

TAMÁS RÉTI

ECONOMICS OF TRANSITION IN THE BALKANS AND CENTRAL EUROPE

Professor **Tamás Réti** Ph.D. is a Hungarian research economist at the Institute of Economic and Market Research and Computing Ltd. (Kopint-Datorg Rt) and he teaches at the Budapest University of Economic Sciences. His field of interest is comparative political economy of Central and Eastern Europe. He has been doing research on the economic transition in the Balkan and also dealing with the economic relationship between the European Union and the associated member countries. The topics of his courses at the Budapest University of Economic Sciences are: Economic of Transition in Eastern Europe and Internationale Business: A Central European Approach. In 1997 he got a visiting professorship at the Bologna University in Forlì. He has publications in American, Czech, Hungarian, Romanian, Slovenian journals and periodicals.

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Introduction

In the last century Balkan economies could be characterised with several long-term tendencies. One can mention among these, existence of strong central governmental power, which has intended to eliminate economic backwardness with the help of industrialisation. Government insisted industrialisation programmes had been accompanied with spreading nationalist ideologies. New Balkan nation-states' governments have preferred to implement self-supporting economic policies which got inevitably in conflict with strong presence of foreign capital and its intention for expansion. Prior to Second World War, Balkan economies could also be featured with power-struggle between domestic capital supported by national governments and penetrating foreign capital. Foreign capital could establish strong influence due to the general weaknesses of their economic systems. However, it turned out that Balkan governments were unable to implement self-sufficiency which relied primarily on ideological reasons and not on economic considerations. On the other hand, foreign investors's interest for the Balkan economies had not been so strong which could initiate necessary modernization.

Furthermore, Balkan economies were mostly primary goods exporters, in their export structure raw materials and agricultural products gave dominant share. Primary products remained decisive in their export, and it had inhibited industrialisation. Economic development of the region prior to 1945 has proved that neither foreign capital inflow, nor domestic investments were capable to reduce economic backwardness. Foreign investments did not have a spillover effect, exports of primary products remained externally sensitive to cyclical changes in the western markets (Lampe J.R. and Jackson M. R, 1982).

Post 1945 Balkan economic model has meant discontinuity with regard to previous economic policies. Notwithstanding, still certain strong continuity existed with regard to growth of the governmental sector, its new functions as owner and asset-manager, and its endeavour to self sufficiency. After 1950 an extraordinary fast industrial growth occurred which was unprecedented in the economic history of Balkan states. This development model has exploited first internal savings for the purpose of forced industrialisation, after

it had been exhausted, it turned to external savings, and tried to pursue the same pattern of modernisation. Naturally, Yugoslav case of self management has provided many distinct features which were rather different from other Balkan' economies. However, the Yugoslav economic model has got to the same economic crisis by the end of the eighties.

1. NATURE OF THE BULGARIAN ECONOMIC CHANGES

In relation to the other central and south-european countries, Bulgaria has started its transition to market economy with more difficult economic legacy. Its economy had been extremely dependent on the Comecon-trade. The value of Comecon-trade in 1990-91 was equal still with 60% of its GDP. Therefore it is understandable that collapse of Comecon-trade has effected dramatically Bulgarian economy. Its dependence on the former Soviet market and supplies was specially high which has overpassed other countries reliance in the region. Bulgarian economic decline after 1990, could only be compared to the former Soviet republics' economic recession. Economic crisis has also been deepened by its inability to service foreign debt: in March 1990 it suspended disbursement of the external debt which was equivalent to 100% of its GDP. Collapse in the Comecon-trade and other shock-effects caused by the transition have led finally to 25% drop in the GDP between 1989-1992.

Economic transformation began in 1991, when new government attempted to introduce radical stabilization and liberalization package which was comparable to the Polish and Czechoslovak programs. However there have been several differences: international currency reserves stayed on very low level, due to its insolvency Bulgaria remained isolated from international money markets, and lastly and most importantly governing parties could not agree on the speed and orientation of the economic transformation. This disorientation within governmental circles had been just a reflection of the uncertainty and ambiguity of the Bulgarian society concerning systemic changes toward economic freedom and less governmental protection.

Stabilization program introduced in February 1991 was based on the policy recommendations of the IMF and World Bank. In the framework of these policy measures Bulgarian government introduced a new managed floating exchange rate, current account convertibility, and restrictive monetary policy. The key point of the stabilization policy was restriction in real money demand. However monetary authorities controlled only part of money supply, since illegal currency trade, whose role could not be eliminated, remained very important. This proved to be a major failure in the stabilization package. Another deficiency of the program occured in the field of wage regulation. Restrictive wage regulation had to perform central role in depressing high inflation. This aim, however, could not be implemented since system of indexation prevented to stop price-wage spiral. High level of inflationary expectations reflected lack of population confidence in anti-inflationary policy. Despite some price liberalization measures, strong administrative control has been maintained in the field of basic goods, services, and utilities. By 1996 very high proportion, about 45% of consumer prices continued to be under government regulation. Next failure of stabilization policy occured within the central budgetary policy. Little was done to reduce budgetary deficit and to make central budget more transparent. A great part of the deficit was produced in off-budgetary funds. All of this deficit has to be financed by the central bank. There were serious shortcomings concerning the central bank's independence. Government budget has usually provided financment to deficits of state-owned enterprises and state-owned commercial banks. Consolidated defi-

cit of government budget exceeded 10% of the GDP in 1993 and 1996. Due to the “soft-budget constraint” financial sector got into crisis. Bad banking loans originated from pre-transition time were increased by riskful lending during the transition. As a result of this lending policy, by the end of 1995 share of bad assets constituted 26% of all banking loans. The most damaging economic policy measures between 1991 and 1996 were those which provided unconditional rescue to loss-maker companies and banks. Governments have several time made attempts to control and remedy this situation but without long-term success. Between 1991-1993 governments forgave overdue loans to banks and firms. This policy has confirmed enterprise and banking sector expectations for easy survival. As a final result of this debt cancellation without preconditions, all state-owned firms suspended repayment of old bank credits (*OECD Economic Surveys*, Bulgaria, 1997).

From January 1995 new Socialist government continued and deepened controversial economic policy of its predecessor. New element of the government program was to strengthen state intervention into the economy. That meant first of all direct government control over state-owned commercial banks' lending policy. This monetary policy turned out costly, since old band loans were followed by new bad loans.

The first stage of Bulgarian transition could be described by general collapse which affected every field of the economy. Deficit-financement has achieved new heights. By 1996 the whole economy was already shaken by the general crisis situation. Economic crisis has exploded on three interrelated areas. First was rapid devaluation of the national currency, second manifested itself in the collapse of the banking sector, and third was a huge explosion in the general government deficit. Banking crisis has shaken total bank sector. Domestic and foreign depositors have lost their confidence in monetary organisations and economic policy of the Bulgarian Socialist Party. Lack of confidence has led to capital flight, withdrawal of leva deposits and a strong jump in the demand for western currencies. Dollarization of the economy has advanced very rapidly with the outcome of losing more government control over money supply. Due to very high interest payment after public debt budgetary deficit grew to 11% of the GDP by 1996. In the meantime primary account indicated a strong surplus, which had a recessionary effect.

Table 1. Major macroeconomic indicators of the Bulgarian economy in percentage

	1992	1993	1994	1995	1996	1997/I	1997 ^a
GDP	-7.3	-1.5	1.8	2.5	-10.9	-9.8	-10.0
Industrial output	-15.9	-10.9	8.5	5.4	-1.1	-15.0	-15.0
Consumer-prices	82.0	72.8	96.0	62.9	123.0	1132 ^b	620
Rate of unempl.	15.2	16.4	12.8	11.1	12.5	14.2 ^c	15.0

Remarks: a: forecast; b: August 1997/August 1996; c: June 1997/June 1996.

Source: Economic Trends in Eastern Europe. 1997/3. Kopint-Datorg Rt., Budapest Hungary.

Monetary and currency crisis has initiated political turn in the Presidential position and has led in Spring 1997 to a parliamentary victory of the opposition. Economic legacy of the ruling Socialist Party turned out to be catastrophic. Economic decline in 1996 was comparable only to the output collapse in other transitional countries at the start of the

transformation. Continuous devaluation of leva and sweeping inflation had devastation effects on the domestic demand. Monetary crisis has further weakened the country's foreign debt repayment capacity, since it was accompanied with growing capital flight (Bobrinsky R., 1997).

Prior to the Spring parliamentary election a caretaker government tried with success to conclude a stand-by agreement with the IMF. As a result of its convincing commitment to market reforms, they have agreed in \$ 657 mn loan with several conditions. The most important precondition of the agreement has been an establishment of a currency board, which aimed to liquidate lack of confidence against national currency and banking system. Currency board has linked money supply on a fixed exchange rate to the volume of currency reserves.

Consumer prices have increased by 311% comparing December 1996 to previous year end. At the outset of 1997 inflation has become hyperinflation, but already during the ruling of the caretaker government it slackened. Economic recession and price explosion have together created fast devaluation of leva. In the first quarter of 1997 one dollar still equalled with 79 leva which reached its peakpoint in February 1997 with 3.200 leva/dollar, thereafter it started to decrease, and by mid June 1997 it fell to 1.720 leva/dollar. It appears that breaking the inflation has happened well before the introduction of the currency board which effectually came to existence on 1 July 1997.

There were several reasons for this positive development. First of all, caretaker government managed to regain some of the lost social confidence since it was determined to prepare a free parliamentary election where decisive changes could be foreseen. Bulgarian economy hit the bottom by early 1997, and general assumption was that with the assistance of international monetary organisations a strict monetary and fiscal policy together with changes in the privatization is manageable. Central bank announced already in January that it would not continue direct borrowing to central budget and granting credits to commercial banks. That meant an end of automatic financing to the budget and off-budgetary funds. Besides these, first tranche of the stand-by credit became available in this year April, sale of big enterprises with the participation of foreign investors has started, and due to high interest rates foreign capital inflow began. New and strict regulation on banking bankruptcy and liquidation has caused more cautious risk assessment in lending. As a next stage of the stabilization, currency board has been introduced with 1.000 leva/1 DM fixed exchange rate. Introduction of currency board indicated that growth in money supply has been dependent on the level of currency reserves. Simultaneously central bank has guaranteed to provide internal convertibility of leva. Growing prestige of the German mark caused also that central bank has shifted composition of its currency reserves, within it decreased proportion of American dollar.

Changes in the Bulgarian political system and initiation of coherent market reforms have greatly extended trust of population in regarding positive development. Social panic came to an end which generated crisis in a great extent. First real signs of the turn have been shrinkage in exchange rate and slowing down in consumer price increase. Economic stabilization has relied first of all on a different relation with international monetary institutions and western money markets.

There have been important changes concerning external economic relations. The Bulgarian Parliament after having ratified the Association Agreement with the European Union, in December 1996 unanimously voted to apply for the full membership. The position of the Socialist-led government was clear, Bulgaria intended to become a full

member of the west-european integration. In the question of the NATO-membership, Bulgarian government's standpoint were more ambiguous, since as an alternative it supported the Russian view to establish an all-European security system.

Drastic reorientation of commercial relations happened after 1990: in the Bulgarian exports the share of the OECD countries jumped from 9.0 to 51.2%, while in its imports it rose from 14.9 to 46.9% between 1990 and 1995. At the same time share of exports and imports with the former CMEA-countries dropped from 80.2 to 33.1% and from 75.9 to 42.6%. The most important exports market in the first three quarters of 1996 were Russia (10.6%), Italy (10.5%), Germany (9.4%), Turkey (7.4%). Share of the European Union in the exports constituted 40%. In the Bulgarian imports the major suppliers were: Russia (29.7%), Germany (12.6%), Italy (7%). The share of the European Union emerged to 37%. It is transparent from the Bulgarian trade statistics that a dual tendency is prevailing. Foreign trade relations have quickly reoriented from the East to the West, and Russian market still has kept its leading position especially in the imports. In the Bulgarian exports Russian, Italian and German markets are equally important. Comparing to other east European economies, Bulgaria is still linked to a great extent to Russia.

In the structure of the exports significant changes were occurring between 1990 and 1995: share of ferrous metallurgy, chemical industry and wood industry many times rose, also there was an increase in the share of textile, clothing, food industry and grain. Conversely, machine-building, metal-processing and electronics have dropped dramatically. Radical shifts in the composition of exports are simply reflecting decline in the overdeveloped and artificially protected industries. However, it also indicates the weakening of the share of the processed goods in the exports. Reorientation of trade has brought about the increase of primary products and semi-products in the exports (*OECD Economic Survey*, 1997).

Activity of the foreign investors until the end of 1996 has been rather limited. The size of foreign investments amounted to \$700 mn, which represented only 3% of the foreign direct investment in central and eastern Europe. The major constraint of the bigger capital inflow was the long lasting political and economic instability. Foreign investors also confronted with the ambiguous privatization policy. It seems that there is an important turn starting from 1997 when the new government's economic policy under the guidance of the IMF is strengthening the country's western orientation and provides a more transparent privatization policy with an active participation of foreign investors.

2. ACHIEVEMENTS IN CROATIAN ECONOMIC STABILIZATION.

In the last two years Croatian economy has achieved considerable results in economic stabilization policy. Stabilization policy started in October 1993 has had first of all anti-inflationary effects. In order to achieve this, in May 1994 new national currency (kuna) was introduced, which central bank has linked to German mark. A stand-by agreement concluded with IMF has also supported stabilization. As a consequence strict restrictive monetary policy managed to brake high inflation, and depressed it to 3-4% in annual average. However, low inflation has been maintained on very high nominal price level. Outcome of Polish-type stabilization has been an establishment of price stability.

However restrictive policy has caused delay in the beginning of economic recovery. Croatian economy after long lasting decline, started to stagnate in 1994-1995, and first year of recovery was 1996. Economic growth has appeared primarily in service industries, in tourism and construction, meanwhile manufacturing has still performed wea-

kly. Growth has not been based on investments but rather on consumer demands. Extraordinary high real interest rates inhibited financment of investments from domestic savings. Start of economic growth happens with preservation of achievements in stabilization, low inflation and stabil exchange rate (*Planecon*, April 1997):

Table 2. Major macroeconomic indicators of the Croatian economy in percentage

	1992	1993	1994	1995	1996	1997/I.	1997 ^a
GDP	-9.7	-3.7	-0.8	-1.5	4.2	N.A.	5.0
Gross Investment	-51.9	-31.1	16.1	-21.7	-18.2	N.A.	
CPI annual average	578.0	1517.5	97.6	2.0	3.6	3.8	3.8
Real wages	-43.5	-0.5	14.4	40.2	5.7	N.A.	
Rate of unemployment	17.8	16.9	17.3	17.5	16.0 ^b	16.5 ^c	16.8
Budgetary deficit in % of GDP	-0.3	0.1	1.5	-1.0	-1.0	N.A.	-2.6

Remarks: a: forecast; b: Calculated with new methodology (Farmers and soldiers are included into active labor force); c: June 1997.

Source: Economic Trends in Eastern Europe, 1997/3. Kopint-Datorg Rt. Budapest, Hungary.

Croatian economy got into new era with the end of war having occurred on the territory of former Yugoslavia, with reoccupation of lost territories to Serb minority, and beginning of reintegration in Eastern-Slavonia. Return to peace-time production and enormous needs for reconstruction has put Croatian economy into very difficult situation. Consolidation in internal political affairs has provided better conditions to implement these tasks. However there has been no positive turn in its western political relations, therefore reintegration to international institutions has been blocked due to discriminatory policy against Serbian minority, lack of willingness to cooperate with the Court of Justice in Hague, and also with exercising governmental control in western Hercegovina. Tudjman-leadership has been implementing controversial policies: it supports moderate reformers in the government to carry out some necessary economic changes, meanwhile it enforces its influence in contrary to Dayton Agreement in Bosnia-Hercegovina. Growing tensions in its western relations have negative effects on economic reconstruction as can be seen from the following developments: in the first half of 1997 World Bank has cancelled a loan of \$ 30mn for banking reconstruction; IMF has postponed disbursement of the next tranche of stand-by loan; and United States and European Union have intervened to suspend negotiation to membership in WTO. Croatian economy's isolation from international organisations has been in contradiction with its government's intention to accelerate modernization with assistance of foreign capital («Croatia», *EIU*, 1997/2-3, London).

Despite to these tensions in foreign economic relations perspectives of growth look fairly favourable. In 1997 increase of GDP will exceed previous years' 4,2%, and it will probably stay high on medium term. During the last two years since the end of war, foundations for economic growth have been established by needs for economic reconstruction, and economic liberalization. There are serious reserves of further growth in underutilized industrial capacities, in the needs to reintegrate formerly lost territories, and also in pent-up population demands. Economic recovery can rely on strong consumer

demand, rising real wages, expanding budgetary spendings, and flourishing tourism (National Bank of Croatia, *Bulletin*, July, 1997).

Major reasons for concern may come from overheatedness of the economy. Symptoms for overheatedness can be found in high current account deficit. Causes of high external deficit are the following: overvalued national currency, real wages are rising faster than labor productivity, and governmental spendings are also expanding quickly. Altogether aggregate domestic demand is developing too fastly which is understandable due to the last years' huge shrinkage in consumption and investment. However there is no similar increase in exports, and revenues from tourism are not enough to compensate for the deficit in the trade balance. For this reason devaluation of the kuna has become timely. Although Croatian government has opposed, as it would jeopardize outcomes of stabilization policy. Since external deficit can be financed from foreign capital inflow which has begun recently to develop, and size of portfolio investments is low, therefore kuna's exchange rate is not under attack. Government's argument is temporarily justified, however it is largely dependent on the progress in privatization. Nevertheless, if inflationary expectations are on the rise, kuna's exchange rate should be changed.

As a result of the Yugoslav war and the disintegration, Croatian foreign trade activity has significantly declined. Due to the loss of the former Yugoslav markets and the transformation recession in the east-central European region, Croatian foreign trade has been forced to make a drastic reorientation. Between 1992-1996 the share of the European Union in the total Croatian exports rose from 42.8% to 51.0%, while in its imports it produced an even higher expansion from 41,8% to 59,4%. The two most important trading partners are Italy and Germany, Slovenia has been standing on the third place. Recently, it is visible that Croatian exports refinds a part of the lost former Yugoslav markets. Foreign trade balance is showing a growing deficit in the last years. The rising deficit is due to the appreciation of the Kuna's exchange rate, weak import demand in Germany and Italy, and the lack of restructuring at the enterprise level. Although Croatia has a high trade with the European Union, but so far it could not establish an Association Agreement.

Amount of foreign investments remained rather low in the last few years. By the end of 1996 altogether \$ 1.2 bn was invested by American, German, French and Italian companies. Croatian reconstruction so far did not bring about a major inflow of foreign capital. Privatization policy so long gave an absolute priority to the domestic investors. The Croatian government has no foreign investor friendly policy, since there has been always a fear of the external influence. Croatia as a young nation-state prefers to have control over its national wealth, even if it has a high price concerning the slow speed of modernization. However, in the recent years there have been certain developments which are slightly indicating a more transparent foreign investment policy. Government has made the initial steps to sell partly public utilities to foreign investors.

3. SYMPTOMS AND CAUSES OF ECONOMIC INSTABILITY IN YUGOSLAVIA.

International Monetary Fund has repeatedly postponed reestablishment of Yugoslavia's membership which was suspended in 1992, simultaneously with the introduction of UN embargo. Meanwhile economic sanctions were suspended at the end of 1995, so called "outer wall" of embargo was maintained which prevented normalization of international financial relations, to have access to western loans, and commencement of foreign investments. It meant an ice-breaking in this chilly environment that the European Union has in Spring 1997 restored its commercial agreement.

Table 3. Major macroeconomic indicators of the Yugoslav economy in percentage

	1992	1993	1994	1995	1996	1997/I.	1997 ^a
GDP ^b	-27	-27.7	6.5	6.6	5.8		4.0
Industry 1990=100	64.4	40.1	40.6	42.0	44.7		49.0
Gross investment	-30	-37	-12	-1.9	3.0		
Rate of investment in GDP	16.6		14.7	10	10		
Rate of unemployment	22.8	23.1	23.2	24.8	28	26.8 ^c	28.0
Real interest rate on loans				30	25		
Retail prices annual average	9237	116x10 ¹⁴	7.1x10 ¹¹	74.1	93.1	14.6 ^d	25.0
Real wage	-48,7	-61	329	-25	2,7	25 ^e	

Remarks: a: forecast; b: until 1995 gross social product which included national income and amortization, from 1996 gross domestic product; c: April 1997; d: July 1997/July 1996; e: June 1997/June 1996.

Source: Economic Trends in Eastern Europe 1997/3. Kopint-Datorg Rt. Budapest, Hungary.

Orientation of the economic development has been greatly determined by the ruling party's policy. Political considerations have often distorted budgetary situation and monetary equilibrium. This happened in the last quarter of 1996, when government reacted to mass demonstrations with disbursement of deferred salaries and pensions. Sudden increase in the money supply has destabilized national currency, and as a result black market exchange rate has arisen. Central bank had to repeatedly take a stand in favor of monetary strictness, and announced that growth in money supply has to come together with an increase in international reserves («Yugoslavia», *EIU*, 1997/1).

Perspectives of the Yugoslav economy, despite the start of recovery, look very doubtful. Former collapse in the total output had not been a consequence of the transition to market economy, but it was caused by the disastrous costs of war in Croatia and Bosnia, by the economic embargo, and finally but not lastly by half-hearted, controversial and slow market reforms. The Milosevic-leadership's relation to the free-market system and multiparty-democracy can be considered as very ambiguous to say the least. For them transition is not an aim to transform the economic system, but it is just a framework to preserve their power.

Although economic recovery seems slow in relation to huge needs for reconstruction, nevertheless its beginning and maintenance can be considered an important achievement. Since January 1994 government managed to eliminate hyperinflation, to bring down its level to two-digits, and simultaneously stabilize currency and keep its exchange-rate fairly stable. Exchange-rate stability is effected by restrictiveness of the monetary policy, deferred budgetary spendings and depressed purchasing power of the population. Besides some moderate positive changes in the macroeconomic situation, there is predominantly stagnation in the enterprise sector.

Within the industry extractive branches and semi-production is gaining ground against manufacturing. Domestic demand has been continuously slowly expanding, exports sales are progressing faster than domestic sales. Industrial production increased with 8.1% in the first half of 1997 compared to the previous years' same period. This year GDP is fo-

recasted to grow by 4%, while industry will expand by 6%. Major part of this growth will manifest in primary and semi-production. In the field of retail prices deceleration of inflation has been continuing. In this year June retail prices were 18.2% higher than a year ago. Real wages increased rapidly during the last year's municipal elections. Fast growth in real wages is due to lowering of inflation and very depressed nominal wage level.

Yugoslav economy is suffering of very serious structural problems: growing deficit in trade balance, appearance of strong wage pressure among public employees and workers in socially-owned enterprises, and strong increase of money supply. International currency reserves are very low: its amount was only DM 750 mn. in August 1997, which does not create a relaxed atmosphere for external financing. Inflow of foreign currency is rising due to the revenue from sales and limited amount of external loans which is raising the exchange rate of the dinar. In spite of this, due to growing trade deficit, a devaluation would be inevitable. For the present the country does not service its foreign debt, but if this happens in the interest of normalizing western relations, it will need more currency inflow. So far negotiations with the London Club have failed, since Yugoslavs demanded cancellation of 80% of their total \$ 2.4 bn debt. They offered to repay the rest \$ 500 mn. after 9 years grace period. It means equally disturbing factor to repay to the population its currency deposits which was frozen in 1991. Growing external imbalances can destroy limited results in internal stabilization. Moreover economy is still largely dependent on foreign capital inflow which remains largely restricted due to the existence of "outer wall of sanctions".

Volume of Yugoslav foreign trade has enormously dropped in the recent years. Due to the economic sanctions and the consequences of the war Yugoslav economy has transformed to a very closed, self-sufficient system. However, after 1995 when trade relations began to normalize Yugoslav export was not able to exploit opening of the foreign markets. In 1996 the two largest exports markets were the so-called Bosnian Serb Republic and Macedonia. Evidently with the more developed Slovenian and Croatian markets Yugoslavia is realizing much lower trade. In its imports Germany and Italy are lead-in trade partners. The backwardness of the composition in the exports is also indicating the dramatic decline in the product-structure. What Yugoslavia currently is able to sell abroad is non-ferrous metals, grain, vegetable, fruit and iron products. All are characterizing an underdeveloped third world economy. Unfortunately the composition of the imports is also witnessing the lack of resources for machinery and equipment. Mostly they are importing raw materials and semi-products («Yugoslavia», *EIU*, 1997/1).

Privatization remained first of all a political question which is determined mostly by the governing party's economic and political interest and not by the needs of the Yugoslav economy. Privatization policy consolidates the position of the current managers who are clients of the political leadership. However as it happens in Bulgaria, and Croatia there are urgent revenue needs for the budget, the social situation has to be appeased, and huge investment demand in the industry. Therefore government is supporting partial sale of few big public utilities, like telecommunication, oil industry, energy production. By all these government is planning to reach \$ 6 bn income which is a very optimistic target, concerning the hesitation of the foreign investors. Although for them this provides a unique opportunity to buy for cheap. As a result, income from sale is easily used for current consumption or subsidisation of socially owned companies. Real danger is that privatization happens without having positive effects on the economy. Size of foreign capital in-

flow is also dependent on the settlement of foreign debt which is under negotiation with the lenders.

4. POSITIVE SHIFTS IN THE ROMANIAN ECONOMIC POLICY

Following the parliamentary elections in November 1996, dramatic changes have occurred in the exchange-rate and price policies. The Romanian National Bank has stopped with fixing the so-called reference exchange-rate and liberalized the interbank currency market. Due to the liberalization of the exchange-rate and announcement of the forthcoming IMF stand-by loan, after rapid devaluation of lei, while its value has fallen from 4000 ROL/USD to 9000 ROL/USD, it started to appreciate to 7.500lei/\$. Explosion in the exchange rate went together with an end of price control in energy, raw materials, fodstuffs and services and led to high increase. Prime Minister Ciorbea announced his government's stabilization program in February 1997 that planned to be stricter and more restrictive than original economic program of the Democratic Convention.

The Ciorbea-program intends to end with former governments' incoherent and drifting economic policies which has resulted in certain achievements in the macroeconomy at the last years of the Iliescu-period, but real structural changes and turnover in property relations had hardly started. Foreign capital inflow remained limited in size, export competitiveness shrank, on the other side there was a growth in the deficits of the current account and governmental budget. Inflationary expectations developed significantly by the second half of 1996, and official exchange rate has become overvalued (*Planecon Report*, March 1997).

Table 4. Major macroeconomic indicators of the Romanian economy in percentage

	1992	1993	1994	1995	1996	1997/I.	1997 ^a
GDP	-8.8	1.5	3.9	7.1	4.1		-2.0
Industry 1990=100	78.3	81.6	84.2	92.1	97.0		95.0
Rate of unemployment	8.4	10.2	10.9	8.9	6.1	6.8 ^b	
Gross investment	4.9	4.7	6.1	10	4.5	-33	
Consumer prices annual average	210.4	256.1	136.8	32.3	39.9	159.1 ^c	150.0
Average monthly gross wage in \$	95	115	123	138	116		
Budgetary deficit in % of GDP	-4.4	-1.8	-4.2	-4.1	-5.7		

Remarks: a: forecast; b: July 1997; c: August 1997/August 1996.

Source: Economic Trends in Eastern Europe 1997/3. Kopint-Datorg Rt, Budapest, Hungary. Based on national statistics.

The failure to join the NATO and EU in the first wave of applicants has negatively effected the Ciorbea-government implementing its radical shock-therapy, because it has reasoned its liberalization and restriction measures with the need of adjustment to western integration. So far monetary and fiscal restrictive measures influenced adversely economic growth. In the first quarter of 1997 industrial production has still exceeded by 13.7% of the previous year's similar period, but starting from April production has been shrinking in comparison to the last year. Contraction in production is visible from the

formation of energy consumption: it fell the most in the energy-intensive branches like chemical, rubber, plastic and mineral industries. As a result of restriction in aggregate demand personal consumption and investments declined considerably in the first half of 1997.

The rise in consumer prices sped up starting in November last year: inflation in August 1997 was 159% higher than a year earlier. The rate of unemployment dropped from 7.2% in the end of first quarter 1997 to 6.8% by the end of August, which was not in line with the intentions of the government. It may be assumed that the government had to face extremely strong opposition to the closure of loss-making companies by the firms themselves and certain government offices. The restructuring of the industry is significantly slower progressing than it planned. It was no surprise that in 17 August the government decided the immediate closure of 17 loss-making enterprises, affecting 30 thousand workers. Understandably, the growing deficit of the budget, government revenues falling short of the planned amount as well higher expenditures made it inevitable to discontinue with the subsidization.

The country has been facing a very difficult second half of this year. The public is meeting the multiplied energy bills, company closures are proceeding, unemployment is rising, and endeavours to increase wages will strengthen. As a consequence of the monetary shock therapy, aggregate demand has shrunk considerably, bringing partial successes in improving external and domestic balances. At the same time, restrictions in domestic consumption have alleviated inflationary tensions only temporarily, as restructuring and the privatisation of large companies and banks remain to be carried out. Major changes in the leading positions of the ministries in December 1997 indicated that the Ciorbea-government is having great problems to implement IMF-backed economic program.

The share of the European Union in the foreign trade achieved 53% in 1996. With the European Union Romanian trade deficit has been continuously growing, and in 1996 it reached \$ 941 mn. The major exports products are still the low-produced goods: iron and steel, cement, but there are some finished consumer goods like furniture, clothes and shoes. It is apparent that exports growth is occurring mostly in the sensitive goods. Major part of the exports contains processing. Therefore exports is very vulnerable to cyclical changes in the Union market. According to the Association Agreement the Union is liberalizing its textile and steel market in 1997 which will give a further impetus to the Romanian exports. The high share of processing (commission work) is having a negative effect on the foreign capital inflow. In the exports the most important trading partners are Germany, Italy, France and Turkey, meanwhile in the imports Germany, Italy, Russia and France are leading.

The Ciorbea-government is attempting to give a major push to accelerate the privatization and the foreign investments. Evidently, the government represents a clear pro-western attitude, and it intends to provide a welcoming foreign investor environment. The list of the major trading partners is coinciding with that of leading investors. In the Romanian foreign economic relations German, Italian, Holland, French, American, British, Turkish, South-Korean connections are predominant. Among the CEFTA-countries Hungary and Czechia are also present as foreign investors. The current methods of privatization attempts to combine voucher with sale for cash, can lead to controversies. Government is under hard pressure to achieve revenue from the sale and it also needs to give a priority to the speed in ownership change, which are further contradictory targets.

5. Conclusions

Economic interest of western countries after the political systemic change evidently turned to the Visegrad-countries, the Balkan economies have been for long years neglected. The reason for this could be found in the fact that in contrary to the central European states, there was no clear and decided break with the political structure of the former communist system, and in the field of the economic policy delays, contradictions were prevailing with the evident reason that ruling parties did not want to decide in favor of the market reforms, but without these they were not able to stabilize their economies.

At the end of the eighties Yugoslavia was the most advanced in its market orientation, and it was the most highly probable that Yugoslavia will be among the first to make a fast transition. The fact that it did not happen, moreover that the biggest economic decline occurred in Yugoslavia, it made a major blow to the western assessment of the Balkan economies' future. The Yugoslav internal political development has been not market-friendly, which together with the nationalistic revival distanced the external economic interest. In Bulgaria socialist governments have for longly remained on power, while they proved to be unable to restrain inflationary pressures, and initiating a restructure in the loss-making enterprise and banking sector. Despite to these negative development, Bulgaria got foreign economic support of several times, but it was not prepared to absorb it in order to change bad economic performance. Similar assessment could be made on the Romanian economy. These cases are indicating that various governments made new experiments to stabilize the economy, also they concluded several agreements with the IMF and World Bank, but in vain. Because these agreement have been only partially implemented, they worsened internal and external balances. Most of the effects of these reform packages have been recession. Among the four analysed countries, Croatia constitutes an exemption, since starting from the end of 1993 it managed to stabilize the prices and its exchange rate. In the two other countries incoherent economic policy has created an even deeper economic crisis, which finally in 1996-97 has forced out a turnaround in the political power.

Due to these limited positive changes one can detect certain increase in the western economic interest toward the Balkan, however it seems to be still weak. These economies in their reorientation of external economic relations got under German and Italian influence. This dual economic penetration is visible in their trade relations and concerning foreign direct investments. However orientation to the European Union is still not clear-cut: as we could see in the Bulgarian imports and exports the Russian market plays an important role, although it is much smaller than few years earlier. Croatia is still in a situation in-between, since it can not stabilize relations with some major international organizations. Although, it will happen. In the Croatian exports share of the former Yugoslav republics is advancing quickly. In the case of Yugoslavia besides the German-Italian orientation trade with the "Bosnian Serb Republic" is developing and importance of Macedonia is also rising. As a positive sign, the European Union in 1997 temporarily re-established former trade concessions. Currently Romania indicates the more evident orientation to the European Union. Although serious problems are raised because of the backwardness in the export structure, and growing trade deficits. Recent changes in the Romanian governments are indicating that political shifts are not enough to carry-out deep structural turns. However, they are prerequisites.

Another positive change that has been happening is in the privatization policy which determines greatly behaviour toward foreign investors. Although, it is too early to draw a

final conclusion. Since it is hard to know whether governments are definitely want changes, and if they want them, they will have the capacity to implement them. The new Bulgarian and Romanian governments together with the Croatians and Yugoslavs are greatly revenue-oriented, they realized that for their future one way-out is the opening, the involvement of foreign investors. This creates a special opportunity for the external investors, since they meet a big privatization supply. Economic pressure now is pushing all the four governments to become more market-friendly. However they are realizing that opening up may create a new situation where governments are losing some of their control over the economy. The question is if they see that it is inevitable and happens anyhow, even without their consent. Of course foreign investments, privatization to outsiders can create social resentment, unemployment may grow, at the start there are more job losses than new jobs, domestic managers may resist to give up their fiefdom, bureaucracy also can be scared of losing control over certain industries, competition may appear etc. A positive turn-out if domestic managers and entrepreneurs see their future in this opening-up, and they become allied with it. Foreign investors at the same time should realize that this special political climate may be short, if they lose momentum, or running after quick short-term profits. Therefore they have an enormous responsibility.

Simultaneously, foreign investments, more trade with the West, improvements in relations with the European Union can not substitute the necessary domestic market reforms, which can also be rather painful and may face strong opposition. It is also important that intra-Balkan economic relations would develop, trade relations normalize, disintegration would stop. It appears from the Croatian and Yugoslav examples, if western relations are not developing enough, its place would be taken over by the softer regional trade. This is a wrong response to the problem. Western trade and Balkan regional trade can not substitute for one another.

The Balkan became a field for German and Italian capital penetration. However it seems that German influence is more extensive and diverging. These economies are mostly belonging to the "Mark-zone". Bulgaria having introduced the currency board, it linked the leva to the German mark. Yugoslavia from January 1994 pegged the dinar to the mark. Similar happened in Croatia with the establishment of the national currency, the kuna. In the region Romania makes an exemption, since in its economy the use of the American dollar is more spread. The United States is also present in the region as an investor and lender, however its role is more important in the field of regional security and through the IMF it influence monetary stabilization.

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