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REPORT FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT ON THE IMPLEMENTATION OF MACRO-FINANCIAL ASSISTANCE TO THIRD COUNTRIES IN 1996

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 the Central and East European countries (CEECs) embarked on the process of transition to a market economy they were faced with similar problems: substantial costs attached to the first steps of reform, additional external shocks (the Gulf War embargo, the collapse of 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 these countries to complement 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 CEECs, the Commission should enlist other donors to contribute in a similar way to support the economic programmes that these countries were implementing in agreement with the IMF and the World Bank.

A number of such support operations by the EU and the G-24 took place in 1990-1994 covering most Central and East European countries eligible for 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 a soft loan to Israel in July 1991. In September of the same year a medium-term loan was decided to help Algeria carry through the political and economic reforms under way.[1] A further loan to Algeria was decided in late 1994.[2] Operations for European Newly Independent States (NIS) were also approved in 1994, comprising loans for Moldova and Ukraine.

In 1995, the focus of the Community's macro-financial assistance continued to shift away from the Central and East European group, which, as a result of a generally positive economic performance, had less and less need to rely on external financial support from official sources. Instead, an increasing part of Community loans were directed towards the NIS and the Mediterranean region. While further amounts were disbursed to Albania, Romania and Lithuania, these were outweighed by disbursements of a second tranche to

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

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

Moldova and of new loans to Belarus and Ukraine. In addition the first tranche of a second macro-financial loan to Algeria was disbursed.[3]

The Community's macro-financial assistance to all third countries is governed by a set of principles which were drawn up on the initiative of the European Commission and agreed among the G-24 to serve as guidelines for the implementation of EU/G-24 macro-financial assistance. These principles, which were subsequently endorsed by the EU Council of Ministers of Finance, underline the exceptional character of this assistance, its complementarity to financing from the IFIs and its macro-economic conditionality.

2. Macro-financial assistance in 1996

The shift of emphasis towards the NIS and away from the CEECs which was evident in 1994 and 1995 was maintained in 1996. There was only one new commitment, which was a loan of ECU 15 million to Moldova. This was disbursed in December, after the IMF Board had approved a new three-year economic reform programme and the Commission services had confirmed that the conditions attached to the loan were met. The other NIS country to which a loan was disbursed in 1996 was Ukraine, which received a first tranche of ECU 100 million from a ECU 200 million loan that had been agreed by the Council in October 1995 to complement assistance from the IFIs and other bilateral donors aimed at supporting the efforts of the Ukrainian authorities to pursue economic reform. The situation in Belarus was marked by a lack of progress in some key aspects of structural reform and the reversal of some measures of liberalization. Consequently, the second tranche of the ECU 55 million loan approved in 1995 was not disbursed. At the end of the year consideration was being given to providing exceptional financial assistance to Armenia and Georgia and, when appropriate, to Tajikistan to enable them to carry out fundamental political and economic reforms in the context of IMF programmes. An essential pre-condition for such assistance will be full settlement of these countries' outstanding financial obligations towards the Community.

The Commission, after consulting the Monetary Committee, decided in early September 1996 to disburse the second tranche (ECU 20 million) of a ECU 35 million grant to Albania, after the new government took measures to address the budgetary imbalances, which included the introduction of VAT, and on the basis of progress in implementing structural reforms stipulated in the Memorandum of Understanding. The second ECU 40 million tranche of Bulgaria's loan of ECU 110 million approved in 1992 was at long last disbursed following the approval of a new IMF stand-by loan. In Lithuania improvements in the procedures adopted by the authorities for consulting and reporting to the Commission on the use being made of the first ECU 25 million instalment of the second ECU 50 million tranche of Community assistance led to the lifting of the freeze that had been imposed on the use of this assistance in 1995.

The smaller amounts disbursed in 1996 partly reflected the tendency for CEECs to have less need of external financing as their economies strengthened. Estonia not only did not draw on the second ECU 20 million tranche of its ECU 40 million loan, but sought to make early repayment of the first tranche. Elsewhere the reasons for the absence of

[3] See: Report on the implementation of macro-financial assistance to third countries, COM(96) 695 of 8 January 1997.

disbursements were less satisfactory. The loan of ECU 130 million to Slovakia decided in 1994 was cancelled because of inadequate progress towards agreement between the Slovak authorities and the Commission on the economic policy conditions to be attached to it, and also because improved financial circumstances meant Slovakia had less need of this support. The second ECU 40 million tranche of the ECU 80 million loan to Latvia approved in 1992 was not released, despite the IMF's approval of a stand-by arrangement in May 1996, because of the Commission's serious reservations about the way in which on-lending of the proceeds of the first tranche was being managed. This assistance is in any case not necessary for balance-of-payments purposes.

At the end of the year two requests for assistance were being actively examined. The new government elected in Romania in November asked for the Community's and G-24's macro-financial assistance to be reactivated in the context of an ambitious programme of macroeconomic stabilization and structural reforms supported by the IFIs. At about the same time, the Former Yugoslav Republic of Macedonia, in view of its difficult external situation, requested macro-financial assistance to complement support from the IMF and the World Bank for its three-year stabilization and reform programme. In the light of the country's urgent needs and substantial progress in transition to a market economy, the Commission initiated internal consultations on providing Community macro-financial assistance of up to ECU 40 million. In view of the acute economic crisis in Bulgaria, the Commission began to examine the possibility of further macro-financial assistance of up to ECU 250 million which would complement funding from the IFIs in support of an anticipated economic stabilization and structural reform programme.

No disbursements of macro-financial assistance were made in the Mediterranean region in 1996. Discussions took place between the Algerian authorities and the Commission services on disbursing the second tranche (up to ECU 100 million) of the 1994 macro-financial loan, but agreement was not reached on the conditions for its release, notably the calendar for implementing a programme of privatization of large state enterprises. In December 1996, however, the Commission decided as part of the MEDA programme to support Algeria's structural reform programme through a Structural Adjustment Facility of ECU 125 million.

Community operations have continued to incorporate 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 that are tailored to specific country needs with the overall objective of stabilizing the financial situation and establishing 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

Two related trends present in 1995 were again in evidence in 1996. Both the range of (potential) beneficiary countries and the range of needs widened. The spectrum of (potential) beneficiary countries now runs from Armenia, Georgia and Tajikistan, which have need of assistance for humanitarian reasons, through to Central and East European countries which have applied for membership of the European Union and on whose in the geographical focus of the Community's macro-financial assistance already observed in 1994 and 1995 extended into 1996.

The Community's macro-financial assistance was originally intended to support macro-economic stabilization and the balance of payments. Over the years the number of countries to which it was appropriate for the Community to extend such support expanded, as a growing number of countries neighbouring the Community committed themselves to rigorous programmes of economic reform. This led to a change in the geographic balance of assistance from the early years, when most beneficiary countries were in the immediate vicinity of the Community, to the present, when assistance is increasingly flowing to somewhat more distant countries.

It also became clear that, while macro-financial assistance geared to the original objective of supporting macro-economic stabilization and the balance of payments was still necessary for some countries, in the case of others macro-financial assistance could more usefully be directed to supporting the government's programme of structural reform. This tendency emerged first in some Central and East European countries, where macro-financial assistance for structural reform could be effectively combined with technical assistance from the Phare programme to strengthen the capacity of institutions that were essential to the success of the structural reform programmes. The complementarity of the different forms of Community assistance was enhanced by broadening the dialogue with each beneficiary country to encompass the totality of assistance to reform efforts. More recently, similar developments have occurred in the context of assistance to some NIS countries. A comparable evolution has taken place in the programmes supported by the IMF and the World Bank, and this has led to closer co-operation between the Commission and these institutions.

For the CEECs the focus on structural reform will be further emphasised in the context of their preparation for accession to the EU. The European Council in Copenhagen in June 1993 agreed that any associated country in Central and Eastern Europe that so desired should become a member state as soon as it was able to satisfy the requisite political and economic conditions. The process of drawing up opinions on whether the ten associated countries of Central and Eastern Europe satisfy these conditions began in 1996 and has since been completed.

The associated countries in preparing for accession to the EU will need substantial investment in areas such as environmental protection, transport, energy, industrial restructuring, agricultural infrastructure and rural society. Policy-based financial support will also continue to be necessary to facilitate the acceleration of structural adjustment. Careful consideration will therefore have to be given to how the Union's various forms of assistance and instruments can be used most effectively to contribute to this effort. It will also be necessary to intensify co-operation with the IFIs so as to achieve as much synergy as possible with their lending in support of structural reform and to ensure consistency between EU conditionality related to accession and conditionality associated with the IFIs operations.

4. Burden-sharing

Since the inception of macro-financial assistance, the absolute amounts committed by the EU have fluctuated substantially (Tables 3 and 3.1), but as a proportion of total balance-of-payments support, Community macro-financial assistance has showed a steady decline.

Initially, an important feature of Community assistance was that very large sums of money were found to support the programmes of the Bretton Woods institutions. The Community played a key role, both as a major provider of these funds and from 1991 as the co-ordinator of bilateral assistance for the CEECs through the G-24.

The IFIs, however, were progressively able to mobilize more resources: 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 Sector Adjustment loans - EFSAL). As a result, the share of the IFIs in the financing packages has risen substantially (Table 3).

At the same time, contributions by external creditors, both public and private, were mobilized in the form of debt-relief and debt-reduction operations (Algeria, Bulgaria, Ukraine), which accounted for a substantial share of balance-of-payments support in 1991, 1994 and 1995. In 1996 debt relief (to Moldova) accounted for a smaller share of balance-of-payments support.

The increase in the resources provided by the IFIs resulted in the lending of the EU and of other bilateral donors (excluding debt relief operations) declining sharply as a proportion of total commitments, from 54% and 25%, respectively, in 1990 to 7% and 4%, respectively, in 1996 (or 6% and 3%, respectively, of total commitments including debt relief operations).[4] While the EU's share of total balance-of-payments support has declined, its share of bilateral balance-of-payments support has remained roughly constant on average at around 60 per cent throughout the period 1990-96 (Table 2).

4 These statistics cover only the countries to which the EU has provided macro-financial assistance.

Table 1: COMMUNITY MACRO-FINANCIAL ASSISTANCE TO THIRD COUNTRIES

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

Country	Maximum amount authorized	Date of Council Decision	Disbursed	Amounts and Dates of disbursements	Undisbursed
A. Macro-financial assistance to CEECs					
Hungary I (*structural* adjustment loan)	870	22.02.90	610	350 - Apr 1990 260 - Feb 1991	260
Czech and Slovak Federal Republic (BOP loan)	375	25.02.91	375	185 - Mar. 1991 190 - Mar 1992	
Hungary II (BOP loan)	180	24.06.91	180	100-Aug. 1991 80 -Jan. 1993	
Bulgaria I (BOP loan)	290	24.06.91	290	150 - Aug 1991 140 - Mar 1992	
Romania I (BOP loan)	375	22.07.91	375	190 - Jan. 1992 185 - Apr 1992	
Albania I (BOP grant)	70	28.09.92	70	35 - Dec 1992 35 - Aug 1993	
Baltics (BOP 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 (BOP loan)	80	27.11.92	80	Feb 1993	
Bulgaria II (BOP loan)	110	19.10.92	110	70 - Dec 1994 40 - Aug 1996	
Romania III (BOP loan)	125	20.06.94	55	Nov 1995	70
Albania II (BOP grant)	35	28.11.94	35	15 - Jun 1995 20 - Oct 1996	
Slovakia (BOP loan)	130	22.12.94	Cancelled	Jul 1996	130
TOTAL A	2860		2315		545
B. Macro-financial assistance to other third countries					
Israel (1) (structural adjustment soft loan)	187.5	22.07.91	187.5	Mar 1992	
Algeria I (BOP loan)	400	23.09.91	400	250 - Jan. 1992 150 - Aug 1994	
Moldova I (BOP loan)	45	13.06.94	45	25 - Dec 1994 20 - Aug 1995	
Algeria II (BOP loan)	200	22.12.94	100	Nov 1995	100
Ukraine I (BOP loan)	85	22.12.94	85	Dec 1995	
Belarus (BOP loan)	55	10.04.95	30	Dec 1995	25
Ukraine II (BOP loan)	200	23.10.95	100	50 - Aug 1996 50 - Oct. 1996	100
Moldova II (BOP loan)	15	25.03.96	15	Dec 1996	
TOTAL B	1187.5		962.5		225
TOTAL A+B	4047.5		3277.5		770

(1) Assistance to Israel includes a loan principal amount of E(ants 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 96)

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	123.5	86.9	300.0	50.0	57.4	184.0	54.0	533.3	47.2	64.1	533.3	71.9
EFTA *	14.2	6.0	8.2	10.1	7.1	123.1	20.5	23.5	67.9	19.9	129.5	11.5	15.6	98.5	13.3
United States											10.0	0.9	1.2	10.0	1.3
Japan	36.3	15.3	20.9	8.5	6.0	100.0	16.7	19.1	88.9	26.1	150.0	13.3	18.0	100.0	13.5
Others											8.7	0.8	1.0		
Total	174.0	73.4	100.0	142.1	100.0	523.1	87.2	100.0	340.8	100.0	831.5	73.6	100.0	741.8	100.0
* of which. A, S, SF	11.7	4.9	6.7	10.1	7.1	81	13.5	15.5	67.9	19.9	69.0	6.1	8.3	50.0	6.7

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	71.1
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	146.3	15.7
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
Total	887.0	88.7	100.0	862.0	100.0	517.8	103.6	100.0	492.8	100.0	1074.8	73.9	100.0	929.0	100.0
* 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	81.4	8.8

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	61.2	2251.5	63.1
EFTA *	27.4	9.1	11.2			697.3	13.4	16.4	563.8	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	846.3	16.2	19.9	682.4	19.1
Others						69.5	1.3	1.6	35.8	1.0
Total	243.4	81.1	100.0	60.0	100.0	4251.6	81.4	100.0	3568.5	100.0
* of which. A, S, SF	16.4	5.5	6.7			405.3	7.8	9.5	349.4	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, 1990-1996 (1) (in percent of total commitments)

Including debt relief

	1990	1991	1992	1994	1995	1996
IFI's	**21**	**50**	**69**	**27**	**33**	**79**
IMF	11	37	40	21	26	62
World Bank	10	13	29	6	7	17
Bilaterals	**79**	**50**	**31**	**73**	**67**	**21**
EU (2)	54	20	19	6	6	6
Other bilaterals (3)	25	13	13	5	3	3
of which						
USA		0		1		3
Japan	10	8	5	2	3	
Debt relief		18		63	59	12
Paris Club		5		32		
London Club				28		
Other (4)		13		2	59	12

Excluding debt relief

	1990	1991	1992	1994	1995	1996
IFI's	**21**	**61**	**69**	**71**	**80**	**90**
IMF	11	45	40	56	63	70
World Bank	10	16	29	15	17	20
Bilaterals	**79**	**39**	**31**	**29**	**20**	**10**
EU (2)	54	24	19	17	14	7
Other bilaterals (3)	25	15	13	12	6	4
of which						
USA		0		2		4
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,
debt rescheduling in favour of Moldova by Russia in 1996.

Table 3.1.: Balance of payments support to recipients of EU macro-financial assistance by contributor, 1990-1996 a)

(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
Bilaterals	**1618**	**79**	**1288**	**77**	**1618**	**79**	**1288**	**77**
EU	1108	54	777	47	1108	54	777	47
USA								
Japan	200	10	200	12	200	10	200	12
Germany	311	15	311	19	311	15	311	19
Other bilaterals								
Total	**2037**	**100**	**1663**	**100**	**2037**	**100**	**1663**	**100**

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
Bilaterals	**5600**	**50**	**5147**	**57**	**2290**	**77**	**1938**	**81**	**1168**	**65**	**1117**	**67**
EU	2190	20	1988	22	540	18	338	14	400	22	400	24
USA	35	0	35	0					10	1	10	1
Japan	850	8	633	7	300	10	150	6	100	6	58	4
Other bilaterals	521	5	487	5					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				
Total	**11207**	**100**	**9077**	**100**	**2980**	**100**	**2381**	**100**	**1808**	**100**	**1657**	**100**

	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
Bilaterals	**887**	**41**	**862**	**40**	**518**	**19**	**493**	**33**	**737**	**51**	**737**	**54**
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												
Total	**2189**	**100**	**2164**	**100**	**2780**	**100**	**1513**	**100**	**1450**	**100**	**1362**	**100**

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$	%
IFI'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
Bilaterals	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												
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
Total	2272	100	1670	100	162	100	123	100	204	100	158	100

	Latvia				Lithuania				Romania II			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US$	%	mio US$	%	mio US$	%	mio US$	%	mio US$	%	mio US$	%
IFI'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
Bilaterals	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												
Japan	35	9	23	8	45	10	34	11				
Other bilaterals	43	11	25	9	58	13	29	9	29	3	29	4
Total	384	100	290	100	462	100	314	100	1059	100	785	100

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$	%
IFI's	4086	27	2772	21	75	63	42	50	1397	19	1182	17	646	13	195	5
IMF	3206	21	2072	16	60	50	34	41	1097	15	882	13	521	11	195	5
WB (policy based)	880	6	700	5	15	13	8	9	300	4	300	4	125	3		
Bilaterals	11299	73	10591	79	45	37	41	50	5920	81	5666	83	4214	87	4125	95
EU	952	6	560	4	41	34	41	50	335	5	201	3	125	3	125	3
USA	100	1	90	1												
Japan	350	2	185	1					150	2	95	1	50	1		
Other bilaterals	252	2	111	1	4	3			135	2	70	1	39	1		
Debt relief	9645	63	9645	72					5300	72	5300	77	4000	82	4000	93
London Club	4920	32	4920	37					1120	15	1120	16	3800	78	3800	88
Paris Club	4380	28	4380	33					4180	57	4180	61	200	4	200	5
Other	345	2	345	3												
Total	15385	100	13363	100	120	100	83	100	7317	100	6848	100	4860	100	4320	100

	Moldova I				Romania III				Slovak Republic				Ukraine			
	Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements		Commitments		Disbursements	
	mio US$	%	mio US$	%	mio US$	%	mio US$	%	mio US$	%	mio US$	%	mio US$	%	mio US$	%
IFI's	164	56	133	56	913	81	447	86	426	64	308	84	465	47	465	47
IMF	104	35	121	51	713	63	247	48	346	52	228	62	365	37	365	37
WB (policy based)	60	20	12	5	200	18	200	38	80	12	80	22	100	10	100	10
Bilaterals	130	44	106	44	218	19	73	14	242	36	60	16	530	53	520	53
EU	54	18	30	12	143	13	63	12	155	23			100	10	100	10
USA	30	10	20	8									70	7	70	7
Japan	40	14	30	13	50	4			60	9	60	16				
Other bilaterals	6	2	26	11	26	2	10	2	27	4			15	2	5	1
Debt relief													345	35	345	35
London Club																
Paris Club																
Other													345	35	345	35
Total	294	100	239	100	1131	100	520	100	668	100	368	100	995	100	985	100

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$	%
IFI's	1877	33	1770	33	270	79	163	81	1607	30	1607	31
IMF	1477	26	1370	26	270	79	163	81	1207	22	1207	23
WB (policy based)	400	7	400	7					400	7	400	8
Bilaterals	3885	67	3573	67	70	21	38	19	3815	70	3535	69
EU	330	6	168	3	70	21	38	19	260	5	130	3
USA												
Japan	150	3							150	3		
Other bilaterals												
Debt relief	3405	59	3405	64					3405	63	3405	66
London Club												
Paris Club												
Other	3405	59	3405	64					3405	63	3405	66
Total	5762	100	5343	100	340	100	201	100	5422	100	5142	100

Balance of payments support 1996

	Total				Moldova II			
	Commitments		Disbursements		Commitments		Disbursements	
	mio US$	%	mio US$	%	mio US$	%	mio US$	%
IFI's	250	79	32	33	250	79	32	33
IMF	195	62	32	33	195	62	32	33
WB (policy based)	55	17			55	17		
Bilaterals	67	21	67	67	67	21	67	67
EU	19	6	19	19	19	6	19	19
USA	10	3	10	10	10	3	10	10
Japan								
Other bilaterals								
Debt relief	38	12	38	38	38	12	38	38
London Club								
Paris Club								
Other	38	12	38	38	38	12	38	38
Total	317	100	100	100	317	100	100	100

a) Disbursements are shown under the year of corresponding commitments
There are no data for 1993 as no EU operation was decided that year

Table 4: Selected economic indicators

	1993	1994	1995	1996 Programme (1)	1996 Estimates
GDP at constant prices	(Percent change)				
Albania	9.6	9.4	8.9	-	8.2
Algeria	-2.2	-0.9	3.9	4.2	4.0
Belarus	-11.6	-20.0	-7.0	-	2.6
Bulgaria	-1.5	1.8	2.1	-	-10.9
Estonia	-8.5	-1.8	4.3	3.1	4.0
Latvia	-16.0	2.0	-0.8	2.0	2.8
Lithuania	-16.2	1.0	3.0	-	3.6
Moldova	-8.7	-31.0	-3.0	4.0	-8.0
Romania	1.5	3.9	7.1	4.0	4.1
Ukraine	-17.1	-23.0	-12.0	-8,0	-10.0
Consumer price (end year)	(Percent change)				
Albania	30.9	15.8	6.0	-	17.4
Algeria	16.1	38.6	21.9	15.0	15.1
Belarus	1990.0	2220.0	290.0	-	39.0
Bulgaria	63.8	122.0	32.9	-	310.8
Estonia	35.6	41.7	28.9	23.7	14.8
Latvia	35.0	26.0	23.0	16.0	13.0
Lithuania	163.0	72.2	35.7	-	13.1
Moldova	837.0	116.0	24.0	15.0	26.5
Romania	295.0	61.7	27.8	19.0	56.9
Ukraine	10155.0	401.0	182.0	47.0	39.7
Fiscal balance	(Percent of GDP)				
Albania	-14.4	-12.4	-10.4	-	-11.4
Algeria	-8.7	-4.4	-1.4	0.3	3.0
Belarus	-8.3	-1.7	-3.2	-	1.9
Bulgaria	-10.9	-5.8	-5.7	-	-11.0
Estonia	-0.7	1.3	-1.2	-1.4	-1.5
Latvia	0.6	-4.1	-4.4	-1.8	-1.2
Lithuania	-5.1	-1.7	-1.8	-	-2.5
Moldova	-6.8	-9.0	-5.5	-3.4	-7.2
Romania	-0.4	-1.9	-2.6	-2.2	-3.9
Ukraine	-10.1	-8.2	-5.0	-3.0	-3.2

Table 4: Selected economic indicators (continued)

	1993	1994	1995	1996 Programme (1)	1996 Estimates
Current account	(Percent of GDP)				
Albania	-29.7	-14.3	-7.5	-	-7.7
Algeria	1.6	-4.4	-5.3	-4.7	2.8
Belarus	-8.7	-11.4	-4.1	-4.3	-9.0
Bulgaria	-12.8	-2.1	-0.5	-	0.0
Estonia	1.3	-7.1	-5.1	-6.9	-10.2
Latvia	6.7	-4.6	-4.0	-4.4	-6.8
Lithuania	-6.2	-2.1	-10.3	-	-8.2
Moldova	-9.3	-9.2	-6.7	-6.8	-14.4
Romania	-4.7	-1.7	-4.9	-3.2	-6.6
Ukraine	-5.9	-6.0	-5.0	-3.8	-3.9
Official foreign exchange reserves (end year)	(Months of imports)				
Albania	2.3	3.2	3.5	-	3.2
Algeria	2.3	2.9	2.1	2.5	4.5
Belarus	0.3	0.3	0.7	na	na
Bulgaria	2.0	3.0	2.8	-	1.6
Estonia	4.0	3.2	2.7	2.7	2.4
Latvia	5.6	5.5	4.8	3.1	2.9
Lithuania	2.4	3.1	3.9	-	2.4
Moldova	1.5	3.1	4.0	3.4	4.0
Romania	0.1	1.1	0.4	1.0	0.6
Ukraine	0.2	2.3	3.7	1.2	1.3

(1) Programme targets as set in : June 96 for Algeria, September 1995 for Belarus, July 96 for Estonia, April 96 for Latvia, May 96 for Moldova, December 95 for Romania, May 96 for Ukraine.

Sources: National authorities and IMF

ALBANIA		
1.	Price liberalization	Prices mostly market-determined, with the exception of medicines and some publicly provided goods and services (health care, urban transport, rail, energy and water).
2.	Trade liberalization	No quantitative restrictions on imports. Export restrictions limited to scrap metal and unprocessed wood. Removal of tariff exemptions, new classification, new tariff rates approved in May 1995. Average tariff rate about 12%. Lower tariffs for some capital goods. Request for accession to WTO still at early stage.
3.	Exchange regime	Since July 1992 free float within a unified exchange market. Exchange system largely free of restrictions on current account transactions, including profit repatriation. Controls remain on some capital transactions
4.	Foreign direct investment	Liberal legislation. Sale of land to foreigners permitted, but owing to delays in land registration process no sale of agricultural land. Economic free zones set up.
5.	Monetary policy	Bank-by-bank credit ceilings. Banks free to determine lending rates, but central bank sets minimum deposit rates to ensure that real interest rates remain positive. Treasury bill auctions (3, 6, 12 months).
6.	Public finances	VAT introduced in July 1996. Budgetary revenue estimated at 19% of GDP in 1996; expenditure estimated at 29.4% of GDP.
7.	Privatization and enterprise restructuring	96% of total arable land privatized. Distribution of temporary titles nearly completed. Small privatization in trade and services completed. Substantial progress in privatization of small and medium-sized industrial enterprises. Privatization of large state-owned enterprises slower. Strategic enterprises offered for sale to foreign investors. Voucher-based mass privatization programme launched in mid-1995 aimed at privatizing 400 medium-sized or large enterprises by end-1998. Only 97 enterprises sold by July 1996 because of difficulties in implementation (including vouchers issued at too high a nominal value). Stock exchange set up in March 1996; trading so far limited to Treasury bills and privatization vouchers.
8.	Financial sector reform	Two-tier banking system dominated by three large inefficient state-owned banks. Bad loans account for more than one-third of all credit. With a view to privatizing two state-owned banks, in December 1996 the government transferred 28 of their branches to the third one. Inefficient banking system caused informal financial market to expand. Several pyramid schemes, offering very high interest rates, collapsed late 1996.

ALGERIA		
1.	Price liberalization	Price liberalization almost completed with abolition of generalized food subsidies, including the most sensitive products (powdered milk, semolina, and regular flour). Controls remain on profit margins and prices of medicine and energy products, though prices for gas and electricity gradually adjusted in 1996 with a view to covering economic cost by end-1997. Competition Law adopted in 1995 institutionalized principle of free pricing, provided safeguards against monopolistic practices and obliged all suppliers to publish prices.
2.	Trade liberalization	Reforms initiated in 1994 were further strengthened. At end-1996, no import restrictions (except for goods permanently banned for social and religious reasons). Maximum import tariff lowered from 60% to 50% in January 1996.
3.	Exchange regime	Some restrictions on availability of foreign exchange for some current invisible payments and for remittances by non-residents. Government made clear its intention to introduce full current account convertibility by end-1997. Managed float regime further enhanced following establishment of fully fledged interbank foreign exchange market in December 1995.
4.	Foreign direct investment	Liberal foreign investment regime, including banking sector, but apart from hydrocarbon sector, no significant foreign investments have taken place owing to the security situation.
5.	Monetary policy	Deregulation of interest rates, including elimination of cap on banks' spreads, in December 1995, together with deceleration of inflation, allowed positive real interest rates to emerge from beginning of 1996. Use of indirect instruments of monetary control further strengthened with a view to facilitating development of open-market operations by central bank.
6.	Public finances	Continued strong fiscal management, including wage containment and tight policies on transfers and subsidies.
7.	Privatization and enterprise restructuring	Privatization Law enacted in 1996. First privatization/liquidation programme covering 274 small enterprises launched. Implementation constrained by need to restructure loss-making companies, strong social resistance and some technical and legal delays. Law allowing sale of all state-owned agricultural land adopted in 1996. Public enterprise restructuring made further progress, in particular for the 23 largest loss-making enterprises. All public enterprises subject to hard budget constraints.
8.	Financial sector reform	Commercial banks almost exclusively state-owned. In 1996, authorities launched overhaul of commercial banks' practices aimed at establishing greater autonomy in credit allocation and implementing new prudential regulations. As a result, all banks improved their capital/risk weighted ratio.

BELARUS		
1.	Price liberalization	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 delayed to mid-1997. Price ceilings administered by local authorities introduced for a number of products (bread, dairy products, baby food, etc.) in mid-1996. Central authorities (directly) control the price of alcohol; profit margins for agriculture are regulated.
2.	Trade liberalization	Most import licences and export taxes abolished in 1994. Requirements for exporters to surrender foreign exchange reintroduced in early 1996, as well as a 10% tax on purchases of foreign exchange. Customs union with Russia entered into force early 1995. As a result, import taxes rose to level of Russian external tariff. Ratification of Partnership and Co-operation Agreement with the European Union on hold.
3.	Exchange regime	Left Russian rouble zone in 1994. Only partial current account convertibility. Limitations on inter-bank currency operations.
4.	Foreign direct investment	Free repatriation of capital and profits. Owing to political uncertainties, flows of foreign direct investment almost zero.
5.	Monetary policy	Two-tier banking system. Central Bank determines monetary policy. Since second half of 1996, expansionary monetary policy. Weekly auctions for a large share (60%) of credits to the banking sector. Mounting inflationary pressures.
6.	Public finances	Introduction of VAT in 1993. General government budget showed small (1.9%) deficit in 1996, but quasi-fiscal activities and arrears not properly accounted for.
7.	Privatization and enterprise restructuring	Slow and delayed privatization process. Only 10% of state assets privatized by end 1996. Mass privatization cancelled despite free distribution of vouchers to the population.
8.	Financial sector reform	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, which weaken their financial position.

BULGARIA		
1.	Price liberalization	Systems of control or monitoring of approximately 50% of goods (weighted by their share in the consumer price index) remained in force up to end-1996.
2.	Trade liberalization	The regime is generally liberal, though an import surcharge at a rate of 5% was imposed in mid-1996.
3.	Exchange regime	A unified and quasi-free floating exchange regime was introduced in 1991. This has been subject intermittently to substantial intervention by the central bank trying to defend the currency.
4.	Foreign direct investment	Liberal foreign investment legislation was adopted in 1992, but was partly tightened in late 1996.
5.	Monetary policy	Although nominally independent, the central bank has had on occasion to provide considerable volumes of direct credit to the budget.
6.	Public finances	In common with the economy as a whole, public finances suffered a severe crisis in 1996, as the deficit reached over 10% of GDP owing to the burden of interest payments on domestic and foreign debt. A large primary balance was, however, recorded. Tax collection is poor, and a reform of taxation is planned.
7.	Privatization and enterprise restructuring	A mass (voucher) privatization programme got under way in 1996. Enterprise restructuring accelerated somewhat as the government initiated action to deal with the largest loss-making state enterprises.
8.	Financial sector reform	Approximately one-third of the banks were closed in 1996. The sector is now dominated by 5 state-owned banks. Banking supervision remains poor.

ESTONIA		
1.	Price liberalization	Major price liberalization in 1991. At end of 1996, remaining price controls affected land and forestry, oil shale, medicines and utilities. Prices of a limited number of services (e.g., rents and public transport) controlled at municipal level.
2.	Trade liberalization	No import duties, except for a very limited number of products (furs, sea- and snow-scooters, and small vessels). Export quotas/licences for clay and gravel. Flat fee of EEK 200 charged per import and export declaration. Free trade agreement with EU in force since 1 January 1995. Estonia has free trade agreements with the EFTA countries and with Latvia and Lithuania (since 1 April 1996). Estonia has applied for membership of the Central European Free Trade Agreement.
3.	Exchange regime	Full current account convertibility. Kroon pegged to DM since 1992 (1DM=8EEK) under a currency board regime, with a technical fluctuation limit of 3 per cent.
4.	Foreign direct investment	Non-residents may freely repatriate profits and proceeds of liquidation of investment.
5.	Monetary policy	Central Bank responsible for operating currency board and, in exceptional cases, for emergency lending to the banking system. Inflation fell in 1996 to 14.8% (year-end figure).
6.	Public finances	Tax reform completed by early 1994. Indirect taxes (VAT in particular) represent more than 50% of government revenues. Excise taxes raised in 1996. General government expenditures represented 42% of GDP.
7.	Privatization and enterprise restructuring	Small-scale privatization virtually completed. At the end of 1996, more than 450 of the 500 medium-sized and large companies had been privatized.
8.	Financial sector reform	Two-tier banking system. Consolidation of the banking sector continued: at the end of 1996, there were 15 commercial banks. The Tallinn stock exchange was successfully launched in 1996 and volumes have increased steadily.

LATVIA		
1.	Price liberalization	By end-1992, price liberalization essentially completed, excluding utility prices and rents. In 1996, there was continued progress in bringing the remaining regulated prices into line with world prices.
2.	Trade liberalization	All trade restrictions abolished in 1992. Free trade agreements with EU, Baltic States and EFTA countries. Latvia has applied for WTO membership.
3.	Exchange regime	Left rouble zone in July 1992. Full current account convertibility. Exchange rate of lats stabilized under managed floating system, informally pegged to the SDR.
4.	Foreign direct investment	Non-residents may freely repatriate profits and proceeds of liquidation of investment. Substantial flows of foreign direct investment (US$ 171 million in 1996).
5.	Monetary policy	Independent central bank. Credit policy conducted through indirect instruments. Interest rates fully liberalized.
6.	Public finances	VAT introduced in February 1992. Flat rate income tax (25%) plus a 10% surcharge on annual income introduced in 1993. Tight control of public finances in 1996; budget deficit turned out lower than expected.
7.	Privatization and enterprise restructuring	Latvian Privatization Agency set up in February 1996 and procedures for privatization made more transparent and quick. Sell-off of Latvian energy supplier and shipping company well under way by end of 1996.
8.	Financial sector reform	Two-tier banking system set up in 1992. Banking crisis in 1995 reduced number of banks to 33, of which only 16 can accept household deposits. 75% of banking sector in private hands, of which 39% in foreign ownership. Capital of state-owned banks strengthened in preparation for privatization. Stock exchange started to operate in July 1995.

LITHUANIA		
1.	Price liberalization	Almost all prices were fully liberalized during 1991-92. Some restrictions remain on utility, housing and transport prices. Progress towards cost-recovery levels for energy prices.
2.	Trade liberalization	Relatively liberal trade regime. All non-tariff restrictions removed during 1991-92. Trade-weighted average tariff below 5% by 1995, with majority of products zero-rated. Trade policies not always implemented as announced, notably tariffs on some agricultural products, which have been reduced by less than envisaged in the IMF programme. Free Trade Agreement with EU entered into force on 1 January 1995.
3.	Exchange regime	Full current account and internal convertibility. Virtually no restrictions on capital transactions. Left rouble zone in Spring 1992. Currency board regime established in April 1994 with the litas pegged to the US dollar at a rate of four to one.
4.	Foreign direct investment	Non-residents may freely expatriate profits and proceeds of liquidation of investment. Foreigners allowed to own land for business purposes since 1996, thanks to a constitutional amendment.
5.	Monetary policy	Since April 1994, monetary policy dictated by currency board arrangement requiring full foreign exchange coverage for reserve money and other litas-denominated liabilities of the Bank of Lithuania.
6.	Public finances	Monetary financing of the budget deficit precluded by the currency board arrangement. Reform intended to make the tax system better suited to a market economy has been largely accomplished (including introduction of VAT). Tax evasion and erosion of the tax base have led to substantial decline in fiscal revenue as percentage of GDP. Nevertheless, budget deficits have remained rather small, thanks to strict management of expenditures.
7.	Privatization and enterprise restructuring	First stage of voucher privatization concluded in 1995 with privatization of 85% of eligible candidates. Second stage of privatization initiated in 1996: envisages cash sales to domestic and foreign buyers.
8.	Financial sector reform	Two-tier banking system established in 1992. Central bank and commercial banking act enacted in early 1995. Financial sector now recovering from banking crisis of late 1995. Government actively pursuing three-pronged policy based upon: clean-up of the troubled banks' balance-sheets; privatization; strengthening of the regulatory framework (tightening of exposure and capital adequacy rules, adoption of international accounting standards and mandatory auditing). Foreign banks allowed to establish subsidiaries. Stock market in place.

MOLDOVA		
1.	Price liberalization	Prices of goods and services fully liberalized with some exceptions (mainly energy products).
2.	Trade liberalization	All export quotas removed. Maximum import tariff of 20%, with a few exceptions.
3.	Exchange regime	New currency introduced in November 1993. Managed float, with slow nominal depreciation against USD. Daily foreign exchange auctions at the Chisinau Inter-bank Foreign Currency Exchange. Current account convertibility.
4.	Foreign direct investment	Liberal regime: free repatriation of profits and proceeds of liquidation of investments within three months of closure. Agency for Foreign Investment Promotion established in January 1995. Partnership and co-operation agreement with EU signed in November 1994.
5.	Monetary policy	Relies on credit ceilings. Policy geared to further reduction of inflation, enforced financial discipline and enhanced central bank independence.
6.	Public finances	VAT introduced in 1992. Tax administration improved. Privatization receipts far below expectations, because of a lack of domestic capital. On expenditure side, overruns resulted from higher-than-programmed social spending and from net lending by the government, which assumed guaranteed loans to enterprises in default.
7.	Privatization and enterprise restructuring	2200 enterprises, representing about 70% of the economy, privatized through the voucher programme. Mass privatization process concluded in October 1996. Privatization for cash not successful, because of a lack of domestic capital.
8.	Financial sector reform	Two-tier banking system. National Bank responsible for monetary policy and bank supervision. Regulation imposing provisions for bad loans approved in 1995. From 1 January 1996, banks with reserve level below Mdl 4 million (about US$ 900,000) forced to close or to merge with a larger bank.

ROMANIA		
1.	Price liberalization	Phased programme of price liberalization introduced at the end of 1990. In 1993, most consumer subsidies eliminated and the number of consumer goods under direct price control greatly reduced.
2.	Trade liberalization	Liberalization of foreign trade regime largely completed by the end of 1992, though in 1995, around half of Romania's imports were subject to special arrangements. Substantial trade restrictions were introduced in 1996 in an attempt to curb rising trade deficit.
3.	Exchange regime	Almost full current account convertibility. Remaining restrictions concern maximum amounts that residents may take out of the country. In early 1996, significant controls imposed on enterprises' and banks' foreign exchange operations; number of banks licensed to operate on foreign exchange market restricted to four.
4.	Foreign direct investment	FDI and portfolio investment regulated by law. FDI inflows dropped in 1996 and are small for the size of the country
5.	Monetary policy	National Bank is independent, though in 1996 it contributed to budget deficit financing and extended directed credits to state-owned enterprises and agricultural sector.
6.	Public finances	Basic tax reform completed. VAT and wage tax main sources of government revenue. Budget deficit soared in 1996, because of increase in subsidies.
7.	Privatization and enterprise restructuring	Little progress on restructuring of inefficient and large energy-intensive enterprises, in particular because of overvaluation of exchange rate and low energy prices. By October 57% of small enterprises privatized, but privatization of large and medium-sized enterprises progressed slowly.
8.	Financial sector reform	Two large private banks collapsed in 1996. Limited deposit insurance scheme introduced in August 1996. In 1996, secondary OTC market (RASDAQ) launched successfully.

UKRAINE		
1.	Price liberalization	Limits set by local governments on profit margins for bread and oil products abolished in May 1996. Most goods no longer subject to price declaration (only energy and transport prices have to be declared). Increases for households in prices of coal, electricity, gas and transport, but still below full cost recovery. Also, increases in rents.
2.	Trade liberalization	System of state orders abolished, except for grain for budgetary reasons. Budget allocations for state procurement of agricultural products limited to needs of budgetary organizations and based on market-determined prices. Import regime free of quantitative restrictions, with few exceptions, which are primarily for health and safety reasons. Maximum import tariff 30%. No export quotas and licences (except for hides and skins). Partnership and Coóperation Agreement with EU signed June 1994.
3.	Foreign exchange regime	Exchange rate determined at interbank auction market.
4.	Foreign direct investment	Tax relief granted to some foreign direct investments constituting at least 20% of an enterprise's charter capital. This relief was granted by a 1993 decree and provided for exemption from income and profit tax for 5 years.
5.	Monetary policy	Central bank credit to commercial banks allocated mostly through the Lombard facility, and to a lesser extent through auction. Directed credits no longer 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% of GDP in 1992 to some 40% in 1996. Ratio revenue/GDP: 37% in 1996.
7.	Privatization and enterprise restructuring	Mass voucher privatization programme launched at beginning of 1995. By end-1996, about 80% of small enterprises and 50% of medium-sized and large enterprises had been privatized. Coal sector reform programme implemented with the help of the World Bank.
8.	Financial sector reform	Measures to strengthen supervision and regulation of the banking sector implemented.

I. ALBANIA

1. Introduction

Albania's macroeconomic and structural adjustment efforts were initiated in 1992 against a backdrop of severe economic, social and administrative deficiencies. The country made considerable progress towards macroeconomic stabilization, supported by an SDR 20 million stand-by arrangement from the IMF, complementary assistance from the EC in the form of an ECU 70 million grant[5] and bilateral assistance from G-24 members.

Following the IMF's decision to back Albania's medium-term programme of structural reforms with a SDR 42.4 million Enhanced Structural Adjustment Facility for the period from mid-1993 to mid-1996, the Council of the European Union decided in November 1994 to grant the country renewed macro-financial assistance up to a maximum amount of ECU 35 million[6].

Performance from 1993 until mid-1995 was satisfactory: yearly GDP growth averaged 9%, tight budgetary and monetary policies were implemented, external imbalances were reduced, foreign reserves were built up to the equivalent of over 3 months' imports and structural reforms progressed. Subsequently, however, the pace of reform slowed down and important budgetary policy slippages appeared, which were only partially corrected after the May 1996 general elections.

2. Macroeconomic performance

In 1996, real GDP grew by 8.2 %, continuing the positive performance of the three previous years. Agriculture, which accounts for over half of GDP, grew 4.5%, down from 5.8% in 1995. For the second year in a row since the beginning of the transition process, industrial output increased slightly, by 0.8%. Production in state-owned industries continued to fall, while output in the newly established private enterprises in the textiles and clothing sector grew. According to official Albanian figures, unemployment in 1996 was 12.1%, down from 13% in 1995.

Fiscal policy slackened in 1996, mainly because of the pre-electoral measures enacted in the first months of the year. In particular, the agricultural land tax was suspended, tax collection was less vigorously enforced and the introduction of the VAT to replace the turnover tax was delayed. Moreover, public sector wages were increased by 20% in April. However, soon after the elections the new government took a series of corrective fiscal measures. On 1 July, the VAT was introduced and exemptions were limited to bread, kerosene and bottled gas. Price controls for some food staples (wheat, flour and bread) were removed. In October, in an additional effort to control the budget deficit, the government froze spending on new investment projects. The reduction of expenditure from the equivalent of 30.8% of GDP in 1995 to 29.4 % in 1996, was nevertheless insufficient to offset a shortfall in revenue of 19% of GDP in 1996, compared with 24% in 1995, and the overall fiscal deficit for 1996 reached 11.4% of GDP.

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5 Council Decision of 28 September 1992 (92/482/EC).

6 Council Decision of 28 November 1994 (94/773/EC).

The pressures exerted by the fiscal deficit and wage increases resulted in faster inflation, reversing a downward trend that had begun in 1993. Consumer price inflation was 17.4% in 1996, up from 6% in 1995. Broad money growth was 40% in 1996.

Imports increased substantially in 1996, and the trade deficit rose to 25% of GDP, up from 19.6% of GDP in 1995. The deterioration of the trade balance was, however, offset by the inflow of workers' remittances, which grew during the second half of the year in response to the increasingly high returns offered in the informal financial sector. The current account deficit remained relatively stable at 7.7% of GDP (7.5% in 1995). Foreign exchange reserves grew to US$ 280 million (equivalent to 3.2 months' imports).

The exchange rate against the dollar had been stable since the autumn of 1992. During the six months leading up to the 1996 general elections, the lek depreciated by around 15% against major currencies, but during the second half of the year it recovered most of the ground it had lost. In general, the Bank of Albania refrained from intervening, except during brief episodes of high volatility.

The most significant adverse development in the Albanian economy in 1996 was the increasing instability of the expanding informal financial sector. The sector started to develop from the very beginning of the transition process, spurred by the weakness of the banking system and the ensuing tight controls on bank credit. Acting like deposit-takers and operating de facto like pyramid schemes, the companies offered higher interest rates than those offered in the banking sector. Until the end of 1995, monthly interest rates offered by these institutions were in the range of 4-5 %. However, in 1996 new companies began offering monthly rates which in some cases exceeded 40%. As a result, the larger incumbents also increased their rates and at the end of the year they were offering monthly rates of 10%.

Following warnings from the IMF in October 1996, the government started to voice doubts as to the soundness of the savings schemes. In November and December 1996 two pyramid schemes collapsed. Despite redistribution to investors of the frozen sums of the two collapsed schemes as partial compensation for losses, turmoil escalated in February 1997 into a major political and security crisis. Several more schemes were shut down. All existing schemes have now suspended interest payments and some are reimbursing principal, albeit on a piecemeal basis.

3. Structural reform

Following considerable progress in 1994 and 1995, the pace of structural reform slowed down during 1996. Nevertheless some important measures were taken.

Tax reform progressed thanks to the introduction of the VAT in July. However, the system still presents a number of weaknesses owing to a high number of exemptions. Moreover, the tax administration needs to be substantially improved.

Price liberalization was virtually completed in 1996 and controls remained only on the prices of a small number of goods and services (health care, urban transport, rail fares, energy and water). Wheat and flour prices were decontrolled. The ceiling on the price of bread was removed (but special bread allowances were granted to government workers).

Under the Mass Privatization Programme (MPP), the privatization of small and medium-sized service and production enterprises was actively pursued and almost completed.

Some 30 larger enterprises were also sold. For the large enterprises (mostly mining companies and public utilities) the authorities decided to give priority to sales to strategic investors, reserving a minority for sale through the MPP. The liquidation of some twenty enterprises that had been transferred to the Enterprise Restructuring Agency (ERA) has also continued, albeit slowly.

Some steps were taken to reform the banking system. In February 1996, the Parliament adopted two laws determining the role and responsibilities of the Bank of Albania, including its relations with the government regarding the financing of the budget deficit. Simultaneously, the law on the banking system was adopted, streamlining the licensing procedures and establishing the regulatory framework for banking activity. However, the regulations relating to the Bank of Albania and the Banking Law were not adequately enforced. Moreover, the regulatory framework for financial activity in Albania remains seriously inadequate. Supervisory regulations that accord with international standards have yet to be developed.

In September 1996 the government announced a strategy to privatize Albania's three state-owned banks within three years. In December most of the branches of the Rural Commercial Bank and of the National Commercial Bank were transferred to the Savings Bank, which the government intends to privatize last. The Savings Bank was left free to close down or restructure the branches.

4. Implementation of macro-financial assistance

The grant of ECU 35 million decided by the Council in November 1994 was disbursed in two tranches. The first tranche (ECU 15 million) was disbursed in May 1995, following signature of the Memorandum of Understanding laying down the macroeconomic and structural conditions attached to the grant. In early September 1996 the Commission decided to disburse the second tranche (ECU 20 million), in view of the measures taken by the new Albanian government to address the budgetary imbalances, including the introduction of the VAT, and of the progress in implementing structural reforms mentioned in the Memorandum of Understanding.

II. ALGERIA

1. Introduction

In 1996, Algeria completed an important stage of the economic and structural reform programme that was launched in the early 1990s. The programme was aimed at transforming an administratively regulated economy into a market economy with a liberalized domestic price system and external trade and payments regimes. A strong track record of policy implementation and stabilization has been established, despite mounting difficulties in the political and security situation.

Positive real economic growth was restored, inflation declined towards a single-digit rate, the current-account and fiscal balances turned into surpluses, and the external and domestic debts were reduced. This performance reflected both favourable exogenous developments, in particular in the hydrocarbon and agriculture sectors, and the continued steadfast implementation of important institutional reforms. During 1990-96, domestic prices were liberalized, together with the trade and payment systems; the restructuring of public enterprises was launched; a programme of privatization/liquidation of small public enterprises was implemented; the banking sector was deregulated; and a managed float exchange rate regime and an interbank foreign exchange market were introduced. On the social front, housing reforms were initiated and the social safety net was modernized.

Algeria's economic and structural reform programme continued to receive strong financial support from the Bretton Woods institutions. Following two stand-by arrangements, in 1991 and 1994, the IMF approved a three-year Extended Fund Facility (EFF) in May 1995 for a total amount of SDR 1,169 million. Algeria has met all the quarterly performance criteria set under the EFF since its inception. In addition, in June 1996, the IMF approved a purchase under the Compensatory and Contingency Financing Facility on account of excess cereal import costs. The World Bank approved a Structural Adjustment Loan (SAL) of US$ 300 million in support of a private sector development programme in April 1996. The first tranche of US$ 150 million was disbursed in June 1996. Reforms of the social safety net were also supported by a US$ 50 million loan.

The Community also supported Algeria's reform process. The Council decided in 1991 to grant Algeria a first loan of ECU 400 million[7], which was disbursed in 1992 (ECU 250 million) and 1994 (ECU 150 million). In 1994, following a request for further macro-financial assistance from the Algerian authorities, the Council adopted a second macro-financial operation (up to ECU 200 million) to be disbursed in two tranches[8]. A first tranche (ECU 100 million) was released in November 1995.

2. Macro-economic performance

The recovery in output growth registered in 1995 was sustained in 1996, when real GDP rose by 4 per cent. The overall contraction of domestic demand was more than offset by the expansion of the export sector. Agriculture, the hydrocarbon sector, construction, and public works were the main engines of growth. By contrast, industrial production continued to decline, by about 4 per cent in real terms, reflecting the poor productivity

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7 Council Decision 91/510/EEC.

8 Council Decision 94/938/EEC.

and tightened credit constraints in the large public enterprise sector. Despite the rebound in economic activity, the unemployment rate continued to increase in 1996 to reach 28.3 per cent at end-year, as economic growth was not sufficient to generate enough employment opportunities.

The pursuit of a tight monetary policy resulted in a further decline of the inflation rate (December-on-December), from 21.9 per cent in 1995 to 15.1 per cent in 1996. Since the central bank repurchase rate was reduced by 2 percentage points to 20%, real interest rates became positive. In addition, bank credits to the less productive sectors of the economy, such as the food importing agencies and some public enterprises, were curbed so as to make room for more profitable and productive investments. The inflation performance was also facilitated by a good harvest, a moderate increase in administered prices, and a small appreciation of the real effective exchange rate of the dinar.

Higher international oil prices and strong fiscal management resulted in an exceptional fiscal performance in 1996. The overall fiscal balance reached a surplus of 3 per cent of GDP, a turnaround equivalent to 7.4 and 4.4 per cent of GDP compared to 1994 and 1995, respectively. While non-hydrocarbon receipts remained unchanged as a proportion of GDP, hydrocarbon receipts increased by about 2 percentage points of GDP in 1996. On the expenditure side, wage containment and continued tight policies on transfers and subsidies allowed for a reduction in current expenditure (as a ratio to GDP) for the third consecutive year. As a result of sustained fiscal consolidation, the outstanding domestic debt was halved during the period 1993-96 to 22.2 per cent of GDP.

Algeria's external position improved considerably in 1996, mainly as a result of the increase of the international crude oil price by US$ 2 per barrel (corresponding to a 23.4 per cent increase in Algeria's crude oil export unit value). The current account balance swung from a deficit of US$ 2.2 billion in 1995 to a surplus of US$ 1.2 billion in 1996 (2.8 per cent of GDP). Hydrocarbon exports, which represented more than 95 per cent of total Algerian exports, increased in value by about 30 per cent to US$ 12.6 billion. Total imports, at US$ 9.1 billion, declined by 10 per cent in the wake of the good harvest, the overall contraction of domestic demand, and the recession in the industrial sector. The capital account balance, though negative, improved by about 2.5 per cent of GDP, owing in part to a pick-up in foreign direct investment in the energy sector. In addition, Algeria continued to benefit from large exceptional financing in the form of public and commercial debt reschedulings. As a result, gross foreign exchange reserves doubled in 1996 to reach US$ 4.2 billion at end-year, equivalent to 4.5 months' imports. Algeria's outstanding external debt declined slightly to 74.2 per cent of GDP at end-1996.

3. Structural reforms

In 1996, the process of liberalizing the economy and establishing market mechanisms was further consolidated, except for the restructuring and privatization of large public enterprises, where the social consensus needed to underpin the reforms was more difficult to sustain in view of rising unemployment and labour unrest.

Domestic price liberalization was almost completed with the abolition of the generalized food subsidies, including those on the most sensitive products, such as powdered milk, semolina, and regular flour. The only remaining controls on profit margins and prices applied to medicine and energy products. Prices for gas and electricity were gradually adjusted in 1996 with a view to covering economic cost by end-1997. The maximum import tariff was lowered from 60 per cent to 50 per cent in early 1996. As of end-1996, Algeria's trade system was free of import restrictions (except for a short list of goods permanently banned for social and religious reasons). Some restrictions remained on invisible current account transactions.

Following the adoption of the Privatization Law, a first privatization/liquidation programme covering 274 enterprises, units of enterprises, and activities in small-scale industry, commerce, services, construction, and transport was launched in April 1996. However, effective transfers to the private sector or liquidation were constrained by the need to restructure loss-making companies, strong social resistance to the inevitable redundancies and some technical and legal delays, as well as the need to ensure transparency. An amendment to the Privatization Law was prepared in late 1996 in order to increase flexibility in privatization procedures, including equity participation by employees, auctions and mass privatization, with a view to launching, in 1997, a second programme of privatization/liquidation involving some larger public enterprises in the manufacturing sector. In addition, a draft law allowing the sale of all state-owned agricultural land was adopted in 1996.

The restructuring of the large public enterprises made some progress, in particular for the 23 largest loss-making companies which had not been granted legal and financial autonomy, and thus remained protected against bankruptcy. By end-1996, in the framework of the World Bank's Enterprise and Financial Structural Adjustment Loan approved in 1991, one enterprise had been liquidated and the other 22 had been granted autonomy and were required to meet performance contracts relating to restructuring measures. All public enterprises had been made subject to hard budget constraints.

In conjunction with the restructuring of public enterprises, an overhaul of commercial banks' practices was implemented with the aim of introducing greater autonomy in credit allocation and applying new prudential regulations on portfolio concentration and loan classification and provisioning. As a result, all banks improved their capital/risk weighted ratio, which was expected to reach the BIS standard of 8 per cent by 1999. Other banking reforms included a further move towards indirect monetary controls and the establishment of a fully fledged interbank foreign exchange market.

4. Implementation of macro-financial assistance

In 1996, discussions took place between the Algerian authorities and the Commission services on the appropriateness of and conditions for the disbursement of the second tranche of the 1994 macro-financial loan (up to ECU 100 million). However, agreement was not reached on the conditions attached to its release, in particular with respect to the calendar for the implementation of a programme of privatization of large public enterprises. Moreover, Algeria's residual financing gap vanished in 1996 as a result of the strong current account performance. In December 1996, the Commission decided, as part of the MEDA programme, and after consulting the Member States[9], to support Algeria's structural reform programme through a Structural Adjustment Facility (SAF) for an amount of ECU 125 million to be disbursed in two tranches of ECU 60 million and ECU 65 million. This grant-based assistance, which is intended to complement the World Bank's SAL, will be disbursed on condition that specific reforms in the area of

[9] In accordance with Council Regulation N° 1488/96.

international trade, housing, agriculture, privatization of small enterprises, and the social safety net are implemented.

III. BELARUS

1. Introduction

Economic and political developments in Belarus were a matter of grave concern in 1996. The moderate progress made towards stabilization in the past faltered: inflation accelerated substantially in the last quarter, and the external sector was particularly fragile. The growth officially recorded in 1996 appears to be mostly the result of state orders, which were financed by cheap credit from the banking system, and led to a major surge of stocks. State interference in the economy intensified, progress with structural reforms was minimal, and privatization was halted.

In 1996 Belarus failed to meet the basic requirements for transition to a market economy, including: a well-defined and guaranteed system of property rights; and legal and administrative institutions to ensure that the rule of law is enforced in a transparent and coherent way. Furthermore, the political will was lacking to make concerted efforts to proceed with the necessary democratic and economic reforms.

Under those circumstances, the international financial institutions interrupted all major programmes of financial assistance. Since 1993, multilateral donors had assisted and encouraged the reform process in Belarus. The IMF had intervened with two tranches of a Systemic Transformation Facility in July 1993 and in 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 the government's economic programme for 1995/96. The IMF board eventually approved the stand-by arrangement on 12 September 1995. The Commission disbursed in December 1995 ECU 30 million of the ECU 55 million balance-of-payments assistance approved in support of the IMF stand-by arrangement. However, the IMF programme soon went off track. The second tranche of the Community loan has consequently not been disbursed, and there are no plans to reactivate it.

The resumption of international financial assistance would require a major effort on the part of the authorities to accomplish an effective liberalization of the economy, to accelerate structural reform, and to implement tight monetary and fiscal policies, so as to ensure that macroeconomic stabilization is sustained and the efforts made so far, entailing major social costs, are not wasted. Until those conditions are met, in line with the position of the Council[10], the EU will encourage the international financial institutions to maintain a case-by-case approach to new lending proposals, observing strict economic conditionality.

2. Macroeconomic performance

The economic picture which emerges from the official statistics is quite mixed. GDP growth for 1996 is reported at 2.6% with respect to the previous year, and accelerating. The increase in GDP is driven by major increases in industrial production. However, economic growth appears to be mostly the result of state orders, which were financed by cheap credit from the banking system, and led to a major surge of stocks. A barter agreement with Russia allowed the use of the stocks accumulated during 1996 to be used in payment for gas arrears to RAO Gazprom.

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[10] Council Conclusions of 24/2/97 and Council Declaration of 29/4/97.

Moreover, there were clear signs that the moderate progress made towards stabilization in 1995 and in the first half of 1996 were in jeopardy, and serious threats to a low-inflationary environment surfaced. After a period of relative stability, inflation accelerated substantially in the last quarter of 1996.

The situation of the external sector deteriorated markedly in 1996. Imports surged as a result of the extremely overvalued exchange rate and caused a sharp deterioration of the current account. The deficit increased from $370 million in 1995 to an estimated $1,220 million, i.e., about 9% of GDP, at the end of 1996.

Economic policy in 1996 was erratic. Monetary policy, relatively restrictive in the first half of the year, suffered a severe blow in the second half. In April President Lukashenko placed the central bank under the authority of the president rather than the parliament. This shift in supervisory powers, together with the suspension of multilateral lending and supervision by the IMF, led to a relaxation of monetary policy, and money emission increased by 64% over the full year. This expansionary monetary policy was inconsistent with the de facto fixed exchange rate regime, as became very clear in the second half of 1996, when pressures increased for a sizeable devaluation of the exchange rate of the rubel.

Fiscal policy, at least on paper, remained more restrictive. Officially, the state budget recorded a modest deficit for 1996, equal to 1.9% of GDP. However, this figure does not take fully into account the rapid build-up of arrears, estimated at 1% of GDP; the existence of quasi-fiscal activities; and extra-budgetary funds. Independent estimates put the deficit for 1996 at about 4% of GDP. Furthermore, the way in which the deficit was financed had major negative consequences for the financial stability of the country. In the second half of 1996, the government resorted increasingly to credits issued by the central bank.

Exchange rate policy was arguably the clearest example of reversal in the process of liberalization. At the beginning of 1995 the authorities decided to peg the rubel against the US dollar with the aim of helping to control inflation. A sizeable real appreciation and growing expectations of a devaluation imposed a major drain on the reserves of the central bank. From November 1995, the authorities resorted to a succession of administrative controls, which included the prohibition of inter-bank trading and major restrictions on the purchase of foreign currency. In April 1996 the Inter-bank Currency Exchange was nationalized and put under the direct control of the central bank. In the mean time, the fixed rate regime was replaced by a currency corridor. The corridor sharply overvalued the rubel, which regularly traded at a 30-50% discount on parallel markets. This prompted the authorities to introduce further administrative controls, including a 10% tax on purchases of foreign exchange introduced in January 1996 and a requirement that exporters surrender 100% of their foreign exchange earnings. Those measures, which were subject to frequent changes and arbitrarily applied, led de facto to the establishment of a multiple exchange regime.

3. Structural reform

The Belarus economy remained unreformed in many areas, and the state continued to play a major role in the production and distribution of goods. Indeed, the authorities' response to growing financial instability was to increase the degree of state interference in the

Liberalization suffered some reversal, both in the case of the exchange rate, and in the case of prices. Most prices were liberalized as early as 1992, and the process of price liberalization was mostly completed at the beginning of 1995. The central authorities continued to control directly the price of alcohol, while administered prices were set for transport, energy and communications. Profit margins for agriculture were regulated. On 30 August, 1996 a presidential decree reintroduced direct price ceilings administered by the local authorities on a number of products (bread, dairy products, baby food, etc.).

Weak commitment in the areas of privatization and enterprise restructuring virtually halted the structural reform process from 1995. Small-scale privatization has been relatively successful, the most noticeable progress being made in the housing sector and retail trade. Large-scale privatization faltered. During 1996 only 164 state-owned enterprises were transformed into joint-stock companies, compared with an original target of 549. A voucher scheme for mass privatization was cancelled, under the pretext of rooting out tax evasion and corruption. As a result only about 10% of Belarus' firms are in private hands.

4. Implementation of macro-financial assistance

On 10 April 1995 the Council approved[11] 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. After approval in September 1995 by the IMF board of a first stand-by arrangement with Belarus, the Commission services visited Belarus to assess the economic and financial situation and to set terms and conditions for the Community macro-financial assistance.

In a Memorandum of Understanding attached to the Community loan, the Belarus authorities undertook significant commitments in several areas of structural reform (price liberalization, privatization, financial discipline of enterprises, and banking reform), as well as compliance with the performance criteria foreseen in the IMF stand-by arrangement.

The Community contribution was set at ECU 55 million on the basis of external financial needs estimated at about $600 million over the period of the IMF stand-by arrangement. The amount of the first tranche of the Community loan was set at ECU 30 million. It was disbursed in December 1995.

Given the lack of progress in several areas of structural reform and the reversal of some measures of liberalization, the second tranche has not been disbursed. Furthermore, all Community assistance to Belarus, except for a limited number of TACIS actions, has been suspended indefinitely.

[11] Council Decision 95/132/EC (O.J. L89 of 21 April 1995).

IV. BULGARIA

1. Introduction

In 1996, Bulgaria underwent a deep economic crisis. This was the consequence of inconsistent macroeconomic policies and poor progress in structural reform. In the final days of the year the economic crisis had political repercussions, as the Prime Minister Mr. Videnov resigned.

Bulgaria started its transition to a market economy later and under more unfavourable conditions than most central European countries. In March 1990, the country had declared a moratorium on the servicing of its foreign currency debt, effectively cutting itself off from international finance. Bulgaria had conducted a particularly large share of its foreign trade with the CMEA, and so was especially badly hit by its break-up. A further external shock came with the disintegration of Yugoslavia and the subsequent embargo on Serbia-Montenegro, which cut Bulgaria's main overland transit route to western markets.

Economic reforms were launched in February 1991. Prices of most goods were liberalized, subsidies were sharply reduced, a unified floating exchange rate was introduced, a two-tier banking system was set up, and the state monopoly on foreign trade was abolished. Good progress was made also in establishing the legislative basis for a market economy: by mid-1992 much of the legal framework was in place.

However, the momentum of structural reform was not maintained. Practical implementation did not match the progress made in establishing the legal base of a market economy. Moreover, there were a number of reversals: price controls were reintroduced on a wide range of goods.

Clear political support for enterprise restructuring and privatization was lacking. State enterprises continued to face "soft budget constraints", and were thus able to build up large stocks of bad debts with state-owned banks. These banks were in turn able to obtain uncollateralized loans from the central bank. The central bank's ability to refuse such loans was constrained, first because it was not clear that it had the powers to close commercial banks; and second because it was unwilling to take the initiative of forcing widespread enterprise restructuring, which would have been the consequence of imposing restrictions on commercial banks' access to central bank credit.

Excessively large budget deficits, financed in part directly by the central bank, contributed to persistent inflation, which the central bank tried to moderate by regular intervention in the foreign exchange market to stabilize the exchange rate. This inconsistency between fiscal, monetary and exchange rate policies caused exchange rate tensions whenever financial markets perceived that the central bank did not have adequate foreign reserves to continue supporting the currency. While the precise timing of these tensions, in Spring 1994 and again from early 1996, has been influenced by Bulgaria's external obligations, they were an inevitable consequence of weaknesses in domestic policies.

2. Macroeconomic performance

Following the signature of a debt and debt-service reduction agreement (DDSR) with foreign commercial creditors in July 1994, Bulgaria enjoyed a period of relatively good economic performance. Modest growth in GDP was recorded in 1994 and 1995. By early 1996 annual inflation had fallen to under 30%. The reduction in inflation was greatly helped by the remarkable stability of the exchange rate during 1995. However, the combination of a stable exchange rate and inflation which, although slowing, remained high relative to Bulgaria's trade partners in western Europe, resulted in a strong real appreciation of the lev. In the absence of any substantive structural reforms this led to a gradual weakening of the country's balance of payments from mid-1995.

Developments in 1996 clearly revealed that Bulgaria's economic recovery in 1994 and 1995 had not been based on solid foundations. GDP fell by over 10%. December-on-December inflation reached over 300%, reflecting a massive depreciation of the currency. The exchange rate fell from approximately 70 leva per dollar at the start of the year to almost 500 leva per dollar by the end of 1996.

As awareness spread in the early months of 1996 that the central bank's foreign reserves were only barely adequate to meet foreign debt-service payments, the lev came under increasing pressure. For some months, the central bank sought to attenuate the depreciation by a combination of interest rate increases and direct intervention in the foreign exchange market. This merely delayed matters, and when the central bank eventually withdrew from the market, its foreign currency reserves substantially depleted, a massive depreciation got under way. This was temporarily halted in the autumn when the central bank raised its monthly interest rate to 25% (equivalent to an annual rate of over 1000%), but the central bank's scope to use interest rates as a means to support the lev was severely restricted by the effect of high interest rates on the real economy.

Because of the lack of structural reform, the banking system was burdened with a high proportion of bad debts from enterprises. Raising interest rates in these circumstances merely increased the share of loans which could not be repaid. This further weakened the banking system: the operations of some 15 banks were suspended during the year. The other main victim of high nominal interest rates was the state budget. Several years of unduly large budget deficits resulted in the state accumulating a large domestic debt. High interest rates raised the cost of servicing this debt.

For these reasons, the central bank lowered interest rates after a few weeks, while maintaining them at a relatively high level of 15% per month. This level of interest rate, while inadequate to support the lev, still added to the burden of interest payments. Moreover, tax revenues fell as a result of the reduction in economic activity. During the second half of 1996, the government had to turn almost exclusively to the central bank to finance its rapidly widening budget deficit. The resultant increase in the money supply led to an acceleration both in the rate of currency depreciation and in inflation.

These developments reduced the dollar value of wages and pensions to extremely low levels. Data on household income and expenditure for the first nine months of 1996 show how the fall in real income affected living standards. The share of income spent on food increased throughout the period, accounting for over half of household purchases in September. While people were spending relatively more on food, they were eating less: compared with the same period of 1995, in the third quarter of 1996 per capita consumption of meat, eggs, fruit and vegetables was some 15% lower; only milk and potatoes were eaten in quantities little changed compared with 1995.

Government attempts to reverse the slide and stabilize the economy during the second half of 1996 were largely unsuccessful. A stand-by arrangement with the IMF ran off track soon after it had been approved. Attempts to agree a revised economic programme were thwarted by a difficult political situation, following the victory of the opposition candidate in the presidential elections in November. The Prime Minister narrowly survived a subsequent no-confidence motion, but his position had been sufficiently weakened that he resigned, along with his government, at an extraordinary plenum of the Socialist Party in late December.

The country was then effectively without a government at a critical time. No credible budget could be adopted for 1997. The opposition initiated a boycott of parliament, and called for immediate elections. There were daily protest marches in the capital Sofia and in other towns. The economic and social situation continued to deteriorate. Strikes and civil unrest spread, as trade unions called for weekly pay increases and for monthly negotiations on wage levels. The situation was resolved in February 1997 when early elections were called and an interim government was appointed. This had an immediately beneficial impact on both political and economic stability.

3. Structural reform

The authorities attempted to relaunch structural reform in mid-1996. This was at the prompting of the Bretton Woods institutions, which insisted on such measures as a condition of their renewed support to Bulgaria. The authorities sought assistance from the IMF and World Bank following unsuccessful attempts in the first months of 1996 to prevent a rapid exchange rate depreciation, which had eroded the central bank's foreign exchange reserves and raised the prospect that Bulgaria would default on its restructured foreign debt. A degree of success was achieved in liquidating large loss-making state enterprises, and in isolating from the banking system loss-making companies which could not be closed down (eg utilities). In addition, some 15 insolvent banks were closed. However, the authorities lacked sufficient credibility, and were unable to arrest the economic downturn. It was not until there was a change of government in the early months of 1997 that prospects of economic stabilization and recovery emerged.

4. Implementation of macro-financial assistance

A first macro-financial loan of some ECU 290 million to Bulgaria was decided by the Council in 1991,[12] and disbursed in two instalments in 1991 and 1992. This loan is to be repaid in December 1997 and March 1998.

A further ECU 110 million loan was approved in 1992,[13] but because of repeated policy slippages, its disbursement was much delayed. A first instalment of ECU 70 million was disbursed in 1994 in the framework of the stand-by arrangement agreed with the IMF in May of that year. Disbursement of the outstanding ECU 40 million instalment did not take place until the second half of 1996, following the approval by the IMF of a new stand-by arrangement.

Bulgaria is currently implementing economic reforms with the support of a new IMF stand-by arrangement. The possibility of additional Community macro-financial lending is presently being examined.

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[12] Council Decision 91/311/EEC of 24 June 1991.

[13] Council Decision 92/511/EEC of 19 October 1992.

V. ESTONIA

1. Introduction

After the sharp contraction of output which followed independence, economic recovery started in the second half of 1993. Revised data on the evolution of real GDP suggest that Estonia experienced fairly rapid improvement thereafter. For 1994, the decline of GDP is now estimated to have been only 1.8% compared to the earlier figure of 2.7%. Growth for 1995 was revised upwards from 2.9% to 4.3%, and for 1996 the first estimates show a 4% real increase. For the last quarter of 1996, real growth of GDP is estimated to have been 7.3%, a clear acceleration of the trend observed in the second and third quarters.

2. Recent economic developments

At the same time, inflation has fallen sharply. In December 1996, year-on-year inflation was 14.8% while a year before the corresponding figure was 28.9%. The fall in inflation was accompanied by a decline in interest rates. The weighted average interest rates on kroon loans of more than one year fell from an average of 16.06% per annum in March 1996, to 13.88% in December 1996. Moreover, these figures underestimate the fall in interest costs incurred by Estonian customers, since a growing share of loans were made in foreign currencies (DM and US$), for which interest rates are lower than for kroon loans. However, real interest rates became positive, as the decline in nominal interest rates was less rapid than the fall in inflation,.

The general government deficit for 1996 reached 1.5% of GDP, higher than in 1995. However, controls on local government borrowings were introduced in 1996 and some taxes were raised.

Restructuring of the economy progressed further in 1996. Privatization advanced rapidly, and by the end of 1996 practically all large enterprises had been sold, with the exception of those in the transport, telecommunication and energy sectors. The consolidation of the financial sector continued through an uninterrupted process of mergers. Estonian banks are now among the largest and strongest banks in the Baltic states.

Given that inflation in Estonia remained higher than in most of its trading partners, the real exchange rate of the kroon appreciated by 8.8 % in 1996. This was one of the causes of a sharp deterioration in the trade deficit, from 8.1 million kroons in 1995 to 13,6 million in 1996 (on a customs basis), equivalent to more than 24% of GDP. Despite growing surpluses in services and net income, as well as a positive balance on transfers, the current account deficit increased in 1996 to 5.3 million kroons, just less than 10% of GDP. The financing of this deficit was less satisfactory in 1996 than in 1995: foreign direct investment decreased, and inflows of portfolio investment and foreign bond issues by banks went up. Also, Estonian foreign direct investment abroad increased sharply in 1996, in particular to the other Baltic countries and to Russia. Nevertheless, the overall balance of payments remained in surplus.

3. Implementation of macro-financial assistance

Official foreign debt remained small and stood at US$ 296 million on 1 January 1997. Gross international reserves continued to increase, reaching US$ 640 million at the end of 1996. Net international reserves also increased. In July 1996, the IMF approved a new 13-month stand-by arrangement for Estonia, of an amount equivalent to SDR 13.95 million.

Estonia has made no purchases under either the previous or the current stand-by arrangement. In 1996, as in 1995, Estonia did not request a drawing on the second tranche of the Community's macro-financial assistance. On the contrary, the Estonian authorities asked to repay early the first tranche, of ECU 20 million, which was disbursed in March 1993.

VI. LATVIA

1. Introduction

Although Latvia only gained independence in August 1991, it had already initiated some reforms under Soviet rule. In 1992, while the country was actively engaged in transformation to a market economy, economic prospects worsened. The dismantling of former trade relations, and the increases in prices of Russian energy exports resulted in a major trade shock. Deficits in the external accounts were considered to be unsustainable without international support. Latvia defined a stabilization and reform programme covering the period mid-1992 to mid-1993 and concluded a stand-by arrangement with the IMF. The Community and other G-24 donors were also called on to contribute to filling the remaining balance-of-payments gap for the programme period, estimated at US$ 210 million. On the basis of favourable prospects of G-24 support, the IMF board approved a stand-by arrangement in late 1992.

The first three years of independence were marked by a decline in output. In 1994 GDP started to grow again, but the incipient recovery was quickly brought to a halt by a banking crisis in 1995. Private and public sector deposits were frozen and interest rates rose. Together these led to a decline in consumption and investment, as well as a reduction in production; GDP contracted by 0.8%. There was also a budget crisis: the deficit was double the original target, as tax collection problems were compounded by the banking crisis. In 1996, the economy started to recover, with economic growth picking up and foreign reserves and banking assets up to pre-crisis levels.

2. Recent economic developments

GDP growth in 1996 reached 2.8%. The increase in activity was largely due to growth in transport and communications. However, the development of other macroeconomic indicators in 1996 was not so encouraging: industrial production growth was relatively modest at 1%; retail sales fell; real wages were flat; and bank lending was weak. Despite the resumption of growth, employment continued to decline, pushing the unemployment rate up to 7.2% in December 1996, compared with 6.6% at the end of 1995.

Public finances were successfully brought under control in 1996, with the fiscal deficit lower than expected. In addition, inflation came down steadily throughout 1996. Year-end inflation was down to 13% from 23% in 1995. As inflation slowed, so interest rates continued to come down.

On the external side, preliminary figures for 1996 show that the trade deficit continued to rise as export growth was outstripped by import growth. This led to a very high trade deficit, estimated at 16% of GDP. The surplus on services partly offset this, but the current account deficit rose to 6.8% of GDP.

The authorities continued to pursue a stable exchange rate policy, with an informal peg to the SDR. The exchange rate of the lat against the dollar at the end of 1996 remained at approximately the same level as at the end of 1995. Since there was two-digit inflation, this represented a real appreciation of the currency, but overall the economy remained competitive.

During 1996, the privatization process received a boost from the new government: responsibility for the work was centralized in the Latvian Privatization Agency and nearly all the assets were transferred to it. As a result, the privatization process became more transparent and quick, as well as more accessible to foreign investors.

The banking sector appeared to have recovered from the crisis of 1995: assets were back to pre-crisis levels and enterprise deposits were rising again. However, the banking sector continued to suffer from a low level of activity: bank lending was limited by the lack of liquid collateral, by insufficient skills in assessing business risk and by a scarcity of long-term savings available for on-lending.

3. Implementation of macro-financial assistance

In November 1992, the Council[14] approved macro-financial assistance of up to ECU 80 million for Latvia, corresponding to about 50% of the balance-of-payments gap. The bulk of the bilateral support from the G-24 came from Japan and EFTA countries. The loan agreement and memorandum of understanding between the Community and Latvia was signed in early 1993, and the Commission disbursed the first tranche (50% of the loan amount) in March 1993. The first tranche was used mainly to on-lend to state and private enterprises in order to help them finance imports in priority areas. The release of the second tranche was to be made following a positive evaluation of performance criteria, regarding both macroeconomic stabilization and progress of structural reform, as set out in the memorandum of understanding.

The Commission, after consulting Member States, exceptionally agreed in a supplemental memorandum of understanding, signed in 1994, to allow the proceeds of the second tranche of assistance to be channelled to profitable projects, through the banking sector. However, in 1994 and early 1995, the country's external accounts were in surplus owing to substantial private capital inflows, and the Latvian authorities did not request the release of the second tranche.

In June 1995, after the financial and budgetary crises, the Latvian authorities requested the release of the second tranche of the Community loan (ECU 40 million), in order to channel the funds to refund small depositors who had lost their savings during the banking crisis. The Commission considered that such a use of the funds would be inconsistent first with the general aim of EC macro-financial assistance, and second with the undertakings of the supplemental memorandum of understanding relating to the second tranche. In addition, the conditionality criteria of the loan required that the IMF programme show a satisfactory track record, which was not the case: the normal autumn review of the stand-by programme could not be completed. The Commission therefore declined the authorities' request, and the second tranche was not released.

In May 1996, the IMF approved a 15-month stand-by arrangement for an amount of SDR 30 million, and the associated IMF programme remains on track. In late 1995 and early 1996 the Commission services asked the Latvian authorities to provide further details of the use of the first tranche of the loan. This request was prompted by the high degree of government involvement in the process of allocating the first tranche, and the granting of government guarantees on the majority of the loan amount. The Commission subsequently requested that the Latvian authorities suspend reuse of repayments on sub-loans, make

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[14] Council Decision 92/542/EEC (O.J. L351 of 2 December 1992).

provisions for losses on re-lending, and improve assessment and monitoring of risks related to on-lending.

VII. LITHUANIA

1. Introduction

Having recovered sovereignty in 1991, Lithuania faced the formidable task of establishing a market economy while setting up the institutional machinery of an independent state. Moreover, the problems of transition were compounded by the break-up of close input and output relations with the Soviet Union and by the increase of prices of energy imports from Russia to world levels. As a consequence of these shocks, hyper-inflationary conditions developed in 1992 and Lithuania suffered the most severe output contraction in Central and Eastern Europe. The economic downturn, however, was brought to an end in 1994 when the introduction of a currency board regime established the conditions for a return to macroeconomic stability.

Since mid-1992, Lithuania's reforms have been supported by the IMF through two successive stand-by arrangements and a three-year Extended Fund Facility expiring in October 1997. Within the context of the first stand-by, the European Council[15] made available complementary macro-financial assistance of up to ECU 100 million.

2. Recent Economic Developments

During 1996, the Lithuanian economy continued to grow in spite of the banking crisis which developed at the end of 1995, when two banks, representing more than 20% of the value of total deposits, were declared insolvent. This immediately led to capital outflows, which, together with the freezing of deposits in the insolvent banks, caused a sizeable monetary contraction and depressed domestic demand. In the second half of the year, however, confidence returned and growth picked up again, led by agriculture and exports; industrial production remained substantially flat. As a result, during 1996, GDP grew by 3.6%, marking a further acceleration of the economic recovery which had begun in 1994 and gained momentum in 1995.

Further significant progress towards price stabilization was achieved in 1996. After peaking at a hyper-inflationary level in 1992, December-on-December inflation fell sharply to roughly 36% by the end of 1995. This trend continued during 1996 when the year-on-year rate decreased further to 13%. The worsening trend in the unemployment situation was reversed in 1996 as the rate of unemployment fell by roughly one percentage point to 6.2%.

The evolution of the trade balance is hard to assess because of important changes in statistical methods, which make comparisons with observations from before 1995 impossible. Nevertheless, according to the available figures, during 1996, the deficits on the trade and current account deteriorated slightly in terms of US$ but improved in terms of percentage points of GDP. Export growth exceeded import growth, and there were no signs of any significant loss in international competitiveness. After falling at the beginning of the year, official reserves recovered to a level above two months' imports.

In 1996 the budget stance was prudent again and the fiscal deficit equalled 2.5% of GDP. As in previous years, however, a revenue shortfall (of some 0.7% of GDP) forced the

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[15] Council Decision 92/542/EEC taken on 23 November, 1992.

authorities to implement emergency expenditure cuts (affecting mainly public investment and agricultural subsidies). The decrease in tax receipts in 1996 was partly due to specific factors, such as the collateral effects of the banking crisis, but it also continued a trend: fiscal revenues have been declining continuously since independence, forcing public expenditures down to levels which are hardly compatible with long-term development.

During 1996, the banking sector started to recover from the crisis of end-1995: most banks recorded good results and managed to improve the quality of their loan portfolio. After some initial indecision, the government began actively pursuing its three-pronged policy based upon a strengthening of the regulatory framework, a rapid clean-up of the troubled banks' balance sheets and eventual privatization. Exposure rules were tightened. International accounting standards and capital adequacy rules were introduced. A loan recovery unit for the cleaning up of non-performing loans was set up, and a draft law for the compensation of deposit-holders in failed banks was submitted to Parliament.

Structural reforms in other areas such as the energy sector, agriculture, the pension system and enterprise ownership also advanced during 1996. The pace of reform, however, remained somewhat disappointing, partly because of the considerable political uncertainty which followed the resignation of Prime Minister Slezevicius in February 1996 and preceded the October general elections. Following the electoral victory of the centre-right coalition, implementation of structural reforms accelerated.

3. Implementation of macro-financial assistance

The first tranche of Community assistance (ECU 50 million) was disbursed in July 1993. The first ECU 25 million instalment of the second tranche (ECU 50 million) was disbursed in August 1995, on the basis of a Supplemental Memorandum of Understanding. As in the case of Latvia and Estonia, the Memorandum earmarked the proceeds of the second tranche for sound bankable projects, on condition that the funds would be channelled through banks complying with prudential regulations and would follow a well-defined procedure for consulting the Commission. However, because of shortcomings in the implementation of this consultation process, the Commission requested a freeze in the use of proceeds of Community assistance in September 1995. During 1996, significant improvements in the consultation process were achieved. In April, the Lithuanian authorities sent an annual report on the status of the macro-financial operation. Moreover, they properly consulted the Commission when requesting the use of the frozen proceeds. In view of this satisfactory progress, the Commission was able to unblock ECU 0.6 million for one financing proposal presented by the Lithuanian authorities which was compatible with the provisions of the Supplemental Memorandum of Understanding.

VIII. MOLDOVA

1. Introduction

By the end of 1996, Moldova had made substantial progress in macroeconomic stabilization. The authorities embarked on a comprehensive programme of financial stabilization at the beginning of 1993. A coherent and consistent set of policy measures allowed a marked reduction of the budget deficit and inflation. Interest rates declined to moderate levels, and the exchange rate remained stable. However, only limited success was achieved in enforcing hard budget constraints on enterprises and in developing a private agricultural sector. Output recovery did not materialize. Major progress was made towards creating a market economy, despite a severe deterioration of the terms of trade, the loss of traditional markets, and the disruption of trade and financial relations in the aftermath of the dissolution of the Soviet Union.

Macro-financial assistance provided by the international community has helped to enhance the efforts of the Moldovan authorities. After two stand-by arrangements in 1993 and 1995, the IMF Board in May 1996 approved a three-year credit under the extended fund facility in support of an economic and réform programme covering the period 1996-98. Those interventions were complemented by assistance from other multilateral and bilateral donors, including two loans from the European Union.

2. Macroeconomic performance

In 1996 GDP is estimated to have declined by 8%, thus continuing the negative trend which has characterized the Moldovan economy since 1991. Agricultural production declined by 13%. A precise estimate of the decline in industrial production is not yet available, but a sharp fall in the second half of the year more than offset some positive growth in the first months of 1996. These indicators, however, are likely to underestimate the amount of economic activity in the country, since the growing amount of private activity is not fully captured in the official statistics.

Macroeconomic policy presented in 1996 some contradictory aspects: while monetary policy remained rather restrictive, Moldova experienced acute fiscal problems. At the end of 1996, the budget deficit amounted to 7.2% of GDP (10% of GDP if calculated according to the methodology used by the Moldovan authorities). The deficit resulted from an increase in expenditure combined with a substantial decline in revenue with respect to the previous year. The deficit was financed through a combination of internal financing and foreign loans. Increasing reliance on external financing contributed to a steady increase of the external debt, which increased from $16 million at the end of 1992 to more than $818 million at the end of 1996. More than one third of the debt is short-term, i.e., with maturities below 5 years.

After a period of stability, inflation accelerated somewhat in the last quarter of 1996, reflecting the relaxation of economic policy. On average, consumer prices increased by 23.5% during 1996.

The nominal exchange rate of the leu depreciated very slowly after its introduction in November 1993. As the depreciation remained well below the inflation rate, the leu appreciated steadily in real terms. This real appreciation was one of the main causes of the sharp deterioration of the trade balance. The trade deficit for 1996 is estimated at about $180 million. It resulted from a sharp increase in imports of goods and services and a decline of exports. The current account deficit for 1996 is estimated at $245 million. Trade data suggest that there has been a noticeable increase in imports of capital goods, which will add to productive capacity. However, the deterioration also stems from a marked increase in imports of consumer goods. This probably reflects the inability of most domestic firms, which in many cases have not undergone any substantial restructuring, to compete with imported goods.

3. Structural reform

Significant progress has been made with structural and institutional reforms in the past few years. However, the process is far from completed. In particular, the process of privatization seemed to lose much of its momentum after the end of mass privatization at the end of October 1996. The privatization by tender of a selected number of enterprises for cash was delayed several times. Furthermore, the significant transfer of property rights to private agents did not prompt significant changes in the behaviour of enterprises. Governance was still inadequate, insiders dominated firms, and the budget constraint was not hardened enough. There was little evidence of enterprise restructuring, as testified by, among other things, the low level of redundancies. There was no attempt by the authorities to isolate 'bad' firms from viable ones, or to develop a strategy for dealing with the worst loss-makers.

Officially registered unemployment remained very low, with an unemployment rate of 1.8% at the end of 1996. However, there was widespread hidden unemployment - in the form of part-time work or unpaid leave - which, if properly accounted for, would bring the unemployment rate at the end of 1996 to approximately 15%. The effects of the transformation on living standards is not clear. On the one hand, income is increasingly generated from private trading or foreign exchange activities - forms which are unlikely to be captured accurately by official statistics - and less from wages, salaries and pensions. On the other hand, macro indicators - such as a significant fall in life expectancy - or sample surveys suggest an overall deterioration, which is especially severe for vulnerable sections of the population like pensioners or families with dependent children.

4. Implementation of macro-financial assistance

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 [16] to assist the country in its efforts to transform its economy into a market economy and to strengthen the reserve position of the central bank. The Community loan was part of an overall package mobilized by the international donor community for 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, of ECU 20 million, took place in August 1995.

The international donor community recognized that to ensure a sound balance of payments situation in the 1995-1996 period, further macro-financial assistance for Moldova was necessary to complement the resources provided by the IMF and the World Bank. In November 1995 the Commission formally adopted a proposal for further macro-financial assistance to Moldova of up to ECU 15 million.

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[16] Council Decision 94/346/EC.

On 25 March 1996, the Council decided to adopt the Commission proposal.[17] Following this decision and the approval by the IMF Board, in May 1996, of a new 3-year economic reform programme, and after positive verification by the Commission services of the fulfilment of the conditions attached to this assistance, the disbursement of the ECU 15 million took place in December 1996.

[17] Council Decision 96/242/EC.

IX. ROMANIA

1. Introduction

Despite positive growth in 1996, and progress on privatization, the new authorities elected in November 1996 inherited a fragile economic situation, the result of insufficient progress towards structural adjustment since 1989. In fact, between 1989 and 1996, successive governments repeatedly launched new reform programmes, only to abandon them a few months afterwards in the face of mounting political resistance. Public support for reform has fluctuated accordingly: it was substantial at the beginning of the transformation, then substantially diminished in the face of mounting costs brought by the transition, only to strengthen again when it became apparent that the path of partial reform followed between 1989 and 1996 was leading to an impasse.

Although growth resumed in 1994, the relatively satisfactory macroeconomic performance registered up to 1996 masked insufficient progress in structural reform, including restructuring of enterprises and of the agricultural sector. In the run-up to the November 1996 presidential and legislative elections, the authorities loosened macroeconomic policy and reintroduced numerous administrative controls (in particular on the exchange market and on foreign trade). The inherent contradictions of the economic policies of the 1989-96 period were only fully addressed after the elections of November 1996, when the new government devised a radical programme of macroeconomic stabilization and structural reform, and began to implement it.

In 1996, major policy slippages by the previous government led to a sharp deterioration in Romania's relations with the IMF, the World Bank and private investors. The previous IMF stand-by arrangement of $ 460 million went off track and then had to be cancelled. The World Bank made the first $80 million payment under its $280 million Financial and Enterprise Structural Adjustment Loan and then froze further disbursements. The Community also could not disburse the second tranche, of a maximum amount of ECU 70 million, of the macro-financial assistance loan decided in 1994. After the November elections, the IFIs took an active role in advising the new government on its economic and social policies.

2. Macroeconomic performance

Despite declining unemployment, the macroeconomic performance in 1996 was less satisfactory than in the previous two years: growth slowed down to 4.1%, inflation accelerated to 56.9% at the end of December and the budget deficit of the general government soared to 3.9% of GDP. In fact, economic activity continued to expand at the cost of increasing macro- and micro-economic disequilibria.

In 1996, industrial output rose by 9.9%. The situation of the agricultural sector was far less satisfactory, with estimates indicating a significant drop in the harvest (by as much as a quarter in tonnage), largely caused by adverse weather conditions. Exports also declined in the course of the year, and GDP growth slowed to 4.1%, a drop of three percentage points over 1995. Growth achieved in 1996 was sufficient to push down the rate of unemployment, from 8.9% in December 1995 to 6.1% a year later. However, since industry was still shedding workers, growth in employment was recorded mostly in the other sectors of the economy (services, construction, and also agriculture).

To a large extent, however, economic growth in 1996 was based on very unstable foundations. Many large state-owned industrial companies and state farms were not subject to a "hard budget constraint" (i.e. they did not face a real risk of bankruptcy even when they consistently made losses), because they were able to obtain cheap credits from state-owned commercial banks, which in turn refinanced themselves easily at the National Bank. In fact, refinancing from the National Bank more than doubled during 1996. This process artificially stimulated activity while maintaining widespread inefficiencies within the economy.

In the run-up to the elections, the previous government embarked on a spending spree (credit to the government almost doubled in nominal terms between August and November). As a result, the budget deficit soared dramatically. The general government deficit rose from 2.6 to 3.9% of GDP, and to 8.3% of GDP for the quasi-fiscal deficit, which includes a number of hidden expenditure items and quasi-fiscal subsidies from the National Bank of Romania. The year 1996 saw a significant increase in inflation, which jumped from an annual rate of 27.8% in 1995 to almost 57%. Inflation was particularly high in November (monthly rate of +5.8%) and December (+10.3%).

External trade significantly worsened in 1996. Not only did exports and imports fall, in dollar terms, but the trade deficit for 1996 is estimated to have risen to $2.1 billion from $1.6 bn in 1995. Exports continued to suffer from the decline of some of the main export markets, as well as the poor competitiveness of domestic products. The current account deficit reached $2.3 billion (approximately 6.6% of GDP). Foreign direct investment increased slightly to $555 million according to EBRD estimates, a relatively low level for a country of Romania's size. In per capita terms, only Bulgaria has attracted less foreign direct investment among the 10 associated countries of eastern Europe.

In 1996, the gross foreign reserves of the banking system grew significantly, which was largely the result of Romania's return to the international capital markets, where it raised $1.4 billion through syndicated loans and bond issues. Its issues on the Japanese market (so-called "Samurai bonds") met with considerable interest. While this was a positive vote of confidence by international investors, it helped push Romania's medium- and long-term external debt to a higher level ($6.9 billion, almost a one-third increase over 1995). Given that investment remains weak, the growth of the foreign debt could become a problem in the future. The debt service obligations (including short-term debt service) increased to 20.2% of exports of goods and services, from 14.5% in 1995.

3. Structural reform

Progress on structural reform remained ambivalent. On the one hand, little action was taken in 1996 to restructure the large loss-making state-owned companies (e.g., the electricity company RENEL lost 600 billion lei in the first ten months of 1996, equivalent to $183 million at the October exchange rate). Nor was anything done to rectify shortcomings in the agricultural sector: a normal market for buying and selling land was not functioning. Inter-enterprises arrears continued to expand: for the energy sector alone, it is estimated that, at the end of 1996, the stock of arrears to suppliers and the state amounted to 3.3% of GDP.

In March 1996, the authorities introduced significant curbs on the foreign exchange markets, restricting the number of official dealers to four Romanian banks, three of them state-owned. This led to an overvaluation of the national currency, which encouraged cheap energy imports for the large and inefficient, energy-intensive, state-owned enterprises. The overvaluation of the leu also discouraged exports. The gap between the official rate and the rate of the private exchange bureaux rose to approximately 45% in mid-November, a clear sign of widespread distortions.

The programme of "financial isolation" of a number of large state-owned "régies autonomes" failed to improve their financial situation and was subsequently abandoned in early 1997. Reform of the agricultural sector did not progress much either. On the contrary, support from explicit and implicit subsidies and transfers soared in 1996 from 4.3% to 5% of GDP. Subsidized credits from the National Bank of Romania to the agricultural sector were one of the main reasons why monetary policy was derailed. Moreover, the larger part of the financial support was captured by intermediaries and producers of agricultural inputs, at the expense of farmers themselves.

Nevertheless, a few positive developments can be identified: mass privatization continued unabated (1300 operations had been carried out as of 10 December 1996, bringing the cumulative figure since 1993 to 2766 companies), although it concerned essentially small companies; some export bans were abolished while many export quotas were expanded; a new secondary stock market (the RASDAQ) opened in October with 1342 companies already listed.

4. Implementation of macro-financial assistance

In its decision of 20 June 1994, the Council had decided to grant to Romania a medium-term balance-of-payments loan for a maximum amount of ECU 125 million, to be disbursed in two tranches[18]. The economic policy conditions for the release of this assistance were agreed by the Commission and the Romanian authorities in a Memorandum of Understanding signed in December 1994. A first tranche of ECU 55 million was disbursed in November 1995.

However, the release of the second tranche was not possible in 1996, because of persistent mal-functioning of the foreign exchange market and lack of progress on structural reforms. For the same reasons, the stand-by arrangement (SBA) with the International Monetary Fund (IMF) went off track and then had to be cancelled. The World Bank also froze disbursement of the second tranche of the Financial and Enterprise Structural Adjustment Loan (FESAL).

Following the elections of November 1996, the new Romanian government requested the reactivation of the Community's and the G-24's macro-financial assistance, in the context of an ambitious economic programme of macroeconomic stabilization and structural reforms supported by the International Financial Institutions.

[18] Council Decision 94/369/EC.

X UKRAINE

1. Introduction

The Ukrainian authorities achieved considerable financial stabilization in 1996, but the economy continued to contract, though at a slower pace. The implementation of a relatively tight monetary policy set by the Ukrainian central bank was a determining factor in drastically reducing inflation, stabilizing the exchange rate and ensuring the successful introduction of a new national currency.

Stabilization, however, became increasingly fragile, because of a slow-down in structural reform, especially with respect to privatization, the tax regime and the overhauling of the public administration. The 1997 budget and an accompanying programme of comprehensive tax and deregulation measures were stalled in Parliament from November 1996.

2. Macroeconomic performance

Ukraine's transition to a market economy, which essentially started in late 1994 after the election of President Kuchma, continued in 1996, though against an uncertain economic background.

The implementation of a tight monetary policy by the Ukrainian central bank paved the way for a dramatic reduction in inflation, the stabilization of the exchange rate and the smooth introduction of a new currency, the hryvnia, in September 1996. Inflation was reduced to 40% at end-1996 (December-on-December), down from 182% a year earlier. The fiscal balance was brought down to some -3.2% of GDP (1995: -5%), though in addition the accumulation of arrears in public wages, salaries and pensions amounted to some 3.5% of GDP.

Although production continued to decline during 1996, the rate of decline was lower than in previous years. Real GDP contracted by another 10% in 1996, but this does not take into account the increasing activity in the unofficial sector, which is estimated to equate more than 50% of official GDP. Agricultural production saw a further sharp reduction (by some 10%) in 1996, which can be only partly attributed to poor weather conditions. Agriculture's share in GDP is now only 13% in a country which was once the "bread basket of the Soviet Union". Industrial production continued to decline in 1996 (by some 5%), and machine-building especially suffered a sharp reduction.

The trade statistics for Ukraine are very unreliable, but it seems that external trade continued to grow rapidly in 1996. Trade with other former Soviet Union countries, Ukraine's major trade partners, began to recover. Exports of goods are reported to have grown by almost 14% in 1996 to $ 15.5 billion, a notable achievement against a background of continuing recession.

Because of significant increases in Russian gas prices, imports grew by 24% in 1996 to $ 19.8 billion. Because the higher energy import prices entailed higher transit fees for the transport of gas through the Ukrainian pipeline system to Central Europe, overall the current account deficit was not affected too seriously: it was $ 1.3 billion in 1996, equivalent to 3.9% of GDP.

Unemployment remained at artificially low levels. Official data indicate that unemployment was about 1-1.5% of the total labour force in 1996, but these figures do not take account of considerable hidden unemployment in Ukraine.

3. Structural reform

The main reason for the continuing economic decline in Ukraine lies in the lack of substantial industrial and enterprise restructuring. The need to restructure Ukraine's economy, which under Soviet control became disproportionately dependent on military production, was clear from the first days of independence. The government's efforts to launch serious restructuring programmes in both industry and agriculture have often faced the opposition of the sizeable conservative forces in Parliament.

Against this adverse backdrop, some progress in structural reform was achieved in 1996. In the area of land reform, the issuing and registration of land titles proceeded well. In the banking sector, the assets of the thirty largest banks were assessed and the management of two troubled banks was closely monitored by the central bank. Privatization, however, slowed down markedly. While the privatization of small-scale enterprises was nearly complete, only 3,500 out of the 8,000 targeted large state enterprises had been privatized by September 1996.

The authorities have identified some 400 large enterprises for privatization through international tender. The list of enterprises includes energy companies and other firms that performed well during Soviet times. Lack of progress in privatization and the uncertain credibility of the reform effort have limited the amount of foreign direct investment that Ukraine has been able to attract. Per capita foreign direct investment in Ukraine remained one of the lowest among all transition countries.

In an attempt to combat negative trends in the economy and to move reforms forward, the government submitted to the Ukrainian parliament in November 1996, together with the 1997 budget, a new programme of reforms. The programme, which included significant cuts in budget spending, a comprehensive tax reform and a further liberalization of the economy, was welcomed as the second stage of major liberal economic reforms in Ukraine, long awaited after the first serious reforms were launched at the end of 1994. However, it met strong opposition from the parliament.

4. Implementation of macro-financial assistance

In December 1994, the Council decided to provide a first macro-financial loan of ECU 85 million to support Ukraine's adjustment and reform process.[19] This long-term loan 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 economic reform, the Council decided in October 1995 to provide Ukraine with a second macro-financial loan of ECU 200

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[19] Council Decision 94/940/EC.

million that would complement financial assistance from the international financial institutions and bilateral donors.[20] The first tranche of ECU 100 million of this loan was released in the second half of 1996.

[20] Council Decision 95/442/EC.