



COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 08.01.1997  
COM(96) 695 final

**REPORT FROM THE COMMISSION  
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT  
ON THE IMPLEMENTATION OF MACRO-FINANCIAL ASSISTANCE  
TO THIRD COUNTRIES IN 1995**

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## I. OVERVIEW

### 1. Introduction

Initially conceived for intra-Community balance-of-payments support, macro-financial assistance from the Community has been extended since 1990 to third countries, mainly those of Central and Eastern Europe, but, progressively, also to other countries, in the former Soviet Union and in the Mediterranean area, with a view to supporting their political and economic reform efforts. As they embarked on their process of transition to a market economy, the countries of this region were faced with similar problems: substantial costs attached to the first steps of reform, additional external shocks (the Gulf War embargo, the collapse of the COMECON), insufficient resources available from the International Financial Institutions (IFIs) and virtually non-existent flows from the private sector.

Against this background, the European Community decided to extend macro-financial assistance to the countries in the region in complement to the financing provided by the IFIs. It was also decided that, in the context of the assistance co-ordination process agreed among the 24 industrial countries (G-24) to help the Central and Eastern European Countries (CEECs), the Commission should get other donors to contribute in a similar way to support the economic programmes that these countries were implementing in agreement with the IMF and World Bank.

A number of such support operations by the EU and the G-24 took place in 1990-1994 covering most central and eastern European countries eligible to G-24 assistance (Tables 1 and 2).

Outside the region of Central and Eastern Europe, several other Community loan operations were decided by the Council during this period. In the context of Community support for Mediterranean countries adversely affected by the Gulf conflict, the Council made available to Israel an ECU 160 million soft loan in July 1991. In September 1991, a medium-term loan of ECU 400 million was also decided in favour of Algeria to help the country carry through the political and economic reforms under way<sup>1</sup>. A further loan to Algeria for an amount of up to ECU 200 million was decided in late 1994<sup>2</sup>.

Operations in favour of European Newly Independent States (NIS) have also been decided in 1994 comprising loans of up to ECU 45 million for Moldova and of up to ECU 85 million for Ukraine.

At the initiative of the European Commission, a set of principles was agreed among the G-24 to serve as guidelines for the implementation of EU/G-24 macro-financial assistance. These principles which underline the exceptional character of this assistance, its complementarity to financing from the IFIs and its macro-economic conditionality, have

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<sup>1</sup> See: Report on the implementation of macro-financial assistance to third countries, COM(94)229 of 7 June 1994.

<sup>2</sup> See: Report on the implementation of macro-financial assistance to third countries, COM(95)572 of 27 November 1995.

been subsequently endorsed by the EU Council of Ministers of Finance (ECOFIN) and are now applying to the Community's macro-financial assistance to third countries.

## **2. Macro-financial assistance in 1995**

In 1995, focus in the Community's macro-financial assistance shifted away from the Central and Eastern European group which, as a result of a generally positive economic performance, is relying less and less on external financial support from official sources. Instead, an increasing part of Community loans were directed towards the NIS and the Mediterranean region.

Within the Central and Eastern European group, a first tranche of ECU 15 million of a grant to Albania totalling ECU 35 million, decided in December 1994, was actually disbursed in May 1995. The second tranche has, however, been delayed due to slippages in policy implementation in Albania. For similar reasons, disbursements pertaining to a ECU 125 million macro-financial loan to Romania decided in 1994 were delayed and the actual disbursement of the first tranche of ECU 55 million took place only in November 1995. In the case of Bulgaria, serious disturbances in the economy have considerably delayed the resumption of external assistance from the international financial institutions, the European Union and bilateral donors. A second tranche of ECU 40 million which is part of a Community loan of ECU 110 million to Bulgaria and which was initially decided in 1992 and reactivated in 1994 is expected to be disbursed in 1996. In the case of Slovakia, no disbursements were made during 1995 under the ECU 130 million loan facility decided in late 1994. To the contrary, in the absence of sufficient progress between the Commission and the Slovak authorities in agreeing on the economic policy conditions to be attached to this facility and on account of the improving economic conditions in the country, the Commission has proposed to repeal the Council decision from 1994 to grant further macro-financial assistance to Slovakia. As regards all three Baltic states for which the Council had approved in 1992 macro-financial assistance, second tranches pertaining to the loans in favour of Latvia and Estonia have not been disbursed, on account mainly of the good record of the countries' balance of payments. In August 1995 the Commission disbursed an ECU 25 million instalment on the second tranche of the Community loan in favour of Lithuania, on account of the country's good record of progress of reforms.

Among the NIS (former Soviet Union), the Commission was, for Moldova, in a position to release the second tranche of ECU 20 million pertaining to a ECU 45 million loan from 1994 in August 1995, following fulfilment on the part of Moldova of the agreed conditions for the release of this tranche. With a view to ensuring a sustainable balance-of-payments situation for Moldova also during the 1995-1996 period the international donor community recognised, in early 1995, the need to provide further macro-financial assistance to this country. The Council consequently decided, in early 1996, to provide Moldova with a further loan of up to ECU 15 million. Belarus, which has been relatively late in embarking on economic reform, agreed a stand-by arrangement with the IMF in 1995. In the circumstances, the Council, after assessing the economic and financial situation of the country, decided in April 1995 to assist Belarus with a macro-financial loan of up to ECU 75 million. The Commission eventually in October set the amount of the loan at ECU 55 million on the basis of the country's revised financing needs. A first tranche of this loan (ECU 30 million) was disbursed in December 1995. Regarding Ukraine, finally, the Commission was, after significant delays on the part of the Ukrainian authorities, in a position to disburse a macro-financial loan of ECU 85 million in December of 1995. In the light of the continued economic difficulties of the country and

renewed efforts by the Ukrainian government to address these difficulties, the Council decided in October 1995 to provide further macro-financial assistance to Ukraine up to an amount of ECU 200 million. The first disbursements under this loan facility are expected for the second half of 1996.

In the Mediterranean region, finally, a second macro-financial loan to Algeria, of the amount of ECU 200 million, was decided by the Council in December 1994 and the first tranche - of ECU 100 million - was disbursed in November 1995.

Each Community operation has continued to respond to the set of principles applying to this type of assistance. In particular, Community macro-financial assistance has supported efforts by recipient countries to bring about economic reforms and structural changes. In close co-ordination with the IMF and the World Bank, it has promoted policies tailored to the specific national needs, designed to stabilize the financial situation and set up market-oriented economies, (macroeconomic performance and progress in reforms in beneficiary countries are summarized in Tables 4 and 5 and discussed country by country in the following chapters).

### **3. Trends and tendencies in macro-financial assistance**

As indicated earlier, developments in 1995 further reinforced a trend that could be seen already in 1994 with respect to the geographical focus of the Community's macro-financial assistance. Simultaneously, the increasing diversity in economic conditions among beneficiaries led to increasingly diverse demands, which - in turn - have made the macro-financial instrument, as such, evolve further. A relevant question for the future is to what extent the existing instrument(s) can be adapted further to suit the goals of the Union while at the same time meeting the evolving needs of beneficiary countries.

In the case of the Central and East European countries, macro-financial support has formed part of a broad effort by the Union to establish closer links with them. Association Agreements have been signed with practically all these countries. In accepting, in Copenhagen in June 1993, the goal of Union membership for them, the European Council put forward political and economic measures to promote this end, among which macro-financial assistance was explicitly mentioned as one avenue. Since then, the process of preparing the associated states of Central and Eastern Europe for membership has intensified.

During this process, the links between macro-economic stabilisation and structural adjustment have become increasingly clearer. For the IMF, it translated into a better integration of such aspects into programmes negotiated with these countries while the World Bank supported national authorities to design specific programmes focusing on key structural reforms to be supported by policy-based lending.

For the Union as well, both timing and content of programmes have been affected. Community lending has become more policy-oriented while at the same time achieving greater synergy with grant-based instruments (mostly PHARE).

The countries in Central and Eastern Europe are in different stages of economic transformation and some of them have clearly moved to a stage in their economic reform process where balance of payments assistance may no longer be needed. The Community macro-financial assistance in its original form, to support macro-economic stabilisation and the balance of payments, is still fully relevant for assisting some of them. In several

other countries macro-financial assistance is now more centred on supporting the government's structural reform programme in combination with PHARE, which whenever possible can contribute to strengthening the capacity of relevant national institutions to underpin such reforms. In general, these developments have also led to increased co-operation between the Commission and the Bretton Woods institutions. At the same time, the dialogue with the authorities in the countries concerned has broadened considerably.

While overall amounts of resources committed have fallen, the Community macro-financial assistance has thus tended to become geographically more targeted on associate countries further to the east and south in Europe.

The trend towards supporting neighbouring countries further away from the immediate borders of the Union is reinforced if we also consider the three European New Independent States that have received macro-financial support from the Community - Ukraine, Belarus and Moldova. Here too, focus has gradually shifted towards more emphasis on structural reform. As in CEECs, grant-based instruments (mainly TACIS) have been relied upon in parallel to support the countries concerned.

The specific examples of Ukraine and Belarus, together with Bulgaria and Romania among the CEECs, also serve to illustrate another trend, namely that countries that have either embarked late on economic reform, like Belarus, or have moved slowly, like Romania, or have lost time while hesitating or even partly reversing reforms, like Ukraine or Bulgaria, all find themselves in relatively difficult positions. In this respect, the macro-financial assistance provided by the Community seems to have well served its cause by reinforcing the transition efforts in those countries who choose to embark on ambitious reform programmes.

#### 4. Burden-sharing

While Community macro-financial assistance has been evolving towards a deepened policy-oriented approach, resources mobilized by the Union in this context have been decreasing substantially (Tables 3 and 3.1). Initially, an important feature of Community assistance was that very large sums of money were to be found to support Bretton Woods institutions programmes. The Community played a key role both as the largest single provider of these funds, (mobilizing 54% of total balance of payments support to Hungary in 1990) and through its role as the co-ordinator of bilateral assistance (the G-24 process for CEECs since 1991), which ensured a wide participation in this effort.

Eventually, more resources were mobilized by the IFIs (whose contribution increased from 21% of balance of payments support - excluding debt relief - in 1991 to some 80 percent in 1995): a new lending instrument, the Systemic Transformation Facility (STF) was created which, together with the increase in the access limits, enabled the IMF to increase its assistance to CEECs and countries of the former Soviet Union. The World Bank, for its part, developed successive generations of policy-based balance of payments operations (Structural Adjustment loans -SAL-, followed by Enterprise and Financial Sectors Adjustment loans -EFSAL<sup>3</sup>).

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<sup>3</sup> Most EFSAL operations discussed with beneficiary countries could not be concluded by end-1995 and are therefore not included in the commitments recorded in Tables 3 and 3.1. When they are, contribution by the World Bank will increase accordingly.

In parallel, contributions by external creditors, both public and private, were mobilized in the framework of debt-relief and debt-reduction operations (Algeria, Bulgaria, Ukraine), accounting for a substantial share of balance of payments support in 1991 and 1994.

In this context, relative contributions<sup>4</sup> from the European Union and from other bilaterals (beyond debt relief operations) declined sharply from 54% and 25%, respectively in 1990 to 14% and 6%, respectively, in 1995 (or 6% and 3%, respectively, of total commitments including debt relief operations).

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<sup>4</sup> Only the countries for which macro-financial assistance from the EU has been mobilized are covered by these statistics.



**Table I: COMMUNITY MACRO-FINANCIAL ASSISTANCE TO THIRD COUNTRIES  
EXTENDED THROUGH END 1995**

Status of effective disbursements as of April 1996 (in millions of ECU)

<u>Country</u>	<u>Maximum amount authorized</u>	<u>Date of Council Decision</u>	<u>Disbursed</u>	<u>Amounts and Dates of disbursements</u>	<u>Undisbursed</u>
<b>A. Macro-financial assistance to CEECs</b>					
Hungary I (Structural adjustment loan)	870	22.02.90	610	350 - Apr. 1990 260 - Feb. 1991	260
Czech and Slovak Federal Republic (Balance of payments loan)	375	25.02.91	375	185 - Mar. 1991 190 - Mar. 1992	
Hungary II (Balance of payments loan)	180	24.06.91	180	100 - Aug. 1991 80 - Jan. 1993	
Bulgaria I (Balance of payments loan)	290	24.06.91	290	150 - Aug. 1991 140 - Mar. 1992	
Romania I (Balance of payments loan)	375	22.07.91	375	190 - Jan. 1992 185 - Apr. 1992	
Albania I (Balance of payments grant)	70	28.09.92	70	35 - Dec. 1992 35 - Aug. 1993	
Baltics (Balance of payments loans) of which :	220	23.11.92	135		85
Estonia	40		20	Mar. 1993	20
Latvia	80		40	Mar. 1993	40
Lithuania	100		75	50 - Jul. 1993 25 - Aug. 1995	25
Romania II (Balance of payments loan)	80	27.11.92	80	Feb. 1993	
Bulgaria II (Balance of payments loan)	110	19.10.92	70	Dec. 1994	40
Romania III (Balance of payments loan)	125	20.06.94	55	Nov. 1995	70
Albania II (Balance of payments grant)	35	28.11.94	15	Jun. 1995	20
Slovakia (Balance of payments loan)	130	22.12.94			130
<b>TOTAL A</b>	<b>2860</b>		<b>2255</b>		<b>605</b>
<b>B. Macro-financial assistance to other third countries</b>					
Israel (1) (Structural adjustment soft loan)	187.5	22.07.91	187.5	Mar. 1992	
Algeria I (Balance of payments loan)	400	23.09.91	400	250 - Jan. 1992 150 - Aug. 1994	
Moldova (Balance of payments loan)	45	13.06.94	45	25 - Dec 1994 20 - Aug. 1995	
Algeria II (Balance of payments loan)	200	22.12.94	100	Nov. 1995	100
Ukraine I (Balance of payments loan)	85	22.12.94	85	Dec 1995	
Belarus (Balance of payments loan)	55	10.04.95	30	Dec 1995	25
Ukraine II (Balance of payments loan)	200	23.10.95			200
<b>TOTAL B</b>	<b>1172.5</b>		<b>847.5</b>		<b>325</b>
<b>TOTAL A+B</b>	<b>4032.5</b>		<b>3102.5</b>		<b>930</b>

(1) Assistance to Israel includes a loan principal amount of ECU 160 million and grants of ECU 27.5 million in the form of interest rates subsidies.

Table 2: EU/G-24 macro-financial assistance to Central and Eastern Europe since 1991 (cumulative amounts)

(Status as of December 95)

Country (Identified gaps)	ALBANIA (US \$ 237 million)					BALTIC STATES (US \$ 600 million)					BULGARIA (US \$ 1130 million)				
	Commitments			Disburs.		Commitments			Disburs.		Commitments			Disburs.	
	Mln US\$	% of gap	% of commit.	Mln US\$	% of disb.	Mln US\$	% of gap	% of commit.	Mln US\$	% of disb.	Mln US\$	% of gap	% of commit.	Mln US\$	% of disb.
Community	123.5	52.1	71.0	100.1	88.7	300.0	50.0	57.4	184.0	54.0	533.3	47.2	58.9	487.7	70.4
EFTA *	14.2	6.0	8.2	4.2	3.7	123.1	20.5	23.5	67.9	19.9	126.0	11.2	13.9	95.0	13.7
United States											10.0	0.9	1.1	10.0	1.4
Japan	36.3	15.3	20.9	8.5	7.5	100.0	16.7	19.1	88.9	26.1	228.1	20.2	25.2	100.0	14.4
Others											8.7	0.8	1.0		
<b>Total</b>	<b>174.0</b>	<b>73.4</b>	<b>100.0</b>	<b>112.8</b>	<b>100.0</b>	<b>523.1</b>	<b>87.2</b>	<b>100.0</b>	<b>340.8</b>	<b>100.0</b>	<b>906.1</b>	<b>80.2</b>	<b>100.0</b>	<b>692.7</b>	<b>100.0</b>
* of which. A, S, SF	11.7	4.9	6.7	4.2	3.7	81	13.5	15.5	67.9	19.9	69.0	6.1	7.6	50.0	7.2

Country (Identified gaps)	CSFR (US \$ 1000 million)					HUNGARY (1) (US \$ 500 million)					ROMANIA (US \$ 1455 million)				
	Commitments			Disburs.		Commitments			Disburs.		Commitments			Disburs.	
	Mln US\$	% of gap	% of commit.	Mln US\$	% of disb.	Mln US\$	% of gap	% of commit.	Mln US\$	% of disb.	Mln US\$	% of gap	% of commit.	Mln US\$	% of disb.
Community	500.0	50.0	56.4	500.0	58.0	250.0	50.0	48.3	250.0	50.7	740.6	50.9	68.9	660.7	71.3
EFTA *	146.0	14.6	16.5	146.0	16.9	95.0	19.0	18.3	95.0	19.3	162.2	11.1	15.1	143.3	15.5
United States	15.0	1.5	1.7	15.0	1.7	10.0	2.0	1.9	10.0	2.0					
Japan	200.0	20.0	22.5	200.0	23.2	150.0	30.0	29.0	125.0	25.4	150.0	10.3	14.0	100.0	10.8
Others	26.0	2.6	2.9	1.0	0.1	12.8	2.6	2.5	12.8	2.6	22.0	1.5	2.0	22.0	2.4
<b>Total</b>	<b>887.0</b>	<b>88.7</b>	<b>100.0</b>	<b>862.0</b>	<b>100.0</b>	<b>517.8</b>	<b>103.6</b>	<b>100.0</b>	<b>492.8</b>	<b>100.0</b>	<b>1074.8</b>	<b>73.9</b>	<b>100.0</b>	<b>926.0</b>	<b>100.0</b>
* of which. A, S, SF	90.0	9.0	10.1	90.0	10.4	50	10.0	9.7	50	10.1	87.3	6.0	8.1	78.4	8.5

Country (Identified gaps)	SLOVAKIA (US\$ 300 million)					TOTAL (US \$ 5222 million)				
	Commitments			Disburs.		Commitments			Disburs.	
	Mln US\$	% of gap	% of commit.	Mln US\$	% of disb.	Mln US\$	% of gap	% of commit.	Mln US\$	% of disb.
Community	156.0	52.0	64.1			2603.5	49.9	60.2	2182.5	62.6
EFTA *	27.4	9.1	11.2			693.8	13.3	16.0	551.4	15.8
United States						35.0	0.7	0.8	35.0	1.0
Japan	60.0	20.0	24.7	60.0	100.0	924.4	17.7	21.4	682.4	19.6
Others						69.5	1.3	1.6	35.8	1.0
<b>Total</b>	<b>243.4</b>	<b>81.1</b>	<b>100.0</b>	<b>60.0</b>	<b>100.0</b>	<b>4326.2</b>	<b>82.8</b>	<b>100.0</b>	<b>3487.1</b>	<b>100.0</b>
* of which. A, S, SF	16.4	5.5	6.7			405.3	7.8	9.4	340.5	9.8

(1) In 1990, the Community committed in favour of Hungary an additional 870 MECU loan which is not taken into consideration in this table since it took place outside the G-24 process.

Source: European Commission

**Table 3: Balance of payments support to recipients of EU macro-financial assistance by contributor, 1990-1995 (1)  
(in percent of total commitments)**

**Including debt relief**

	1990	1991	1992	1994	1995
<b>IFI's</b>	<b>21</b>	<b>50</b>	<b>69</b>	<b>27</b>	<b>33</b>
IMF	11	37	40	21	26
World Bank	10	13	29	6	7
<b>Bilaterals</b>	<b>79</b>	<b>50</b>	<b>31</b>	<b>73</b>	<b>67</b>
EU (2)	54	20	19	6	6
Other bilaterals (3)	25	13	13	5	3
of which					
USA	0	0	0	1	0
Japan	10	8	5	2	3
Debt relief	0	18	0	63	59
Paris Club		5		32	0
London Club				28	0
Other (4)		13		2	59

**Excluding debt relief**

	1990	1991	1992	1994	1995
<b>IFI's</b>	<b>21</b>	<b>61</b>	<b>69</b>	<b>71</b>	<b>80</b>
IMF	11	45	40	56	63
World Bank	10	16	29	15	17
<b>Bilaterals</b>	<b>79</b>	<b>39</b>	<b>31</b>	<b>29</b>	<b>20</b>
EU (2)	54	24	19	17	14
Other bilaterals (3)	25	15	13	12	6
of which					
USA	0	0	0	2	0
Japan	10	9	5	6	6

- (1) Based on Council Decisions for EU operations.  
No operation was decided in 1993.
- (2) EU macro-financial assistance.
- (3) Including EU Member States.
- (4) Syndicated commercial banks loan in favour of Algeria in 1991,  
debt relief in favour of Ukraine by Russia and Turkmenistan in 1994 and in 1995.

Table 3.1.: Balance of payments support to recipients of EU  
macro-financial assistance by contributor, 1990-1995  
(in millions of US\$ and in percent of total commitments and disbursements)

## Balance of payments support - 1990

	Total				Hungary I			
	Commitments		Disbursements		Commitments		Disbursements	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
IFI's	419	21	375	23	419	21	375	23
IMF	219	11	175	11	219	11	175	11
WB (policy based)	200	10	200	12	200	10	200	12
<b>Bilaterals</b>	<b>1618</b>	<b>79</b>	<b>1288</b>	<b>77</b>	<b>1618</b>	<b>79</b>	<b>1288</b>	<b>77</b>
EU	1108	54	777	47	1108	54	777	47
USA	0	0	0	0	0	0	0	0
Japan	200	10	200	12	200	10	200	12
Germany	311	15	311	19	311	15	311	19
Other bilaterals		0		0	0	0	0	0
<b>Total</b>	<b>2037</b>	<b>100</b>	<b>1663</b>	<b>100</b>	<b>2037</b>	<b>100</b>	<b>1663</b>	<b>100</b>

## Balance of payments support - 1991

	Total				Algeria I				Bulgaria I			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
IFI's	5607	50	3930	43	690	23	443	19	640	35	540	33
IMF	4177	37	2825	31	390	13	293	12	390	22	390	24
WB (policy based)	1430	13	1105	12	300	10	150	6	250	14	150	9
<b>Bilaterals</b>	<b>5600</b>	<b>50</b>	<b>5147</b>	<b>57</b>	<b>2290</b>	<b>77</b>	<b>1938</b>	<b>81</b>	<b>1168</b>	<b>65</b>	<b>1117</b>	<b>67</b>
EU	2190	20	1988	22	540	18	338	14	400	22	400	24
USA	35	0	35	0	0	0	0	0	10	1	10	1
Japan	850	8	633	7	300	10	150	6	100	6	58	4
Other bilaterals	521	5	487	5	0	0	0	0	104	6	95	6
Debt relief	2004	18	2004	22	1450	49	1450	61	554	31	554	33
Paris Club	554	5	554	6					554	31	554	33
Syndicated loan	1450	13	1450	16	1450	49	1450	61				
<b>Total</b>	<b>11207</b>	<b>100</b>	<b>9077</b>	<b>100</b>	<b>2980</b>	<b>100</b>	<b>2381</b>	<b>100</b>	<b>1808</b>	<b>100</b>	<b>1657</b>	<b>100</b>

  

	CSFR				Hungary				Romania I			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
IFI's	1302	59	1302	60	2262	81	1020	67	713	49	625	46
IMF	852	39	852	39	2012	72	845	56	533	37	445	33
WB (policy based)	450	21	450	21	250	9	175	12	180	12	180	13
<b>Bilaterals</b>	<b>887</b>	<b>41</b>	<b>862</b>	<b>40</b>	<b>518</b>	<b>19</b>	<b>493</b>	<b>33</b>	<b>737</b>	<b>51</b>	<b>737</b>	<b>54</b>
EU	500	23	500	23	250	9	250	17	500	34	500	37
USA	15	1	15	1	10	0	10	1				
Japan	200	9	200	9	150	5	125	8	100	7	100	7
Other bilaterals	172	8	147	7	108	4	108	7	137	9	137	10
Debt relief												
Paris Club												
Syndicated loan												
<b>Total</b>	<b>2189</b>	<b>100</b>	<b>2164</b>	<b>100</b>	<b>2780</b>	<b>100</b>	<b>1513</b>	<b>100</b>	<b>1450</b>	<b>100</b>	<b>1362</b>	<b>100</b>

Table 3.1. (cont.)

## Balance of payments support - 1992

	Total				Albania I				Estonia			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
IFT's	1564	69	1193	71	48	29	28	23	116	57	109	69
IMF	909	40	768	46	28	17	18	15	86	42	83	53
WB (policy based)	655	29	426	26	20	12	10	8	30	15	26	17
<b>Bilaterals</b>	708	31	476	29	115	71	95	77	87	43	48	31
EU	423	19	298	18	83	51	83	67	46	22	23	14
USA	0	0	0	0	0	0	0	0	0	0	0	0
Japan	120	5	79	5	20	12	9	7	20	10	13	8
Other bilaterals	165	7	100	6	12	8	4	3	22	11	13	8
<b>Total</b>	<b>2272</b>	<b>100</b>	<b>1670</b>	<b>100</b>	<b>162</b>	<b>100</b>	<b>123</b>	<b>100</b>	<b>204</b>	<b>100</b>	<b>158</b>	<b>100</b>
	<b>Latvia</b>				<b>Lithuania</b>				<b>Romania II</b>			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
IFT's	215	56	196	68	245	53	194	62	940	89	666	85
IMF	170	44	151	52	185	40	149	48	440	42	366	47
WB (policy based)	45	12	45	16	60	13	45	14	500	47	300	38
<b>Bilaterals</b>	169	44	94	32	217	47	120	38	119	11	119	15
EU	91	24	46	16	114	25	57	18	90	8	90	11
USA	0	0	0	0	0	0	0	0	0	0	0	0
Japan	35	9	23	8	45	10	34	11	0	0	0	0
Other bilaterals	43	11	25	9	58	13	29	9	29	3	29	4
<b>Total</b>	<b>384</b>	<b>100</b>	<b>290</b>	<b>100</b>	<b>462</b>	<b>100</b>	<b>314</b>	<b>100</b>	<b>1059</b>	<b>100</b>	<b>785</b>	<b>100</b>

## Balance of payments support 1994

	Total				Albania II				Algeria II				Bulgaria II			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
IFT's	4086	27	2772	21	75	63	42	70	1397	19	1182	17	646	13	195	5
IMF	3206	21	2072	16	60	50	34	58	1097	15	882	13	521	11	195	5
WB (policy based)	880	6	700	5	15	13	8	13	300	4	300	4	125	3	0	0
<b>Bilaterals</b>	11299	73	10357	79	45	37	18	30	5920	81	5666	83	4214	87	4088	95
EU	952	6	336	3	41	34	18	30	335	5	201	3	125	3	88	2
USA	100	1	90	1	0	0	0	0	0	0	0	0	0	0	0	0
Japan	350	2	185	1	0	0	0	0	150	2	95	1	50	1	0	0
Other bilaterals	252	2	101	1	4	3	0	0	135	2	70	1	39	1	0	0
<b>Debt relief</b>	9645	63	9645	73					5300	72	5300	77	4000	82	4000	93
London Club	4920	32	4920	37					1120	15	1120	16	3800	78	3800	89
Paris Club	4380	28	4380	33					4180	57	4180	61	200	4	200	5
Other	345	2														
<b>Total</b>	<b>15385</b>	<b>100</b>	<b>13129</b>	<b>100</b>	<b>120</b>	<b>100</b>	<b>59</b>	<b>100</b>	<b>7317</b>	<b>100</b>	<b>6848</b>	<b>100</b>	<b>4860</b>	<b>100</b>	<b>4283</b>	<b>100</b>
	<b>Moldova I</b>				<b>Romania III</b>				<b>Slovak Republic</b>				<b>Ukraine</b>			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
IFT's	164	56	133	56	913	81	447	100	426	64	308	84	465	47	465	53
IMF	104	35	121	51	713	63	247	55	346	52	228	62	365	37	365	41
WB (policy based)	60	20	12	5	200	18	200	45	80	12	80	22	100	10	100	11
<b>Bilaterals</b>	130	44	106	44	218	19	0	0	242	36	60	16	530	53	420	47
EU	54	18	30	12	143	13	0	0	155	23	0	0	100	10	0	0
USA	30	10	20	8	0	0	0	0	0	0	0	0	70	7	70	8
Japan	40	14	30	13	50	4	0	0	60	9	60	16	0	0	0	0
Other bilaterals	6	2	26	11	26	2	0	0	27	4	0	0	15	2	5	1
<b>Debt relief</b>													345	35	345	39
London Club																
Paris Club																
Other													345	35	345	39
<b>Total</b>	<b>294</b>	<b>100</b>	<b>239</b>	<b>100</b>	<b>1131</b>	<b>100</b>	<b>447</b>	<b>100</b>	<b>668</b>	<b>100</b>	<b>368</b>	<b>100</b>	<b>995</b>	<b>100</b>	<b>885</b>	<b>100</b>

Table 3.1 (cont)

## Balance of payments support 1995

	Total				Belarus				Ukraine II			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%	mio US\$	%
	1877	33	1770	34	270	79	163	81	1607	30	1607	32
IMF	1477	26	1370	26	270	79	163	81	1207	22	1207	24
WB (policy based)	400	7	400	8		0		0	400	7	400	8
	3885	67	3443	66	70	21	38	19	3815	70	3405	68
EU	330	6	38	1	70	21	38	19	260	5		0
USA	0	0	0	0		0		0		0		0
Japan	150	3	0	0		0		0	150	3		0
Other bilaterals	0	0	0	0		0		0		0		0
Debt relief	3405	59	3405	65	0	0		0	3405	63	3405	68
London Club	0	0	0	0	0	0		0		0		0
Paris Club	0	0	0	0	0	0		0		0		0
Other	3405	59		0	0	0		0	3405	63	3405	68
	5762	100	5213	100	340	100	201	100	5422	100	5012	100

Table 4: Selected economic indicators

	1992	1993	1994	1995	
				Programme (1)	Estimates
<b>GDP at constant prices</b>					
	(Percent change)				
Albania	-9.7	9.6	9.4	6.0	9.0
Algeria	2.2	-1.8	1.1		4.3
Belarus		-11.6	-20.0		-7.0
Bulgaria	-7.3	-2.4	1.8		2.6
Estonia	-19.3	-3.5	4.0		4.0
Latvia	-35.0	-15.0	2.0		0.0
Lithuania	-37.7	-16.2	1.5		3.0
Moldova	-29.1	-8.7	-31.0		-3.0
Romania	-13.6	1.3	3.9		6.9
Slovak Republic	-7.0	-4.1	4.8	2.0	7.4
Ukraine	-17.0	-17.1	-23.0	-10.0	-12.0
<b>Consumer price (end year)</b>					
	(Percent change)				
Albania	236.6	30.9	15.8	10.0	6.0
Algeria	31.7	20.5	28.0		22.0
Belarus		1990.0	2220.0		290.0
Bulgaria	79.4	63.8	122.0		32.9
Estonia	942.0	36.0	42.0		28.0
Latvia	958.0	35.0	26.0		23.0
Lithuania	246.0	163.0	45.0		35.0
Moldova	2198.0	837.0	116.0	10.0	24.0
Romania	198.5	295.0	62.0		33.3
Slovak Republic	9.1	25.0	11.7	8.0	7.2
Ukraine	2000.0	10155.0	401.0	138.0	182.0
<b>Fiscal balance</b>					
	(Percent of GDP)				
Albania	-21.3	-15.9	-13.6	-14.0	-8.4
Algeria	-1.3	-9.2	-4.4		-1.4
Belarus		-8.3	-1.7		-3.2
Bulgaria	-15.0	-15.7	-6.6		-6.7
Estonia	0.2	-0.7	0.0		0.3
Latvia	-0.8	0.6	-4.1		-4.4
Lithuania	0.5	-5.1	-4.2		-33.4
Moldova	-23.4	-6.8	-9.0	-3.5	-5.5
Romania	-4.6	-0.1	-1.0		-2.8
Slovak Republic	-12.8	-7.6	-1.4	-3.0	0.5
Ukraine	-30.4	-10.1	-8.2	-4.6	-5.0

Table 4: Selected economic indicators (continued)

	1992	1993	1994	1995	
				Programme (1)	Estimates
<b>Current account</b>					
(Percent of GDP)					
Albania	-65.7	-33.4	-13.5	11.1	9.7
Algeria	2.9	2.1	-4.3		-5.6
Belarus		-8.7	-11.4		-4.1
Bulgaria	-9.3	-7.9	-0.3		2.3
Estonia	7.6	-5.7	-9.0		-10.6
Latvia	2.3	6.7	-4.6		-4.0
Lithuania	3.4	-6.2	-4.3		-3.4
Moldova	-3.0	-9.3	-9.2		-6.0
Romania	-8.6	-5.5	-1.4		-4.4
Slovak Republic	0.4 (2)	-5.4	5.7	-2.3	4.3
Ukraine	-3.5	-5.9	-6.0		-4.4
<b>Official foreign exchange reserves</b>					
(Months of imports)					
(end year)					
Albania	0.7	2.2	3.3	3.3	3.8
Algeria	2.2	2.3	2.6		1.8
Belarus		0.3	0.3		1.5
Bulgaria	3.5	2.4	3.2		3.3
Estonia	4.5	4.0	3.2		2.8
Latvia	2.0	5.6	5.5		4.8
Lithuania	2.6	2.4	2.7		3.5
Moldova	0.0	1.5	3.1	3.0	4.0
Romania	0.2	0.1	4.0		1.9
Slovak Republic	1.1	1.2	1.4	2.4	3.8
Ukraine	-	0.2	2.3	4.3	3.7

(1) Programme targets as set in : July 93 (and revised in Aug 94) for Albania, May 94 for Algeria, March 95 for Moldova, May 94 for Romania, July 94 for Slovakia, April 95 for Ukraine.

(2) After fiscal transfers from the Czech lands, estimated at about 7% of Slovak GDP.

Sources: National authorities and IMF



**TABLE 5**  
**STATUS OF ECONOMIC REFORM**

**5.1 ALBANIA**

1.	Price liberalisation	Most price controls and subsidies eliminated, with the exception of bread and flour. Electricity prices will soon be fixed by a regulatory body.
2.	Trade liberalisation	No quantitative restrictions on imports. Export restrictions limited to scrap metals and wood.
3.	Exchange regime	Free float since July 1992 within a unified exchange market. Early licensing of foreign exchange dealers and exchange bureaux. Current account convertibility. Agreement on the large external debt arrears to commercial banks reached in August 1995.
4.	Foreign direct investment	Liberal legislation. Liberalisation of land sale to foreigners. Creation of economic free zones.
5.	Monetary policy	Tight monetary policy. Use of bank-by-bank credit ceilings. Administrative guidance to ensure that interest rates remain positive in real terms. Treasury bill auctions (3, 6, 12 months).
6.	Public finances	Tight fiscal policy until October 1995. VAT introduction delayed until July 1996. Removal of tariff exemptions, new classification, new tariff rates approved in May 1995. Revenue: 24.6 % of GDP in 1995.
7.	Privatisation and enterprise restructuring	96 % of total arable land privatized. Distribution of temporary titles nearly completed in March 1996. Laws on land market, mortgage, collateral, leasing, subleasing, bankruptcy. Small privatisation in trade and services completed. Industrial enterprises: privatisation of small and medium-sized enterprises largely completed; progress with biggest state-owned enterprises. Mass privatisation process. Strategic enterprises and utilities offered for sale to foreign investors. Stock exchange.
8.	Financial sector reform	Two-tier banking system. State-owned banks to be privatized in the course of 1996 and 1997 with majority share offered for sale to foreign investors. Audits completed in 1996. New law on the role and responsibilities of the Bank of Albania. New law on the banking system with streamlining licensing procedures to facilitate the entry of new private banks. Several applicants. Important informal banking system. End of the state monopoly in the insurance sector.

## 5.2 ALGERIA

1.	Price liberalization	Major price liberalisation and subsidies elimination in 1994. In 1995, more "sensitive" products (public utilities, basic food staples etc.) moved closer to total liberalization. The Competition Law enacted in January 1995 institutionalised the principle of free pricing while providing safeguards against monopolist practices.
2.	Trade liberalization	Further strengthening of the reforms initiated in 1994. No quantitative restrictions on imports left apart from a few products for religious reasons. Import restrictions on ten basic commodities abolished in May 1995.
3.	Exchange regime	Following two devaluations in 1994, the foreign exchange allocation system has been substantially liberalised. In 1994, the Dinar was moved from a fixed peg to a managed float. A full-fledged interbank foreign exchange market was established as of end-December 1995. The premium on the parallel market has dropped considerably but remained substantial at 20% at end 1995. Total current account convertibility of the Dinar expected in the near future.
4.	Foreign direct investment	A liberal foreign investment regime, including the banking sector, was adopted in 1993. However, apart from the hydrocarbon sector, no significant foreign investments have taken place in view of the security situation.
5.	Monetary policy	Interest rates have been liberalised and the temporary ceiling on the commercial banks' spread was abolished in December 1995. Real rates, however, remained negative in 1995. The use of indirect instruments for monetary management was strengthened. Repurchase-auctions and a formal auction system for the sale of negotiable treasury bonds on the money market were established in 1995.
6.	Public finances	The overall fiscal deficit in 1995 dropped further to 1.4% of GDP, mainly due to expenditure reductions (strict wage controls and subsidy reductions) with exchange rate depreciation also contributing to the budgetary improvement.
7.	Privatisation and enterprise restructuring	Hardening of budget constraint, financial restructuring and signing of management contracts for the 23 largest loss-making enterprises. Interruption of all on-lending to autonomous public enterprises from the Treasury. Launching of a restructuring programme for all public construction enterprises. Initiation of a divestiture programme for 103 small and medium enterprises with World Bank support. Enactment of a new privatisation law.
8.	Financial sector reform	Commercial banks are almost exclusively state-owned. Signing of performance contracts and recapitalisation of four public banks (out of five) in 1995. Capital adequacy ratio requirements gradually increasing.

### 5.3 BELARUS

1.	<b>Price liberalisation</b>	First price liberalisation in 1993. Most prices (except for state monopolies) freed by end-1994-early 1995. Phased increases of public utilities prices up to 80% of cost recovery levels by end-1995.
2.	<b>Trade liberalisation</b>	In 1994 abolition of most import licences and export taxes, as well as surrender requirements for exporters. (However reintroduction in early 1996 of surrender requirements).  Early 1995 entry into force of a Customs Union with Russia. As a result, increase of import taxes up to the Russian external tariff. Partnership and Co-operation Agreement with the European Union (not yet ratified).
3.	<b>Exchange regime</b>	In 1994 departure from Russian rouble zone. Only partial current account convertibility. Limitations on inter-bank currency operations. Managed exchange rate (informal peg) to the dollar at 11500 rbl/US\$ over the year 1995.
4.	<b>Foreign direct investment</b>	Free repatriation of capital and profits. Owing to political uncertainties, only minor flows of foreign direct investment.
5.	<b>Monetary policy</b>	Two tier banking system with Central Bank conduct of monetary policy. In 1995 tightening of monetary policy. Weekly auctions for a large share of credits to the banking sector (60%). Restrictive monetary policy and positive real interest rates proved successful to bring inflation down from hyper-inflationary levels to below 5% per month in second half 1995.
6.	<b>Public finances</b>	Introduction of VAT in 1993. General government budget in deficit in 1994 (2%) and 1995 (2.3%). General government revenue: 48.9% of GDP (1995).
7.	<b>Privatisation and enterprise restructuring</b>	Slow and delayed privatisation process. Only 6% of state assets and 12% of small firms privatised by end 1995. Free distribution of vouchers to the population not yet completed.
8.	<b>Financial sector reform</b>	A large share of the banking sector privately owned. Prudential regulations progressively tightened, minimum capital requirement recently increased to 2 million ECU. Banks remain burdened with bad loans weakening their financial position.

### 5.4 BULGARIA

- |    |  |  |
|----|--|--|
| 1. | Price liberalisation                       | At present some 50% of goods are subject to monitoring or control. Price controls still maintained on some public services (energy, telecommunications, water supply and transports).  |
| 2. | Trade liberalisation                       | Export prohibitions have been removed. Average import tariff on industrial goods: 22%. Some import protection measures are still in place..  |
| 3. | Exchange regime                            | Since 1991, unified and quasi-free floating exchange rate regime. Internal current account convertibility established (few restrictions). Limited BNB interventions in support of the lev. Official (Paris Club) debt rescheduling reached in April 1994. This was followed by the finalization of DDSR Arrangement with (London Club) commercial creditors in July. |
| 4. | Foreign direct investment                  | Liberal foreign investment legislation adopted in early 1992. Small amounts of foreign investment so far recorded owing to external debt problems, policy slippages and political uncertainty.   |
| 5. | Monetary policy                            | Bank credit ceilings were discontinued in mid-1994. In 1994 monetary and credit indicators used as nominal anchor. Limited open market operations.   |
| 6. | Public finances                            | New rules on tax administration adopted in 1994. VAT entered into force in April, same year. Revenue/GDP ratio in 1995: 38% - budget deficit/GDP ratio: 6.7.   |
| 7. | Privatisation and enterprise restructuring | Property restitution programme well advanced. A financial rescue plan for enterprises was initiated in 1994 but important problems remain. Privatization, although having been delayed, is now proceeding in a more rapid pace.  |
| 8. | Financial sector reform                    | Banking supervision remains weak. Despite an early bank consolidation effort, substantial non-performing loans have been accumulated undermining credibility in the banking system necessitating tough structural action..   |

### 5.5 ESTONIA

1.	Price liberalisation	Major price liberalisation in 1991. By end 1992, virtual completion of price liberalisation, including in energy sector.
2.	Trade liberalisation	In early 1992, abolition of most import tariffs (except few luxury goods), and of most remaining quotas and licensing requirements except for oil shale, clay, quartz. Import subject to a 0.5% administrative fee plus 18% VAT. Few exports tariffs. Free trade agreement with Baltic and Nordic countries, and with the European Union (as of 1.1.95).
3.	Exchange regime	Current account convertibility. In 1992 departure from rouble zone. Since 1992, Estonian Kroon pegged to the DM, at a rate of eight Kroons to one DM, under a currency board system.
4.	Foreign direct investment	Free repatriation of profits and proceeds of liquidation of investment by non-residents.
5.	Monetary policy	Central bank responsible for operation of currency board (Issue Department) and, in exceptional cases, for emergency lending to banking system (Banking Department, responsible for managing reserves in excess of currency board cover). Restrictive monetary policy proved successful to bring inflation down from hyper-inflationary levels to two digit levels (29%, 1994 year-end figures). Central Bank does not interfere with the commercial banks' setting of interest rates.
6.	Public finances	Already in 1991, personal income tax and VAT introduced, turnover tax replaced by corporate income tax; social security, natural resource and specific excise taxes. Balanced general government budget in 1995. General Government expenditure at 40% of GDP in 1995.
7.	Privatisation and enterprise restructuring	Small-scale privatisation virtually completed (about 1000 SMEs privatised). Wide distribution of vouchers, large-scale privatisation already advanced in 1995 (400 enterprises privatised by year-end, out of 500 to be privatised).
8.	Financial sector reform	Two-tier banking system. Increased pressure on state enterprises to restructure through hard budget constraints and selective application of the bankruptcy law. Reduction of number of commercial banks from 40 to 24 through regular increases in minimum capital requirement following a banking crisis in Winter 92/93. Stock exchange introduced. Credit Institutions Act enhanced supervision and prudential regulation powers of Central Bank.

## 5.6 LATVIA

1.	Price liberalisation	Major price liberalisation in 1991 and 1992 including for energy products. By end-1992, price liberalisation essentially completed, excluding utility prices and rents.
2.	Trade liberalisation	All trade limitations abolished in 1992. Free trade agreements with Baltic States and Nordic countries, and with the European Union (as of 1.1.95).
3.	Exchange regime	In July 1992 departure from rouble zone. Current account convertibility. Exchange rate of lats stabilised under managed floating system, informally pegged to the SDR.
4.	Foreign direct investment	Free repatriation of profits and proceeds of liquidation of investment by non-residents. Substantial flows of foreign direct investment (165 million US\$ in 1995).
5.	Monetary policy	Independent central bank. Strict monetary policy resulted in lowest inflation rate among Baltic States. Credit policy through indirect instruments. Exceptional Central Bank 6-month credit line to the Government in 1995.
6.	Public finances	VAT introduced in February 1992. In 1993 introduction of flat rate income tax (25%) plus a 10% surcharge on annual income. General government expenditure at 38% of GDP, and budget in deficit in 1995 (3.3%% of GDP).
7.	Privatisation and enterprise restructuring	Well advanced small-scale privatisation. Privatisation agency established in 1994. Auctions of large enterprises started in November 1994. State enterprises not ready for immediate privatisation transformed into stock companies, to be managed by a State Property Fund established in 1994.
8.	Financial sector reform	Two-tier banking system. 49 former branches of the Bank of Latvia either merged into a core bank (21 now forming the Universal Bank to be restructured and privatised later) or privatised, except for one which was liquidated. Capital adequacy ratio increased in January 1994. Balance sheets of Universal Bank of Latvia and of Latvian Savings Bank recently strengthened. Nine bank licences withdrawn in 1994. Stock exchange already introduced.

## 5.7 LITHUANIA

- |   |   |
|---|---|
| 1. Price liberalisation                       | Major price liberalisation in 1991, 1992 and 1993, including for most energy products. Level of subsidisation reduced for household heating (prices raised 50% in October 1994), electricity (prices raised 33% in October 1994), and transport.  |
| 2. Trade liberalisation                       | Export quotas and licensing removed partially in the course of 1992 and completely in June 1993. All import controls and licenses removed. Since May 1994 import tariffs for a broad range of goods, representing two thirds of imports, suppressed. In July 1994 import tariffs on several agricultural goods raised to average 40%, and lowered to average 30% in October. Free Trade Agreement with EU entered into force on 1 January 1995. |
| 3. Exchange regime                            | Current account convertibility. Lithuania left rouble zone in Spring 1992. Since April 1994, Litas pegged to US dollar at a fixed rate four litas to one dollar.  |
| 4. Foreign direct investment                  | Free repatriation of profits and proceeds of liquidation of investment by non-residents.  |
| 5. Monetary policy                            | Independent central bank (new central bank law enacted in December 1994). In April 1994, introduction of a currency board arrangement, according to which the money in circulation is limited to the amount of foreign exchange held in the central bank. Monetary expansion moderate in 1994 (45% year average growth).  |
| 6. Public finances                            | The tax system was reformed and now includes personal income and profit taxes, property tax, natural resource tax, individual excise taxes, as well as general sales tax. New value added tax replacing previous general excise tax. State budget in deficit in 1995 (3.4% of GDP).   |
| 7. Privatisation and enterprise restructuring | Substantial progress on small and large-scale privatisation through auctions, public shares subscriptions and voucher system. By January 1995, 76% of all companies eligible for privatisation (1/3 of state capital) privatised. Little progress on land privatisation. Autonomous operation of state enterprises promotes efficiency.   |
| 8. Financial sector reform                    | Creation of two-tier banking system established in 1992. Central Bank and Commercial banking act enacted in early 1995, tightening prudential rules. International auditing of banks now compulsory. Stock exchange already introduced. In June 1996 new law denationalizing bankrupt Innovation Bank and establishing a bad loans agency. Foreign banks' subsidiaries allowed as of 4 June 1996.   |

## 5.8 MOLDOVA

1.	Price liberalization	Full liberalisation of prices of goods and services with some exceptions (mainly energy products).
2.	Trade liberalization	All export quotas removed, including those on grain and grain products abolished on 1 December 1995. Maximum import tariff lowered to 20 % by end November 95, with a few exceptions. Excise taxes on exports to non-CIS countries introduced in late 1995, but to be suppressed before adoption of the new IMF programme.
3.	Exchange regime	New currency introduced in November 93. Freely floating and rather stable against the US\$ in 1995. Daily operated FX auctions at the Chisinau Inter bank Foreign Currency Exchange. Current account convertibility. Acceptance in June 1995 of IMF Article VIII.
4.	Foreign direct investment	Liberal regime: free repatriation of profits and proceeds of liquidation of investments within three months of the closure. Agency for Foreign Investment Promotion established in January 1995. Partnership and co-operation agreement with the EU signed in November 1994. Conference on foreign investments in Moldova held in Chisinau in September 1995 to attract foreign investors.
5.	Monetary policy	Relying on credit ceilings. Key objective: rapid reduction of inflation, based on introduction of new currency, enforced financial discipline and enhanced central bank independence.
6.	Public finances	VAT introduced in 1992. Tax administration improved. Strong VAT receipts, including arrears. Receipts of privatisation far below expectations, because of a lack of domestic capital. On expenditure side, overruns due to higher-than-programmed spending in social sphere and to net lending by the Government, owing to the assumption by the Government of guaranteed loans to enterprises in default.
7.	Privatisation and enterprise restructuring	New programme for 95/96 adopted in March 95. 2200 enterprises, representing about 70% of the economy privatised through the voucher programme, concluded in November 1995. Privatisation for cash not successful, because of a lack of domestic capital. Liquidation proceedings initiated against 20 state enterprises.
8.	Financial sector reform	Two-tier banking system with National Bank responsible for monetary policy and bank supervision. Regulation imposing provisions for bad loans approved in 1995. Starting from 1 January 1996, all banks failing to keep their reserve level at a minimum of Mdl 4 million (about US\$ 900.000) forced to close or to merge into a larger bank.



## 5.9 ROMANIA

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|---|--|
| 1. Price liberalisation                       | The process of price liberalisation began in November 1990. By the middle of 1995, only 3% of all prices on consumer goods and services were administered (down from 90% in 1989). In the cases of industrial producer prices and procurement prices on raw materials, the share of administered prices was equal to 7% and 27%, respectively.   |
| 2. Trade liberalisation                       | Full liberalization apart from a limited number of import/export quota/bans still in force, either for health reasons or for subsidised goods. Europe agreement with the EU in force since 1 February 1995. MFN status in the US.  |
| 3. Exchange regime                            | Limited current account convertibility. A market-based exchange rate regime was established in April 1994 but multiple exchange rates persist. Foreign exchange is available to individuals through private exchange bureaux. The authorities, however, have a history of backtracking on their measures to liberalise the foreign exchange market. After dropping considerably in the middle of the year, the premium in the bureau de change market had risen above 20% again by end 1995. |
| 4. Foreign direct investment                  | Free legal environment for equity participation and profit repatriation by non-residents. Lack of progress with respect to privatization has limited the volume of investment inflows.   |
| 5. Monetary policy                            | The Central Bank uses both direct and indirect instruments for monetary policy management. Central Bank financing of Treasury deficits has almost ceased. Weak financial discipline of state companies.  |
| 6. Public finances                            | Good progress with fiscal reform and introduction of new taxation systems, including VAT. Overhaul of the income tax system is expected by end 1996. Fiscal deficit is relatively low and under control.   |
| 7. Privatization and enterprise restructuring | Little progress with medium- and large scale enterprises privatization through the State Ownership Fund. Some success with small-scale privatization through buy-outs. Large inter-enterprise arrears hamper financial restructuring of loss makers which are a source of considerable quasi-fiscal pressure. A new attempt at restructuring the most problematic enterprises was launched at the end of 1995 with the support of the World Bank.  |
| 8. Financial sector reform                    | In 1995, a reform programme for the banking system was agreed with the World Bank, a number of prudential rules were adopted and the interbank clearing system was reformed. Progress with the privatisation of state-owned banks remained very slow with only one bank in the process of being divested. In November 1995, trading began on the Bucharest Securities Exchange.  |

### 5.10 THE SLOVAK REPUBLIC

1.	Price liberalization	95% of total turnover based on free prices, with regulation still in force in the areas of energy, public transportation, rents, telephone, telegraph and pharmaceutical products.
2.	Trade liberalization	Imports liberalized except for a few sensitive items subject to import licences. Export licensing remains for a limited number of products. Free trade agreements with the EC, the EFTA countries and the Visegrad countries. Customs union with Czech Republic since dissolution of the CSFR. A 10% surcharge on consumer imports was introduced in March 1994 and reduced to 7.5% in mid-1996.
3.	Exchange regime	In October 1996, remaining restrictions on current account convertibility lifted and clearing system with Czech Republic terminated. Exchange rate pegged to a basket of Western currencies since February 1993.
4.	Foreign direct investment	No limits on equity participation in enterprises by non-residents, except in the case of a few sensitive or defence-related sectors. Free repatriation of profits and proceeds from the liquidation of investment.
5.	Monetary policy	National Bank of Slovakia, established in January 1993, operates independently from government. Slovak crown introduced in February 1993. Increasing reliance on indirect instruments of monetary control : remaining credit ceilings on banks abolished in January 1996.
6.	Public finances	VAT reformed, excise tax system and personal income tax introduced in January 1993. General government revenues estimated at 51% of GDP in 1995.
7.	Privatisation and enterprise restructuring	First wave of large scale privatization completed by Spring 1993. Second voucher privatization scheme, launched in 1994, cancelled in mid-1995. Current privatization strategy emphasizes traditional methods (in particular, direct sales to managers and employees). Bankruptcy law came into effect in June 1993 but few companies have filed for bankruptcy.
8.	Financial sector reform	Two-tier banking system established in January 1990. Partial privatization of major financial institutions under first wave of large-scale privatization. State stakes in State Savings Bank, two largest commercial banks and largest insurance company to be sold off in 1996. Since 1991, several measures to strengthen banks' balance-sheets. Stricter rules for classification and provisioning of bad loans introduced in mid-1995. Bratislava Stock Exchange in operation since 1993 but financial markets remain underdeveloped.

## 5.11 UKRAINE

1. Price liberalization	Limits on profit margins abolished. Reduction in number of goods for which price changes must be approved in advance. Increases in coal, electricity, gas, transportation and housing prices for households aiming at achieving cost recovery during 1996.
2. Trade liberalization	System of state orders abolished. All domestic trade restrictions abolished. 1995 budget allocations for state procurement of agricultural products limited to needs of budgetary organizations and at market determined prices.  Import regime free of quantitative restrictions, with few exceptions primarily for health and safety reasons. Maximum import tariff lowered to 30%. Elimination of all export quotas and licences except for exports subject to VERs.
3. Foreign exchange regime	Abolition of official exchange rate and unification of exchange rate determined at interbank auction market. High degree of current account convertibility reinstated.
4. Foreign direct investment	Decree of May 1993 grants tax relief (exemption from income and profit tax for 5 years) for certain investments constituting at least 20% of a enterprise's charter capital.
5. Monetary policy	Allocation of all Central Bank credit to commercial banks by auction. No more directed credits issued. Central Bank refinance rate adjusted to ensure that it remains positive in real terms.
6. Public finances	Since 1992 gradual tightening and rationalization of budget including reform of VAT, enterprise and income taxes. Reduction of public expenditure from 72% in % of GDP in 1992 to some 45% in 1995. Ratio revenue/GDP: 40% in 1995.
7. Privatisation and enterprise restructuring	Mass voucher privatization programme launched at beginning of 1995. Some 1500 medium and large enterprises privatized. Programme will be accelerated in 1996. Progress with small-scale privatization. Decision to close some 15 loss-making coal mines. Bankruptcy procedures simplified in 1995.
8. Financial sector reform	Central bank law submitted to Parliament. Plans to strengthen supervision and regulation of the banking sector. Provisioning against bad loans to be made tax deductible. Auditing in process. Profit tax for banks reduced to 40%. Deposit insurance scheme to be introduced.

## II. ALBANIA

### 1. Introduction

Supported by an IMF Stand-By Arrangement (SBA) and by complementary financial assistance from the EC<sup>5</sup> (ECU 70 million) as well as from G-24 bilateral members, Albania's macroeconomic and structural adjustment efforts were initiated in 1992 and have largely been successful. Following the decision by the IMF to provide further assistance in the form of a 3-year (August 1993 - July 1996) Enhanced Structural Adjustment Facility (ESAF), the Council decided on 28 November 1994<sup>6</sup> to grant Albania renewed macro-financial assistance up to a maximum amount of ECU 35 million, with the same aim of ensuring a sustainable balance of payments situation and strengthening the reserve position of the country.

Albania had so far fulfilled the policy conditions attached to the present IMF ESAF when, in September 1995, the IMF could not complete the second review under this facility, because of disagreement over budgetary policies. The ESAF is currently not operative but, with the proviso that a strong financial package would be implemented immediately after the May 1996 general elections, ESAF discussions could resume relatively quickly.

### 2: Macroeconomic performance

GDP growth of 9 % was achieved in 1995. Agriculture has led the recovery, responding favourably to price reform and privatization. However, marketable surpluses still represent a small fraction of the production (12-20 %) and marketing channels are improving slowly. Construction, transport, and other (private) services have made strong contributions to growth. Albania's industrial output has begun to recover.

The target for the domestically-financed budget deficit had been set at 7 % of GDP for 1995. However, wage increases in the public sector in the second part of the year made this goal unattainable and the deficit instead reached 8.1 % of GDP. Starting in 1995, the central bank's financing of the deficit will be strictly limited to a maximum amount of 10% of government revenues of the previous year (for 1995: Leks 4.6 billion or 2.8 % of GDP). Therefore, the government and the central bank have recently taken measures to support the development of the treasury bill market. Six-month and more recently 12 month treasury bills have been introduced, and the government has started the securitization of its outstanding debt.

The total fiscal deficit, at 13 % of GDP, was still high in 1995. All categories of public expenditure have been reduced in relation to GDP: public spending was equivalent to 33% of GDP in 1995, whereas in 1991 it represented over 60 %. The structure of expenditure has been improved, shifting away from subsidies and social benefits towards public investment. Employment in the budgetary institutions has also been sharply reduced, by over one-quarter between mid-1992 and end-1994. Further reductions have been achieved in 1995 but failed to offset the impact on expenditure of a 20 % wage increase in the

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<sup>5</sup> Council Decision of 28 September 1992 (92/482/EC)

<sup>6</sup> Council Decision of 28 November 1994 (94/773/EC)

public sector. The tax base has been widened by the introduction of personal income, land and property taxes. VAT implementation at a 12.5 % rate was delayed until July 1996.

As a result of tight fiscal and monetary policies, year on year inflation had fallen considerably, from over 300 % in late 1992, to around 15 % by spring 1995 and to 6 % in December 1995. However, wage pressures in the public sector stopped this downward trend in the first months of 1996. Unemployment is also reported to have been reduced to 15 % of the labour force, substantially lower than its peak of 36 % in early 1993.

The exchange rate against the dollar has been stable since the autumn of 1992 and even appreciated somewhat in late 1995 (94 Leks/US\$ in December 1995), reflecting in part the international weakness of the dollar. The renascent inflation in early 1996 put the Lek under pressure (104 Leks/US\$ in April 1996), but interest rates were raised to reverse the tendency. Payments for current international transactions are virtually free from restrictions.

Exports grew rapidly in 1993 and 1994, albeit from extremely low levels: in 1995, exports (at US\$ 200 million) corresponded to about one-third of the value of imports. The resulting deficit was financed by foreign aid and emigrants' remittances, the latter normally amounting to roughly twice the value of exports in recent years. The current account deficit, at US\$ 21 million, fell considerably in 1995. However, this was mainly due to the level of remittances, whose sustainability is questionable. Foreign exchange reserves improved (US\$ 240 million or 3.8 months of imports at year-end) even though the Bank of Albania had carried out the upfront cost of the foreign debt agreement (US\$ 96.4 million).

### **3. Structural reforms**

Although most prices have been liberalized, price controls remain in place for a small number of goods and services. This is the case of flour and bread for which, respectively, subsidies and price ceilings are in place. Further action will become necessary, but given the political sensitivity of this matter in a pre-election context, no moves are envisaged in the short run. In the case of electricity, the pricing policy is to be reassessed in the more global perspective of the reform of the energy sector. No more subsidies are scheduled for electricity in the 1996 Albanian state budget.

With regard to external debt, Albania reached a satisfactory agreement (fixed price buyback at 20 % and a par bond option) with its external commercial creditors in late August 1995. The upfront cost of this agreement has been paid.

A new system of customs tariffs entered into force on 1 July, eliminating the exemptions on investment machinery, equipment, agricultural machinery and medical equipment, and introducing a new classification (six-digit harmonized classification) and new tariff rates (7/25/40 percent). These changes had a limited impact on the 1995 budget revenue, owing to a late introduction (July) and the low rate (7 %) applied to previously exempted goods. Moreover, medicines as well as imports of materials that are re-exported have been exempted from tariffs. A backward move has been observed: the export of all kind of wood products, except furniture and charcoal, has been banned from early 1996.

Since 1992, Albania has applied a market-determined floating exchange rate regime. In practice, current account convertibility of the Lek has been achieved, and the authorities envisage progressively lifting restrictions on capital transactions. The Bank of Albania's

interventions in the foreign exchange market are guided primarily by its targets for net international reserves.

With regard to fiscal and budgetary reform, VAT implementation (at a single rate of 12.5%) was delayed because of both technical and political difficulties. However, the VAT law was amended in March 1996 and the introduction has now been fixed for 1 July 1996. Employment in the budgetary institutions has continued to be reduced and its level has fallen below the requested level of 160,000 at end-June 1995, against 174,000 in August 1994.

Concerning the privatization of state-owned enterprises, the government decided in early 1995 to implement a broad mass privatization programme (MPP) for the medium and large-sized enterprises. This MPP has started and vouchers are being distributed; three rounds of auctions have already been held comprising 69 enterprises and creating 15,000 shareholders. Moreover, over 3,000 small and medium-sized enterprises have already been privatized through normal auctions and the remaining few have been transferred to the MPP program.

In the case of public utilities and resource-based enterprises, the Government has decided to give priority to sales to strategic investors. Legislation enabling the privatization of the electricity company (KESH) has been approved by the Parliament. Legislation also envisages a framework for the regulatory body entitled to formulate the pricing policy for electricity. Privatization is starting with the electricity distribution system, with pilot sales of three regional networks. 30 % of these distribution units are sold through the mass privatization programme, while for the remaining 70 % the Government is preparing the bidding documents allowing strategic foreign investors to become shareholders. Similar legislation for other sectors has been approved (mining and telecommunications sectors) or is under preparation (water supply sector). New investments in these sectors have been planned with the support of international donors.

A law covering private investment funds and which sets out the legal framework for their establishment, licensing, operation and governance was approved in July 1995. Parliament adopted a law on sales of shares in October and an Albanian stock exchange came into operation in early May 1996.

With regard to incentives for foreign investments, the creation of free economic areas has been adopted and foreigners have been allowed to buy land in Albania.

Concerning the liquidation or privatization of the 32 problematic Enterprise Restructuring Agency (ERA) enterprises, 5 of these have been privatized through mass privatization. Six of them are in the process of liquidation, while for the others a strategy of splitting them into smaller units before privatization in the MPP is being followed. Total employment in ERA enterprises was in the order of 10,000 in late 1995 against 49,000 a few years ago, with a majority of the enterprises ceasing activity and the remaining ones drastically reducing their workforce.

In the key agricultural sector, the Parliament approved in August 1995 the law on a "Land Market" allowing, in particular, the sale and purchase of land. Moreover, laws on mortgages, collateral, land leasing and administrative mechanisms to resolve land disputes were approved during 1995. With regard to the former state farm land, land "users" have received the full ownership rights, whereas, with regard to the former cooperative land, the right to lease, sublease and mortgage land has been established for those who have

already received temporary certificates of land ownership. These temporary certificates have been issued covering approximately 85 % of agricultural land. Their distribution has been continuing and will be completed shortly. Through the Land Market Action Plan supported by PHARE, the authorities have been accelerating the establishment of a land registry, a necessary condition for the issuing of ownership permanent titles. Concerning the agro-industrial sector, the privatization process is well under way: 2/3 of the "small and medium" state-owned agro-enterprises and 50 % of the "large" ones have been privatized. The remaining 50 % of "large" ones will be privatized later during the Mass Privatization Programme.

In the financial sector, several major steps have been taken:

- concerning the privatization of the state-owned banks, Parliament adopted on 16 November 1995 the law on transforming the state banks into commercial companies. Business plans were completed, but their scope was rather limited. With a more ambitious objective, a privatization feasibility study for the Rural Commercial Bank (RCB) and an external independent audit on the two other state-banks were carried out. Moreover, privatization advisors for the Rural Commercial Bank (RCB) have recently been appointed whereas those for the National Commercial Bank (NCB) will be appointed by June 1996. Based on bank external audits already completed, viable parts of these banks will be offered for sale to foreign strategic investors before the end of 1996. Negotiations are already under way for the RCB. The Savings Bank (SB) should be offered to private investors by July 1997. The objective is to attract foreign investors to take over a majority share, whereas the remaining state share will be sold on the domestic market. 10 % of the banks capital will be sold in the form of privatization vouchers;
- concerning banking regulation and legislation, a system of clearance and a chart of accounts are being prepared in line with international standards, with the aim of replacing the existing system during 1997. In February 1996, Parliament adopted the law determining the role and responsibilities of the Bank of Albania, including its relationship with the Government in terms of lending. Simultaneously, the law on the banking system was adopted, streamlining the licensing procedures and regulations for banking activity in Albania (in particular for co-operative banks and other financial institutions). Since then, several foreign and two Albanian private banks have lodged requests to open subsidiaries in Albania; three of them have already been licensed. A modern law on procedures on bankruptcy, including specific provisions for banking and insurance institutions, was adopted by the Parliament in October 1995. A new law on insurance, allowing private firms to operate, has ended the state monopoly in this area.

#### **4. Macro-financial assistance**

On 28 November 1994, the Council of Ministers decided to grant Albania further macro-financial assistance up to a maximum amount of ECU 35 million in the form of a grant in the context of an initiative of the Group of Twenty-Four, aiming at mobilizing a total of US\$ 72 million. This grant is complementary to assistance provided by the IMF under a 3-year Enhanced Structural Adjustment Facility (ESAF) initiated in mid-1993, with a view to ensuring a sustainable balance of payments situation and strengthening the reserve position of the country.

The Community grant was to be disbursed in two tranches. The disbursement of the first tranche (ECU 15 million) was effected in May 1995, following signature of the Memorandum of Understanding (MoU) laying down the macroeconomic and structural conditions attached to the grant.

The approval by the General Affairs Council of 10-11 April 1995 of the Commission's report on progress in Human Rights in Albania allowed the Commission services to go ahead with the implementation of the second tranche (ECU 20 million) of this assistance. The Commission concluded in July 1995 that the Albanian authorities had achieved satisfactory progress in their adjustment and reform process and that Albania, consequently, was complying with the conditions attached to the grant. Nevertheless, owing to Albanian difficulties in reaching the 1995 budgetary targets and in agreeing new budgetary objectives in the pre-electoral context of 1996, the conclusion of a third annual programme under the current ESAF had been delayed and, as a result, the Commission decided to postpone the disbursement of its second tranche.

Since then, the Albanian authorities have irrevocably fixed the date for the beginning of VAT implementation for 1st July 1996. Moreover, further significant progress in the areas of reform where delays had been experienced (privatization of state-owned enterprises, banking sector reform, land ownership certificates) have been achieved. These positive developments, in addition to Albanian assurances about corrective measures which would be implemented to cope with the worsening budgetary situation, have cleared the way towards the disbursement of the grant.



### III. ALGERIA

#### 1. Introduction

Despite a favourable track record of policy implementation and some signs of macroeconomic stabilization, Algeria's pace of structural reform and the development of a dynamic private sector in 1995 were seriously hindered by continuing political uncertainty and security problems which negatively affected growth, employment and domestic as well as foreign investment projects. Thus, the development of a political dialogue with the opposition is an essential prerequisite for progress in macroeconomic stabilization and for more decisive reform measures.

A major turnaround occurred in 1994, in light of a further serious degradation of the socio-economic situation of the country. The Algerian Dinar was devalued by some 45% and the fixed exchange rate regime was replaced by a managed float, aiming at a stabilization of the real effective exchange rate. Prices, imports and access to foreign currency were substantially liberalized. Consumer subsidies were gradually reduced and a more effective social safety net was put in place. Financial discipline for state-owned enterprises has since been tightened and the first steps towards privatization have been taken. Despite diversification efforts, the country's economy is still heavily dependent on hydrocarbons (20% of GDP, 60% of fiscal revenue and 95% of exports). In this respect, Algeria is a "policy-taker" country, in the sense that its economic development prospects in the medium-term still rely heavily upon the development of oil prices in the world market which in 1995 stabilized at a low level (approximately 15 dollars a barrel).

The ambitious policy programme launched during 1994 was confirmed by the new government which was formed in the aftermath of presidential elections in November 1995. Algeria's renewed reform efforts were supported by the International Financial Institutions and the Community throughout 1994 and 1995. In May 1994 the IMF approved a one-year Stand-by arrangement of US\$ 1 bn. This was followed by a three-year Extended Fund Facility (EFF) of US\$ 1.8 bn in May 1995. The first Fund review occurred in December and it was concluded satisfactorily, leading to a new "purchase" of funds by Algeria in 1996.

In January 1995, the World Bank approved a US\$ 150 million Emergency Rehabilitation Loan. In late 1995 the World Bank finalized a Financial Enterprise Structural Adjustment Loan (FESAL), which was actually approved by the Board in April 1996. The total lending envisaged is US\$ 400 million of which 300 million for adjustment support and the rest for supporting agricultural and housing sectors. Arrangements on external debt rescheduling were also reached with both the Paris and London Clubs in 1994 and 1995, respectively.

In August 1994 the Community released the remaining second tranche (MECU 150) of its first macroeconomic loan in favour of Algeria, decided in 1991. In December 1994 the Council adopted the European Commission's proposal for an additional MECU 200 macro-financial assistance, to be disbursed in two tranches.

The conditions attached to the disbursement of the first tranche (notably further liberalization of imports, reforms in the financial sector and progress towards restructuring and privatization of public enterprises) are contained in the Memorandum of

Understanding negotiated with the Algerian authorities in January 1995. After reviewing the fulfilment of these conditions, the first tranche (MECU 100) was disbursed in November 1995.

It was agreed with the Algerian authorities that the conditions related to the disbursement of the second tranche would be negotiated at a later stage in a Supplemental Memorandum of Understanding. Furthermore, agreement has been reached for a fast mobilization of existing grants under various co-operation protocols. Reinforced bilateral assistance is also envisaged under the Community's 1996-1998 MEDA programme.

## **2. Macro-economic performance**

Despite some encouraging first results and the mobilization of generous external assistance, Algeria's overall economic situation in 1995 remained quite fragile, reflecting the impact of a number of internal and external shocks, a small non-hydrocarbons production base, modest job creation capacity, growing security problems, a backward financial system and administrative resistance to reforms.

In 1995, real GDP growth is estimated at 4.3%. This result was the first positive change in per capita GDP in more than five years. The increase in real GDP was driven mainly by strong hydrocarbon exports and by a rebound in agricultural production following two drought years. Growth, however, remained insufficient to have a positive impact on the high unemployment rate (25% at the end of 1995). Despite progressive (but still incomplete) price liberalization, the Dinar devaluation and subsidy reduction in 1995 the government managed to keep the annual inflation rate below 30% through the use of a mix of administrative price control measures on basic commodities (which constitute the core of the basket upon which inflation rate is calculated) and moderately restrictive monetary, fiscal and incomes policies.

The fiscal deficit dropped further from 4.4% in 1994 to 1.4% in 1995, reflecting the implementation of a number of restrictive measures aimed at compressing the upward dynamics of public wages and salaries, the reduction of subsidies and transfers as well as the increase in fiscal and duty revenues.

The exchange rate system is presently based upon a sort of managed floating with limited Central Bank interventions in support of the Dinar, compatible with the availability of foreign currency reserves (which at the end of 1995 were equivalent to 1.8 months of imports, down from 2.6 months at the end of the previous year).

The substantial devaluation of the Dinar in 1994 coupled with a floating rate mechanism led to a sharp reduction in the gap between the official and parallel exchange rate. In early 1994 this gap was 250% and this contracted to around 50% as of mid-1995. However, the persistence of this gap (albeit declining) reflects an imperfect implementation of current account convertibility announced in 1994 and the continuing use of practices restricting the access to foreign currency by residents, particularly for tourism and small cross border trade purposes. The gap also fuels further devaluation expectations, unrecorded (and potentially destabilizing) foreign currency dealings and capital outflows.

Interest rates are still negative in real terms which has a depressive effect on savings and weakens the confidence in the Dinar by encouraging a shift from Dinar to dollar denominated accounts and holdings by residents.

The overall balance of payments situation deteriorated in 1995. During the first half of the year, a considerable external shock (due to adverse exchange rate movements and deteriorating terms of trade) compounded the negative short term impact expected to result from external liberalisation. Faced by these challenges, the authorities chose to adjust, tightening demand management and increasing the rate of depreciation of the Algerian Dinar under the managed float, thus actually managing to achieve a small surplus in the trade balance (US\$ 0.06 bn). However, this was more than outweighed by a 27.7% increase in interest payments. As a result, the current account continued to deteriorate, showing a deficit of 5.6% of GDP for 1995 against a deficit of 4.3% the previous year.

On capital account, some FDI went into the hydrocarbon sector. The country has virtually no access to the international capital market and despite London and Paris Club debt arrangements leading to the normalization of relations vis-à-vis Western creditors, virtually no new bank lending was made available to Algeria in 1995.

Following the above-mentioned debt relief arrangements, debt service as percentage of exports dropped from 82% in 1993 to around 49% in 1995. But servicing residual debt is still a heavy burden for Algeria given weak oil revenues, higher prices in the world grain market and declining foreign currency reserves.

### **3. Structural reforms**

Stringent administrative import controls and foreign currency allocation have been abolished in April 1994 and were replaced by a more liberal regime comprising a system of professional criteria for importers and a limited list of prohibited imports. The latter list has been gradually reduced and was abolished end 1994, except for goods prohibited for religious and security reasons. The list of goods subject to professional criteria is also being reduced. State monopolies on certain imports have also been eliminated. According to the new legislation, access to foreign currency has been completely liberalised for all visible current account transactions by private and public enterprises. Only imports financed through foreign credits are still subject to authorization.

However, the implementation of these liberalization measures is imperfect and is delivering only mixed results, given, in particular, the presence of a growing number of unlicensed, informal traders who have no access to banks' foreign currency. Therefore they fuel informal foreign currency deals via private (tolerated) bureaux thus encouraging market segmentation and a persistent gap between official and parallel exchange rates. Compulsory surrender requirements have been lifted. Residents are allowed to open foreign currency accounts at local banks. There is no limit on the amount held and interest is offered at more attractive rates than for Dinar deposits.

The legal environment for enterprises has improved considerably. A Competition Law was adopted in January 1995 which liberalizes the price regime and puts stringent limits on cartels and monopolies. A Commercial Code, introduced in 1993, has put private and public enterprises on an equal legal footing. The Investment Code on Joint Ventures provides for full repatriation of profits.

The restructuring of the public enterprise sector is based upon two strategies, financial and administrative restructuring and privatization. However, the reform process of public enterprises moved only slowly in 1995.

In 1995, five public enterprises were granted financial autonomy and the Treasury stopped all on-lending to autonomous public enterprises. The authorities imposed a ceiling on the access to commercial bank credit for the 23 largest loss-making enterprises and initiated their financial restructuring under World Bank guidance and support. Performance and "management" contracts have been signed with 7 other public enterprises in April 1995. A restructuring programme for all 94 public construction enterprises was also launched in order to strengthen the housing sector with a view to shifting construction activity in housing to the private sector, while reorienting public enterprises to public works. Some 88 local public utilities have been closed down.

A Privatization Law was adopted in July 1995 and in August the authorities announced the intention to privatize over 500 public enterprises. The same legislation also restored to the original owners some previously nationalized land. A pilot programme for privatizing 5 hotels has been launched but results have been short of initial expectations, given that the present political and security situation is not conducive to private sector investments in Algeria, domestic or foreign.

As part of the reform of the banking and financial system, the Bank of Algeria has strengthened its supervisory capacity and established more effective prudential regulations and controls. The five state-owned commercial banks have been audited regularly since 1992, institutional development plans put in place and performance contracts signed. On the basis of the audits, four banks were recapitalized with a view to increase their capital adequacy ratio (which is expected to rise to the BIS norm of 8% by 1999). Banks are now free to set their own creditor and debtor interest rates as a temporary ceiling on their spread was eliminated in December 1995. A new private bank was chartered in September 1995 but private involvement in the banking sector remains extremely limited in spite of a liberal investment regime.

#### **4. Implementation of macro-financial assistance**

Following the agreement in principle between the Algerian authorities and the IMF in April 1994 and a request for further macro-financial assistance from the Algerian authorities, the Council endorsed the Commission's intention to release the remaining second tranche of the 1991 programme and agreed in principle on additional macro-financial assistance for an amount of ECU 200 million.

The second tranche of ECU 150 million was effectively disbursed in August and the Commission proposal for an additional ECU 200 million macro-financial assistance, to be disbursed in two tranches, was adopted by the Council on 22 December 1994<sup>7</sup>. A Memorandum of Understanding specifying the conditions related to the disbursement of the first tranche of ECU 100 million was agreed with the Algerian authorities in early 1995. The structural reform conditions relate to further liberalisation of the imports and exchange rate regimes, reforms in the financial sector and progress towards restructuring and privatization of public enterprises. Furthermore, the Memorandum emphasizes Community concerns in the social sector and the synergy between macro-financial assistance and other Community aid instruments, with a view to facilitate the

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<sup>7</sup> Council Decision 94/936/EEC

implementation of economic reforms in Algeria. After reviewing the fulfilment of these conditions, the Community decided the disbursement of the first tranche in November 1995.

The conditions related to the release of the second tranche will be negotiated at a later stage in a Supplemental Memorandum of Understanding provided the IMF programme remains on-track.

## IV. BALTIC COUNTRIES

### 1. Introduction

The three Baltic states, who recovered their sovereignty in August 1991, had already initiated reforms under the past regime after the adoption by the Supreme Soviet of the bill on their economic independence in November 1989. In 1992, as they were already actively engaged on the way of reforms to a market economy, economic prospects worsened. The dismantling of trade relations among former Soviet republics and the increase of prices on energy imports from Russia to world levels resulted in a trade shock. External accounts deficits were expected to be unsustainable without international support. The three countries defined stabilisation and reform programmes covering the period mid-1992 to mid-1993 and concluded stand-by arrangements with the IMF. G-24 donors were called to contribute to fill the remaining expected balance of payments gap for the programme period, estimated at a level of US dollar 105 million for Estonia, US dollar 210 million for Latvia and US dollar 285 million in the case of Lithuania. On the basis of favourable prospects of support within the G-24, the IMF board approved the respective stand-by arrangements in September and October 1992.

In November 1992, the EC Council<sup>8</sup> approved macro-financial assistance of up to ECU 220 million for the three countries (ECU 40 million for Estonia, ECU 80 million for Latvia and ECU 100 million for Lithuania) in support of the countries' programmes, corresponding to about 50% of the estimated balance of payments gap. The bulk of the remaining bilateral support within the G-24 group came from Japan and EFTA countries. Loan agreements and memoranda of understanding between the Community and each beneficiary were signed in early 1993. The Commission disbursed the first tranche (50% of the loan amounts) in March 1993 for Estonia and Latvia, and in July 1993 for Lithuania. The release of the second tranche was made subject to a positive evaluation of performance criteria, regarding both macroeconomic stabilisation aspects and progress of structural reforms, as set out in the memoranda of understanding.

### 2. Recent economic developments

#### *Estonia*

After a sharp decline in 1992 and early 1993 the Estonian economy was emerging from recession by the end of 1993. GDP grew by 4% in 1994 and about the same level in 1995 (4.5%). Unemployment, at about 5%, remained moderate. Macro-economic stabilisation, after price increases which reached hyper-inflationary levels in 1992 and 1993, was to a large extent achieved after the introduction in June 1992 of a currency board arrangement under which the monetary base is limited by the amount of hard currencies and gold detained by the central bank. A new currency, the Estonian Kroon, was introduced at the same time. This proved successful in stabilising the economy: inflation dropped and continued to decline from 42% in 1994 to 29% in 1995 (year-end figures). Inflationary pressures remained strong, however, in 1995, particularly in the area of services. Under the currency board arrangement central bank lending to the state is prohibited, which contributes to budgetary discipline. In 1995 government expenditure increased above the programmed budget, but this increase was counter-balanced by growing tax revenues and

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<sup>8</sup> Council Decision 92/542/EEC (O.J. L351 of 2 December 1992)

social security contributions. The financial balance was in surplus (0.8% of GDP). Increased government deposits in the banking sector resulted in a slightly lower fiscal balance surplus (0.3% of GDP). The 1996 budget envisages an almost balanced budget.

Estonia has already implemented the bulk of structural reforms leading to a market economy. Prices and foreign trade are completely free. The small scale privatisation covering some 1000 small enterprises is now virtually completed. Out of the 500 medium and large scale enterprises about 100 remain in the state's hands and are expected to be privatised in 1996, with the exception of natural monopolies. Land privatisation, which was slow to start, is being accelerated. Financial sector reform appears as the most sensitive area. The Bank of Estonia has increased its supervision capacities and reduced its share of assets in the Savings Bank to 25% of the capital. The state also reduced below 10% its minority shareholding in commercial banks. Capital adequacy requirements are being gradually increased. An action plan was set up to restructure a virtually insolvent bank, the North Estonian Bank.

The Free Trade Agreement with the European Community entered into force on 1 January 1995. External trade continued to grow at a high pace, particularly imports which increased in 1995 by 33% over 1994. Estonia's external trade with the European Union increased markedly after independence and is characterised by a large deficit on the Estonian side. The overall trade deficit considerably increased to an estimated US\$ 690 million, or 20% of GDP. Owing to a positive services balance, particularly growing tourism receipts which grew to about US\$ 150 million, the current account deficit remained below this level (285 million dollars or about 8% of GDP, excluding official transfers). Estonia however succeeded in financing this substantial current account deficit with a large capital account surplus: for the third consecutive year the capital account was in surplus, due principally to high inflows of foreign direct investment of about US\$ 200 million. Official foreign exchange reserves continued to grow and, at US dollars 580 million at end-1995, covered approximately 3 months of imports. Under the currency board arrangement the Estonian Kroon is pegged to the DM at a fixed 8 to 1 rate. This has led, given the two digit inflation level, to a relative loss of external competitiveness which remains sustainable given the low initial rate of peg of the Estonian Kroon to the Deutsche Mark and the moderate rate of industrial price increases.

In March 1995 the IMF approved a new fifteen-month stand-by arrangement for SDR 14 million (US\$ 21 million), on which the authorities did not make any purchases.

### *Latvia*

After a sharp deterioration in 1992 and 1993, Latvia's overall economic situation had stabilised in 1994: growth was at about 1%, inflation continued to slow down, falling to 26% at year-end, and the budget deficit remained within 2% of GDP. In April 1995, the IMF confirmed its support of the authorities' policy by approving a second stand-by arrangement for a 13-month period.

In 1995, the budget deficit had initially been programmed to remain at 2% of GDP as in 1994. However, Latvia's budget situation deteriorated in early 1995 and the budget deficit rose to 92 million lats (US\$ 184 million) in 1995, or 4% of GDP. Additionally, a major crisis in the banking sector occurred in April 1995 with the main Latvian commercial bank, Banka Baltija, being declared insolvent, which alone accounted for 20% of the country's deposits. By mid-1995 eight other banks had been declared insolvent and a

number of others were no longer allowed to take deposits. Altogether, the insolvent banks represented a total assets value of one third of the total bank assets in the country, or about US\$ 1.2 billion.

As a result of the crisis, broad money dropped by 10% over the second quarter. However, the high percentage of savings held in cash in foreign currencies obviously dampened its contractionary effect. GDP overall declined by 1.5% in 1995. Unemployment remained stable at about 6.3% by end-1995. The Bank of Latvia maintained its conservative monetary policy stance, and inflation thus continued to slow down, falling from 26% in 1994 to about 23% in 1995.

In the Summer the authorities adopted a package of measures to address immediate and long term needs of the financial sector, by enhancing prudential regulations and setting up a deposit insurance scheme. Other structural reforms continued in 1995. The Privatisation Agency became fully operational and 230 additional firms were privatised in 1995. The sale of shares of the Universal Bank, one of the three main public banks, started in the third quarter of the year. The Free Trade Agreement signed with the European Union came into force on 1 January 1995.

Imports and exports increased markedly in 1995, and reflected the continued shift of trade towards the West. As in 1994, the trade balance remained negative over the year (440 million US\$ deficit, or 10% of GDP). The positive services balance, mainly due to the transport sector, allowed for a current account deficit of about half the size of the trade deficit (180 million US\$, or 4% of GDP, excluding official transfers).

The authorities have successfully pursued a stable exchange rate policy with an informal peg to the SDR and, despite speculative attacks which led to a loss of foreign exchange amounting to 90 million US dollars in Spring, the Lats exchange rate remained broadly at its previous level in 1995. Under a two-digit inflation this translates into a real appreciation in the exchange rate. The overall competitiveness of the economy however seems to have been maintained.

In order to cover its current account deficit Latvia is dependant upon private capital inflows, which remained substantial in 1995 in spite of the financial crisis. Thus, the damage of the crisis was contained and Latvia's reserves position remained relatively strong, with approximately US\$ 600 million net reserves at year-end, which corresponds to around 5 months of imports. The IMF programme went-off track after the Spring crisis and its Summer review could not be completed. In early 1996 the IMF staff concluded a new stand-by arrangement with the authorities which the IMF board approved in May of this year.

### *Lithuania*

After four years of recession, Lithuania's economy began to show signs of recovery in 1994, with a 2% increase in GDP. Growth for 1995, despite a drop in GDP in the first quarter of the year, is estimated at 2.5%. The fundamental growth trend is now considered to be solid and is expected to be fuelled by investment and export growth. Unemployment, however, significantly rose in 1995 to about 7% of the active population, against 2% at the end of 1994.

Inflation, which had peaked at hyper-inflationary levels in 1992, slowed down in 1993 and early 1994. On 1 April 1994, a currency board arrangement was introduced under which



monetary growth is limited by the market value of gold and hard currencies held by the Bank of Lithuania. The reduction in inflation after the introduction of the currency board has been striking: price increases fell substantially in 1994, at a year-end rate of 45%. Inflationary pressures however remained in 1995, fuelled by the low foreign exchange rate of the litas and increases of public prices. As a result, inflation, with an estimated 35% (year-end rate), remained above the authorities' initial target (25%) in 1995. The fiscal deficit target (GDP 3.4%) for 1995 was broadly met, despite weak revenue performance in early 1995 which forced the government to cut expenditure.

Structural reforms have been further implemented. Prices had already been liberalised in 1993. The only items with prices remaining under government control relate to cases of monopolistic situations. The bankruptcy law, which has started to be implemented, was redrafted in early 1996 in order to make it more operational. Housing and small-scale privatisation are now virtually completed but, owing to delays in the establishment of the Privatisation Agency, large scale privatisation has been delayed until 1996. The financial sector reform is the most sensitive area. After the enactment of the Central Bank and Commercial Bank laws in early 1995 and the subsequent tightening of prudential regulations, the banking sector went through drastic adjustments and 4 small banks (out of initially 28) were declared insolvent and will in most cases eventually be liquidated. In December the crisis worsened when two medium-sized banks, Litimpeks and Innovative Bank, were also declared insolvent. The authorities, with IMF and World Bank support, prepared a new set of measures to consolidate the three major state-owned banks, to create a depositors insurance scheme and to review the commercial banking law. Compensation to depositors of the insolvent banks amounted to 30 million litas (i.e. half the total of their estimated losses), of which 20 million were programmed in the 1996 Budget. Parliament eventually approved, in June 1996, a law to re-nationalise Innovation Bank and to recapitalize it with resources collected from new issues of government bonds, amounting to the equivalent of 250 million US dollars. Bad loans from the Innovation bank as well as from the state-owned Commercial bank and Savings bank were transferred to a newly established ad hoc bad loans agency.

For the third consecutive year the trade balance was in deficit (US\$ 335 million, or 4.5% of GDP), with exports increasing slightly faster than imports (respectively 15% and 13% increases). The shift of trade towards the West continued, and was reflected in higher growth rates of west-oriented trade flows (more than 20%). The weak point of external trade remains the energy balance (deficit: 5.7% of GDP), with imports of energy representing 40% of the total imports. The current account deficit remained near the level of 1994 (US\$ 250 million, or about 2.3% of GDP, excluding official transfers). On 1 January 1995, the Free Trade Agreement with the European Union entered into force.

The uncertainties in the area of the local banking sector translated into lower private capital inflows than in the previous years (US\$ 135 million), and which did not counter-balance the current account deficit. In December the Central Bank lost US\$ 45 million of reserves as a result of the crisis of confidence after Litimpex Bank and Innovation Bank were declared insolvent. Significant medium- and long-term borrowing (US\$ 230 million) was necessary to cover the remaining financing needs, out of which US\$ 60 million were borrowed on the private capital market in December. At year-end official reserves were estimated at about US\$ 800 million, or 3.5 months of imports.

The IMF Board approved in June 1996 the third review of the current programme, an SDR 134.55 million three-year (1994-1997) Extended Fund Facility (EFF). This will

contribute to consolidate the reserves and help finance key energy and investment related imports.

### **3. Implementation of macro-financial assistance**

Owing to the expected increasing demand for investment related hard currency finance, and to the track record of surplus of the three countries' external capital account, the Commission, after consulting Member States exceptionally agreed in supplemental memoranda of understanding signed with the authorities in 1994 and 1995 to channel the bulk of the loans' second tranche through the banking sector, for sound bankable projects in need of hard currency financing.

Economic stabilisation and progress of structural reforms conditionality criteria attached to the Community macro-financial assistance have been satisfactorily met in Estonia. The Estonian authorities however, after having considered drawing the loan's second tranche in 1994, eventually did not request its disbursement in 1995.

In Latvia the IMF programme went off-track after the financial and budgetary crisis in Spring 1995, and the normal Autumn review of the stand-by programme could not be completed. In June the Latvian authorities requested the release of the Community loan's second tranche (ECU 40 million). Commission services subsequently went on mission in July to assess the situation and seek explanations from the authorities on their intended use of the funds. The authorities made it clear that the funds would be channelled to refund small depositors which had lost their savings in the bankruptcy of Banka Baltija. The Commission considered that this would be inconsistent with the general aim of the EC macro-financial assistance, which is to finance balance-of-payments external related needs and not to cover internal budgetary financing needs. This would also be inconsistent with the normal conditionality criteria of the loan (including a satisfactory track record of the IMF programme) and with the undertaking of the Memorandum of Understanding signed in 1994 relating to the loan's second tranche. Accordingly, the Commission, after having consulted the Member States, declined the authorities' request to release the loan's second tranche in October 1995.

In the case of Lithuania, the Authorities requested the disbursement of the second tranche (ECU 50 million) of Community assistance in early 1995. On account of progress of stabilisation and reforms, particularly in the areas of privatisation and of the banking sector prudential regulations, Lithuania complied with the conditionality criteria attached to the release of the second tranche. A Memorandum of Understanding relative to the use of proceeds under this second tranche was signed in July. As already foreseen in Latvia and Estonia, it was agreed that the use of proceeds of the second tranche would be earmarked for sound bankable projects and channelled through banks complying with Central Bank prudential regulations. Owing to the local banking sector's limited absorption capacity, it was agreed to split the second tranche in two separate ECU 25 million instalments and to release the first one, which the Commission disbursed in August. The authorities decided to channel the bulk of the funds through two medium-sized banks complying with central bank sound banking criteria. In September however the Commission requested a freeze in the use of proceeds of Community assistance pending improvements in the envisaged consultation process. In November, Commission services went on mission to Vilnius and requested further improvements in the management of the Community macro-financial assistance.

In spite of internal tensions, particularly in the financial sector area, the Baltic economies have successfully implemented the core reforms leading to a market economy and have overall been performing remarkably well. The growth trend is now considered to be solid, and the level of external financing needs which had been anticipated when the IMF concluded the first generation of stand-by arrangements in late 1992 has eventually, to a large extent, been covered by private capital inflows. The scope for external official macro-financial assistance has been more limited than initially anticipated, and the Commission thus did not release the full amount of Community macro-financial assistance initially approved. External tensions on the Baltic countries' balance of payments remain possible on account of growth-driven increasing trade deficits. The Commission will keep the situation under regular review.

## V. BELARUS

### 1. Introduction

Belarus, which had been one of the most developed republics under the command economy regime of the Former Soviet Union (FSU), embarked on reforms later than most countries in the region. A first limited set of reforms were launched in 1993 and were supported by the IMF with a Systemic Transformation Facility (STF) first tranche. Following the Presidential elections in July 1994, the authorities launched stabilisation reforms in the second part of 1994 and in early 1995. The IMF released the second STF tranche by end-January 1995. The conclusion of a more ambitious programme in the form of a stand-by arrangement, initially envisaged for March 1995 was postponed pending the adoption of new reforms. The IMF board eventually approved a stand-by arrangement on 12 September 1995.

On 10 April 1995 the Council of the European Union<sup>9</sup> approved a Community macro-financial assistance to Belarus in the form of a 10-year loan, conditional upon the conclusion of an IMF stand-by arrangement, to support the country's programme of macro-economic adjustment and structural reforms. On the basis of preliminary estimates from the IMF of the country's residual external financing gap for 1995, the amount of the Community assistance was set at a maximum of ECU 75 million. In addition, it was understood that the mobilisation of Community macro-financial assistance to Belarus would require that the country fully met its financial obligations to the Community in a timely manner.

### 2. Macroeconomic performance

The drop of production in Belarus was in the initial stage of transition lower than in other FSU countries, with GDP down by about 10% per year in 1992 and 1993, which was less than in Russia. However, a considerable drop (-20%) was recorded in 1994, one of the most severe in the countries in transition, followed by a further 10% decrease in 1995. Investment dramatically declined over the last five years below 50% of its 1990 level. Inter-republican payments and trade in the FSU collapsed in 1993 resulting in a general deterioration of enterprises' situation in Belarus. Inter-enterprise and bank credits piled up, with Central Bank unlimited refinancing of the banking system, which triggered price increases reaching hyper-inflationary levels in 1993 and 1994. The general government deficit remained under control, however, below 2% of GDP in both 1993 and 1994.

Belarus left the Russian rouble zone only in April 1994 when the Belarus rouble was declared the only legal tender in the country. Stringent monetary policy was implemented from early 1995. As a result, inflation dropped from 40% per month in January to 2.5% in June and, despite high increases of public utilities tariffs, the authorities succeeded in stabilising inflation which remained below an average monthly 5% until the end of the year. Market mechanisms for the allocation of central bank credits were introduced in early 1995. The authorities pursued over the year a flexible interest rate policy aiming at maintaining positive and attractive real interest rates, so as to mobilise rouble deposits within the banking system. The positive real interest rates and a tight monetary policy contributed to stabilise the Belarus rouble in nominal terms at 11500 rouble per US dollar,

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<sup>9</sup> Council Decision 95/132/EC (O.J. L89 of 21 April 1995)

and led to a significant appreciation in real terms against the dollar (+340 % over the year 1995). The budget deficit, at 2.3% of GDP for 1995, was limited within the level agreed with the IMF. The bulk of this deficit was financed internally.

The current account which had been in deficit in 1993 and 1994 (about -10% of GDP), remained negative in 1995 (-3.5% of GDP). The competitiveness of Belarus' exports to the west was reduced by raising import tariffs to Russian levels as a result of the entry into force of the Customs Union with Russia in early 1995. Despite fears of a loss of external markets, 1995 recorded a high growth of exports (+75%). Imports, at the same time, increased by 65%, and the trade balance, as a consequence, remained in deficit (-6% of GDP). Belarus progressively lifted restrictions on foreign exchange transactions in 1995 and thus moved towards current account convertibility.

### 3. Structural reform

Initial progress in the area of structural reform had only recently been undertaken and remain a weak point in Belarus. Cross subsidisation of households by industry with regard to energy prices was high. A first wave of adjustment of public prices took place in Autumn 1994, when prices on communal services were increased. Rents, water and heating increased by factors of 42, 24 and 9, respectively. Further increases took place in early 1995. The number of "monopolistic enterprises", for which prices are regulated, was reduced from about 350 in mid-1994 to 50 in mid-1995. As a result, most prices have now been freed. Public sector prices, which are still highly subsidised, were increased in July to 60% of cost recovery levels and further adjusted in December to 80% of these levels. State orders in production and procurement have been reduced to 6% of the total output but remained particularly high in the agricultural sector.

Most import licences requirements and the surrender requirements on exports had been abolished by end-1994 and early 1995. External trade however remained subject to some limitations. Export taxes which had been abolished in December 1994 were reintroduced in early 1995 as a result of the entry into force of the Customs Union with Russia. (At the time of writing this report the authorities have reintroduced, in early 1996, new administrative limitations on external trade and foreign exchange transactions).

The banking sector is burdened with bad loans and remains globally inefficient. Progress was made recently on accounting standards, but external auditing remains scarce. The authorities recently raised capital requirements for banks from ECU 1 million to ECU 2 million. It was further decided to proceed with the liquidation of two small insolvent banks. Inter-enterprise arrears reportedly accounted for more than 50% of GDP by end-1995. Actions to improve enterprises' financial discipline were adopted but seemed to be inefficient in the absence of effective bankruptcy sanctions, owing mainly to the lack of clear mechanisms to declare enterprises insolvent (a revised Bankruptcy law was later approved in May 1996). In the context of high energy prices, loss of markets and increasing payments arrears, profitability in enterprises has been cut by about 50% over the last three years. The number of loss-making enterprises increased significantly in 1995 up to 29% of the total (April 1996 figures, on the basis of 1995 accounts).

Privatisation is only at an initial stage. Enterprises representing no more than 6% of the total asset value had been privatised by end-1995. The privatisation of small enterprises, which has been the most rapidly conducted part of privatization in countries of Central and Eastern Europe was delayed in Belarus due to rigid auctioning procedures, and, by the end of 1995, only 12% of small enterprises had been privatised. A voucher

privatisation programme approved in 1994 was designed to cover the subscription of 50% of the total assets to be privatised, but the distribution of vouchers to the population, which was to be completed by end-1995 was substantially delayed. The privatisation process overall slowed down in 1995.

The process of reforms in agriculture has also been slow. Agricultural prices were only freed in early 1995, while input prices of the agricultural sector had been liberalized earlier, leading to a squeeze in profitability of the state-owned farms and to the accumulation of arrears, in particular on energy supplies. About 20% of the sovkhozes and kolkhozes farms were transformed into joint-stock enterprises. However, privatisation had not yet started by end-1995 and is likely to be particularly complicated under such difficult financial circumstances. There is further scope for reform of the ownership status of agricultural land, which by law is the state's property and can only be leased for 99 years, without possibility to sell or mortgage leases.

#### **4. Implementation of macro-financial assistance**

After approval on 12 September 1995 by the IMF board of the first stand-by arrangement with Belarus, in late September Commission services went on mission to Belarus to assess the economic and financial situation and discuss with the authorities of the country the terms and conditions of the Community macro-financial assistance.

A Memorandum of Understanding setting out the macro-economic and structural transformation conditions attached to the Community assistance was agreed. Beyond the respect of the macro-economic performance criteria foreseen in the IMF stand-by arrangement, the Belarus authorities undertook significant commitments in several areas of structural reform (price liberalisation, privatisation and enterprise reform, financial discipline of enterprises and banking reform), on which progress will be essential for the disbursement of the second tranche of the assistance.

Over the programme period of the IMF stand-by arrangement (July 1995 - June 1996) the country's external financing needs have been estimated at about US\$ 600 million, almost half of which would be covered by the IMF. The Community contribution, taking into account the revised residual gap, was set at ECU 55 million and, matched together with the other bilateral donors' contributions, contributed to fully cover the residual balance-of-payments financing gap. The amount of the first tranche was set at ECU 30 million, and disbursement took place in December 1995.

## VI. BULGARIA

### 1. Introduction

In 1995, the Bulgarian economy witnessed continued, modest progress in terms of stabilization and growth both in the public and private sector, essentially reflecting a relatively unambitious policy programme launched by the new Government, following the December 1994 elections. On the other hand, developments in the area of structural reform continued to disappoint, particularly as regards the adoption of measures aimed at accelerating privatization and addressing significant managerial and financial problems of the domestic banking sector which continues to be overburdened by a huge number of non-performing loans.

The insufficient progress on overall economic reform and lack of credibility in the government's policy programme for 1995 led to a declining confidence of the International Financial Institutions, Western commercial banks and private investors.

The deterioration in the western perception of Bulgaria's financial risk and a number of fundamental reserves repeatedly expressed by the IFIs on the pace of the country's structural adjustment in 1995 was a major setback for the Bulgarian authorities, particularly if one takes into account that in 1994 both the IMF, the World Bank and western commercial creditor banks agreed on a major, global assistance package in favour of Bulgaria. In fact, in April 1994 the Fund approved a twelve-month Stand-by facility worth 97 million associated with a Systemic Transformation Facility for US\$ 324 million and in September, same year, it decided, together with the World Bank, further to augment its financial contribution by US\$ 225 million. Moreover, in April 1994 a Paris Club debt rescheduling arrangement was agreed with official creditors and this was followed by a debt and debt service reduction programme (DDSR) agreed with Western commercial banks in July.

In the event, the Fund's assistance was suspended in late 1994 and failure to reach a new agreement for further funding in 1995, due to disagreements on the compliance of the Bulgarian government with the Fund and the World Bank's macro-economic and structural adjustment conditions led to a further worsening of the country's external financial position at the end of 1995 and during the beginning of 1996. Continuing absence of external financial assistance, very low foreign direct investment (FDI), (particularly if compared with other central and Eastern European countries) and the steady erosion in the country's foreign currency reserves has brought Bulgaria again on the verge of an external payment crisis. And this is particularly disturbing, in view of huge external debt-related obligations falling due in 1996 and beyond (in excess of US\$ 1 bn a year).

In the framework of the G-24 coordination process, the Community decided in April 1994<sup>10</sup> to reconfirm its commitment of a loan of ECU 110 million, decided in October 1992. The release of a first tranche (ECU 70 million) took place in December 1994.

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<sup>10</sup> COM(94)118 Final 94/0103 (CNS) of 21 April 1994

## **2. Macroeconomic performance**

The policy programme for 1995, approved only in May by the newly elected government, was a rather uncertain and unclear compromise between the demand on the one hand, to rein in high inflation via moderately restrictive monetary, income and fiscal policies, attain exchange rate stabilization, sustain output growth, investment and export and, on the other, to minimize the social costs of the country's economic transformation by postponing privatization and granting a generous social safety net.

Key measures aiming at enhancing financial discipline in selected large loss-making state owned enterprises or, if required, liquidating them, rehabilitating banks and strengthening bank supervision were either postponed or insufficient, thereby jeopardizing the sustainability of macroeconomic stabilization.

After five years of recession, the economy began a recovery in 1994. Real GDP grew by 1.4%, followed by an increase of 2.6% in 1995. A sharp depreciation of the lev in Spring 1994 boosted exports and industrial output, while imports were reduced. The foreign trade balance swung from a deficit of almost US\$ 1 billion in 1993 to a surplus of over US\$ 400 million in 1995. Reserves of foreign exchange held by the central bank rose from US\$ 0.6 billion at the start of 1994 to US\$ 1.5 billion by mid-1995.

Industrial production increased by 5% in 1994. The rise in output was concentrated in chemicals and basic metallurgy. These sectors were able to expand exports, their competitive advantage deriving from the currency depreciation and also from cheap energy. Up until very recently, energy prices remained below world levels.

Other macroeconomic indicators also pointed to positive economic developments. The budget deficit, which had been in double digits as a percentage of GDP during the early years of the 1990s, was cut to 7% in 1994 and 1995. Having peaked at over 16% of the labour force in early 1994, the unemployment rate fell to under 11% in mid-1995. The rate of inflation slowed, from an average monthly rate in the range of 4 to 6% during 1992-1994, to below 2% per month in Spring and Summer 1995.

The reduction in inflation was helped by a prolonged period of stability in the nominal exchange rate, but also by increased Government intervention in markets, reversing earlier liberalization measures. Weighted by their share in the consumer price index "basket", approximately 50% of goods are now subject to some form of official monitoring or control. One consequence of these measures, combined with low domestic wheat purchase prices and ineffective export controls, is the emergence of bread queues.

In general, the improvement in macroeconomic performance was not based on solid microeconomic, or structural foundations. In the financial and enterprise sectors, lack of progress in restructuring and privatization contributed to the development of a symbiotic relationship between banks and companies. Unprofitable enterprises with loan arrears continued to have access to credit from banks. Banks continued lending to enterprises in the expectation - based on past experience - that the state would ultimately bail them out. The central bank implicitly colluded with this situation by providing uncollateralized loans to commercial banks.

By the second half of 1995, there were increasing signs that the economic situation was unsustainable. The growth in industrial output slowed to below 2% for the year. The price advantage conferred by the Spring 1994 currency depreciation was eroded by the



subsequent exchange rate stability and the differential between domestic and foreign cost increases. Consumer price inflation accelerated somewhat, and the exchange rate began to come under pressure. Foreign exchange reserves declined as the central bank intervened in support of the lev.

The country is regularly meeting its external debt-related obligations stemming from the implementation of the Paris Club debt rescheduling arrangement and DDSR arrangement with the London Club creditor banks. In 1995, debt-related payments amounted to some US\$ 718 million.

Following the arrangements, Bulgaria's relations with the international financial community have been restored but the recent eruption of a new financial crisis in the country's banking system and declining confidence in the currency has again increased Bulgaria's financial risk with depressive effects on the value of "Brady bonds".

### 3. Structural reforms

Despite a number of constraints, policy slippages and weak management, Bulgaria was in 1995 successful in preserving previous policy achievements such as trade liberalization, current account convertibility and a liberalized exchange rate regime. Undoubtedly, maintaining this "acquis" may become more problematic particularly in view of the country's new financial fragility, exchange rate volatility, loss of confidence on the lev and the insufficient speed in the structural adjustment process.

The progress in trade liberalization has been encouraging but uneven. In 1995, Bulgaria implemented a liberalized customs policy (in particular in trade with the EU) but at the same time it adopted a number of temporary import restrictions aimed at protecting selected domestic industries and agriculture, such as minimum import prices, restrictive import licenses, tariff quotas etc.

Bulgaria still operates export quotas, export fees and export taxes on selected goods. Occasional export bans were imposed in 1993 on industrial products but were eventually lifted in July 1995. Bulgaria's Interim Association Agreement with the EU entered into force on January 1, 1994.

The progressive adoption of an outward-oriented trade regime has been associated with efforts aimed at further liberalizing the exchange rate regime. A major liberalization was introduced in February 1994 whereby foreign exchange ceilings for current personal payments (tourism etc.) by residents have been raised significantly and current account convertibility is ensured for trade related payments. Some restrictions on current payments and transfers are however still in force. Residents are allowed to hold foreign currency deposit accounts (export proceeds are subject to repatriation but not a surrender requirement). Some inter-governmental clearing and barter arrangements with third countries were also terminated in 1995.

As regards the reform of the state enterprise sector, the new government has pursued its strategy based upon three main "pillars", i.e. the implementation of financial rescue plans for state enterprises (SOEs), enterprise restructuring and privatization. Moreover, policy implementation was delayed by political conflict, policy and administrative shortcomings, lack of commitment to harden budget constraints on SOEs, insufficient financial resources

and a weak banking system. In this respect, 1995 has been a sort of transition year towards a more decisive and ambitious reform programme which presently is being prepared, for implementation in 1996.

The financial rescue strategy lays its foundation on a law passed in December 1993 authorizing the government to issue long-term bonds in both domestic and foreign currency aimed at replacing uncollectable lev and dollar-denominated loans and interest arrears accumulated in banks' portfolios by end of 1991. Loans to state enterprises will therefore be borne by the government which eventually may convert them into equity or decide for their write-off or rescheduling as soon as companies are restructured or privatized. In the end of 1995 Bulgaria had concluded some 77 privatization deals where domestic debt bonds were used in debt-equity swaps amounting to 2.9 bn leva. Few more privatizations were also carried out through debt-for-equity swaps with the use of government "Brady bonds" (issued on the occasion of the DDRS arrangement) held by Western investors.

In the field of restructuring, steps were taken late in 1995 with a view to strengthening SOEs' financial discipline. Loss reduction and rationalization plans were prepared as well as a list for closing non viable enterprises or to put them into "financial isolation", implying that all banks would be prohibited from extending further loans to them. However, these plans were not implemented.

The privatization programme approved in June 1995 listed some 600 eligible firms but at the same time it indicated some key sectors (such as energy, railways, mining etc.) which would be excluded from the programme. Large SOEs will be only partly privatized, reflecting the new government strategy to keep a significant state control in any sizeable firm. In 1995 the Privatization Agency completed only 69 privatization deals (out of 170 deals originally envisaged for 1995) with total proceeds of 12.1 bn leva (of which only 3 bn paid in cash and the rest by swapping government foreign and domestic debt bonds into enterprise equity).

Furthermore, in 1995 a mass privatization scheme was launched, involving some 1000 public enterprises. Sale of vouchers began in January 1996 and sell-off tenders are expected to be issued by the autumn.

The situation of the Bulgarian banking system worsened considerably during 1995 and the beginning of 1996 reflecting continuing undercapitalization, inadequate management, insufficient supervision by the BNB, lack of financial discipline ("easy credit"), fragmentation and a growing amount of non performing loans to enterprises. Despite some measures taken in 1994 and 1995 focusing on the strengthening of the bank supervision capability at the BNB and implementing a bank consolidation programme by the Bank Consolidation Company (BCC), the situation deteriorated so much (particularly in two main banks, Mineralbank and Economicbank) that presently the country's financial system is on the verge of collapse.

In order to address the problem of the banking system, the Bulgarian authorities presently envisage a number of new, wide-reaching measures such as limiting new credits by the BNB, further strengthening of bank supervision, removal from office of banks' administrators and bank licenses revocation. More medium-term strategies being

considered include the closure on financial stabilization of public enterprises which are the biggest debtors to these two "ailing" banks and, in parallel, their financial restructuring and recapitalization, in view of their subsequent privatization.

#### **4. Implementation of macro-financial assistance**

The disbursement of the ECU 110 million Community loan decided in October 1992 in the framework of G-24, as a complement to the IMF assistance to Bulgaria, was delayed as the 1992 stand-by arrangement with the Fund went off track. For the same reason no other G-24 assistance was released under this initial package. At the end of 1993 conditions were restored for the resumption of EU/G-24 assistance to Bulgaria. Following the adoption of a new IMF stand-by arrangement, on May 16, 1994, the Council agreed with the Commission that the 1992 decision on Community macro-financial assistance to Bulgaria could be re-activated in the context of the new programme. The release of a first tranche (ECU 70 million) took place in December 1994 on the basis of the approval of the new IMF Stand-by and the debt relief arrangement agreed between creditors. The release of the second tranche is conditional upon observance by Bulgaria of standard macro-economic performance criteria including a satisfactory track record of the IMF Stand -by, a proper implementation of DDSR operation and progress with structural reform.

## VII. MOLDOVA

### 1. Introduction

On 13 June 1994 the Council of the European Union decided to grant the Republic of Moldova a loan of ECU 45 million with a maximum duration of ten years<sup>11</sup> to assist the country in its efforts to transform its economy to a market economy and to strengthen the reserve position of the central bank. The Community loan was part of an overall package mobilised by the international donor community in favour of Moldova to complement the resources provided by the IMF and the World Bank. The first tranche of the loan, amounting to ECU 25 million, was disbursed in December 1994. The disbursement of the second tranche which was subject to the fulfilment of conditions specified in the Memorandum of Understanding (MOU) attached to the loan agreement, took place in August 1995.

### 2. Macroeconomic performance

Following the introduction, in November 1993, of its national currency - the Moldovan leu, Moldova has made a decisive turn towards financial stabilisation in the context of the 15-month economic programme supported by an IMF stand-by arrangement (approved in December 1993) and complementary assistance from the international community, including the ECU 45 million Community loan.

In March 1995, a new stand-by arrangement was approved by the IMF to support the 1995 economic programme of the Moldovan government. The objectives of this programme were the consolidation of financial stabilisation and the implementation of structural transformation measures to restore economic growth.

After a 31% decline in GDP in 1994, due to severe weather conditions and to the continuing disruptions to output and trade associated with the collapse of central planning, Moldova's economic recession appeared to have bottomed out and preliminary estimates indicate that real GDP, including that of the region of Transnistria, fell by 3 percent in 1995, which suggests a modest rise in activity in the economy excluding Transnistria. This improvement was partly due to a recovery in the important agricultural sector with the return of normal climatic conditions - a rise of some 4% was registered, but also to a reduction in the rate of decline of industrial production, which is estimated to have dropped by "only" 10%. Official unemployment remained relatively low, i.e. at some 2% by end-1995, but a lot of workers were on unpaid leave and the actual unemployment figure far exceeded 10%. Real wages rose in 1995 but dollar wages, which averaged US\$ 32 per month, remained low compared to those of neighbouring countries.

The 1995 programme's key monetary objective was to cut inflation to a sustainable, low level through tight credit policy. The National Bank of Moldova (NBM) successfully achieved this aim in the first half of 1995: monthly rates below 0.75% were registered, compared to annual inflation of about 800% in 1993 and 120% in 1994. However, inflationary pressures re-emerged in the autumn of 1995. These were partly due to increases in administered prices and seasonal increases in food prices, but also to strong capital inflows, which were unsterilized since the NBM was reluctant to allow a significant

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<sup>11</sup> Council Decision 94/346/EC

appreciation of the leu. In the fourth quarter, as the inflationary consequences of these policies were becoming apparent, the central bank tightened monetary policy, which was reflected in upward pressure on interest rates. With an average monthly rate of 3.5% between September and December, inflation reached 24% for the whole year, the lowest in the CIS.

The fiscal performance improved in 1995, with the general government cash deficit falling from 9% of GDP in 1994 to 5.5% in 1995, not so far from the 3.5% official target. The deficit was financed by higher-than-expected net foreign financing - mainly postponement of repayments due to Russia - and by higher-than-expected sales of government securities. A severe control of expenditure - falling from 30.2% of GDP in 1994 to 28.5% in 1995 - was necessary to make this reduction possible. On the revenue side, VAT receipts and land tax collections were particularly strong. Revenue collection remained insufficient, however - 24% of GDP against 23.5% in 1994 - and privatisation receipts were far below expectations, because of a lack of domestic capital. Both revenue and expenditure arrears - including almost all wage arrears - were reduced as a percentage of GDP.

The balance of payments remained under severe pressure in the first half of 1995, primarily because of the continued impact of the terms-of-trade shock caused by the increase in imported energy prices to world market levels. In the second half of the year, however, a better-than-expected export performance coupled with an important reduction in energy imports resulted in the trade balance showing only a small deficit. For the whole year, the current account deficit was just over US\$ 100 million, or 6% of GDP. Moldova was still highly dependent on foreign assistance, medium- and long-term loans representing an important part of capital inflows in 1995. Disbursements of assistance came from the EU, the USA, Japan and the Bretton Woods institutions for a gross amount of some US\$ 120 million. Direct investment remained low at US\$ 22 million in 1995, to be compared to US\$ 18 million in 1994. Complementary to this amount, the balance of payments recorded in 1995 a US\$ 41 million foreign investment representing equity swapped for debt to the Russian company Gazprom. Gross reserves of the central bank reached about US\$ 260 million by end-1995, or the equivalent of 4 months of imports, compared to 3 months at end-1994 and 1.4 months by the end of 1993.

By the end of June 1995, Moldova accepted the obligations of Article VIII, sections 2, 3 and 4 of the IMF's Articles of Agreement and has since then maintained an exchange system free of restrictions on payments and transfers for current international transactions. The Moldovan leu, introduced in November 1993, was remarkably stable during the whole of 1995, having fluctuated in a narrow band around Mdl 4.5 per US\$.

All quantitative performance criteria under the SBA-supported IMF programme were observed for all quarters of 1995. A new 3-year programme has been prepared by the Moldovan authorities, and a request for an EFF to support this programme will be considered by the IMF Board in May 1996. Prior actions will however have to be taken, notably in the area of energy policy (price rise to provide cost recovery) and price and trade liberalisation (reduction of import tariffs, abolition of excise taxes on exports to non-CIS, amendment of the system of reference prices for exports).

Arrears remained a substantial problem in Moldova in 1995, despite the progress made by the Government in reducing its own arrears, and even though some progress were made in stabilising the situation. Several measures have already been implemented to tackle the problem and further measures are envisaged in the new programme.

### **3. Structural reforms**

Important measures were initiated in 1995. The privatisation process slowed in early 1995, owing partly to a "wait-and-see" attitude of enterprise managers for the new 1995/96 Privatisation Programme, finally approved by Parliament in March 1995. It gathered momentum in the following months, however, and according to Government estimates, 2200 enterprises, representing about 70% of the economy were privatised through the voucher programme, concluded in November 1995. Cash privatisation revenues were however disappointing: 44 enterprises were privatised for an amount of Mdl 22 million (about US\$ 5 million), to be compared to a schedule of 200 enterprises to be privatised for an estimated value of Mdl 140 million (about US\$ 30 million). Important to note is the role of fiduciary companies and investment funds which, following first estimates, subscribed about 70% of total shares. The development of a securities market will however be vital to the final success of the privatisation process. In this respect, the start in June 1995 of the Moldovan Stock Exchange operations was an important step. Satisfactory progress has been registered since then, especially when compared with the experience of other stock exchanges at a similar stage of development. Concerning apartments and housing, roughly 70% of all apartments were privatised, and housing privatisation is scheduled to be completed by mid-96. Progress in privatisation of agriculture has been slow: a number of state farms and collectives have been transformed into joint stock companies but land cannot be transferred for cash - and this will remain the case until 2001 under the present law, which represents a legal impediment to privatisation of agriculture.

Important progress was recorded in enterprise restructuring: liquidation proceedings were initiated against 20 state enterprises, of which 10 were completed. However, much remains to be done to enforce financial discipline. Progress in bankruptcy and collateral laws has been slow: the bankruptcy law, still under discussion in Parliament, will need substantial revision to reach international standards.

The maximum import tariff was lowered to 20% in December 1995, with a few exceptions, and the remaining export quotas - on grain and grain products - was lifted. However, the 1996 draft budget, presented by the Government in November 1995, included provisions on tariffs and export taxation, which raised fears of a reversal of the significant trade liberalisation advances made over the past two years. As already indicated, these trade measures will have to be cancelled to allow for the adoption of the new EFF-supported IMF programme.

### **4. Implementation of macro- financial assistance**

The Community loan of ECU 45 million, decided on 13 June 1994, was to be disbursed in two tranches, upon the fulfilment of conditions specified in the Memorandum of Understanding (MOU) attached to the loan agreement. The first tranche, of ECU 25 million, was disbursed in December 1994, on the basis of the successful completion of the first programme review under the IMF stand-by arrangement. The disbursement of the second tranche, of ECU 20 million, was conditional upon a successful track record of the IMF stand-by arrangement and subject to a positive evaluation by the Commission of performance criteria and of progress made with respect to structural reform in the areas of price, trade and foreign exchange liberalisation, privatisation, and financial discipline of enterprises and financial sector.

In view of the measures taken and the commitments provided by the authorities, the conditions attached to the disbursement of the second tranche of the Community loan were broadly met. The disbursement of the second tranche therefore took place in August 1995.

In order to ensure a sustainable balance of payments situation in the 1995-1996 period, further macro-financial assistance in favour of Moldova, to complement the resources provided by the IMF and the World Bank, was recognised as being necessary by the international donor community, in the framework of the Consultative Group meeting organised by the World Bank in March 1995. In this context, the ECOFIN Council indicated on 20 March 1995 that it would favourably consider a Commission proposal for further Community assistance. Following the disbursement of the second tranche of the first macro-financial assistance, the Commission formally adopted in November 1995 a proposal for further macro-financial assistance to Moldova of up to ECU 15 million. The Council decided on 25 March 1996<sup>12</sup> to adopt the Commission proposal. The implementation of this new assistance is however subordinated to the adoption by the IMF of the new three-year programme to be supported by an EFF and will also be subject to the fulfilment of conditions still to be negotiated with the Moldovan authorities and to be included in a new Memorandum of Understanding.

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<sup>12</sup> Council Decision 96/242/EC

## VIII. ROMANIA

### 1. Introduction

Romania was a relatively latecomer among Central and Eastern European countries in the implementation of the adjustment and reform process required for the establishment of a market economy. Despite a number of exogenous shocks (collapse of the traditional Soviet market, the need for a fast trade re-orientation, the negative impact of the UN imposed embargo on Serbia etc.), Romania's macroeconomic performance has been encouraging in 1995.

Available data point to a very high real GDP growth in 1995. The official unemployment rate was brought down and the high inflation rate (1993:300%) was drastically reduced. In 1995 the estimated budget deficit/GDP ratio was 2.8%. Consumer prices have been liberalized, trade has been re-oriented towards the West and exports are expanding vigorously. The role of private enterprises is increasing in terms of added value, employment, capitalization, investment and exports.

In 1995 the country regained access to the international capital market. At the same time, Romania experienced growing difficulties with implementing tight monetary and fiscal policies; the trade balance and the current account both deteriorated, the exchange rate failed to stabilize and a significant divergence (up to 20%) re-appeared by the end of last year between the interbank exchange rate and the (relatively free) exchange bureaux rate, reflecting the government's involvement in the forex market. This means that Romania is de facto under a dual exchange rate regime. The government continues to rely heavily upon administrative, regulatory and restrictive licensing measures particularly vis-à-vis financial intermediaries and commercial banks active on the foreign exchange market.

In 1995 foreign currency reserves declined substantially, reflecting the Central Bank's attempt to stabilize the leu exchange rate.

Results attained so far with structural reform appear to be mixed, particularly as regards the demonopolization of financial services, financial restructuring and privatization of state-owned enterprises, further reductions in subsidies and further trade liberalization. Despite some delays and "stop-and-go" policies, many decisions have finally been adopted during 1995 and the legislative and administrative lay-out is now available for programme implementation in 1996 and beyond.

The IMF review in November-December 1995 led to the approval by the Fund of an extension of the current stand-by arrangement to April 1997 and the increase of it to US\$ 750 million, to be disbursed in several tranches. At the same time, the World Bank finalized a FESAL loan in favour of Romania worth US\$ 280 million. The Community decided to disburse the first tranche (ECU 55 million) of its macroeconomic loan, totalling ECU 125 million in November 1995.

### 2. Macroeconomic developments

The main objective of the government's macroeconomic programme for 1995 was to bring annual inflation down from 62% as of end of 1994 to around 30%, reduce the fiscal deficit, support production and exports, liberalize the foreign exchange market, stabilize the leu exchange rate, and improve the country's external position. To attain these



ambitious objectives, the government committed itself to continue implementing a rather restrictive monetary, fiscal and incomes policy and, at the same time, accelerate structural reforms and develop market-based regulatory instruments in the financial market.

To strengthen the overall position of the country's balance of payments and stabilize the leu, adequate external financing was required, under the form of IMF and WB financial support, FDI investment and borrowing on the international capital market. In this respect, efforts were made with a view to increasing the Western and IFIs' confidence on the Romanian policy programme and in the country's economic perspectives on the medium-term.

Moreover, while Romania's economic performance continued to be positive in 1995 in several respects, only a sluggish progress was recorded in carrying out structural reforms. The overall situation became more problematic by the end of the year with the re-appearance of a major spread between the official and the market-determined exchange rates; foreign currency reserves further contracted, the country's external position weakened considerably and the confidence on leu declined sharply.

GDP real growth in 1995 reached 6.9% (against 1.3% and 3.9% in 1993 and 1994 respectively). Industrial production increased by 8.9%, agriculture by 4.9% and construction by 11.9%. Hourly labour productivity increased by 15% in 1995, compared to the same period of the preceding year. The unemployment rate contracted from 11% at the beginning of 1995 to 9.3% at the end of December. This was caused in large part by a reallocation of employment towards the agricultural sector, which appears to have absorbed a substantial portion of the labour force released from industry. This trend could hardly be seen as sustainable, given the low level of productivity of the agricultural sector, which already employs above 30% of the total labour force. Inflation has been reduced substantially from an annual rate of 62% in 1994 to 33.3% in 1995. However, consumer prices increases sharply accelerated during the last quarter of the year, partly in the light of seasonal factors and partly reflecting the fact that non-inflationary economic growth cannot be sustained without major structural adjustment.

In 1995, the budget deficit ratio was contained to 2.8% of GDP, reflecting administrative decisions aimed at cutting direct current public expenditure, limiting public financial transfers to loss-making enterprises and raising fiscal revenue, following the implementation of a tax reform in 1994. A considerable quasi-fiscal deficit still exists under the form of preferential lending by the Central Bank and state owned banks to loss making SOEs. Some autonomous extra-budgetary funds have also been established.

In 1995, Romania's external position deteriorated. The trade deficit was around US\$ 1.3 bn, more than twice the deficit recorded in 1994 (US\$ 582 million). The deficit rose in spite of a rather promising expansion of exports, which increased by about 22% compared to 1994. Moreover, the increase in imports was much higher, slightly above 32%, reflecting a surge in the demand for Western manufactured and capital goods as well as energy, mainly by loss-making public enterprises. In line with the weakening current account position (which recorded a deficit of 4.4% of GDP) in 1995, foreign exchange reserves declined, to reach US\$ 2.7 bn by the year-end equivalent to less than two months of imports, down from a level corresponding to about four months of imports at the beginning of the year.

FDI through joint ventures started to pick up in the third quarter of 1995. However, foreign investment performance in 1995 was disappointing with new flows in the region of US\$ 400 million against 500 million witnessed in 1994. In 1995, Romania also managed to regain access to the international financial market through a series of syndicated loans which were over-subscribed.

Romania's external debt remains relatively low. At the end of 1995 the medium and long term external debt increased moderately to US\$ 5.3 billion, from US\$ 4.5 billion at the end of the previous year.

Monetary and fiscal policy has followed a rather uneven path in 1995. Restrictive policies, responsible for most of the positive results particularly as regards the decline of inflation rate and the leu's relative stability during the first half of the year were somewhat loosened in the course of 1995. However, in view of negotiations on the extension of the IMF stand-by arrangement, the authorities again tightened monetary policy during the last two months of 1995 mainly through a sharp increase in the refinancing rate and introduced a restrained draft budget for 1996. The National Bank of Romania (NBR) still provides preferential credit ("directed credit") in favour of the agricultural sector, export and energy at an interest rate of 35%.

The implementation of credit control measures by the monetary authorities reduced commercial banks' access to the Central Bank refinancing, thus weakening their financial position. The subsequent credit squeeze led to a considerable expansion of payment arrears at enterprise level.

The continuing administrative intervention on the foreign exchange market throughout 1995 and the temporary measures taken by the monetary authorities in March 1996, limiting the number of banks licensed to operate on the forex market, have been causes of serious concern. At present, a dual exchange rate fixing mechanism is "de facto" in place, and the volume of daily foreign exchange transactions on the inter-bank market contracted sharply during the first quarter of 1996.

### **3. Structural reforms**

Eliminating arrears and imposing financial discipline on loss-making state-owned enterprises constituted key objectives in Romania's economic stabilization and restructuring programme for 1995. A number of large state-owned companies and "Regies autonomes" have been targeted for strict financial surveillance. These measures include isolation from the banking system, negotiation of conciliation agreements with their creditors as well as elaboration and implementation of Financial Recovery Plans. Also it was envisaged to accelerate the standard and mass privatization programmes. Results attained so far are preliminary and difficult to assess because of a number of delays in programme implementation, growing financial problems, and administrative inefficiency. The overall picture, however, is rather disappointing. Parliament approved the long-overdue Commercial Insolvency Law in March 1995. The law permits out-of-court conciliation procedures and, if required, the initiation of bankruptcy proceedings, while allowing sufficient flexibility for rescue operations.

The large state enterprises which still dominate the economy continue to benefit from partially hidden quasi-subsidies such as below-market interest rates and directed credits. If properly accounted for, these would increase the public deficit, thus clearly making the

fiscal policy stance less restrictive. Furthermore, state companies unable to service their debts are rarely forced into liquidation, which adds to the inefficiency of the financial sector.

The number of privatized enterprises has increased, but by the end of the year only one third of small enterprises, and merely 6% of large ones, had been privatized. The response of the public to the mass privatization programme launched in mid-1995 has been worse than expected, thus obliging the authorities to postpone the deadline for registration. Citizens may now invest their vouchers directly into companies until the end of March 1996, or in the Private Ownership Fund until the end of April.

The procedure for privatising two of the five major state-owned banks was due to start in 1995 but was postponed until 1996 and only one bank has so far been nominated, the Romanian Development Bank.

#### **4. Implementation of macro-financial assistance**

Following Romania's agreement in principle with the IMF on a new programme for 1994-95, the authorities requested the EU and the G24 to grant further macro-financial assistance to Romania to cover the residual external financing gap of US\$ 275 million under the 1994-95 programme. Commitments by the EU/G-24 reached some US\$ 219 million or nearly 80% of the residual gap. This includes further EU macro-financial assistance for an amount up to ECU 125 million, in two tranches, decided by the Council on 20 June 1994<sup>13</sup>. In December 1994, the Commission agreed with the Romanian authorities the macro-economic conditions attached to the disbursement of the loan. However, the disbursement of the first tranche (ECU 55 million) was delayed, due to policy slippages that occurred during the implementation of the programme in the first quarter of 1995.

In early July the Romanian authorities reached an understanding with the IMF that paved the way for completion of the first review of the programme, which eventually took place in November/December 1995. The disbursement of the first tranche of the EU loan took place in November 1995.

The disbursement of the second tranche (70 MECU) is linked to the effective implementation of specific structural reform measures, including progress in privatization, financial restructuring of loss-making enterprises and banking sector reforms, agreed upon with the Romanian authorities in the Memorandum of Understanding.

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<sup>13</sup> Council Decision 94/369/EC

## **IX. THE SLOVAK REPUBLIC**

### **1. Introduction**

The dissolution of the Czech and Slovak Federal Republic (CSFR) on 1 January 1993 had several negative implications for the Slovak economy at a time when it was still suffering from the shock associated with the dismantling of the Council of Mutual Economic Assistance and from the difficulties accompanying the transition to a market economy. The dissolution of the federation implied the loss of substantial fiscal transfers from the Czech-lands, disrupted trade with the Czech Republic, restricted Slovakia's access to the international capital markets, and was accompanied by speculation against the Slovak crown that practically depleted its official foreign exchange reserves.

In this context, the Slovak government agreed with the IMF in mid-1993 on a macroeconomic stabilization programme for the rest of that year, which was supported by the approval in July 1993 of a first purchase in the amount of SDR 64.4 million under the IMF's Systemic Transformation Facility (STF). In addition, the World Bank granted Slovakia a US\$ 80 million Economic Recovery Loan (ERL) in November 1993.

In July 1994, the IMF approved a 20-month stand-by credit and a second purchase under the STF totalling SDR 180 million, in support of a more comprehensive economic programme for 1994-95. In parallel, the World Bank began discussions on a possible Enterprise and Financial Sector Adjustment Loan (EFSAL). In support of this programme, the EU Council adopted on 22 December 1994<sup>14</sup> a decision making available macro-financial assistance to Slovakia amounting up to ECU 130 million, as part of a G-24 initiative to respond to the request by the Slovak authorities for complementary assistance. Other members of the G-24 made further commitments amounting to US\$ 87.3 million.

### **2. Macroeconomic developments**

The improvement in macroeconomic performance that started in 1994 continued and intensified in 1995. The recovery of economic activity accelerated, with real GDP growing by an impressive 7.4% and industrial production by an estimated 8.4%. Domestic demand replaced net exports as the driving force behind economic expansion. The strengthening of domestic demand, however, largely reflected the behaviour of private consumption and stock building. Fixed investment, which had been declining sharply ever since the transition process began, recorded practically no growth in 1995. The economic upswing has also been reflected in a decline in the unemployment rate from 15.2% in January 1995 to 13.7% in February 1996.

Despite this strong growth performance, inflation has continued to show a downward trend. Inflation, as measured by the year-on-year consumer price index (CPI) declined from 11.7% in December 1994 to only 6.1% in March 1996, the lowest inflation rate recorded by any transition country. Real wage growth remained high in 1995 (real wages in the industrial sector increased by about 6%) but is, to a significant extent, being offset by strong productivity gains.

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<sup>14</sup> Council Decision 94/939/EC.

The reduction in inflation has continued to be supported by restrictive macroeconomic policies. Reflecting larger than anticipated revenues from VAT and income tax, the state budget finished 1995 with a deficit of Sk 8.3 billion, well below the Sk 21 billion deficit that had been programmed. At the same time, the general government surplus was estimated at about 0.5% of GDP, which compares to a deficit of 1.4% of GDP in 1994 and of 7.6% of GDP in 1993. Monetary policy has also remained relatively tight, although its stance has been somewhat eased compared to 1994. The net domestic assets of the banking system expanded by 5% in 1995, approximately as programmed. The money supply (M2), however, grew faster than programmed, reflecting the rapid expansion of net foreign assets, in turn a consequence of the stronger than expected balance of payments situation. M2 is estimated to have increased by 20.8%, compared to a programme target of 10%. Consistent with its policy of increasingly relying on indirect instruments of monetary control, the National Bank of Slovakia (NBS) abolished all remaining credit ceilings on banks in January 1996.

After the remarkable improvement experienced in 1994, Slovakia's balance of payments continued to strengthen in 1995. The current account, which had swung from a deficit of 5.4% of GDP in 1993 to a surplus of 5.7% of GDP in 1994, recorded a new surplus of 4.3% of GDP in 1995. The evolution of the trade balance in the first months of 1996, however, suggests that the surplus will continue to shrink in 1996 reflecting the strength of domestic demand.

The capital account also improved in 1995, with total net capital inflows reaching almost US\$ 1 billion, compared to US\$ 130 million in 1994. The main factor behind this rise in net capital inflows has been the substantial increase in foreign borrowing by Slovak enterprises and banks. Also, the tight management of interbank liquidity by the NBS, in combination with the perceived stability of the Slovak crown (and, during the first half of 1995, the expectation of a revaluation against the Czech crown), has led to some short-term capital inflows. Foreign direct investment inflows, however, have remained low, partly reflecting uncertainty over the government's market-oriented reforms and, in particular, over privatization (see below).

Slovakia's access to the international capital markets has been facilitated by successive upgradings of Slovakia's credit ratings. In May 1995, Moody's assigned to Slovakia an investment grade rating (Baa3). Standard & Poor's, for its part, upgraded Slovakia's rating in April 1995 (from BB<sup>-</sup> to BB<sup>+</sup>) and again in April 1996 (to BBB<sup>-</sup>, an investment grade mark). Slovakia has thus become one of the few transition countries that can boast investment grade ratings from the leading US rating agencies.

These favourable trends in both the current and capital accounts have been translated into a substantial increase in international reserves. Official reserves (including gold) rose from US\$ 1.75 billion at the end of 1994 to US\$ 3.4 billion at the end of 1995. This represents a comfortable level of about 4 months of imports. During the same period, the reserves of whole banking system have increased from US\$ 3.1 billion to US\$ 5 billion.

Following a 10% devaluation of the Slovak crown in July 1993, the exchange rate of the crown has been kept stable against a basket of Western currencies. In July 1994, the number of currencies in the basket was reduced from five to two (the Deutsche mark and the US dollar). In view of the termination of the bilateral clearing system with the Czech

Republic in October 1995, the Slovak crown was revalued by 5% against the Czech currency. In January 1996, the fluctuation band around the central rate was increased from +/- 1.5% to +/- 3%.

Slovakia inherited from the Czechoslovak federation a relatively low external debt. Although debt and debt service ratios have deteriorated since the country reached independence, they remain at reasonable levels. The foreign debt-over-GDP ratio has increased from 25.7% in early 1993 to 33.8% in October 1995. The debt service-over-exports ratio, for its part, has risen from 3.3% in 1992 to an estimated 9.5% in 1995.

### **3. Structural reforms**

In Spring 1994, the Slovak authorities adopted a plan to accelerate privatization based on a greater reliance on voucher privatization. By November 1994, about 3.5 million citizens had registered to buy vouchers. The new Slovak government formed in December 1994, however, decided in June 1995 to cancel the voucher privatization scheme. Instead of shares in state enterprises, the Slovak citizens that bought vouchers have been given 5-year interest bearing bonds issued by the National Property Fund (NPF). NPF bonds totalling Sk 33.3 billion (or the equivalent of about 8% of GDP) were issued in January 1996. This new scheme not only implies a new delay in the privatization process but could have negative fiscal implications, particularly given the fact that the total market value of the shares that were earmarked for voucher privatization is likely to be significantly below the total face value of the bonds issued by the NPF.

The decision to cancel the voucher scheme is part of a more general shift in privatization policy announced by the current government. The new privatization policy emphasizes standard methods of privatization. Direct sales (largely sales to managers and employees) have gathered momentum since mid-1995, but (they) are being criticized for their lack of transparency. Another important element of the new privatization policy is the government's decision, incorporated in Law No. 175 passed in July 1995, to keep permanent state ownership in 29 so-called "important enterprises" (including the big utilities in the energy sector, telecommunications and armament enterprises). Since the bulk of the "important enterprises" had initially been included in the 1994 voucher privatization scheme, this measure has effectively reduced by about 35% the total book value of the enterprises slated for privatization under the second wave of large-scale privatization. Law No. 175 also allows the state veto power over key decisions in 45 so-called "strategic enterprises" (including the largest industrial enterprises) and shifts the exercise of the state ownership rights over "strategic enterprises" back from the NPF to the founding ministries. These decisions regarding "strategic enterprises" could slow both the privatization and the restructuring of these enterprises. However, the part of Law No. 175 allowing the state to maintain (or regain) "golden shares" in "strategic enterprises" has been declared unconstitutional by the Slovak constitutional court.

Regarding the Slovak financial system, substantial progress still needs to be made with respect to the problem of non-performing loans, privatization and the promotion of competition. Stricter regulations on the classification and provisioning of bad loans came into force in July 1995. Government concern about the negative fiscal repercussions, however, has so far prevented the passing of tax law amendments temporarily granting to banks full tax deductibility for bad-loan provisions, a measure that the authorities had originally envisaged to take place by end-1994. In January 1996, the government announced its intention to sell in 1996 its majority holdings in the country's largest savings

bank (Slovenska Sporitelna), the two largest commercial banks (VUB and IRB) and the largest insurance company (Slovenska Poistovna). In February 1996, the Parliament passed a new banking law strengthening the supervisory powers of the NBS.

Following abuses and irregularities by certain privatization investment funds (PIFs) and investment companies, the Ministry of Finance, in the first half of 1995, restricted the operations of several of them. In addition, new legislation was adopted in July 1995 aimed at increasing the transparency and control of their activities, and at better protecting the shareholders of the PIFs. Unfortunately, however, the new regulations, in conjunction with the cancellation of the voucher privatization scheme, will also limit the role of PIFs in corporate governance. In particular, with effect from the end of 1996, the limit on the maximum equity stake an PIF may hold in a given company will be reduced from 20% to 10% of the company's capital.

Under pressure from the EU and WTO, the Slovak authorities reduced the 10% import surcharge on consumer goods which was introduced in March 1994, to 7.5% from mid-July 1996. Following deliberations in the WTO Balance of Payments Committee, the Slovak authorities have announced that they would abolish the surcharge by the end of 1996.

On 1 October 1995, a new foreign exchange act came into effect. The Slovak crown was made fully convertible for current account purposes, and the bilateral clearing system maintained with the Czech Republic since early 1993 was terminated. The authorities also intend gradually to relax certain restrictions on capital movements.

Most prices in Slovakia have been liberalized. The share of items that still have regulated prices represents only about 5% of total turnover. These items include energy (electricity, gas, heating and petrol), water, pharmaceutical products, rents, telephones and public transportation. Electricity, gas and heating tariffs paid by households remain significantly below their economic cost-recovery levels. The upward adjustment of these tariffs envisaged under the World Bank ERL's and the IMF's stand-by programmes have not been implemented.

#### **4. Implementation of macro-financial assistance**

Slovakia met all the macroeconomic targets and performance criteria agreed with the IMF in the context of the 1994-95 stand-by programme. However, the failure to implement the structural reform conditions prevented a successful completion of the mid-term review of the programme, which had initially been scheduled for March 1995. The main factor preventing the approval of the mid-term review were the delays and the subsequent policy shifts in the area of privatization, including the unexpected cancellation of the shares-for-vouchers scheme and its replacement by the scheme based on the issuance of NPF bonds. The authorities also failed to comply with the conditions regarding the granting of temporary full tax deductibility for bad loan provisions made by banks, the adjustment of energy prices and the elimination of the import surcharge. The slow formulation and instability of privatization and other structural policies also led the World Bank to discontinue discussions on an EFSAL operation in April 1995.

In May 1995, the Commission services held discussions with the Slovak authorities on the economic policy measures to be attached to the implementation of the EU loan facility. During the discussions, however, insufficient progress was made, with the Slovak authorities showing little flexibility with respect to the measures emphasized by the

Commission, in particular the early phasing out of the 10% import surcharge, the adjustment of energy prices and the need to prevent the new regulations on PIFs from weakening their role in corporate governance. The resumption of the discussions was complicated by the government's decisions on privatization announced in June 1995, including in particular the cancellation of the shares-for-vouchers privatization scheme, which was considered by the Commission to be an essential condition for the effective disbursement of the assistance.

Meanwhile, and as noted above, Slovakia's macroeconomic and, in particular, balance of payments situation experienced a remarkable turnaround. In view of the strengthening of the external position, the Slovak government announced that they did not wish to draw on the remaining tranches of the IMF stand-by credit. In the event, Slovakia only made the first two purchases (totalling SDR 32.2 million) under this stand-by arrangement, which expired in March 1996.

In this context, on 23 January 1996, the Commission approved a proposal for a Council decision repealing the 1994 decision granting further macro-financial assistance to Slovakia. This decision is expected to be adopted by the Council in 1996.

Regarding the implementation of the complementary macro-financial assistance committed by other G-24 members, Japan released its US\$ 60 million assistance in early May 1995, in the form of an Exim Bank co-financing of the World Bank's ERL. No disbursements by other donors had taken place at the time of writing of this report.



## X. UKRAINE

### 1. Introduction

The on-going struggle between reformers and conservative forces continues to characterize economic policy and slows down progress in economic reform in Ukraine. In the second half of 1995 several slippages in policy implementation led to a weakening of the exchange rate and to the budget and inflation targets being missed. Therefore, the IMF suspended the execution of its Stand-By Arrangement (SBA) in December (and eventually let it expire in early 1996). Nevertheless, progress in stabilisation has been considerable in 1995: the speed of decline in the economy was halved from -23. % in 1994 to -11,8%, inflation and the general government deficit were brought down, and the trade balance improved. Structural reforms were started in the end of 1994 and have achieved some results, mainly in price and trade liberalisation and more recently in small-scale privatization. However, progress on large-scale privatization and restructuring has been slow and foreign direct investment is still negligible. As a consequence of erratic policy implementation and slow structural reform as well as severe weather conditions, it is expected that economic growth will only recover in 1997.

### 2. Macroeconomic performance

It took three years after the independence of the country before economic reforms were finally started in Ukraine in October 1994. After his election, President Kuchma introduced a programme of price, trade and exchange liberalisation, combined with reductions in subsidies and state intervention. A tighter fiscal policy was adopted, buttressed by a restrictive monetary policy. The programme was able to slow down the rapid economic deterioration. By mid-1995, monthly inflation was reduced to around 5%, the exchange rate of the karbovanets (Ukraine's temporary currency) stabilised, international reserves accumulated and a stabilisation of output seemed possible in the short-term.

However, President Kuchma and Prime Minister Marchuk continued to be confronted with a conservative majority in Parliament that managed to delay or even cancel some reform measures. Furthermore, during the summer of 1995, doubts arose over the commitment of the government to continue the transformation process. The government encouraged the commercial banks to increase their credits to insolvent enterprises, enterprise subsidies were increased and the budget continued to pay for accumulated gas debts of the enterprise sector. Monetary financing of the deficit was also higher than expected. Consequently, the karbovanets weakened again and the end-of-year budget and inflation targets were missed. Because structural reform was also lagging, the IMF decided in December 1995 to postpone a decision on the disbursement of the fourth tranche of the SBA.

Although Ukraine was not able to observe the objectives of its stabilisation programme in winter 1995/96, progress in stabilisation has been considerable in 1995. The speed of decline in the economy was halved from -23% in 1994 to -11,8% in 1995 with even some month-on-month improvements before August. It is now expected that GDP will continue to fall in 1996 before stabilising in 1997 at an output level of around 40% of the pre-transition level. However, because of the growing importance of the informal sector, official figures might underestimate the actual progress in economic activity. Yearly inflation was brought down from 401% in December 1994 to 182% one year later.

Further improvement is expected for 1996. Although different data sources differ widely on sign and level of the trade balance, they all show an improvement in 1995, as a consequence of growing exports, mainly to non-FSU countries and stagnating imports.

Registered unemployment in Ukraine remains extremely low at about one half percent of the labour force. Actual unemployment, however, may be considerably higher since hidden unemployment in large state firms and administration remains high and many enterprises in difficulty maintain their personnel but send them on unpaid leave. Wages generally increased quite rapidly in 1995. Real wages increased by 12% and the average wage increase in the government sector in the first half of 1995 was about 50% in real terms, bringing wages to the same levels as in the enterprise sector, thereby adding pressure on the budget and on inflation.

The government budget for 1995 aimed at reducing the cash deficit from 8.6% of GDP in 1994 to 3%. The actual outcome is more likely to have been around 4%, mainly due to an overrun in public expenditures. The overrun is even more important when it is taken into account that the government again accumulated some payment arrears on energy imports which are not visible in the deficit figure on a cash basis.

### **3. Structural reforms**

Before 1994, Ukraine made little or no progress with structural reform. After his election, President Kuchma issued a decree, in November 1994, to initiate a voucher-based mass privatization programme and set a target of 8,000 (out of 18,000) medium and large enterprises to be privatised in 1995. However, due to organisational problems, opposition from the Parliament and local bureaucracies, too high reservation prices, the exclusion of foreign investors as well as a lack of confidence on the part of the general public, only 2,700 enterprises were actually put up for sale and the majority of shares in only 1,500 of these enterprises have effectively been sold. This lack of progress is particularly preoccupying in the important agricultural sector. Continued disagreement between the President and Parliament on the way to proceed has prevented any significant progress. Until recently, progress with regard to small-scale privatization has also remained limited. The beneficial effects of new measures that were introduced in late 1994 only appeared in the third quarter of 1995. Consequently, an important number of small businesses was still to be privatised in 1996, although it was originally intended to end this operation by the end of 1995.

Given the limited progress on privatization and the absence of foreign direct investment, enterprise restructuring continues to be weak. The old monopolistic structure of the economy is still widely present, mainly in heavy industries and in the chemical and pharmaceutical sectors. Because directed bank credits and important subsidy flows persist, the budget constraint for most enterprises remains soft. Furthermore, inter-enterprise arrears are accumulating rapidly and although a bankruptcy legislation exists, its implementation is ineffective.

### **4. Implementation of macro-financial assistance**

The EU loan of ECU 85 million decided on 22 December 1994 (94/940/EC) was to be disbursed in a single tranche conditional upon an IMF stand-by arrangement, a rapid implementation of the EU/G-7 Nuclear Safety Action Plan for Ukraine and progress with structural reform. After significant delays on the part of Ukraine, it was finally disbursed in December 1995.

In view of Ukraine's urgent financial needs and against the background of further efforts being made by the Ukrainian authorities to pursue with economic reform, the Council decided on 23 October 1995<sup>15</sup> to provide Ukraine with further Community macro-financial assistance in the form of a second loan of up to ECU 200 million that would complement financial assistance from the international financial institutions and other bilateral donors.

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<sup>15</sup> Council Decision 95/442/EC

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ISSN 0254-1475

COM(96) 695 final

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Catalogue number : CB-CO-96-704-EN-C

ISBN 92-78-13749-9

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Office for Official Publications of the European Communities

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