporting record privatization revenues. In Poland FDI, portfolio and other short-term investments increased as confidence rose following the normalization of credit relations and improving economic performance. Henceforth, Poland became the main destination of foreign capital entering the area. Starting in 1995,

Croatia, Romania and Slovenia also experienced larger and sustained capital inflows.

In several cases capital inflows were responding to the large premia on domestic interest rates⁴¹¹ stemming from tough anti-inflationary policies. These high yields attracted foreign investors and encouraged residents to seek cheaper credits abroad. This practice was perhaps most pronounced in the Czech Republic between 1993 and early 1997 and in Poland which was swamped by short-term flows in 1995-1998.

In the countries of the former Soviet Union, capital imports generally picked up only in 1992 or later. Inflows into the Baltic states increased rapidly (to nearly 13 per cent of GDP), until the downturn in 1999 (chart 4.1.1). In the Asian CIS, capital imports doubled in six years. However, the stable ratio of inflows to GDP conceals uneven developments between countries (table 4.3.1). In the *European CIS*, however, the ratio declined slowly until foreign financial crises and domestic problems caused inflows to plunge in 1998-1999. Although the exact size of *Russia's* capital flows is uncertain, all measures indicate substantial volatility. Chart 4.1.1 shows reported financial inflows and, separately, the sum of recorded flows and "errors and omissions". This latter item, generally considered to reflect unrecorded capital flows (i.e. largely capital flight), has typically been large and negative (as is common in the developing countries, but not recently in eastern Europe). Net capital outflows (including unrecorded capital) averaged about 3 per cent of GDP in 1993-1998. This has been made possible by a large current account surplus and foreign borrowing.

The early reforming countries – the Czech Republic, Hungary and Poland – have attracted most of the foreign capital (table 4.5.2), about 60 per cent of the regional total. On a per capita basis, the Czech Republic and Hungary also rank high as do some of the south European and Baltic countries (chart 4.5.2). The top five countries attracted nearly nine times more capital per capita than the bottom five. Several low income countries (Azerbaijan, Armenia and The former Yugoslav Republic of Macedonia) are near the top of a ranking based on the ratio of inflows to GDP (table 4.5.2).

Much of the intercountry differences in total capital inflows reflects their degree of economic reform (chart 4.5.3). This is not surprising, as access to even official funds is often conditional on the implementation of structural reforms and sound macroeconomic policies. Private capital is unlikely to be attracted to countries where the protection of property rights is weak and the institutional framework for market-based activity is deficient.

"International support for eastern transformation", *Economic Survey of Europe in 1991-1992*.

⁴¹⁰ This section is based on national balance of payments statistics. However, data through 1997 in World Bank, *Global Development Finance* (Washington, D.C.), 1999 has been used for the official and private flows in chart 4.5.5 (a breakdown which is generally not possible from available balance of payments statistics). The discussion of medium- and long-term debt below, based on balance of payments data, necessarily includes both official and private debt (although as shown below the former has declined in importance). Due to various recording problems, there is considerable uncertainty about the Russian balance of payments data.

⁴¹¹ In Hungary and Poland, such premia were high even allowing for the pre-announced rates of currency depreciation. The fixed peg exchange rate policy in the Czech Republic was perceived by investors as removing exchange rate risk. UN/ECE, *Economic Bulletin for Europe*, Vol. 49, 1997.

TABLE 4.5.2

Net capital flows into the transition economies, by type of flow, 1993-1998

	Total flows (1993-1998)			Private flows (Per GDP) ^a	
	Dollars (billions)	Per capita	Per GDP ^a	Total	Long- term
Eastern Europe^b	110.9	1 036	133	106	79
Albania	0.9	298	111	26	39
Bosnia and Herzegovina ^c ..	3.8	1 082	..	..	..
Bulgaria	2.5	292	62	47	-1
Croatia	7.6	1 686	250	159	137
Czech Republic	22.7	2 208	169	154	112
Hungary	20.5	2 017	204	207	160
Poland	32.4	837	112	80	61
Romania	12.4	550	87	44	42
Slovakia	8.3	1 547	163	148	73
Slovenia	2.2	1 094	78	108	108
The former Yugoslav Republic of Macedonia	1.5	748	175	20	5
Baltic states	9.0	1 181	188	92	79
Estonia	2.4	1 646	218	131	100
Latvia	1.5	595	106	109	103
Lithuania	5.1	1 389	223	63	55
CIS	-28.0	-131	-22	21	16
Armenia	1.7	473	229	14	12
Azerbaijan	4.0	528	256	99	99
Belarus	3.8	366	62	14	10
Georgia	1.8	348	105	6	6
Kazakhstan	6.1	372	77	76	71
Kyrgyzstan	1.5	325	141	26	23
Republic of Moldova	1.1	252	113	43	40
Russian Federation	-40.8	-277	-40	21	17
Tajikistan	0.8	129	136	29	23
Turkmenistan	1.7	392	148	156	110
Ukraine	8.0	156	47	23	17
Uzbekistan	2.9	124	59	39	30
Total above^b	91.9	231	39	56	43
Memorandum items:					
CETE-5	86.1	1 295	143	125	92
SETE-7^b	24.8	612	108	58	46
Russian Federation ^d	2.6	18	3	21	17
Asian CIS	20.4	288	105	61	53
Three European CIS ^e	12.9	195	54	21	16

Source: UN/ECE secretariat estimates, based on national balance of payments statistics. Private flows in 1993-1997 are from the World Bank, *Global Development Finance* (Washington, D.C.), 1999.

Note: Total flows are the sum of the capital and financial accounts and errors and omissions as reported in the national balance of payments statistics. Total private flows includes FDI, long-term private guaranteed and non-guaranteed debt, short-term debt and portfolio equity flows.

^a Per \$1,000 GDP in 1997. These are purchasing power parity (PPP) estimates of GDP.

^b Excluding Bosnia and Herzegovina and Yugoslavia.

^c 1994-1998.

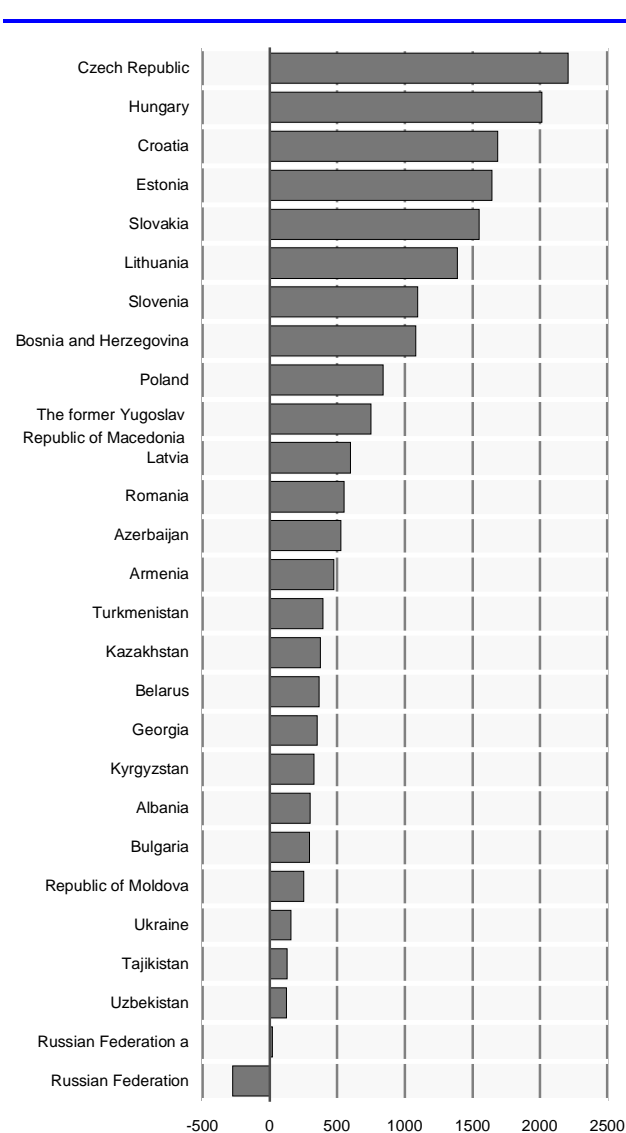
^d Excluding errors and omission from total flows.

^e Belarus, Republic of Moldova and Ukraine.

The geographical distribution of net capital flows into the transition economies has gradually become more diversified (chart 4.5.4). Since the first half of the decade, the dominance of central Europe has diminished while the shares of the other groups (but not the European CIS) have risen.

CHART 4.5.2

Capital flows into the transition economies, 1993-1998
(Dollars per capita)



Source: UN/ECE secretariat, based on national balance of payments statistics.

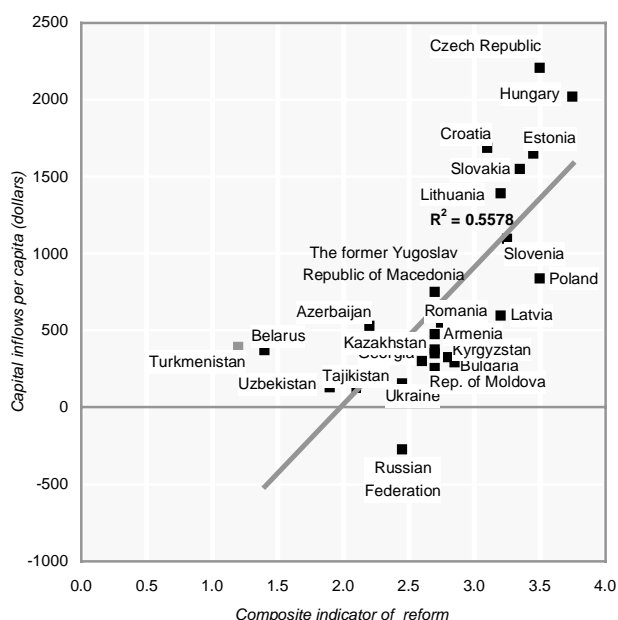
Note: Flows include errors and omissions.

^a Excludes errors and omissions.

Financial inflows (often including IMF funds) have allowed for the rebuilding of official reserves (chart 4.1.1). In eastern Europe, reserves increased markedly as a result of the surge in capital inflows in 1993-1995. However, the rate of accumulation slowed as current accounts deficits rose (which was also true in the Baltic states). In three European CIS countries official reserves were drawn down in response to the tightening of financial constraints in 1997-1998 (the upturn in reserves in 1999 stems from their shift to current account surplus (section 4.1). Capital and current accounts have been roughly balanced in the Asian CIS and official reserve positions of most of these countries have been consequently weak.

CHART 4.5.3

Progress in transition and total capital inflows per capita, 1993-1998
 $(y = -1764 + 892X)$



Source: UN/ECE secretariat, based on national statistics. Transition indicators are from EBRD, *Transition Report 1999* (London).

Note: The regression excludes Turkmenistan.

The growth of capital inflows into the transition economies has been associated with major changes in their composition. In the early stages of the transition, official funds, initially mostly IMF credits and grant aid, accounted for the bulk of financial inflows (chart 4.5.5). In central Europe, IMF loans peaked already in 1991, their subsequent rapid repayment⁴¹² offsetting the growth of other multilateral loans and grants. The pattern was similar in the Baltic states, although net repayments of IMF credits started later. By contrast south-east Europe has continued to rely heavily on official sources.⁴¹³ In the three European and Asian CIS the use of official resources rose until 1995. Russia received large grants in the first half of the decade, but bilateral loans (used extensively by the Soviet Union) have diminished. However, borrowing from the IMF has been heavy, especially in 1995-1996. By 1997, the net flows of private funds into the transition economies were generally several times larger than official flows (chart 4.5.5 and table 4.5.2). This was most pronounced in central Europe, which

⁴¹² The Czech Republic, Hungary and Poland were free of IMF debt by 1996.

⁴¹³ Croatia is an exception. Bosnia and Herzegovina, which is not included in the chart for lack of data, has drawn on an official aid package of \$5 billion included in the Dayton Accord.

accounted for 57 per cent of total private flows during 1993-1997. Relative to GDP, the central European countries, Croatia, Estonia, Latvia, Azerbaijan and Turkmenistan, have been the leading recipients (table 4.5.2).

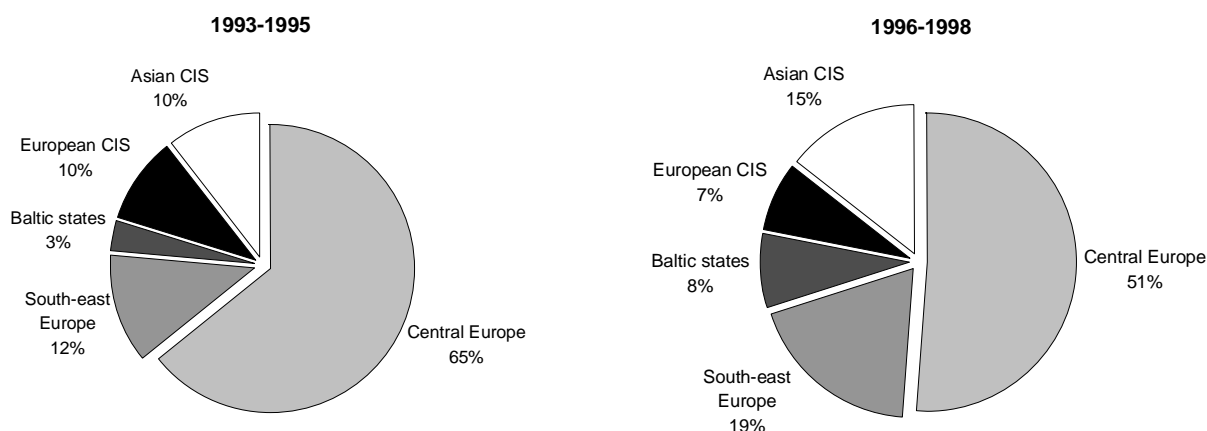
The growing importance of private capital has been associated with an increasing share of funds of a long-term nature (FDI and long-term debt, table 4.5.3). The emergence of FDI as the principal source of external finance (see section 4.3) is generally viewed favourably since such funds are often accompanied by new technologies, improved corporate governance and marketing, and so on. FDI has tended to be linked for most of the period with the privatization of state assets, which also helps to explain why slowly reforming countries have received little FDI. However, reinvested profits and greenfield investments are becoming more important. On average, the share of FDI in total net inflows is higher in transition economies than in developing economies.⁴¹⁴

South-east Europe and the Baltic states have increased their use of long-term, mainly private, debt (table 4.5.3). Typically this mode of financing is only open to creditworthy countries. In southern Europe, Croatia and Romania have resorted to private debt financing to cover large current account deficits since FDI inflows have been small. By contrast, long-term debt inflows into central Europe diminished in 1996-1998, when sovereign borrowing was largely obviated by foreign private investment. In Slovenia the current account was in surplus and Hungary was actually paying off foreign debt (with privatization revenues), having brought the current account under control. However, Slovakia's growing current account deficits were financed by foreign debt. In the CIS, low credit ratings generally constrained access to financial markets, although Kazakhstan, and for a limited period, the Republic of Moldova, Russia and Ukraine, were able to issue bonds. Borrowing became considerably more difficult for virtually all the transition economies after the Asian and Russian financial crises.

Short-term funds are defined here as short-term debt, portfolio equity investment and errors and omissions as reported in the balance of payments. The latter item is generally taken to represent unrecorded capital flows, which in the transition economies have been generally positive (the exceptions are Kazakhstan, Russia and recently, Ukraine). Virtually all the transition economies have received large short-term inflows (often associated with tight macroeconomic policies and high interest rates), but in central Europe their importance grew, from 20 per cent of total inflows in 1993-1995 to

⁴¹⁴ In 1990-1998, FDI accounted for 34 per cent of capital inflows into the developing economies (up from 18 per cent in 1983-1989). UNCTAD, op.cit., chart 5.3.

CHART 4.5.4

Share of regions in total net inflow of finance in transition economies, 1993-1998
(Per cent)

Source: UN/ECE secretariat, based on national balance of payments statistics.

Note: The chart excludes the Russian Federation because its average net inflows were negative during these periods. Southern Europe excludes Bosnia and Herzegovina and Yugoslavia. Net inflows include errors and omissions.

TABLE 4.5.3

Net capital flows into the transition economies, by type of finance, 1993-1998
(Per cent of GDP)

	CETE-5		SETE-7 ^a		Baltic states		Russian Federation		European CIS		Asian CIS	
	1993-1995	1996-1998	1993-1995	1996-1998	1993-1995	1996-1998	1993-1995	1996-1998	1993-1995	1996-1998	1993-1995	1996-1998
Capital transfers ^b	1.8	0.1	0.8	0.2	-0.1	0.1	0.2	-0.1	0.1	0.2	-0.4	-0.6
Foreign direct investment	2.3	2.6	0.9	2.9	4.2	5.7	0.4	0.7	0.6	1.3	3.4	5.3
Long-term debt	0.9	0.3	1.5	3.4	4.8	4.3	-0.7	-0.3	4.8	2.5	4.8 ^c	3.7 ^c
External bonds	1.4	0.4	-0.1	0.8	0.1	0.7	-0.1	1.5	-0.2	0.4	-	0.4
IMF	-0.5	-0.1	0.1	-	1.4	-0.2	1.1	0.9	1.6	0.6	1.0	0.9
Short-term funds	1.3	2.3	1.1	1.0	-2.4	1.7	-2.0	-2.4	-0.7	-0.5	..	..
Portfolio investment ^d	0.6	0.6	-	0.7	-0.4	-0.9	-0.2	4.0	0.1	0.7	..	..
Short-term flows	0.3	0.9	0.7	-0.1	1.3	1.5	0.1	-3.9	-0.6	-0.5	..	..
Errors and omissions	0.4	0.8	0.4	0.4	-3.4	1.2	-1.9	-2.5	-0.2	-0.7	..	..
Total net flows	6.2	5.2	4.2	7.4	6.5	11.8	-2.1	-2.1	4.8	3.6	7.8	8.4
Memorandum item:												
Total flows (billions)	40.5	45.3	7.8	16.7	2.0	7.0	-16.5	-24.3	6.3	6.6	7.4	13.0

Source: National balance of payments statistics; World Bank, *Global Development Finance* (Washington, D.C.), 1999 (for net bonds and portfolio equity flows).

^a Excludes Bosnia and Herzegovina and Yugoslavia.

^b Includes debt write-offs under debt restructuring agreements, especially important for Poland (in CETE-5) during 1993-1995 (see text).

^c Includes portfolio investment, short-term investment and errors and omissions.

^d Excludes external bonds.

44 per cent in 1996-1998. In general these short-term funds have not been necessary for current account financing, a risky practice because of their volatility. However, they have posed challenges for macroeconomic policy, large inflows causing exchange rate appreciation and necessitating sterilization operations.⁴¹⁵ On the other hand, outflows triggered

during the past two years by contagion or unsustainable domestic policies have sometimes led to currency crises.

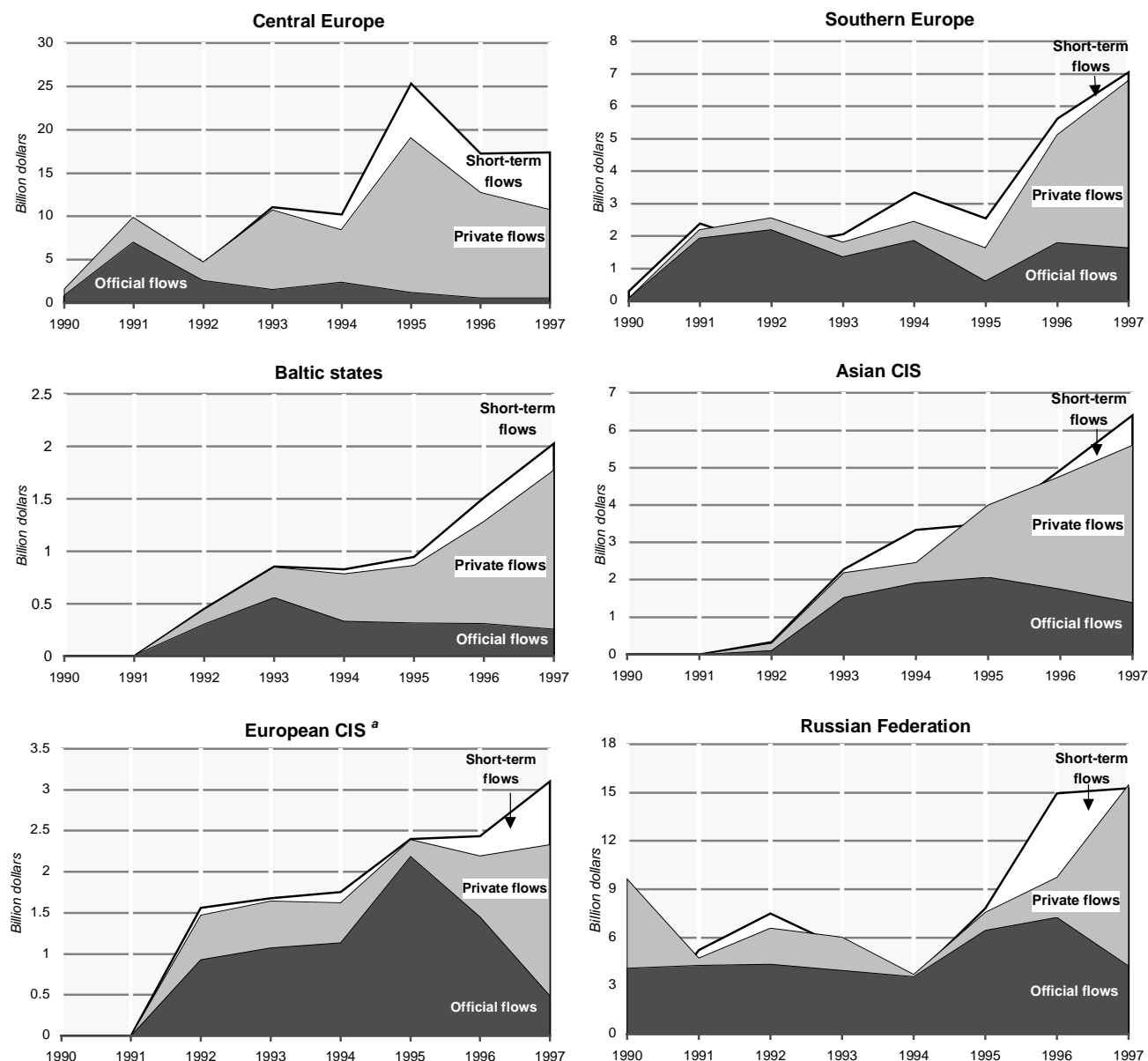
(v) Concluding observations

Despite the difficult financial situation in the early 1990s and the various obstacles to be overcome (in some countries key problems were not sorted out until the middle of the decade), many transition economies have attracted capital inflows of the order of 5 per cent of GDP or more, similar to that received by the developing

⁴¹⁵ UN/ECE, *Economic Bulletin for Europe*, Vol. 49, 1997 and *Economic Survey of Europe*, 1999 No. 1, sect. 4.3.

CHART 4.5.5

Total, official and private net resource flows to the transition economies, 1990-1997
(Billion dollars)



Source: UN/ECE secretariat, based on World Bank, *Global Development Finance* (Washington, D.C.), 1999.

Note: Official flows include official loans and grants; private flows include FDI, long-term debt and short-term flows (short-term funds and portfolio equity flows).

^a Excluding Russian Federation.

economies in the 1990s.⁴¹⁶ However, a significant number have still failed to create the conditions for attracting private capital inflows and recently several have suffered new setbacks (e.g. Russia in 1998).

It is likely that IMF programmes and other official funds provided vital support early in the transition in helping to build credibility, boosting foreign exchange reserves and paving the way for credit ratings (although

Slovenia accomplished this without any IMF funds at all). IMF resources appear to have been particularly important in 1991 when western banks withdrew new credits. In most central European and Baltic countries, resort to IMF facilities was temporary (as in fact it was intended to be), but in general recidivism has prevailed in the region.

The developments described above have implications for the sustainability of financial inflows and current account deficits. The shift toward private long-term capital is desirable since the global supply is relatively elastic (unlike official funds). Provided that

⁴¹⁶ UNCTAD, op. cit., table 5.1.

these countries remain creditworthy, financing through long-term debt should not be a problem. However, the risk of market instabilities and of interruptions to the flow of long-term funds persists (as occurred in 1997 and 1998). Although most creditworthy transition economies have been able to tap the international fund markets again, corporate borrowing is still below the levels prevailing before the Asian financial crisis. The growth of FDI has been viewed positively since it does not add to foreign debt (although it eventually gives rise to profit repatriation) and appears to be more stable than other funds. Moreover, FDI proved to be resilient in the wake of the Asian and Russian crises (section 4.3 above). With policy makers increasingly relying on FDI for current account financing, assuring future flows takes on additional importance (section 4.4).

Despite their particularly difficult initial financial conditions, Poland, Croatia, Slovenia and the Baltic states currently enjoy some of the highest credit ratings and

have attracted the largest amounts of foreign capital among the transition economies. In doing this they have demonstrated that dire financial straits are not necessarily a permanent impediment to market entry. They have benefited from the increasing willingness of investors to differentiate between countries on the basis of economic fundamentals (although in crises they are still likely to suffer from contagion). Other countries, including some considered creditworthy in 1990, have not fared as well in the ratings. It is also true, however, that some of these have still been able to attract funds temporarily. Plenty of lenders were prepared to extend cash (at high yields) in the absence of fundamental reform as long as debt levels did not seem to be excessive, although financial crises have generally followed. Experience also shows that debt restructuring is a necessary but not a sufficient condition for regaining long-lasting access to the capital markets. Even debt reduction has not guaranteed success in this regard as reflected in the lone positive example of Poland.