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Some Aspects of Medium-term Development in Central and Eastern Europe

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Introduction

Ten years have passed since the beginning of the big political, economic and social changes in the countries of Central and Eastern Europe conveniently called "transition". In spite of the obligate remarks about the slowness and inconclusiveness of the transition process, the past decade brought about stormy changes in the life of the people, their behavioural patterns, the political process in those countries, their economic structures, laws and institutions, as well as in international relations.

While Central and Eastern European economies crashed into a strong and long depression following 1989, living standards deteriorated dramatically for some years in all formerly socialist countries and continue to deteriorate in many of them. Employment declined, large-scale unemployment that had been practically unknown before the political changes, became a fact of life, social differences aggravated. A significant share of the population has much bigger incomes in real terms and much more opportunities (for education, info-communication, employment and travel) than before the political changes, however living conditions of the majority of population deteriorated. External and domestic liberalisation, privatisation of the former state-owned enterprises and development of a new privately owned sector of the economy is an established fact, or is, at least, well under way. "Structural reforms" are well on the economic policy agenda. Re-orientation of external economic and other relations (from East to West, or from the CMEA to European Union and to the global economy) was both an early necessity (because of the Soviet collapse) and a significant achievement of those countries. Now, the most of the formerly socialist countries are part of the international processes of integration and globalisation.

Has transition come to an end? Is it completed? Yes and no. The initial clear division line between „market" economies on the one hand, and „transition" economies, on the other, does not exist any more. The increasingly frequent insistence of some economists or political leaders in the East that transition is over, clearly indicates the perceived need for recognition of their achievements as well as for equal treatment with the other ("Western", "European", or "developed") countries. The changes as compared to the pre-1989 situation in all walks of life have really been fundamental. To be sure, the EU Commission regards some Central and Eastern European countries as already functioning market economies while others are seen as being on the way to become a functioning market economy. It is perhaps Russia and some other CIS countries only, with respect to whom the label "market economy" is misplaced. It is true that the market economies of Central and South-Eastern Europe have some characteristics different from the West of the continent, yet. The differences in institutional and legal systems, regulations, or those concerning the way of functioning of the economy, however, are mostly due to the lower level of economic and technological development, obsolete industrial structures, lacking financial and physical infrastructure. In the most of the countries policies are directed at putting an end to those differences, first of all, in the framework of the accession to the European Union. However, the drive to comply as soon as possible with the requirements of a "full-fledged" market economy (a drive that was nourished both by the international organisations which provide those countries with advice and by domestic vested interests) produced some contradictory results: in some important respects centrally planned economies of not so long ago became more liberal, less controlled, with more inequalities and much less solidarity and social protection, than the old market economies of Western Europe. Supported by the World Bank (and other organisations), some Central European countries have got "ahead" of the members of the European Union in restructuring their old-age pension system, for example.

Nevertheless, the word "transition" and the notion of the "end of transition" can be interpreted more simply. One possibility is to use the words in the context of what is the place of those economies in the world. According to this kind of interpretation, transition is the way from the CMEA (the Soviet-dominated international economic organisation of the socialist countries) to the European Union. Joining the Union would be the final step in the transition. This is an acceptable interpretation having in mind that EU membership is the strategic (not only economic) policy aim of the former socialist countries west of Russia. Accession to the European Union would mean that the aim is reached and the joining countries should be regarded as "normal" market economies for good.
Another possibility is to look at some important indicators of economic growth. That is the obvious point of reference of the recent (and, in some cases, much earlier) declarations concerning the end of the transition. While in some cases mention is made of the end of the economic fall and disarray, in other ones the statements refer to the recovery of the highest pre-transition level of GDP and the start of a new phase of growth. The former is the case in Russia (and most probably this year or the next in Ukraine), the latter - in all countries of Central Europe from Slovenia to Poland (the latter was the first country in Eastern Europe to exceed its pre-transition GDP-level as early as in 1996).

This paper intends to outline some of the factors (both international and domestic) that could influence the economic development of the Central and Eastern European countries in the coming 3-4 years. In the first section we present a brief summary of economic performance of (some groups of) Central and Eastern European countries during the decade of transition. Next, some recent developments (in 1999-2000) will be presented. The third section will deal with the factors, which could help or impede economic growth in those countries in the future. The most important differences among groups of countries or regions - such as Russia, Central Europe, South-Eastern Europe and the Baltic states[1] - will be indicated. The last section concentrates on the prospects of the EU membership of the candidate countries - one of the most important factors that will shape the economic and political fates of Central and Eastern Europe.

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[1] For the purposes of this paper Central Europe (frequently called East Central Europe) consists of Poland, the Czech Republic, Slovakia, Slovenia and Hungary. South Eastern Europe includes the other (than Slovenia) countries which were part of the former Yugoslavia, as well as Albania, Bulgaria and Romania (we shall deal mostly with the two latter countries). There are three Baltic states: Estonia, Latvia and Lithuania. All the groups mentioned plus the members of CIS (the Commonwealth of Independent States) are the Central and Eastern European countries.

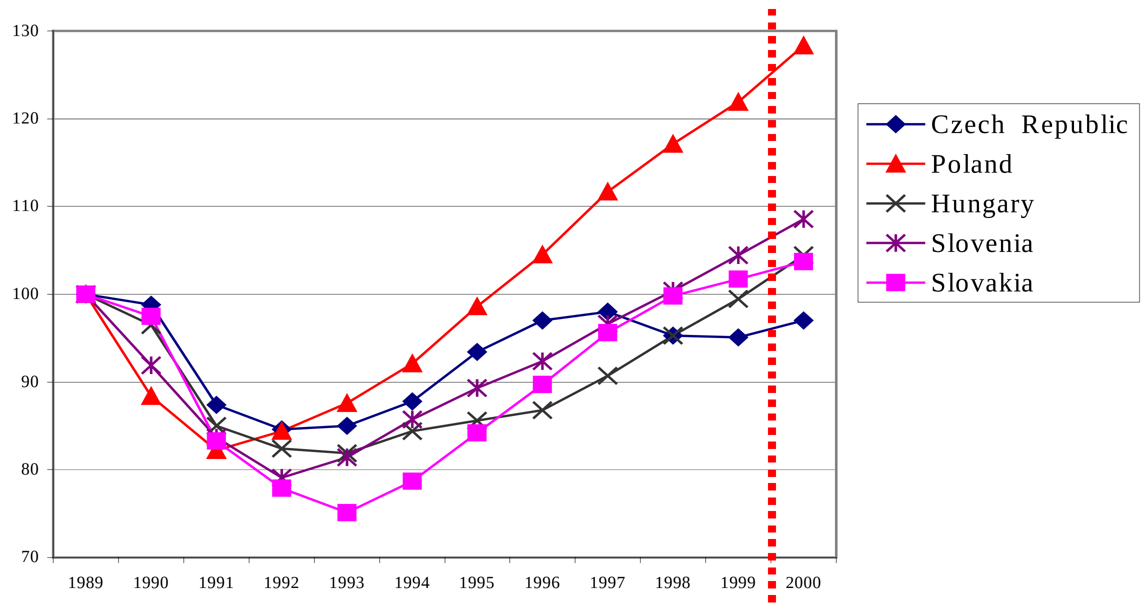
I. Recovery gains strength in some countries and is about to start in others

Despite some recent encouraging news, the growth performance of the transition economies in the past decade as a whole is modest at best. In the early years depression (János Kornai called it "transformational recession") was general. Fall of GDP of about 20% in 2-3 years after 1989 was considered quite normal. The economic profession regarded the catastrophic situation a mix of good and bad news. Some stressed that the tremendous losses of production, of industrial capacities and of incomes would lead to enormous human sufferings, longer-term functional disturbances of the economies concerned and protracted difficulties of the future recovery (or even to eventual development impasse). According to others, the fall in production and in incomes (as huge as it was) was inevitable, and even welcome.

The graphs below show the different (fall and) growth paths in terms of GDP and industrial output of selected countries of Central and Eastern Europe in the last decade. The basis is 1989, which is usually regarded the starting year of political transformation. (To be sure, in some countries GDP peaked prior to the political changes, and 1989 was a recession year already.) The graphs include preliminary data for 1999 and, as far as GDP is concerned, Kopint-Datorg's views of the expected developments in the year 2000.

Figure 1a

Real GDP Growth in Central Europe (1989 = 100)

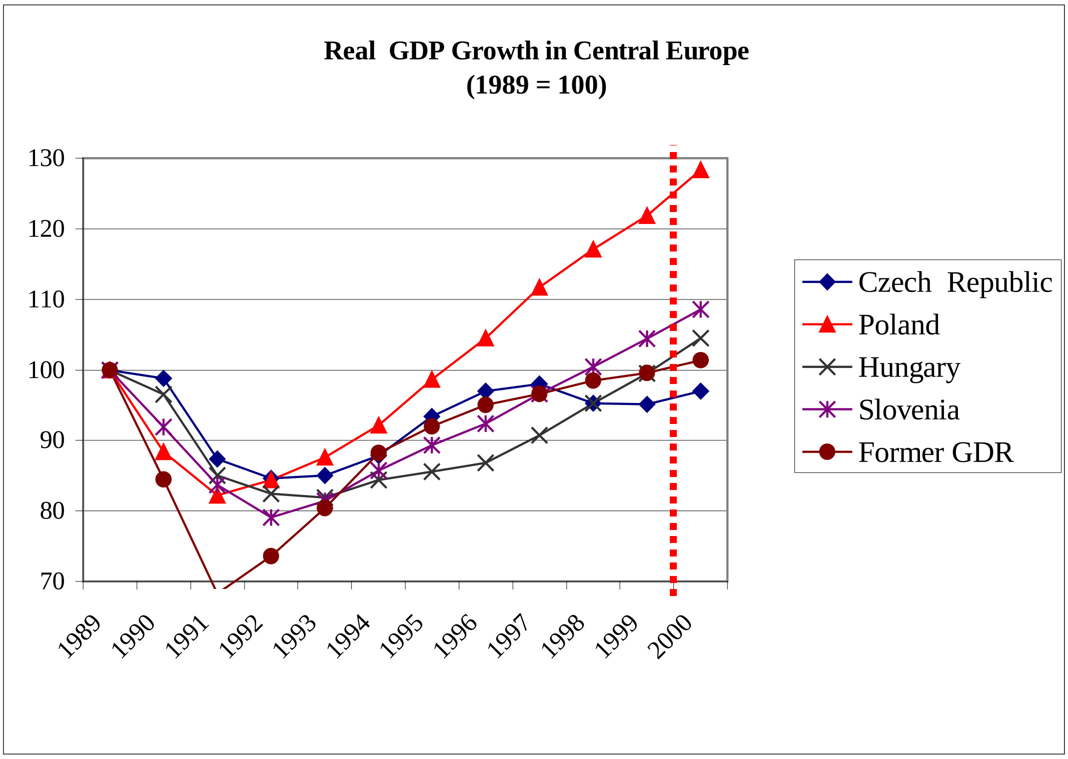


Source: Kopint-Datorg

Each country in Central and Eastern Europe has had her own specific development path, however some typical models can be revealed. Looking at the graphs that indicate the evolution of GDP, on the one "extreme" there are countries of Central Europe. After having attained the nadir (Poland in 1991, Slovenia in 1992, the Czech Republic, Slovakia and Hungary in 1993), GDP in most of those countries increased continuously year by year and by the year 1999 or 2000 for all practical purposes they have reached the pre-transition level of GDP (in the case of the pioneering Poland that occurred much earlier and Poland's GDP in 2000 may reach 128% of the 1989 level according to our estimates). In Hungary growth accelerated later than in some other countries, from 1997 on – mostly as a result of the dynamic inflow of FDI.

The pattern of the GDP growth in the Czech Republic has had some specifics as compared to other countries in Central Europe. This country faced a recession (or, a second, more modest than the first, wave of falling GDP) in the years 1998-1999. The generally accepted interpretation of the recent Czech recession relates the downswing, among others, to the deficiencies of micro-adjustment during the initial years of transition. In other words, the 1998-1999 recession should not be regarded as a cyclical phenomenon only, but more as an aftermath of the earlier economic policies in this country. Slovakia - together with Poland - was the fastest growing one in Central Europe between 1994-1998. In 1998 and 1999, its growth rate was slowing down significantly (because of the need for macroeconomic stabilisation and speeding-up of structural reforms), however GDP growth remained in the positive domain.

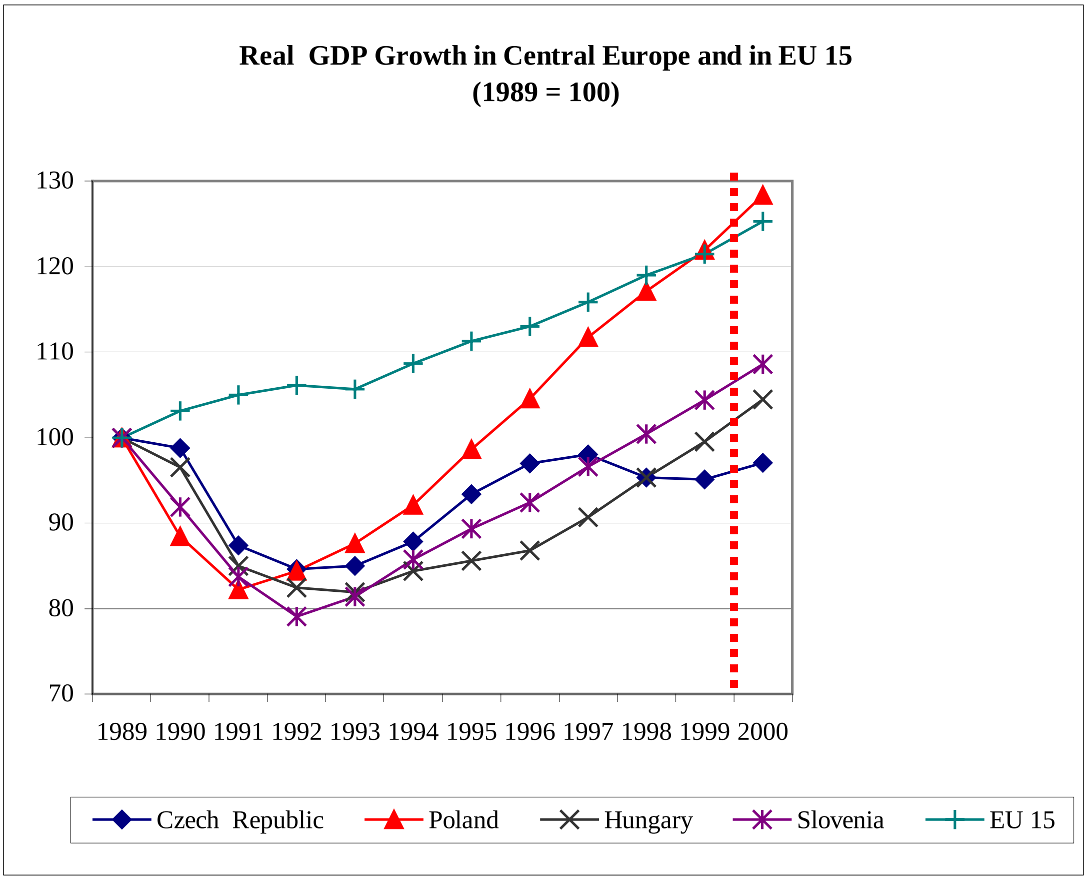
Figure 1b



Source: Kopint-Datorg, UN ECE

According to the available UN ECE data, GDP development in Eastern Germany - the former GDR - shows astonishing similarities to the Central European group. In spite of the justified doubts concerning the reliability of any 1989 or 1990 economic statistical data on Eastern Germany, the presumably similar growth pattern has arisen under the most different conditions. Eastern Germany developed in the framework of the re-unified Germany - one of the biggest and strongest economies of the world. As a consequence, macro-economic constraints of the East German development were those of the German economy as a whole, and not of the small and weak (and comparable to the other Central European economies) former GDR. Large-scale financial transfers from West to Eastern Germany are also well known. In those circumstances household incomes and consumption could increase in spite of low level of activity, while in Central Europe incomes and consumption growth were allowed conditional of GDP growth only.

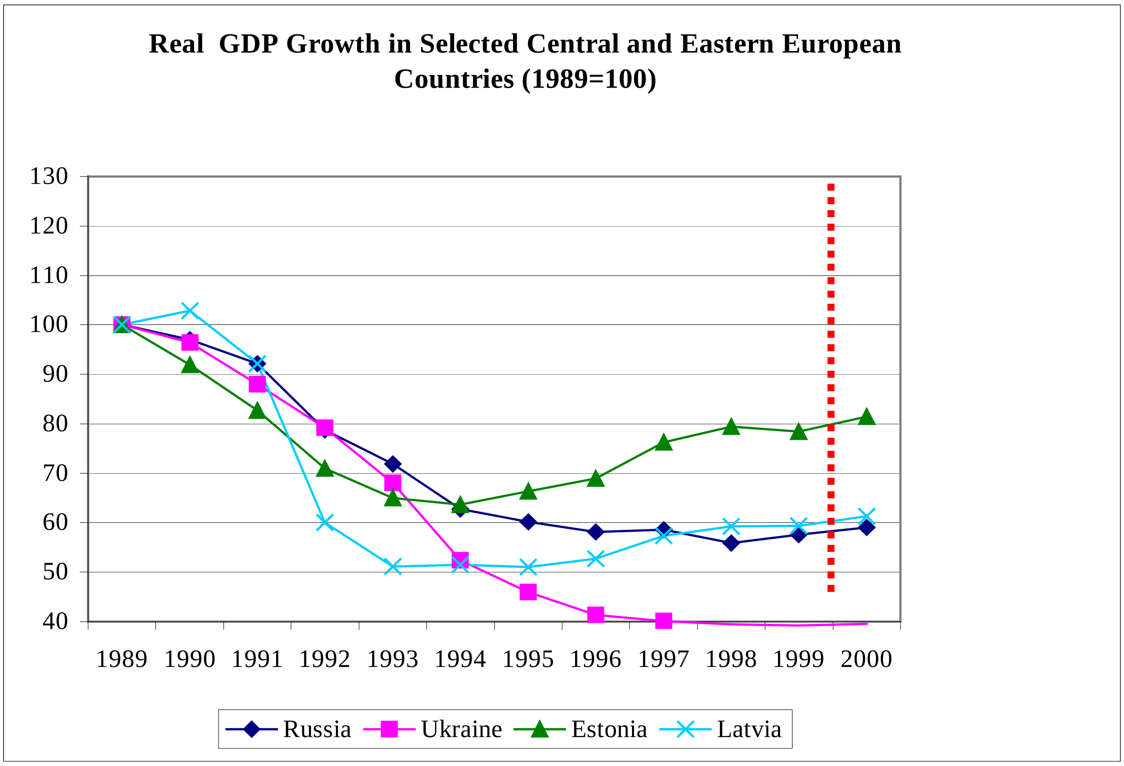
Figure 1c



Source: Kopint-Datorg, UN ECE

In spite of the mostly dynamic economic growth in Central Europe in the second half of the last decade, the gap between them and the present members of the European Union has widened during the 90s as a whole. Of course, economic structures in Central Europe have changed dramatically since 1989, and in many most important qualitative respects, they are pretty close to the structures that exist in the West of the continent. However, the problem of overcoming relative backwardness and closing up the development gap remains the number one policy issue in Central Europe. It is important to note in this context that success in reconstruction (in terms of GDP growth) does not mean general progress as far as many important economic and social indicators are concerned. In Hungary, for example, inter-regional differences very strong, consumption still remains well below the 1989 level, decline in employment was about the deepest in the whole Central and Eastern Europe (together with Bulgaria): about 30% of the 1989 employment have been lost, male life expectancy declined, etc.

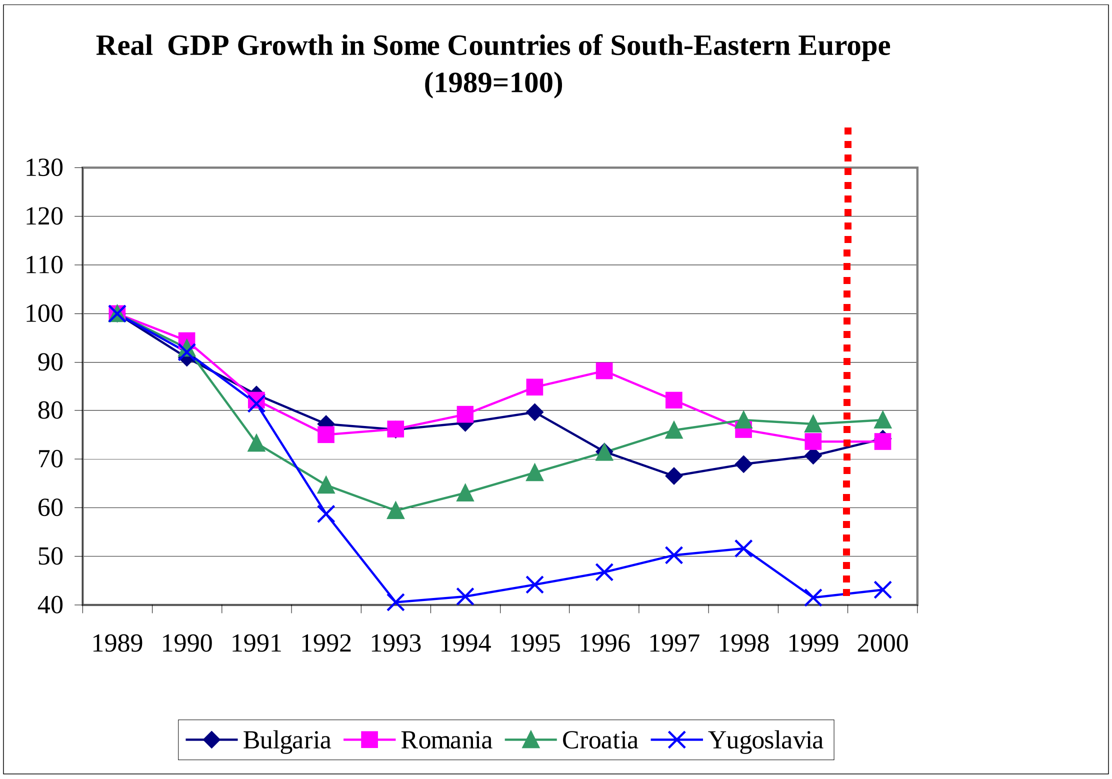
Figure 2



Source: Kopint-Datorg

On the other extreme, there are Russia and the other countries in the Commonwealth of Independent States. Russian GDP did fall almost continuously between 1989 and 1998 (with a slight exception in 1997). 1999 was the first year of meaningful growth (3.2%). Even so, the present Russian GDP level is about 40% below that of 1989. Even worse is the situation of Ukraine - one of the largest European countries - where economic fall was literally uninterrupted until the last year and the actual level of GDP is 60% below that of a decade ago. This is not the place to explain the unprecedented decline but it seems to be clear that the weakness of what used to be the Soviet economy (as compared even to the other European member-countries of the CMEA) is the starting point of any plausible explanation. This fact (together with the impact of its rapid disintegration in the early 90s) may explicate the growth difficulties of the Baltic States - including those of Estonia, one of the pioneers of transition and the process of accession to the EU. (Levels of GDP in the Baltic countries remain far below pre-transition or pre-independence levels.)

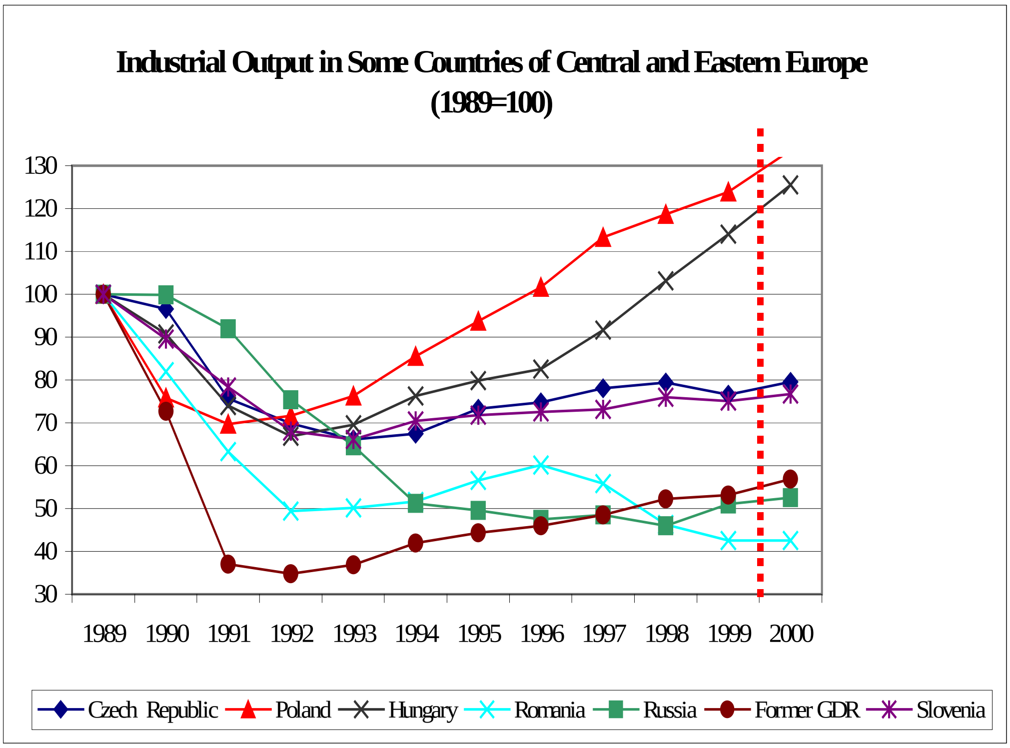
Figure 3



Source: Kopint-Datorg

Finally, South-Eastern Europe is in-between the two extremes. In the most of post-Yugoslav countries the four Balkan wars of the 90s have determined the economic "development" so far. In this paper, we will deal mostly with Bulgaria and Romania - two former CMEA member countries on the Balkans - showing a very specific „growth" path: two separate periods of severe and protracted decline of GDP in a decade. As a result, Bulgaria reached the lowest point of GDP as late as 1997 at 67% of the pre-transition level, and Romania - in 1999 (about 73-74% of the 1989 GDP). Initial level of economic development of these two countries was also below that in Central Europe, and now it seems that the last decade has brought about a widening gap between Central and South-Eastern Europe. (It remains to be seen whether it will mean divergent paths of longer-term development.)

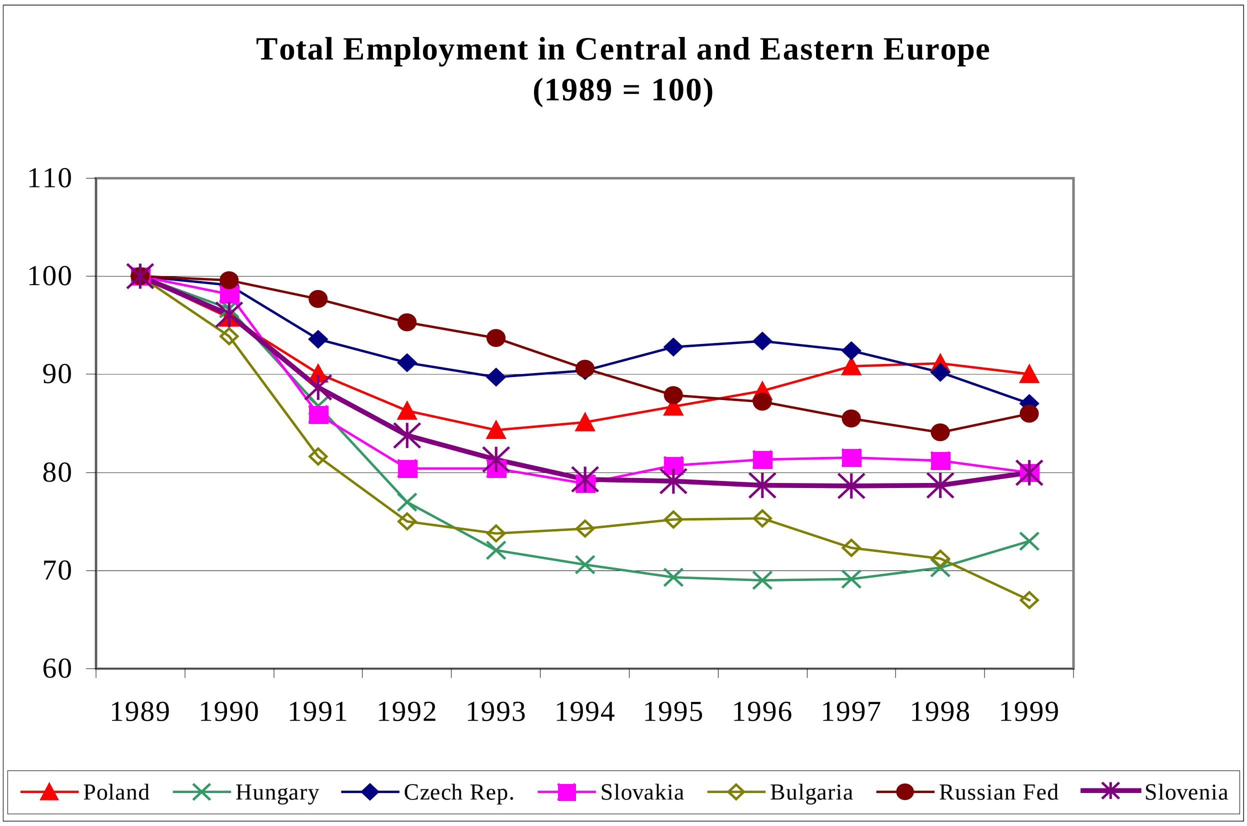
Figure 4



Source: Kopint-Datorg, UN ECE

As far as trends of industrial output are concerned, some further intra-regional differences strike one's eye. All the differences among the above mentioned regions hold true. Development of industrial production is as divergent as that of GDP. Russia (and Ukraine) performed poorly until 1998, and the „double downswing" in case of both Bulgaria and Romania is valid concerning industrial production too. (In both countries 1999 output levels of the industry were the lowest since 1989.) However, there is an important additional division within the Central European group in the industrial field. On the one hand, Poland and Hungary are undergoing a rapid re-industrialisation process. In those countries, gross industrial output this year may be 20-30% higher than it was at the beginning of the transition. On the other, the Czech Republic, Slovakia and Slovenia did not reach the 80% of the 1989 level of industrial output yet. (Industrial production in the former GDR is even more below that in the year of re-unification.) The reasons behind such diverging trends in industrial development may be manifold. Export-oriented policies and strong export growth drove dynamism of industrial production, by the large-scale inflow of foreign direct investment, especially into the manufacturing sector. Dynamic growth of domestic market both for consumption goods and investment in some countries and in some years should also be mentioned. Relatively early beginning of the entrepreneurship in the framework of the old system (economic reforms under socialism) certainly contributed to the revival and dynamism of industrial development in the 90s. On the other hand, the past over-extension of inefficient and structurally incompetitive industries and state enterprises that were unable to withstand competitive pressure after liberalisation, as well as the lack of definitive government policies to support micro-level restructuring had a negative impact on industrial growth.

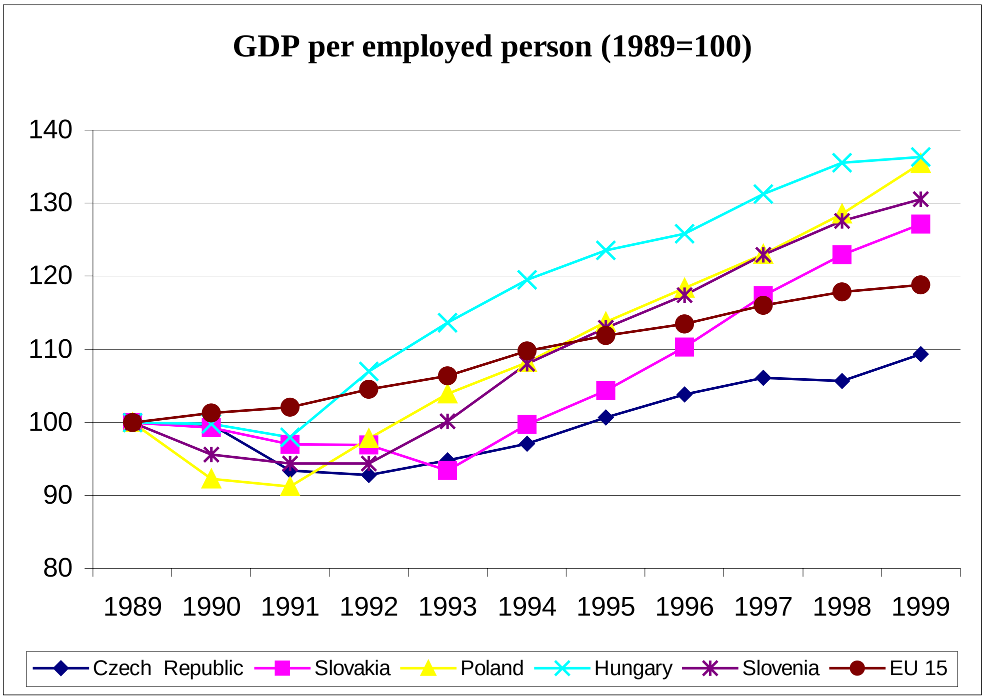
Figure 5



Source: UN ECE, WIIW

One of the biggest social problems in the post-socialist Central and Eastern Europe was unexpected and abrupt end of full employment and the consequent inability to handle the problem of unemployment. The decline of employment was the most pronounced in such very different countries as Bulgaria and Hungary. The period of the dynamic reduction of employment coincided with the general GDP decline in the first post-1989 years. In the last years, a kind of relative equalisation of employment levels among the Central European countries has started. While in Slovenia and Hungary in the last years there are signs of the start of a slow growth in employment, in the other three countries - where previous decline in employment had been less severe - employment seems to decline somewhat further.

Figure 6



Source: Kopint-Datorg, WIIW

At the same time, diverging trends in GDP and employment growths witness strong progress in productivity measured as GDP per employed person. It is important that while GDP levels in Central Europe except for Poland are near those of 1989, productivity of the countries of the region - except for the Czech Republic - has surpassed the initial level and its growth rate is well above the same indicator in the European Union. Especially dynamic was the growth of GDP per employed person in such countries as Poland, Hungary and *Slovenia (more than 30%* above the 1989 level in 1999).

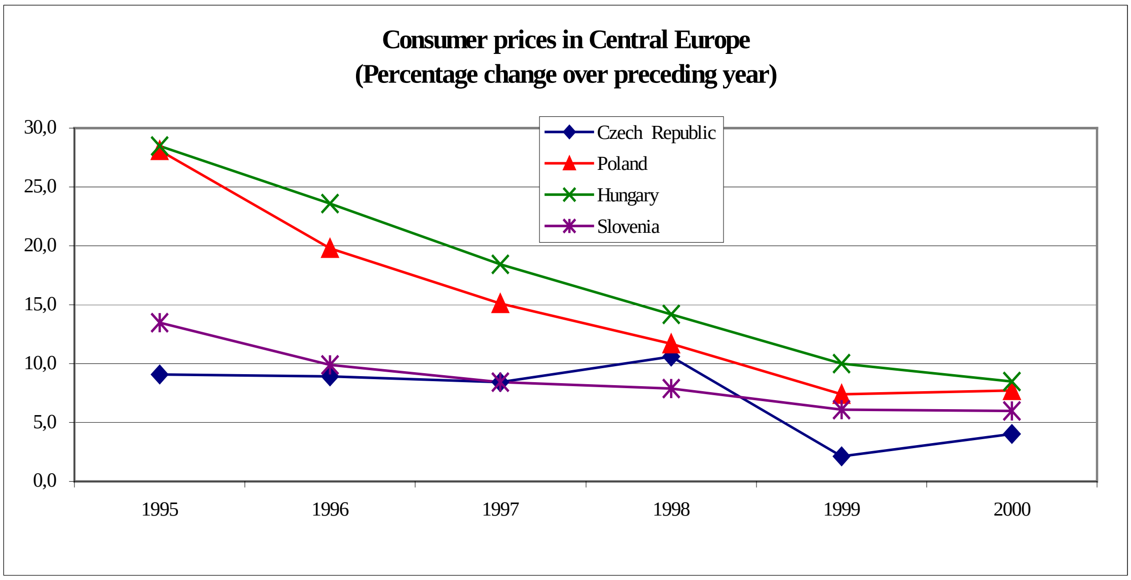
II. Recent developments: growing dependence on international economy

One of the most important features of the economic development in Central and Eastern Europe in 1999 was its close dependence on the changes of the global environment. Typically, economic growth decelerated in most countries (as compared to the previous year, but accelerated in the second half-year as compared to the first one). In this way, the direct impacts of the Russian crisis and of the cyclical development in the European Union (continued slowdown in the early months of 1999 followed by the upturn in the middle of the year) are clearly discernible in the growth patterns of most Central and Eastern European countries. In such dynamically growing countries as Poland and Hungary GDP growth in the fourth quarter equalled about 7%. The global faith in the favourable directions of Central European development strengthened: both Poland and the Czech Republic registered all-time-highs of the inflow of foreign direct investment. In Slovenia, dynamic GDP growth at a rate of about 4% continued. For the Czech Republic, last year marked the end of protracted recession. Although the GDP still fell slightly, by 0.2%, over the whole year, the steady improvement of quarterly data makes it certain that the economy returned to the path of modest growth. Another exception from the typical pattern was Romania: here recession continued at a decelerating rate. GDP was down by 3.2% last year (following the decline of 6.6% in 1997 and 5.4% in 1998). Recession however is no longer a universal phenomenon in this country: some branches registered output growth. The most atypical pattern however was that of Russia (and of other CIS member countries). We shall touch upon Russia's economy in 1999 somewhat later.

The deterioration of external environment had negative impact on trade (exports in a number of countries declined) and especially, on industry. Except for Poland and Hungary, where growth rates of 4.4 and, respectively, 10.5% were recorded, in 1999 industrial output diminished in all Eastern European countries west of the CIS - although industrial growth also picked-up speed towards the end of the year. On the annual level, the output decline was in the range of 8-12% in such countries as Romania, Bulgaria, Latvia and Lithuania. Beside the exports, weak or weakening domestic demand contributed to the industrial slowdown as well.

In 1999 unemployment increased almost in all countries of the region, except for Slovenia and Lithuania. Unemployment rates have become especially high even in such relatively successful Central European countries as Slovakia (19.2% at the end of 1999) and Poland (13%). Unemployment remained at a high level in Slovenia (13%). It is disturbing that unemployment is showing a distinctly upward trend in the Czech Republic - one of the countries with the lowest unemployment level until some years ago. Now, unemployment levels in Central and Eastern Europe (and even in Central Europe) are higher than those in the countries of the European Union where a moderately diminishing trend of unemployment has become apparent.

Figure 7



Source: Kopint-Datorg

Inflation rates are very much diverging across the region: in 1998 annual rates of consumer price changes were between 4.7% in Lithuania and 59.1% in Romania, in 1999 - between 0.8% (also in Lithuania) and 86% in Russia. Most countries are far from fulfilling the Maastricht inflation criteria, but the times of hyperinflation seem to be over, and the trends are encouraging. In 1999, price increases continued to subside in most countries in an annual (year on year) comparison, and in Russia (where in year on year basis inflation accelerated) on a December to December basis. Russian inflation had been galloping in the last months of 1998 following financial crash in August of that year. Global price developments had a decisive impact on short-term domestic price movements. The global disinflationary process that had lasted until the spring of 1999 when oil prices started to rise, led to lower than presumed prices in many Central and Eastern European countries especially until mid-year. Bottoming-out of the inflation in the developed countries markedly influenced price developments within this region as well. In some countries disinflationary impact of external developments was supported by rigorous domestic policies: this resulted in annual CPI fall from 22.3% in 1998 to 0.4% in 1999 in Bulgaria (in this country, for some months, deflation was the case). Annual inflation (measured at CPI) in the Czech Republic went down from 10.7% a year before to 2.1%, in Poland – from 11.8% to 7.4%, and in Hungary – from 14.3% to 10%. (Inflation has diminished in each consecutive year – without interruption – since 1991 in Poland, since 1993 in Slovenia and since 1996 in Hungary.) 1999 inflation in Slovakia was influenced (in the upward direction) by long-overdue increases of the officially regulated prices.

Problems related to structural adjustment and to external and internal imbalances, however, bore hard – and continue to do so – on the growth performance and conditions of living of some countries having produced fast growth earlier. In the Czech Republic, structural reforms made headway (privatisation of the biggest banks, partly terminated, partly in progress; privatisation/re-organisation of large companies). In Slovakia last year, parallel with the slow-down of growth, the alarming 1998 growth of the deficit on trade and on the current account moderated (the latter from 10 to 6% of the GDP), and the position of the general government improved. Structural reforms (e.g., privatisation, transformation of the financial system) gathered speed. In Poland, as growth was generated almost exclusively by internal demand, exports performed weakly and the deficit of the current account relative to the GDP rose to 7.5% in 1999 following 4.3% in 1998. This is the single most important macro-economic problem for Poland that could jeopardise the future dynamism of growth. In Hungary, where the engine of growth was the continuing expansion of commodity exports, the deficits of the current account and the general government relative to the GDP declined. What is more, thanks to export-led buoyancy, last year's growth in this country acquired a specific new feature: the acceleration of growth within the year (from quarter to quarter) has not led to growing external or internal deficits, even in spite of the parallel increase of consumption. In the Slovenian economy, with growth at around 4%, both commodity exports and tourism declined, and hence growth was driven by internal demand – investment and household consumption. The deficit of the current account rose steeply to 2.5% of the GDP and the external debt of the country was also up, but this implies no financing problems yet.

The South East European countries ended last year with better results than expected. The termination of military operations in Yugoslavia exerted a positive influence on the position of every country of the region: decline proved less marked at the annual level and growth, if any, faster. In Romania, as internal demand shrank, household consumption and investment continued to decline and the conditions of living of the population are very poor indeed. Export performance, on the other hand, ameliorated slightly, and the large-scale contraction of imports resulted in smaller trade and current account deficits than in 1998. The Bulgarian external deficit is still remarkable, and the FDI inflow regularly lags behind the expected values, but foreign creditors and international financial organisations have solid trust in the country. As opposed to Romania, the position of the government is stable.

In Yugoslavia, economic performance showed radical decline in 1999, a consequence, primarily, of military actions and the maintenance of foreign sanctions. However, the shrinking of the economy, estimated at 19.3%, was smaller than expected. In the second half of the year, reconstruction funded by the country's own resources was launched. Serbia received some aid from China and Russia only. Inflation accelerated under the impact of expansive monetary policy and of commodity shortage - in December, its annual rate was 50% -, but the price increase has not led to hyperinflation. The population was supplied with electricity, central heating and food throughout the winter, despite regular power cuts. The unemployment rate attained 32%.

In Russia, economic growth is on, but recovery from the decade-long very deep recession promises a lengthy process – provided that nothing would check it. Last year, as mentioned above, the GDP expanded by 3.2% and industrial output grew by 8.1%. The industrial upswing has continued this year at rates of 10.7 and 13.7% in annual comparison in January and February, respectively. (According to the most recent information from official sources, the first quarter GDP-growth was 6.8%). Economic growth in the last year, however, was stimulated almost exclusively by external factors – the increase of international oil prices, and import substitution due to the drastic depreciation of the Russian currency. Fixed investments practically stagnated (grew by a mere 1%) last year, after having contracted to one-fifth in the course of the past decade. The trade surplus increased by about USD30 billion overwhelmingly as an outcome of the fall of imports (by about USD43 billion in the first 6 months of 1999). However, towards the end of the year, Russian exports to non-CIS countries started to increase dynamically. A major part of the unprecedented trade surplus of 1999 in excess of USD40 billion still leaves the country illegally – or, more precisely, does not enter it at all –, although its proportion has probably diminished compared to the previous year. This tremendous sum of illegal capital exports is the single most worrying factor of the Russian situation from the point of view of Western governments and international organisations. Oil and gas production stagnated - a real achievement after a decade or more of decline (in the case of oil). The increase of revenues on oil and gas exports has improved the balance of the central budget, stabilised the exchange rate of the rouble and hence (as indicated above) all in all moderated the inflation rate also. Last year's annual average inflation rate of 85.7% decelerated to 36.5% by December, and in January and February this year, twelve-month rates of 28.9 and 25.1%, respectively, were recorded.

The historically established differences among geographical regions and economic sectors within Russia, as well as discrepancies according to the degree of international openness, quality of labour force and a lot of other criteria, have become enormous in the years of post-Soviet depression. The indicators of living standards point to no change in the catastrophic situation. In many places, it is a „target” to be achieved only that employees should receive their remuneration (and receive it in cash, not in kind). The calculated wages per head diminished by 23% in 1999 and despite the general improvement of macro-economic indicators retail trade declined by 8% in real terms as compared to 1998.

In spite of all those facts, the dawn of the post-Yeltsin era coincides with the revival of hopes for economic consolidation. Although future economic policies of the new president, Vladimir Putin are far from being unambiguous, the new era may bring some version of political stability to Russia - the most important pre-condition of the start of the process of economic reconstruction. Economic growth should be based on large-scale accumulation of capital, modernising investments and re-structuring - as well as on the increasing openness of the country towards the outside world. Outward orientation seemed to be jeopardised by the war in Chechnya, however foreign capital have remained relatively calm, and the transnational companies having settled in Russia continued business as usual. This was the case with the World Bank and the EBRD as well, while the IMF suspended its credits to Russia last September and continues to insist on further structural reforms as condition for their renewal. Debt re-scheduling agreements both with London and Paris Clubs have been achieved.

Ukraine is de facto insolvent. The country, on the edge of the financial precipice for a long time, tries to force its creditors to reschedule debts -- largely with success. For years, the Ukrainian leadership has carried out a most agile balancing act between the West and Russia, exploiting the international economic and political interest conflicts of its two major creditors and driving both to the position of forced creditor. Economic decline is slowing down. Last year, the GDP shrank by only 0.4%, this year it is likely to register slight growth. Industrial output already increased by 4.3% last year, and buoyant industrial growth was registered in the first three months of the current year, with the exception of the fuels and energy sector.

III. Mainline medium-term scenario: towards continued growth

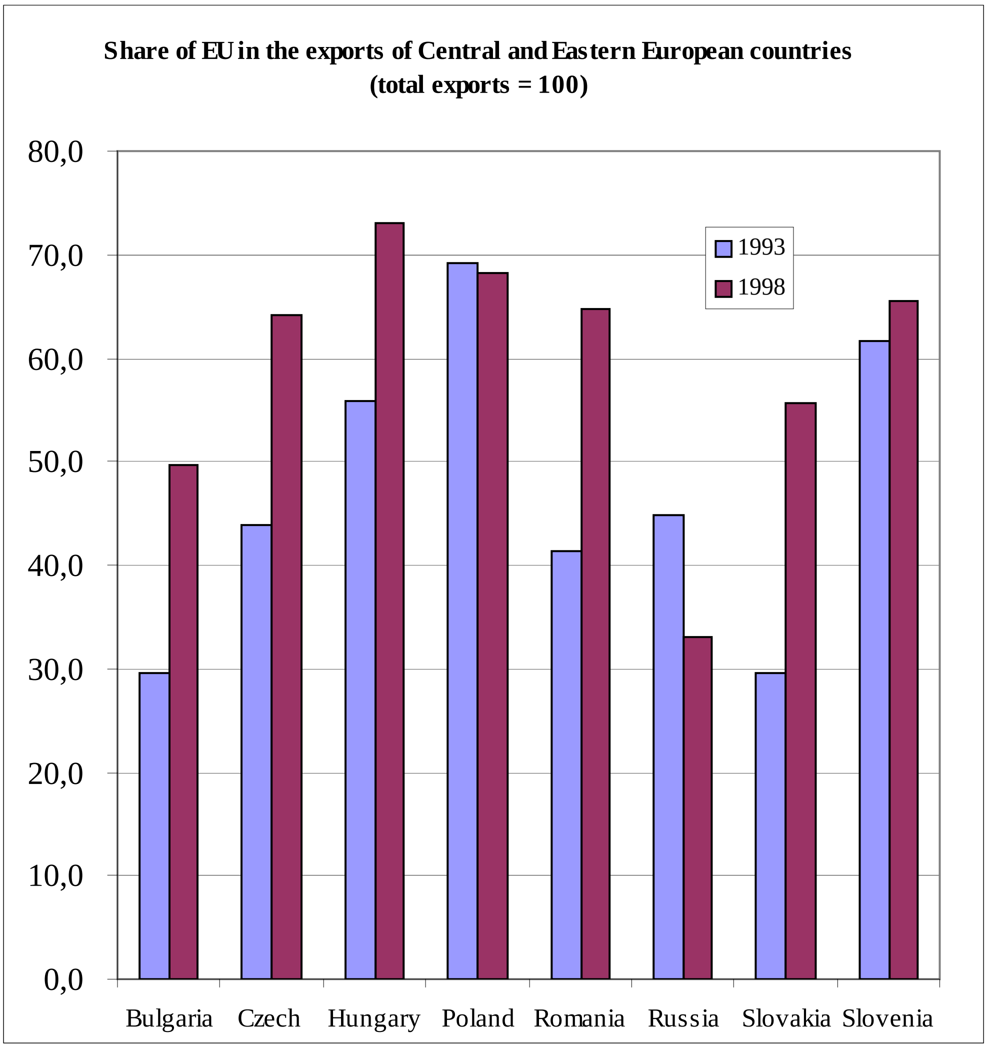
Economic processes in various countries and regions of Central and Eastern Europe in the years to come may be as different as they were in the past decade or in the last year. Ten years after the political changes both constraints and driving forces of the growth are diverse. We assume that in the countries where reconstruction is progressing, the chances of an „orderly” or „normal” development (without shocks and without the need for further „shock-therapies”) are incomparably better than in those countries where reconstruction is not an established fact yet. In other words, Central Europe is capable of an average GDP growth of about 4-6% without very wide annual fluctuations. Some countries (most notably Poland) may be close to the upper edge of the band, while others may lag somewhat behind. Some countries announced that they aim at growing twice as rapidly as the average of the European Union. This target is feasible. (However, because of Central Europe’s dependence on exports to Western Europe, the countries of the region would be very much interested in an above-3% GDP growth in the EU.)

We are more uncertain as far as South Eastern Europe is concerned. Yugoslav economic situation is function of the country's external relations. Supported by a favourable international judgement, Bulgaria seems to be capable of entering a dynamic period of reconstruction. This is not the case with Romania where grave political and economic tensions make recovery from the recession of the last years especially difficult. Following last year's recession, economic growth may revive in the Baltic states - although their dependence on external environment (which includes Russia) is extra-ordinary large.

Finally, in Russia (and in other CIS countries) annual economic growth of 3-4% in the medium-term is quite conceivable. However, given the tremendous decline of the past decade, a moderate rate like this would not be enough to achieve the 1989 GDP level by the end of the next decade - a very sad outlook indeed. The uncertainties surrounding Russian economic development are unmeasurably larger, than those of Central Europe. Under favourable international circumstances (which are not necessarily the same as those for Central Europe) and adequate government policies (which are not that easy to define) reconstruction could proceed much more rapidly as well. (According to the most recent announcements, the Russian government is expecting 4.5% GDP growth in 2001, 5% in 2002, and 6% in 2003.) On the other hand, having in mind that the 1999 upswing in Russia can mostly be attributed to short-term factors (such as international oil price hike and import cut-backs), while the big structural issues inherited from Soviet times (those of arms industry, agriculture, quasi-monocultural character of exports) or having come to life as a consequence of the economic and political mis-management of the 90s (mafia economy and illegal capital outflow, demonetisation, tremendous inequality and standards of living far below where they were at the start of the transition) are from from being solved, one cannot totally exclude the possibility of continuing stagnation or of relapse into stagnation.[2]

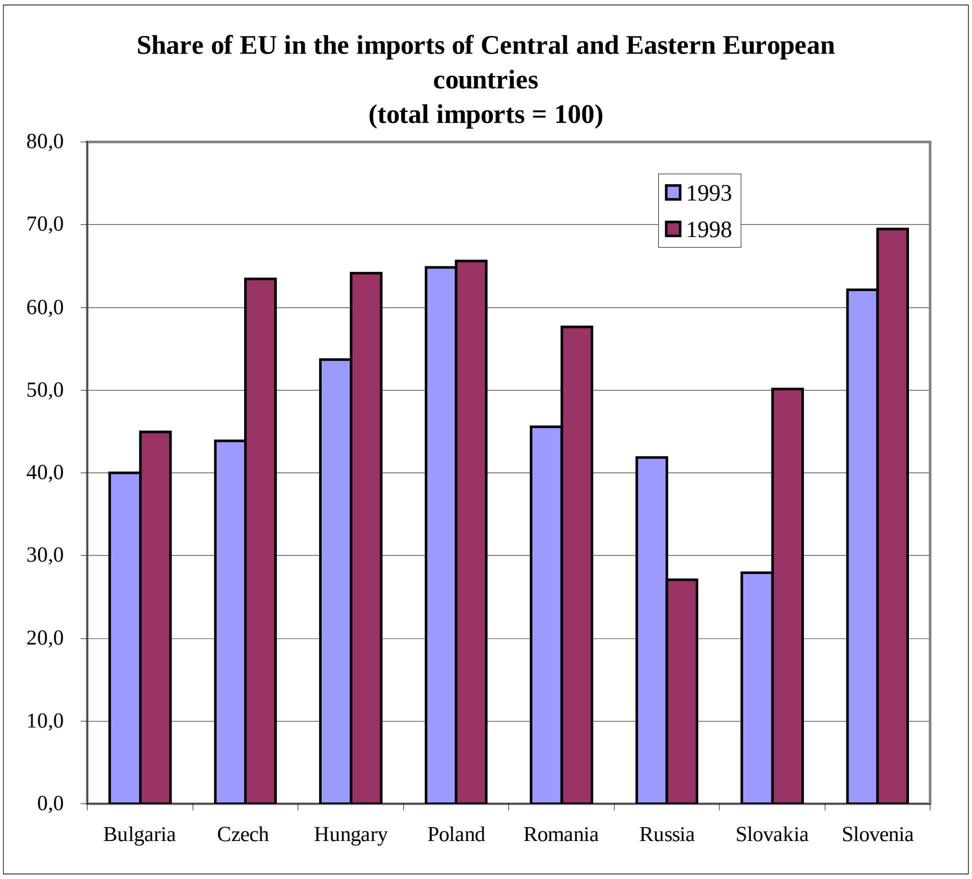
[2] For the pessimistic view on Russia, cf. Joseph Stiglitz: What I learned at the world economic crisis. The Insider. In: The New Republic, April 17, 2000.

Figure 8



Source: Kopint-Datorg, WIIW

Figure 9



Source: Kopint-Datorg, WIIW

As far as Central Europe is concerned, the increasingly parallel cyclical movement of the region's economies with the (West-) European cycle is one of the most important and encouraging factors that will be shaping their economic development in the near future. Of course, that means, among others, that the risks and dangers for the European Union (for example, aggressive tightening of monetary growth by the European Central Bank, or eventual collapse of the US equity market) are risks and dangers for the growth of the Central European countries as well. However, from risks like those (and from other possible crises in the international economy) small and weak economies can not find safe harbour. On the other hand, joining the waves of an upswing in the countries of the Union opens new dimensions for export-oriented growth in Central Europe. As indicated by Figures 8 and 9, in the case of a typical Central European country, close to 70% of its foreign trade is with the European Union – a larger share than that of intra-EU trade in exports and imports of most of Union member countries. This percentage is result of two kinds of developments. One is the cut back on trade with Russia (the second stage of which did occur as late as in 1998 and 1999 in the aftermath of the Russian financial crisis). The other is the dynamic growth of trade with Western Europe. The trade growth is mostly driven by foreign direct investment in the manufacturing sectors of Central European economies. The FDI inflow is a contradictory process (that is not without some unfavourable implications for the economy and society), however it has played a crucial role in dynamically developing exports and imports. In Hungary for example, the share of companies with 10% or more foreign ownership in exports was about 74%, in imports – 71% in 1999. They are mostly responsible for the dynamic growth of machinery exports – now the single largest commodity group in exports (57% of the total).

IV. Accession to the EU: some implications of a further delay

In this situation, progress in EU accession is a crucial determinant of further macro-economic developments in Central Europe as well as of other candidates for EU-membership. Accession before long would contribute to stability and growth by promoting investment and trade.[3] Uncertainty concerning accession timetables and conditions would lead to losses of development dynamics and disorientation. In face of recent developments, those crucial points should be emphasised.

The Union's commitment towards Eastern enlargement remains incontestable. However, its plans and ideas concerning the details of the envisioned accession have always been somewhat obscured. Recent developments suggest that there is growing uncertainty on the part of the European Union as far as the enlargement is concerned. A further delay in the accession process - as compared to the previous designs or expectations of allowing the first new members in the first years of the new millennium into the EU - is the most probable version. "What was once a rumor is now accepted as fact: The first wave of new members will not join before 2004 or 2006 at the earliest, and perhaps even later."[4]

As it is well-known, the first phase of accession negotiations launched in May 1998 (i.e. the "screening") had largely been closed with the first-round countries. The second phase, i.e. the negotiations proper (chapter-by-chapter) are on, with 10-12 chapters (out of about 30) already "provisionally" closed with the applicants from the East. However, the Commission has slowed down the process of opening new negotiation chapters and answering the requests of the candidates concerning transition periods. What is more, chapters already closed provisionally will be re-opened in the course of 2000 "to allow

[3] According to Interim Reports commissionned by the Laxenburg institute IIASA for the Czech Republic and Slovakia, and comparing accession and non-accession scenarios for those countries, „the EU accession will bring about higher economic growth through several channels. The EU membership (and its prospects already in the run-up to accession) will increase private investment, both because of greater inflow of FDI, as well as because of lower risk premium and hence lower real interest rates. Real wages are expected to grow faster in the accession scenario, thus fueling private consumption" and somewhat worsening the trade balance. „EU membership will have a strong positive effect on both imports and exports... the higher growth will also be fueled by the subsidies from EU Structural Funds." Jan Fidrmuc and Jarko Fidrmuc: Macroeconomic Developments in the Czech Republic and the EU Accession Process, February 2000, p. 25; Jan Fidrmuc and Jarko Fidrmuc: Macroeconomic Developments in Slovakia and the EU Accession Process, February 2000, p. 31. The latter point is being stressed in a study on Hungary's accession. "The expected transfers from the European Union will be utilised to prepare the ground for another boom in FDI and indigenous investment in the eastern and other badward parts of the country, which will raise the growth rate. to 5 percent and beyond. János Gács: "Alternative scenarios for Hungary's Accession and Macroeconomic Development." Kopint-Datorg Discussion Papers, N° 60, April 2000.

[4] Michael Stabenow: European Puzzle. Frankfurter Allgemeine Zeitung (English edition), April 7, 2000. The author adds: "This must be a sobering thought for the 12 candidate countries. For the EU, in contrast, it is a demonstration of its incapacity, 10 years after the fall of Berlin wall, to establish a clear timetable for bridging Europe's political and economic divide."

newly adopted EU acquis, not yet addressed during the negotiations, to be included. The Commission proposes to use this occasion to establish a strong link between the negotiations and preparatory process. No chapter would thus be provisionally closed (or closed again after re-opening) unless the EU is satisfied that the candidates' preparations are in line with their commitments in terms of preparation for accession."[5] In other words, while the position of the applicants (as well as their suggestions and requests) are more or less clear, the big unknown is the position of the Union as far as terms and details of accession are concerned.

The Helsinki European Council last December altered the previous Community attitude concerning the range of the participating countries in the present round of negotiations. According to the EU's new position, negotiations were opened - in addition to the five (plus Cyprus) "first round" countries - with all the former socialist applicant countries which meet the Copenhagen political criteria and have proved to be ready to take the necessary measures to comply with the economic criteria. This new policy (under the catchword "acceleration" of the negotiations) is meant to signal to first-round countries that accession order (not to speak of accession timetable) is far from being fixed definitely: the current positions of candidate countries may change, and accession decisions will be based on the current and future performance of each applicant. This is a significant revision of the previous negotiating strategy. The foregoing strategy had as its starting point the consideration that the most of the difficulties of Eastern enlargement arise from the fact that countries which have applied for membership are at a much lower level of economic development than the EU average. It was for this reason that priority in the accession process was offered to the relatively more developed candidate countries. Those countries could be considered functioning market economies and (at least, in the medium run) would be able to withstand competitive pressure within the Union. In the aftermath of the Helsinki European Council, this consideration was, in some sence lost. True: according to official statements, in this new situation it will be possible to objectively differentiate among the candidates. Each country will progress towards membership according to its own merits. „Each of the applicant countries will proceed at its own pace, depending on its degree of preparedness."[6] This is a kind of compensation to Slovakia – one of the economically more developed candidates - for having been left out from the first round because of its domestic political situation of the time only. In general, the new approach seems logical and fair. However, the question is what should be considered as "merit". If "merit" is not a kind of short-term "good behaviour" (whatever that means) but the level of relative economic development and the state of the economy (and of the society) of a country, then sweeping changes can not occure within the time horizon that figures in the Union' documents concerning Eastern enlargement. Therefore, it is to be feared that the extension of the number of the negotiating countries will not result in the acceleration of the enlargement, but would lead to the addition to the already existing list of serious uncertainties concerning the date, the order and the terms of accession. As a consequence, it can become even more difficult to say, what should be done by the candidate countries in order to accelerate the accession process.

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[5] EU Commission Composite Paper. Reports on progress towards accession by each of the candidate countries. Brussels, 1999, pp. 27-28.

[6] ibid, p.9.

What is the explanation of the change in the Union policies? According to the popular view, the unpreparedness of the Union itself, and the lack of progress concerning institutional reform are mostly responsible for the present situation. The most important impediments to Eastern enlargement are to be found on the Western part. As it may be clear from the above, development in the candidate countries is far from being satisfactory in all respects. Even the most hopeful candidates are in the early stages of the catching-up process only. However, most (perhaps all) of the Central European countries (the nucleus of early candidates) are doing better than they did some years ago. Economic growth in those countries seems to be sustainable and mostly dynamic in European comparison, integration to the European integration in some respects (trade) is almost full, there are promising investment opportunities there. In addition, there is considerable progress as far as legal approximation and the establishment of the administrative and judical capacity for putting into praxis the acquis is concerned. There are risks and dangers to the favourable scenario of the development in the candidate countries, but the risks are to a large extent external: the major risks are function of the process of the EU accession itself, and of the perceptions about the intentions of the Union. Accession in the foreseeable future means less risks. Uncertain commitment on the part of the Union as far as the details of Eastern enlargement are concerned, means greater difficulties for the candidates and more risks for them in the globalised environment.

In other words, there are no obvious reasons for the EU policy revisions from the point of view of what is happening in Central European economies. Quite to the contrary: it is procrastination of the accession process that could lead to undesirable economic, social or political consequences both around and within the candidate countries. Further delay in Eastward enlargement with reference to the alleged unpreparedness of the candidates, as well as to their unwillingness to follow some important Union policies or principles, under some circumstances may, however, in fact lead to undesirable consequences, and prove to be self-fulfilling prophecies.

From the point of view of international developments as well, the arguments for swift action have become weightier in the course of the last year or two. To quote a Commission paper, "the idea of EU enlargement has acquired new impetus over the past year. One of the key lessons of the Kosovo crisis is the need to achieve peace and security, democracy and the rule of law, growth and the foundations of prosperity throughout Europe. Enlargement is the best way to do this."[7] We do not think that recent developments within the Union would change this way of thought. All in all, early start of the admission process would be an act of stabilization.

[7] ibid. p.4.

Table 1

GDP of Central and Eastern European Economies
(percentage change over previous year)

Country	1991	1992	1993	1994	1995	1996	1997	1998[a]	1999 estimate	2000 forecast
Russia	-5.0	-14.5	-8.7	-12.7	-4.1	-3.5	0.8	-4.6	3.2	2.5
Ukraine	-8.7	-9.9	-14.2	-22.9	-12.2	-10.0	-3.2	-1.7	-0.4	0.5
Czech Republic	-11.5	-3.3	-0.9	2.7	6.4	3.9	1.0	-2.3	-0.2	2.0
Slovakia	-14.5	-6.5	-3.6	4.8	6.9	6.6	6.5	4.4	1.9	2.0
Poland	-7.0	2.6	3.8	5.2	7.0	6.1	6.8	4.8	4.1	5.3
Romania	-12.9	-8.8	1.5	4.0	7.2	3.9	-6.6	-5.4	-3.2	0
Bulgaria	-8.4	-7.3	-1.5	1.8	2.8	-10.1	-6.9	3.5	2.5	3.5
Yugoslavia[b]	-11.6	-27.9	-30.8	2.5	6.1	5.9	7.4	2.6	-19.3	4.0
Croatia	-21.1	-11.7	-8.0	5.9	6.8	6.0	6.5	2.7	-0.3	2.5
Slovenia	-8.9	-5.5	2.9	5.3	4.1	3.1	3.8	3.9	4.0	4.0
Estonia		-12.4	-8.5	-2.0	4.3	3.9	10.6	4.0	-1.4	4.1
Latvia		-33.8	-11.7	0.6	-0.8	3.3	8.6	3.6	0.2	3.2
Lithuania		-34.0	-30.4	-9.8	3.3	4.7	7.3	5.1	-4.1	2.2
Hungary	-11.9	-3.0	-0.8	2.9	1.5	1.3	4.6	4.9	4.5	5.0

a Preliminary
b Gross material product
Source: Kopint-Datorg

Table 2

Industrial Production in the Central and Eastern European Economies
(percentage change over previous year or corresponding period of it)

Country	1991	1992	1993	1994	1995	1996	1997	1998	1999
Russia	-8.0	-18.0	-14.1	-20.9	-3.3	-4.0	1.9	-5.2	8.1
Ukraine	-4.0	-6.4	-8.0	-27.3	-11.7	-5.1	-1.8	-1.5	4.3
Czech Republic	-21.6	-7.9	-5.3	2.0	8.7	2.0	4.5	1.6	-3.5
Slovakia	-19.4	-9.2	-3.8	4.8	8.3	2.5	2.7	5.0	-3.2
Poland	-11.9	3.9	6.4	11.9	9.4	8.3	10.8	4.6	4.7
Romania	-22.8	-21.9	1.3	3.3	9.4	6.3	-7.2	-17.3	-8.0
Bulgaria	-20.2	-18.4	-10.0	10.6	4.4	3.8	-10.2	-9.4	-12.5
Yugoslavia	-17.6	-21.4	-37.3	1.3	3.8	7.5	9.5	3.4	-24.1
Croatia	-28.5	-14.6	-5.9	-2.7	0.3	3.1	6.8	3.7	-1.4
Slovenia	-12.4	-13.2	-2.8	6.4	2.0	1.0	1.0	3.7	-0.5
Estonia				-3.0	1.9	2.9	14.6	4.1	-3.9
Latvia				-9.5	-6.3	1.4	6.1	2.0	-8.8
Lithuania				-26.6	5.3	5.0	3.3	7.0	-9.9
Hungary	-16.6	-9.8	4.0	9.6	4.6	3.4	11.1	12.6	10.5

Source: Kopint-Datorg

Table 3

CPI in the Central and Eastern European Economies

(percentage change)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000 fore-cast
Russia	100.0	15.3 fold	8.7 fold	309.0	197.4	47.8	14.7	27.6	85.7	26.0
Ukraine	94.0	12 fold	47.3fold	891.2	376.7	80.2	15.9	20.0	22.7	25.0
Czech Republic	56.7	11.1	20.8	10.0	9.1	8.8	8.5	10.7	2.1	4.0
Slovakia	61.2	10.0	23.2	13.4	9.9	5.8	6.1	6.7	10.5	9.5
Poland	71.1	43.0	35.3	32.2	27.8	20.0	14.9	11.8	7.4	7.7
Romania	170.2	210.4	256.1	136.7	32.3	38.8	154.8	59.1	45.8	30.0
Bulgaria	254.3	82.0	72.8	96.0	62.9	123.0	1082.3	22.3	0.3	6.0
Yugoslavia	121.0	92 fold	$1.16x10^{14}$	$7.1x10^{11}$	78.6	91.5	21.6	29.8	50.1c	38.0
Croatia	123.0	663.6	1516.6	97.5	2.0	3.6	3.7	5.7	4.2	4.5
Slovenia	115.0	207.3	31.7	21.0	13.5	9.9	8.4	7.9	6.1	6.0
Estonia		1069.3	89.4	47.7	28.9	23.1	11.1	8.2	3.3	3.5
Latvia		951.2	109.2	36.6	26.0	17.6	8.4	4.7	2.4	3.8
Lithuania		1020.5	410.4	72.2	39.6	24.6	8.9	5.1	0.8	3.2
Hungary	35.0	23.0	22.5	18.8	28.2	23.6	18.3	14.3	10.0	8.5

a January to January
b February to February
c December to December
Source: Kopint-Datorg

Table 4

Unemployment in the Central and Eastern European Economies

(percentage of active population, year-end)

Country	1991	1992	1993	1994	1995	1996	1997	1998	1999
Russia	0.1	0.8	5.5[a]	7.1[a]	8.2[a]	9.3[a]	9.0[a]	11.8[a]	11.7[a]
Ukraine	-	0.2	0.4	0.5	0.6	1.8	2.3	3.7	4.3
Czech Republic	4.1	2.6	3.5	3.2	2.8	3.5	5.2	7.5	9.4
Slovakia	11.8	10.4	14.4	14.8	13.1	12.8	12.5	15.6	19.2
Poland	11.8	14.3	16.4	16.0	14.9	13.2	10.3	10.4	13.0
Romania	3.1	8.4	10.4	10.9	8.9	6.6	8.8	10.3	11.5
Bulgaria	11.5	15.2	16.4	12.8	11.1	12.5	13.7	12.2	16.0
Yugoslavia[b]	22.2	23.8	23.1	25.2	24.6	26.1	25.6	27.2	32.0
Croatia	14.1	15.5	14.6	14.8	15.1	15.9	17.6	18.6	20.8
Slovenia	10.1	13.4	15.4	14.2	14.5	14.4	14.8	14.6	13.0
Estonia				5.1	5.0	5.5	4.6	5.1	6.5
Latvia		2.3	5.8	6.5	6.6	7.2	7.0	9.2	9.1
Lithuania			4.4	4.5	7.3	6.2	6.7	6.9	10.0
Hungary	7.5	12.3	12.1	10.4	10.4	10.7	10.4	9.1	9.6

a According to the methodology of ILO
b until 1996 annual average
Source: Kopint-Datorg

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