Transition report 2007

People in transition

European Bank
for Reconstruction and Development

About this Report

The EBRD seeks to foster the transition to an open market-oriented economy and to promote private and entrepreneurial initiative in central eastern Europe and the Baltic states, south-eastern Europe, the Commonwealth of Independent States and Mongolia. To perform this task effectively, the Bank needs to analyse and understand the process of transition. The purpose of this Report is to advance this understanding and to share our analysis with our partners.

The responsibility for the content of the Report is taken by the Office of the Chief Economist. The assessments and views expressed in the Report are not necessarily those of the EBRD.

Acknowledgements

This *Transition Report* was prepared by the Office of the Chief Economist of the EBRD, under the general direction of Erik Berglöf. It also includes contributions from the Office of the General Counsel (Annex 1.1), the Environment and Sustainability Department (Annex 5.1) and the Infrastructure Team.

The editorial team was led by Alan Rousso and Simon Commander with the collaboration of Ralph de Haas, Elisabetta Falcetti and Peter Sanfey. Lucie Newman provided administrative support.

The writing teams for the chapters and annexes comprised:

Chapter 1 Alex Chirmiciu and Franklin Steves, with contributions from Clotilde Bureau (Box 1.1) and Alex Lehmann (Box 1.2).
Annex 1.1 Roman Chapaev and Gian Piero Cigna.

Chapter 2 Anatoli Annenkov and Ralph de Haas with the assistance of Yevgeniya Korniyenko and contributions from Fabrizio Coricelli, Rika Ishii, Yevgeniya Korniyenko and Toshiaki Sakatsume (Box 2.2).
Annex 2.1 Tatiana Lysenko and Yevgeniya Korniyenko.

Chapter 3 Pauline Grosjean and Gerard Roland with the assistance of Elcin Akcura and contributions from Alan Rousso and Franklin Steves (Box 3.1) and Anna Andreenkova (Box 3.2).
Annex 3.1 Utku Teksoz.

Chapter 4 Simon Commander and Helena Schweiger with the assistance of Ermal Hitaj.

Chapter 5 Paul Grout and Libor Krkoska with the assistance of Elena Rydvalova.
Annex 5.1 Michaela Bergman, Alke Schmidt and Felix Weinhardt.

The country assessments were prepared by the country economists of the Office of the Chief Economist. Their responsibilities are as follows: Albania – Johannes Emmerling and Peter Sanfey; Armenia – Heike Harmgart; Azerbaijan – Anita Taci; Belarus – Tatiana Lysenko; Bosnia and Herzegovina – Peter Sanfey; Bulgaria – Francesca Pissarides; Croatia – Helena Schweiger; Czech Republic – Vanessa Mitchell-Thomson; Estonia – Vanessa Mitchell-Thomson; FYR Macedonia – Johannes Emmerling and Peter Sanfey; Georgia – Anita Taci; Hungary – Zbigniew Kominek; Kazakhstan – Ralph de Haas; Kyrgyz Republic – Rika Ishii; Latvia – Heike Harmgart; Lithuania – Franklin Steves; Moldova – Alex Chirmiciu; Poland – Zbigniew Kominek and Tatiana Lysenko; Mongolia – Toshiaki Sakatsume; Montenegro – Peter Sanfey; Romania – Francesca Pissarides; Russia – Libor Krkoska and Alex Lehmann; Serbia – Peter Sanfey; Slovak Republic – Vanessa Mitchell-Thomson; Slovenia – Helena Schweiger; Tajikistan – Pauline Grosjean and Rika Ishii; Turkmenistan – Heike Harmgart; Ukraine – Elisabetta Falcetti; and Uzbekistan – Rika Ishii. Editorial advice was provided by Julian Exeter. The data tables were prepared by Elcin Akcura, Marko Atanasovsky, Lasha Chochua, Yevgeniya Korniyenko, Tatiana Lysenko and Elena Rydvalova.

Editorial guidance was provided by Anthony Martin and Hannah Goodman in the Publications Unit and by Robert McGowan. The Report was designed and print managed by Jon Page, Steven Still and Joanna Daniel in the Design Unit.

The Report benefited from comments and feedback from the EBRD Board of Directors and their authorities, the EBRD Executive Committee, the EBRD's Resident Offices and Country Teams, and staff from the International Monetary Fund and the World Bank. Wendy Carlin, Fabrizio Coricelli, Joly Dixon, Saul Estrin, Sergei Guriev, Peter Haiss, Fabio Mucci, Debora Revoltella, Pavel Veprek and Ekaterina Zhuravskaya read sections of the Report and provided comments. Jose Carbajo, Bota Hopkinson, Zbigniew Kominek, Henrik Lannero, Matthias Loening, Tanya Normak and Thomas Maier from the EBRD provided substantial comments to Chapter 5.

Much of the background material for this *Transition Report* came from the EBRD/World Bank Life in Transition Survey, which received funding from the governments of Canada, Taipei China and the United Kingdom. This funding is gratefully acknowledged.

Transition report 2007

People in transition

Contents

Transition countries

Central eastern Europe and the Baltic states
Population (million)

Czech Republic	10.3
Estonia	1.3
Hungary	10.1
Latvia	2.3
Lithuania	3.4
Poland	38.1
Slovak Republic	5.4
Slovenia	2.0

South-eastern Europe
Population (million)

Albania	3.2
Bosnia and Herzegovina	3.8
Bulgaria	7.7
Croatia	4.4
FYR Macedonia	2.0
Montenegro	0.7
Romania	21.7
Serbia	9.9

Commonwealth of Independent States and Mongolia
Population (million)

Armenia	3.2
Azerbaijan	8.4
Belarus	9.7
Georgia	4.5
Kazakhstan	15.4
Kyrgyz Republic	5.1
Moldova	3.4
Mongolia	2.7
Russia	142.2
Tajikistan	6.6
Turkmenistan	6.5
Ukraine	47.1
Uzbekistan	26.0

Executive summary

Chapter 01
Progress in transition

The transition countries have made further progress in structural and institutional reforms over the past year but at a slower pace than in previous years. The pace of reform continues to be fastest in south-eastern Europe (SEE), with significant progress in the less advanced countries of the Western Balkans which are still catching up with the rest of the transition region.

In the Commonwealth of Independent States and Mongolia (CIS+M) there have been substantial advances in creating a private economy in countries with strong pro-market support, particularly in Mongolia and Georgia. In the western CIS countries, market developments and external economic factors triggered a number of reforms in the financial sector. Resource-rich countries in the CIS+M made limited progress. In central eastern Europe and the Baltic states, where transition has gone furthest, progress in the past year has been limited.

While first-phase market-enabling reforms are largely completed, recent reform progress has mostly focused on second-phase market-deepening reforms – privatisation and reforms in the financial sector – and third-phase market-sustaining reforms, particularly competition policy. Infrastructure reform remains a key challenge. Many transition countries need to improve the security of their gas supply by importing from a broader range of countries or by encouraging energy efficiency through tariff reform aimed at achieving full cost recovery.

Recent turbulence in international financial markets will lead to higher funding costs, impose credit constraints and increase risk aversion on the part of international investors. This is likely to have an impact on financial sectors throughout the transition region.

Chapter 02
Macroeconomic overview

Average economic growth in the transition region reached 6.9 per cent in 2006, the fastest rate of economic expansion since the start of the transition process. Rapid growth has been underpinned by strong domestic demand, fuelled by high levels of foreign direct investment, significant remittances from workers living abroad and a rapid expansion in bank lending. Global demand and oil and gas prices remained high, as reflected in strong export growth. As a result, unemployment rates and poverty levels have fallen. Throughout the transition region, rising prosperity has triggered higher demand for housing, leading in turn to booming construction and sharp increases in house prices.

At the same time, signs that economies are overheating are becoming apparent throughout the region in the form of inflation and rising external imbalances. While exports have remained strong, the competitiveness of several Baltic states and countries in south-eastern Europe is at risk. Against this background, monetary policy has gradually been tightened. Fiscal policy has so far been unable to ease inflationary pressures and external imbalances, and is in many countries expected to fuel already overheating economies.

The global financial turmoil that started in August 2007 is making external finance dearer, which may help overheated economies in the transition region to cool down. In a less benign scenario, countries with high external funding needs may experience a stronger economic downturn.

Chapter 03
People's attitudes to transition

Seventeen years of political and economic transition have had a profound effect on people's thinking and everyday lives. According to the 2006 EBRD/World Bank Life in Transition Survey, general life satisfaction is higher in the wealthier, more advanced countries in central eastern Europe and the Baltic states, lower in south-eastern Europe, where unemployment has spiralled, and mixed in the Commonwealth of Independent States and Mongolia. Those who have benefited most from transition – broadly the younger, the better educated, the better connected and the more mobile sections of society – tend to be more satisfied with their lives.

A majority of people feel that their living standards in absolute terms have improved since the transition began, but also feel that their household's wealth in relative terms has deteriorated. Income inequality, which has grown in most countries, may have fed the perception that people have been made worse off in relative terms by transition.

Support for democracy is quite strong in the transition region despite the fact that many people feel the political situation has deteriorated since the transition began. Support for the market economy is highest in the new EU member states but overall it is weaker than support for democracy. Evidence from the World Values Surveys suggests that attitudes and values regarding markets and democracy in the transition countries are not converging towards views held in mature market economies in western Europe and the United States.

Chapter 04
People's attitudes and their experiences in the labour market

Labour markets in the transition countries have undergone a profound transformation in the past 17 years. A massive reallocation of labour from the state to the private sector and from manufacturing to services has occurred, leaving many people without jobs or in jobs below their skill level. Some have taken on more menial jobs and others, particularly women, have withdrawn from the labour force, often to care for children, since new employers have often been unable or unwilling to provide free or subsidised child care.

Unemployment levels rose quickly at the onset of transition, but have recently begun to fall across much of the region, partly as a result of increased migration into western Europe following EU accession. Movement between different types of employment – private, state and self-employment – has been brisk, suggesting more flexible labour markets and better matching of workers to jobs. However, major upheaval in the labour market leaves some workers worse off and can therefore have a negative impact on their attitudes towards the market and reform.

Those with less education and fewer skills have tended to face poorer prospects, leading to lower levels of life satisfaction and a more pessimistic view of the power of the market to improve people's lives. They tend to favour greater government involvement in the economy – in terms of setting prices for basic goods, guaranteeing employment and owning large enterprises. By contrast, the self-employed, whose numbers have increased rapidly during transition, along with skilled workers tend to be relatively satisfied and expect less from government. Increasing employment levels is clearly a priority for governments across the region. Improving the quality of education and training will help to address the skills shortage in many countries and will help people to return to the labour force.

Chapter 05
Delivering public services

Policy-makers in transition countries face difficult choices as they respond to the pressure to improve the quality and efficiency of public services. According to the Life in Transition Survey, health care dominates people's concerns about public services. Those who regard health as the first priority for extra government investment are equally likely to be wealthy as poor.

The health care sector illustrates many of the issues facing policy-makers as they embark on ambitious programmes to raise the quality of public services. Satisfaction with the quality of services remains low despite the fact that standards of care and levels of public spending appear to be higher in the transition region than in countries with equivalent levels of GDP per head.

Involving the private sector helps governments to relieve the strain on government resources, to control costs and to provide the level of consumer service that responds to people's needs. The challenge is to build structures that introduce efficiency gains while continuing to meet the twin objectives of access for all and affordability. Private funding can be made available at both centralised and local levels but what can be achieved depends crucially on the quality of the legal and political frameworks.

Good procurement processes need to be in place to reduce the opportunities for "insiders" to gain privileged access to contracts and to avoid a re-run of some of the problems that emerged during the initial wave of privatisations in the 1990s. Community-based monitoring and greater transparency – through independent media and local non-governmental organisations – can help to reduce bureaucracy, corruption and the misuse of funds.

Foreword by the EBRD's Chief Economist

Sustained growth improves living standards but reforms need a boost.

Countries in the transition region continued to grow at an impressive pace over the past year. Growth in the region as a whole was at an all-time high of 6.9 per cent for 2006 (weighted average), driven to a great extent by domestic consumption, investment and the expansion of domestic credit, but also by favourable market conditions. However, the recent turmoil in international financial markets has raised questions about whether market conditions will remain benign, as explained in a separate discussion in Chapter 1.

The global liquidity crisis that began in summer 2007 has so far had a limited effect on the transition countries. Most have strengthened their finances and institutional frameworks in recent years. Since the crises of the 1990s, foreign banks have invested heavily in the region, strengthening local banking systems. In many transition countries foreign-exchange reserves have grown to all-time highs, thanks to high oil and gas prices and prudent macroeconomic management.

Nevertheless, the re-pricing of risk and higher costs for inter-bank lending across the region will reduce demand for bank credit, lower consumption and investments and slow economic growth. A prolonged squeeze on global liquidity would have a significant impact on those transition countries with large external imbalances and on individual institutions with large financing needs. Households, many of which have borrowed in foreign currency, will also come under pressure in the event of currency depreciations.

Ongoing corrections in housing markets in some countries put pressure on banks and enterprises that are particularly exposed to this sector.

These vulnerabilities must be addressed through continued structural and institutional reforms aimed at strengthening the financial sector and promoting entrepreneurial activity. However, whether owing to fatigue for some countries following accession to the European Union, uncertainties over the chances of EU membership for those in the "waiting room" or complacency brought on by the large oil and gas windfall, the pace of reforms in 2007 was the slowest since the transition began. Most importantly, popular support for reforms is weakening in many transition countries. Opinion polls throughout the region tell a story of deep and widespread discontent and there have been more frequent changes of government in recent years.

It is this striking contrast between strong growth and improving living standards on the one hand and broad dissatisfaction with the outcomes of transition on the other that is the starting point of this year's *Transition Report*. Lack of satisfaction is important in its own right – economic results must be measured more broadly than just in terms of GDP growth – but it also undermines support for economic and political reforms. Moreover, understanding public attitudes and values is critical to the design of policy, not least for the delivery of public services such as health care and education.

For these reasons the EBRD initiated the Life in Transition Survey (LiTS), which asks a wide variety of people – from farmers and factory workers to stay-at-home carers and entrepreneurs – how transition has affected them and their frame of mind. This unique exercise, undertaken jointly with the World Bank in 28 out of 29 of the EBRD's countries of operations, combines a traditional household survey – employing objective measures such as expenditures, living conditions and labour market status – with a survey of people's perceptions.

The results show that most people recognise that their lives are better today than before the transition began. The LiTS data on the ownership of goods and household expenditure reveal the emergence of a solid middle class in many countries with all that this means for consumption patterns and political attitudes. At the same time, people have a profound sense that their household wealth has deteriorated in relative terms; a clear majority reported that their relative position on a ten-step income ladder had fallen. This has made them sceptical about how and whether the market can improve their lives and safeguard their livelihoods. It has also eroded their support for reform-minded political parties and has led them to expect more from their governments in terms of tackling social and economic problems and correcting past injustices.

Yet, one of the most compelling results from the LiTS is the strong support for democracy and markets across the entire region and the weak support for the repressive systems of the past.

Despite the many hardships brought on by transition, a large majority of the people who have lived through this experience have embraced the move to economic and political freedom. As expected, this is especially true for those made better-off by the transition, for the better educated and more highly skilled segments of the workforce and for the younger generation. Although transition has been difficult, most people believe that the next generation will be better-off than the present one.

Nevertheless, support for the broad concepts of markets and democracy does not translate into public support for all types of market and democratic reforms. One result from the LiTS that applies across almost all countries is the strong support for increased government intervention in the economy. Despite relatively low levels of trust in government institutions, many people in the transition countries appear to trust markets even less. While they do not wish to see a return to central planning, they want the state to take more responsibility for making markets function better, for redistributing wealth and for managing strategic assets, such as oil and gas and electricity.

In one important respect, the transition process still has a long way to go in many countries. According to the LiTS, volunteerism, membership in clubs and other local community groups, participation in demonstrations, strikes and other forms of civic activism are abnormally low compared with developed market democracies. Civil society was almost entirely absent during communist times, although a sense of community may have existed through bonds of trust and cooperation at the local level. However, 17 years of transition has led to an erosion of trust in society and lower levels of confidence in key market and political institutions. It has also resulted in the perception of higher levels of corruption. This reduces social cohesion in the community, an important ingredient in sustaining markets and supporting democracy, and weakens the consensus for further reform.

The LiTS results have important implications for public policy. People surveyed clearly expect more from their governments in delivering public services – health, education, housing and basic municipal services. The deterioration in these services is less visible in terms of quantity – for example, the number of doctors and teachers per 1,000 citizens delivering these services – than in terms of quality. Hospitals and schools have not always been able to keep up with technological advances and the basic infrastructure needs to be modernised. Improving access to, and raising the quality of, public services must be an important part of any government's response to the widespread popular dissatisfaction.

While some countries have the ability to respond with additional government spending, most do not. For example, in the resource-rich countries in the CIS, years of accumulated savings in oil funds can now be channelled into infrastructure and social sector investment to improve public services in health, education, and municipal services. However, even where money is available, the ability to spend it efficiently and modernise effectively is beyond the capacity of the local governments that normally provide these services.

Private-sector involvement – through partnerships with the public sector, concessions, long-term contracts or other arrangements – is beginning to address the persistent problems that governments have in upgrading public services. However, as illustrated by the example of health care in Chapter 5, the challenges in designing and implementing such partnerships are not trivial, given the importance of government regulation in the delivery of many public services. Moreover, the parties involved often differ greatly in experience, with the public institution usually entering such an arrangement for the first time while the private operator may have experience in numerous projects globally.

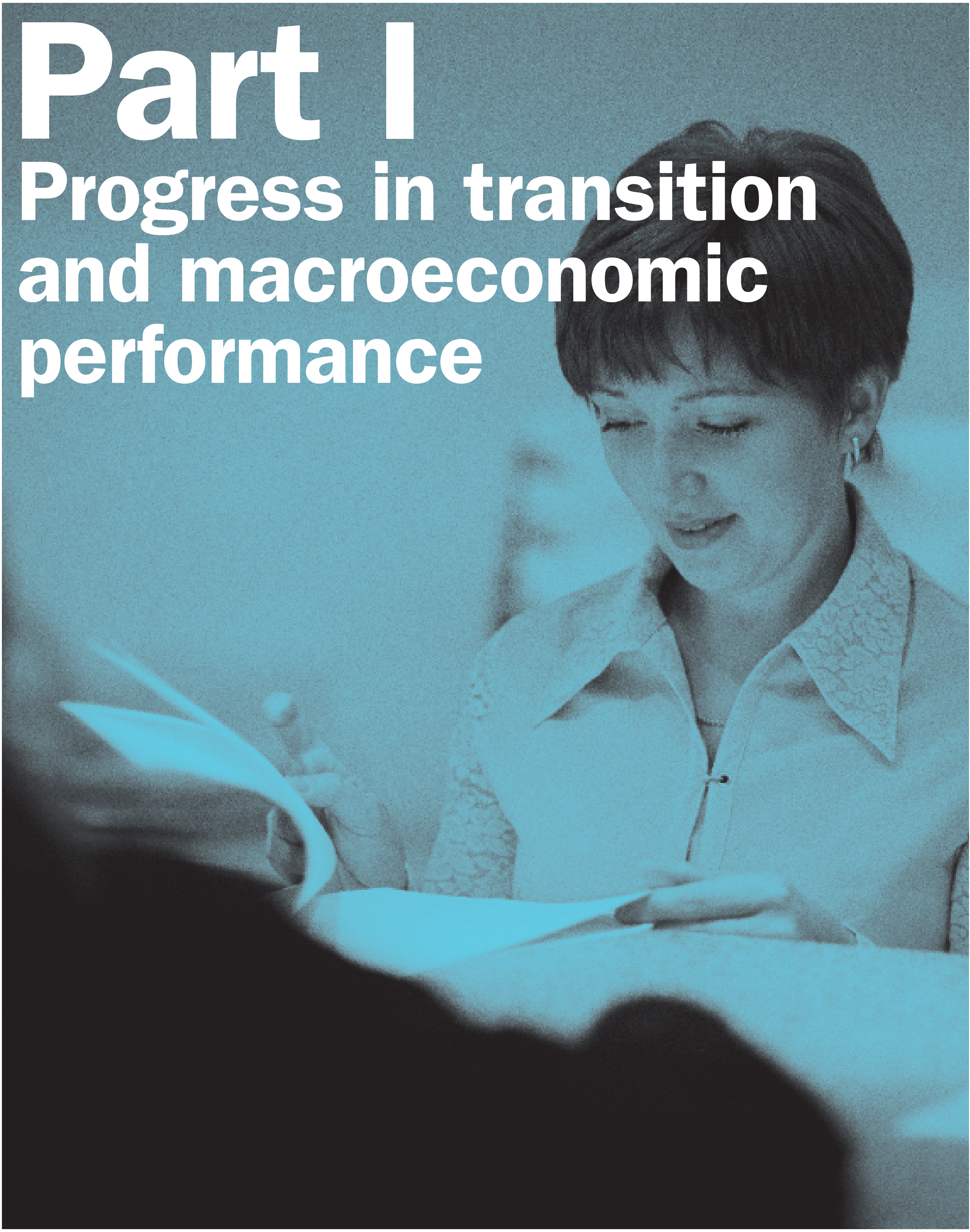
Experience has shown the importance of strengthening regulatory and administrative practices when it comes to handling tricky procurement issues, encouraging competition and overseeing projects. Reliable and independent courts are also needed to enforce contracts and settle disputes. But perhaps the key ingredient to making these partnerships work is the engagement of local communities.

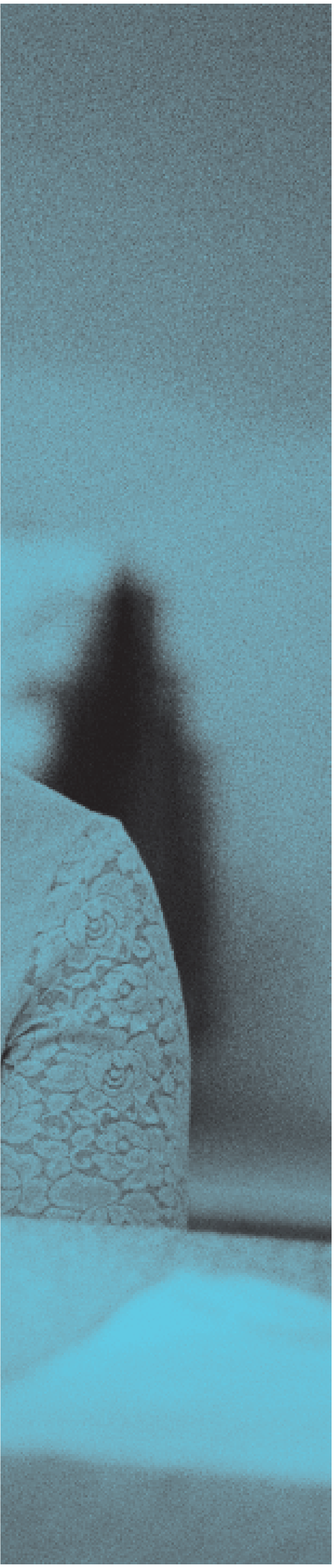
Special-interest groups, non-governmental organisations, an independent media and the establishment of public awareness campaigns can provide the monitoring function needed to ensure that the providers of public services remain committed to access, affordability and quality, in accordance with negotiated agreements. Most importantly, transparency and consultation can ensure that the public is better informed and has more realistic expectations about the implementation of complex projects. Experience from other parts of the world shows that community-based monitoring can be highly effective in reducing corruption and improving public service delivery.

The EBRD can play a role in supporting government authorities at different levels in the process of delivering public services. By learning from other projects in the region and by actively strengthening the capacity of local governments to implement projects, we can help to improve the efficiency of private-sector involvement in the delivery of public services. Ultimately, these efforts will also strengthen the commitment of local people to this process and improve not only access to public services but also people's sense of well-being.

Erik Berglöf
Chief Economist of the EBRD
1 October 2007

Part I
Progress in transition and macroeconomic performance





Part I of the *Transition Report* discusses the main economic developments in the transition region over the past year.

Chapter 1 reviews the latest progress in reform and provides the 2007 transition indicator scores for each of the nine dimensions of market reform tracked by EBRD economists. The scoring covers four broad areas of reform – enterprises, markets and trade, financial institutions and infrastructure. The chapter also assesses how the region's energy needs could be affected by price rises and/or disruptions to supply and how the transition countries will be affected by recent turbulence in the financial markets. Annex 1.1 reports the findings of this year's Legal Indicator Survey on securities markets.

Chapter 2 looks at the transition region's macroeconomic performance in terms of output and inflation, monetary policy, fiscal policy and external balances. The chapter considers how the booming housing market and rising property prices are likely to affect the overall economy and examines the emerging trade relationship between China and the transition countries. Annex 2.1 provides tables on a number of key macroeconomic indicators, including forecasts for growth and inflation for 2008.

01
Progress in transition

Progress in structural and institutional reforms across the transition region continued over the past 12 months, albeit at a slower pace than in previous years. Reform was fastest in south-eastern Europe (SEE), with significant progress in the less advanced countries of the Western Balkans. Reforms in the Commonwealth of Independent States and Mongolia (CIS+M) occurred predominantly in the non-resource rich countries, whereas resource-rich countries made only limited progress. Two patterns of reforms were observed in the CIS+M. First, there were substantial advances in creating a private economy in countries with strong pro-market support. Secondly, in the western CIS market developments and external economic factors triggered a number of reforms in the financial sector. In central eastern Europe and the Baltic states (CEB), where transition has gone furthest, progress in the past year was limited.

The EBRD tracks reform developments in 29 transition countries through a set of nine transition indicators. These indicators cover three phases of progress. The first phase – market-enabling reforms – includes the liberalisation of prices, the liberalisation of trade and access to foreign exchange, and small-scale privatisation. The second phase, designed to be market deepening, includes large-scale privatisation, the reform of the banking sector and the creation and development of securities markets and non-bank financial institutions. The third phase – market-sustaining economic reforms – includes enterprise restructuring and modernisation, the implementation of governance standards, the development and enforcement of effective competition policy, and reform of vital market-supporting infrastructure.

Reform progress by country

Transition progress across the region continued over the past year, albeit more slowly than in previous years. A total of 20 transition score upgrades were awarded to 14 countries. Progress in market-oriented reforms was fastest in south-eastern Europe, with 10 score upgrades, followed by the Commonwealth of Independent States and Mongolia with eight, and central eastern Europe and the Baltic states with only two score upgrades.*

Central eastern Europe and the Baltic states

Since transition began, central eastern Europe and the Baltic states (CEB) have made dramatic progress towards developing market economies (see Charts 1.2 and 1.3). However, reform has slowed considerably since accession to the European Union in 2004 and score upgrades in the past year were recorded only in Latvia and Lithuania. In Latvia, there were improvements to banking regulation, particularly anti-money laundering procedures. Bank lending grew by more than 50 per cent, with domestic credit reaching 89 per cent of GDP at the end of 2006. In Lithuania, securities legislation and regulation were both improved. There was also market-driven development of the leasing market and a substantial expansion of securities markets.

No upgrades in the main categories of reform were awarded elsewhere in CEB, although there were some notable developments in specific areas of infrastructure. In the railways, an upgrade was awarded to Hungary following the establishment of a regulatory office and independent companies for passenger and freight services, and increases in competition in railway freight transportation (see Table 1.3). This contrasts with Estonia, where there was a score downgrade following the renationalisation of Estonian Railways through a buy-back of shares in April 2007.

In much of CEB, a lack of domestic political and social consensus has led to fragile coalition governments that are less inclined to pursue difficult reforms. Further progress in the reforms that are still needed will require more political support and the development of substantial market-based institutional expertise.

* The number of upgrades are shown in Chart 1.1. For a full list of the transition indicator scores for all 29 transition countries, see Table 1.1 and for a summary of the reasons for this year's upgrades, see Table 1.2.

South-eastern Europe

The past year has been relatively strong for reforms in south-eastern Europe (SEE), where 10 upgrades were awarded. Among the advanced countries in SEE – Bulgaria, Croatia and Romania – there has been notable reform progress in the latter two countries in the past year. Progress for all three countries in recent years has been linked to their EU accession process. Bulgaria and Romania acceded in 2007 while Croatia remains a candidate country.

In Romania, development of the financial sector was largely a market-based response to earlier reforms and privatisations. The rapid expansion of credit to private enterprises and households coupled with better banking regulation warranted an upgrade in the transition score for banking. At the same time, stock and bond markets have grown rapidly, private pension funds have been authorised and started operations, and the insurance and leasing markets have continued to expand. In Croatia, one-stop shops have improved business entry conditions while a “regulatory guillotine” process has generated a comprehensive list of business regulations to be simplified. These measures were complemented by a stronger competition authority, resulting in an upgrade in the transition score for competition policy.

However, most reform in SEE in the past year took place in the Western Balkans, where transition is substantially less advanced and proximity to European markets has fostered notable progress in institutional reforms. All countries made progress in at least one area, although the level of reform still remains significantly behind the new EU member states. Two transition score upgrades were awarded to Montenegro, which maintained its post-independence reform momentum. The Stabilisation and Association Agreement with the European Union, signed in October 2007, and accession to the Central European Free Trade Agreement in December 2006 both show a commitment to a liberal trade regime. The establishment of a Department for Protection of Competition in 2006, coupled with a competition law broadly in line with EU standards, resulted in a transition score upgrade for competition policy.

Bosnia and Herzegovina also progressed in a number of areas. Republika Srpska sold an oil refinery, some industrial holdings and the fixed-line telecoms operator, which led to a transition score upgrade for large-scale privatisation. There was also progress in competition policy, with the strengthening of the competition office. In roads, the corporatisation of the roads agency has been completed in both Entities; open tendering is being used more extensively for construction and maintenance and road user charges help to ensure the financing of road maintenance.

FYR Macedonia received a transition score upgrade for competition policy for legal amendments in 2006 and 2007, while a number of competition office decisions have been upheld in court challenges. Similarly, the competition authority established in Serbia in 2005 has demonstrated its capacity to implement competition legislation. In Albania, better telecoms regulation, coupled with the full privatisation of Albtelecom, warranted an upgrade of the telecoms score, which led to an upgrade of the overall infrastructure reform score.

Commonwealth of Independent States and Mongolia

Mongolia made the most progress in reform in 2006-07, with transition score upgrades for large-scale privatisation, competition policy and banking reform. The sale of several large state-owned enterprises, including the Savings Bank and Gobi Cashmere, have driven privatisation forward, while the competition authority has established a good track record for defending competition rules. The banking sector is fully private and has grown substantially over the past year, with domestic credit to the private sector increasing by over 40 per cent in 2006.

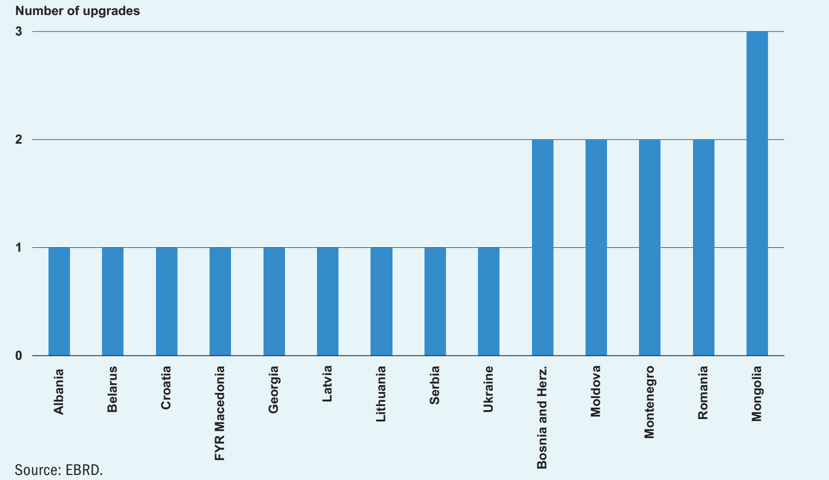
There were four transition score upgrades in the western CIS. In Ukraine a new law on securities and the Stock Exchange was adopted in 2006. The non-bank financial sector has developed due to substantial growth in the mortgage, leasing and insurance markets, warranting a transition score upgrade for securities markets and non-bank financial institutions. In Moldova, the scores for banking reform and interest rate liberalisation and competition policy were upgraded. The acquisition of domestic banks by international players such as Société Générale and Erste Bank is a milestone in the development of the financial system. In competition policy, an autonomous competition authority was established in February 2007 and has already issued an important ruling. In Belarus the "golden share" rule, which grants the state the right to participate in the management of privatised enterprises, was abolished for the banking sector and one mid-sized bank was privatised, while private credit continues to expand rapidly. However, interest rates continue to be dictated centrally, keeping Belarus's banking reform score among the lowest in the transition region.

In Russia, there was limited reform progress overall in the past year, although further steps were taken to implement the existing railway reform programme. This has led to more competition in freight services (wagons, containers, logistics, leasing and terminals) and a very active private sector. Other noteworthy developments were observed in banking – credit has expanded vigorously, particularly rouble credit, the first securitisation under domestic law was completed and Société Générale acquired Rosbank, one of the top 10 banks in Russia. However, the sector continues to be dominated by two large state-owned banks, while consolidation of small banks is very slow.

In the Caucasus, only Georgia has made substantial transition progress over the past year. With the privatisation of regional electricity distribution and generation companies, privatisation in Georgia is largely complete. Further energy sector reforms, including tariff reform and increased collection rates, resulted in a transition score upgrade. A score upgrade for the water sector was awarded to Armenia, where successful involvement of the private sector in water management has led to improved operations. However, in Azerbaijan reforms have stalled, as high oil prices and rapid economic growth have reduced the sense of urgency for reform.

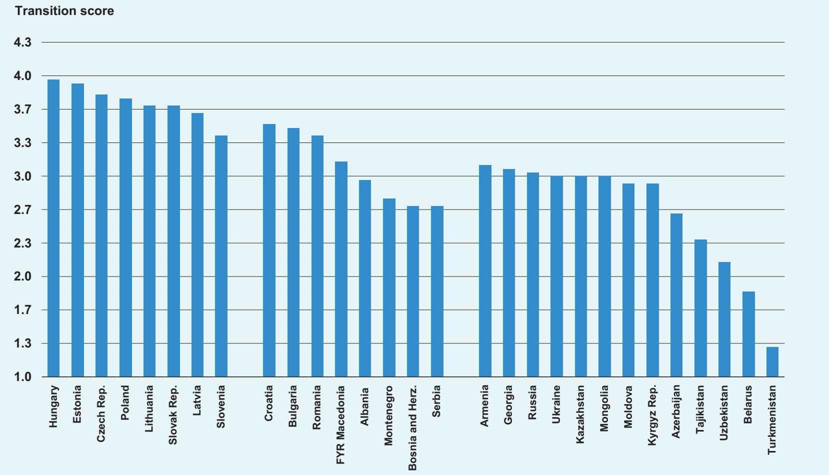
In Central Asia few significant reforms have been completed over the past 12 months and no transition score upgrades were awarded in the main categories of reform. In Kazakhstan, the first transparent Central Asian money market index, KazPrime, was launched and ATF Bank was acquired by Unicredito Group of Italy. Furthermore, the road sector transition score was upgraded because a number of reforms were implemented: road user charges were set at a level sufficient to cover maintenance costs, maintenance contracts are now fully tendered and private companies are becoming increasingly involved in maintenance.

Chart 1.1
Progress in transition, 2006-07



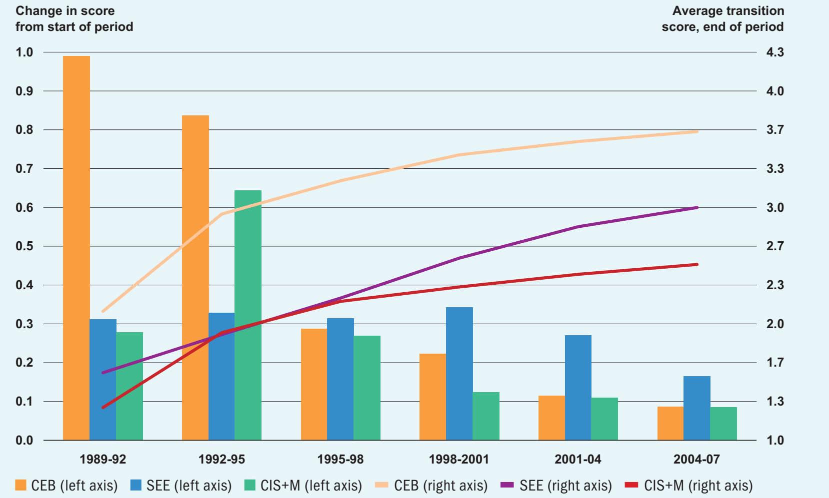
Source: EBRD.
Note: The chart shows the total number of upgrades in the nine areas of reform covered by the transition indicators (see Table 1.1). No change was recorded in Armenia, Azerbaijan, Bulgaria, Czech Republic, Estonia, Hungary, Kazakhstan, Kyrgyz Republic, Poland, Russia, Slovak Republic, Slovenia, Tajikistan, Turkmenistan or Uzbekistan.

Chart 1.2
Average transition score by country, 2007



Source: EBRD.
Note: The transition indicators range from 1 to 4+ (shown in the chart as 4.3), with 1 representing little or no change from a rigid centrally planned economy and 4+ (4.3) representing the standards of an industrialised market economy.

Chart 1.3
Regional patterns of progress in transition, 1989–2007



Source: EBRD.
Note: See Chart 1.2 for a description of transition scores.

Table 1.1
Transition indicator scores, 2007

Country	Population mid-2007 (million)	Private sector share of GDP mid-2007 (EBRD estimate in per cent)	Enterprises: Large-scale privatisation	Enterprises: Small-scale privatisation	Enterprises: Governance and enterprise restructuring	Markets and trade: Price liberalisation	Markets and trade: Trade and foreign exchange system	Markets and trade: Competition policy	Financial institutions: Banking reform and interest rate liberalisation	Financial institutions: Securities markets and non-bank financial institutions	Infrastructure: Infrastructure reform
Albania	3.2	75	3	4	2+	4+	4+	2	3–	2–	2+ ↑
Armenia	3.2	75	4–	4	2+	4+	4+	2+	3–	2	2+
Azerbaijan	8.4	75 ↑	2	4–	2	4	4	2	2+	2–	2
Belarus	9.7	25	1	2+	1	3–	2+	2	2 ↑	2	1+
Bosnia and Herzegovina	3.8	60 ↑	3 ↑	3	2	4	4–	2 ↑	3–	2–	2+
Bulgaria	7.7	75	4	4	3–	4+	4+	3–	4–	3–	3
Croatia	4.4	70 ↑	3+	4+	3	4	4+	3– ↑	4	3	3
Czech Republic	10.3	80	4	4+	3+	4+	4+	3	4	4–	3+
Estonia	1.3	80	4	4+	4–	4+	4+	4–	4	4–	3+
FYR Macedonia	2.0	65	3+	4	3–	4+	4+	2+ ↑	3–	2+	2+
Georgia	4.5	75 ↑	4 ↑	4	2+	4+	4+	2	3–	2–	2+
Hungary	10.1	80	4	4+	4–	4+	4+	3+	4	4	4–
Kazakhstan	15.4	70 ↑	3	4	2	4	4–	2	3	3–	3–
Kyrgyz Republic	5.1	75	4–	4	2	4+	4+	2	2+	2	2–
Latvia	2.3	70	4–	4+	3	4+	4+	3	4 ↑	3	3
Lithuania	3.4	75	4	4+	3	4+	4+	3+	4–	3+ ↑	3
Moldova	3.4	65	3	3+	2	4	4+	2+ ↑	3 ↑	2	2+
Mongolia	2.7	75 ↑	3+ ↑	4	2	4+	4+	2+ ↑	3– ↑	2	2
Montenegro	0.7	65	3+	4–	2	4	4 ↑	2– ↑↑	3–	2–	2
Poland	38.1	75	3+	4+	4–	4+	4+	3+	4–	4–	3+
Romania	21.7	70	4–	4–	3–	4+	4+	3–	3+ ↑	3– ↑	3+
Russia	142.2	65	3	4	2+	4	3+	2+	3–	3	3–
Serbia	7.5	55	3–	4–	2+	4	3+	2 ↑	3–	2	2
Slovak Republic	5.4	80	4	4+	4–	4+	4+	3+	4–	3	3–
Slovenia	2.0	70 ↑	3	4+	3	4	4+	3	3+	3–	3
Tajikistan	6.6	55	2+	4	2–	4–	3+	2–	2+	1	1+
Turkmenistan	6.5	25	1	2	1	3–	1	1	1	1	1
Ukraine	47.1	65	3	4	2	4	4–	2+	3	3– ↑	2+
Uzbekistan	26.0	45	3–	3+	2–	3–	2	2–	2–	2	2–

Source: EBRD.

Note: The transition indicators range from 1 to 4+, with 1 representing little or no change from a rigid centrally planned economy and 4+ representing the standards of an industrialised market economy. For a detailed breakdown of each of the areas of reform, see the methodological notes on page 210.

The private sector share of GDP is calculated using available statistics from both official (government) and unofficial sources. The share includes income generated from the formal activities of registered private companies, as well as informal activities where reliable information is available. The term "private company" refers to all enterprises in which private individuals or entities own the majority of shares.

The accuracy of EBRD estimates is constrained by data limitations, particularly in the area of informal activity. EBRD estimates may, in some cases, differ markedly from official data. This is usually due to differences in the definition of "private sector" or "non-state sector". For example, in the CIS+M, "non-state sector" includes collective farms, as well as companies in which only a minority stake has been privatised.

↑ and ↓ arrows indicate change from the previous year. One arrow indicates a movement of one point (from 4 to 4+, for example), two arrows a movement of two points. Up arrows indicate upgrades, down arrows indicate downgrades.

Past scores for the following have been revised this year: in Montenegro, the small-scale privatisation indicator was upgraded to 3+ for 2003 and 4– for 2005, and trade and foreign exchange was upgraded to 4– for 2005; in Poland, competition policy was revised upward to 3+ for 2005; and in Romania, the securities markets and non-bank financial institutions indicator was revised upward to 2+ for 2003. Population data for Serbia excludes Kosovo.

Table 1.2
Changes in transition scores

Country	Transition indicator	Change in score	Reason for upgrade
Albania	Infrastructure	2 to 2+	Progress in telecoms, including privatisation of Albtelecom and significant improvements in sectoral regulation.
Belarus	Banking reform and interest rate liberalisation	2– to 2	The abolition of the “golden share” in the banking sector and resulting privatisation of one mid-sized bank alongside the rapid expansion of private credit.
Bosnia and Herzegovina	Large-scale privatisation	3– to 3	Progress in privatisation in large state-owned firms in Republika Srpska, including telecoms, an oil refinery and some industrial concerns.
	Competition policy	2– to 2	The competition council has grown in strength and began to take action against cartel and abuse of dominant position enquiries in the past year.
Croatia	Competition policy	2+ to 3–	The competition authorities have been strengthened and entry restrictions have been lowered over the past year.
FYR Macedonia	Competition policy	2 to 2+	Amendments in 2006 and 2007 strengthened competition law, and the competition office has proven its capacity to enforce competition policy.
Georgia	Large-scale privatisation	4– to 4	With the sale of regional power distribution and generation companies, large-scale privatisation in Georgia is nearly complete.
Latvia	Banking reform and interest rate liberalisation	4– to 4	Improved anti-money laundering procedures matched by a number of interventions, as well as a sharp decline in Russian rouble foreign exchange trading.
Lithuania	Securities markets and non-bank financial institutions	3 to 3+	Ongoing improvements to securities markets and insurance legislation and regulation, as well as continued deepening of leasing markets.
Moldova	Competition policy	2 to 2+	Effective establishment of the long-awaited autonomous competition authority, which has already begun to issue decisions.
	Banking reform and interest rate liberalisation	3– to 3	Improved central bank legislation and supervision, accompanied by entry of three strategic foreign banks in the past year.
Mongolia	Large-scale privatisation	3 to 3+	A number of large state-owned enterprises were privatised in 2006, including the Savings Bank and Gobi Cashmere.
	Competition policy	2 to 2+	The regulatory authority established in 2004 has proven its capacity to enforce competition legislation, intervening in 30 cases over the past year.
	Banking reform and interest rate liberalisation	2+ to 3–	Growth in the banking sector remains robust, with foreign entrants and improving prudential regulation standards.
Montenegro	Trade and foreign exchange	4– to 4	Signing of SAA indicates commitment to liberal trade, progress on WTO accession negotiations; CEFTA accession.
	Competition policy	1 to 2–	The Department for the Protection of Competition was established in 2006; Montenegro’s competition law is generally in line with EU standards.
Romania	Banking reform and interest rate liberalisation	3 to 3+	Rapid expansion of credit to the private sector combined with improved regulatory standards.
	Securities markets and non-bank financial institutions	2+ to 3–	Expansion of the stock market; ongoing development of bond markets.
Serbia	Competition policy	2– to 2	A growing track record of enforcement of anti-trust regulation and merger control by the anti-monopoly authority set up in 2005, evidenced by the increase in law enforcement cases and the number of the authority’s professional staff.
Ukraine	Securities markets and non-bank financial institutions	2+ to 3–	Implementation of 2006 Law on Securities and Stock Exchange, accompanied by rapid deepening of corporate and bank debt markets.

Source: EBRD.
Note: See Table 1.1 for transition indicator scores for all transition countries.

Reform progress by sector

First-phase, "market-enabling" reforms involving market liberalisation and small-scale privatisation have largely been completed across the transition region. "Market-deepening", second-phase reforms of large-scale privatisation and financial sector reform have progressed in the new EU member countries, but much remains to be done elsewhere. Third-phase, "market-sustaining" reforms – governance and enterprise restructuring, competition policy and infrastructure – remain unfinished even in the more advanced transition countries, and have only begun in the less advanced transition countries.

First-phase reforms

First-phase, "market-enabling" reforms are necessary to allow prices to become the main signalling and coordination mechanisms in the economy. Small-scale privatisation and liberalisation of prices, trade and foreign exchange were the first reforms to be implemented after the collapse of central planning. The transition scores for first-phase reforms (see Chart 1.4) suggest that a large number of transition countries, including some less advanced countries, are close to completing these reforms. All EU member states and the EU candidate countries in central eastern Europe and the Baltic states (CEB) and south-eastern Europe (SEE) have largely reached the level of market-enabling reforms adopted by advanced market economies elsewhere in the world. Albania, Bosnia and Herzegovina, Montenegro and Serbia are less advanced, but are rapidly catching up. In the Commonwealth of Independent States and Mongolia (CIS+M), all countries except for Belarus, Turkmenistan and Uzbekistan have made substantial progress towards liberalising prices. The remaining reforms are mainly in the area of trade liberalisation, namely adopting liberal and rule-based trade regimes and acceding to the World Trade Organization. Over the past year there was only one transition score upgrade awarded in this category: trade and foreign exchange liberalisation in Montenegro.

Second-phase reforms

Second-phase, market-deepening reforms of large-scale privatisation and financial sector reform require more than just political will. They need to be supported by institutional reforms. Successful large-scale privatisation requires a legal and regulatory framework to support the complex sale processes. Development of financial systems requires competition, entry of experienced financial institutions and effective regulation.

Progress in second-phase reforms over the past year was recorded across all areas (see Chart 1.5). In the banking sector in the CIS+M, the entry of major foreign banks last year was a milestone in reform progress, particularly in the smaller economies, such as Moldova and Mongolia. There was also a surge in foreign bank ownership in Ukraine, resulting in an increase from 20 to 35 per cent in foreign-owned banks' share of banking system assets. In other countries, such as Georgia, domestic banks owned by strategic investors have continued to strengthen competition, which is ultimately to the benefit of borrowers. In Romania, reforms and bank privatisation have led to more vigorous competition, which has consequently boosted credit to the private sector, including household lending.

Another important development over the past year was the strengthening of banking regulation and supervision in several countries, including Latvia, Moldova and Romania. In Belarus, which is at an early stage of banking reform, the abolition of the "golden share" rule (which grants the state the right to participate in the management of privatised enterprises) was an important step in liberalising the heavily regulated banking sector.

Increased bank lending in the transition region was accompanied by significant growth in the non-bank financial markets. Capitalisation and trading volumes of stock and bond markets grew substantially in the past year, not only in the EU member states but also in the large CIS+M countries – Kazakhstan, Russia and Ukraine. The expansion of pension funds and leasing and insurance companies was also strong. There were important legislative and regulatory improvements for securities markets and non-bank financial institutions in several countries, such as Lithuania and Ukraine.

Non-bank financial markets are playing an increasingly important role in financing the transition economies, particularly the larger ones. The recent increase in the number and volume of initial public offerings and bond issues reflects the region's deepening integration into the global economy, providing transition economies with access to a broader set of financial resources and instruments. However, international financing also exposes the transition economies to fluctuations in global financial markets, and prudential supervision must adapt to this new environment to mitigate risks arising from this exposure (see Box 1.2).

While the privatisation process is largely complete in the EU member states, some progress in large-scale privatisation was recorded in SEE and the CIS+M. In Bosnia and Herzegovina, for example, delays in the transition process mean that numerous competitive sectors are still under state ownership and therefore privatisation efforts remain focused on industrial enterprises. In Belarus and Mongolia, state-owned banks were privatised, while in Georgia, Romania and Russia the sale of state assets mostly involved regional electricity distribution companies or power generation companies. In many CIS+M countries the privatisation process has either stalled or state ownership and control has been consolidated in areas such as natural resources, as is the case in Russia.

Third-phase reforms

Third-phase, market-sustaining reforms – governance and enterprise restructuring, and reform to competition policy and infrastructure – are the key remaining challenges in CEB. In the less advanced transition economies these reforms are at an early stage (see Charts 1.4 and 1.6). Most progress in third-phase reforms over the past year was in SEE and was almost exclusively concentrated in competition policy. Deeper economic integration with western Europe has inspired EU-style competition law and there were a number of legislative improvements in several countries, including Bosnia and Herzegovina, FYR Macedonia and Montenegro. Implementation of competition policy has also advanced in the past year. All transition score upgrades for competition policy in SEE (except Montenegro) and the CIS+M were prompted by more active enforcement of competition laws. In addition, several countries, such as Croatia, Georgia and Moldova, are taking measures to ease market entry and exit restrictions by streamlining licensing requirements or establishing one-stop registration shops.

In overall infrastructure, only one transition score upgrade was awarded, which was to Albania. However, there has been progress in all five infrastructure sub-sectors across the region (see Table 1.3). For electricity, the main driver of reform in Georgia and Romania was the deeper involvement of the private sector: in both countries regional distribution companies were privatised and tariff collection in Georgia has improved. In Romania, the regulatory process is increasingly in line with international best practice. In the context of rising energy prices on global markets, increased concerns about energy security and mounting pressure to address climate change, reform of the energy sector is increasingly urgent (for an assessment of the security of gas supply in the region, see Box 1.1).

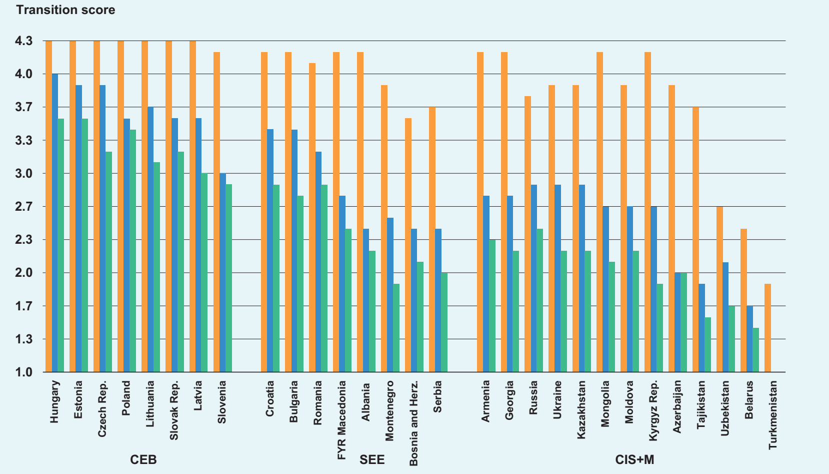
In the railway sector developments were mixed. Significant progress was achieved in Hungary and Russia, where competition in freight transport has improved the services provided. Private rail operators in Russia are booming, while Hungary has further reformed its incumbent operators by creating independent companies for freight and passenger services, and has established a national regulator for railways, although the fiscal burden of passenger services and the state-guaranteed debt stock of the national railway company remain problems. In Estonia, by contrast, the renationalisation of the railways reversed earlier privatisation (see Table 1.4).

Bosnia and Herzegovina and Kazakhstan were awarded transition score upgrades for noteworthy reforms in the road sector. In Bosnia and Herzegovina, the road agencies were corporatised, while in both countries road user charges cover maintenance costs and the use of tendering for maintenance and construction contracts is increasingly widespread.

Progress in telecoms was confined to SEE, where transition score upgrades were awarded to Albania, FYR Macedonia and Montenegro. The privatisation of Albtelecom in Albania was finalised and telecoms regulation has been strengthened. In FYR Macedonia and Montenegro service provision has improved due to more competition and higher ownership rates for mobile phones.

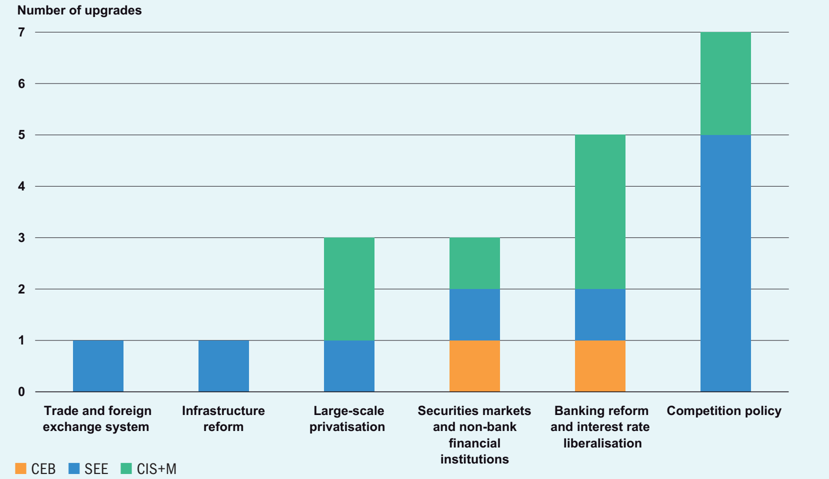
In the water and waste-water sector, Armenia and Ukraine were awarded transition score upgrades. In Ukraine a new tariff methodology allows for cost-recovery tariff setting, but effective implementation of cost-reflective tariffs remains a challenge. Payment discipline has improved noticeably in recent years. Armenia has successfully engaged the private sector through management contracts in Yerevan and the Lake Sevan region, while demand-side reforms, such as metering, have led to improved payment discipline, despite tariff increases.

Chart 1.4
Progress in transition by phases of reform, 2007



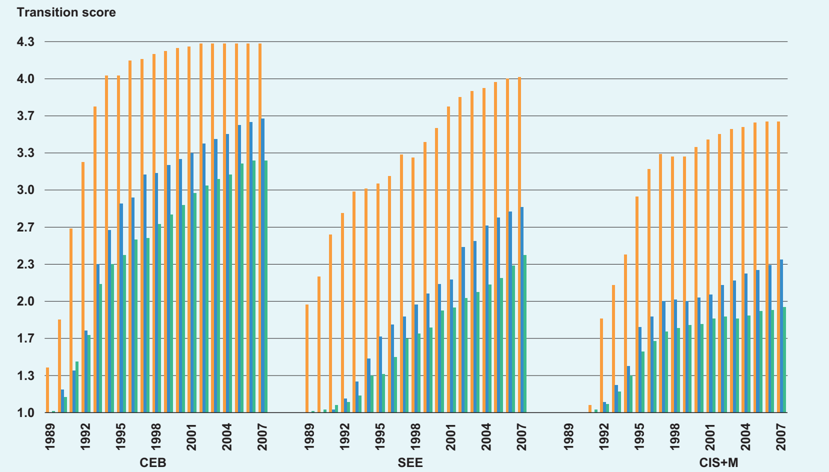
Source: EBRD.
Note: See Chart 1.2 for a description of transition scores.

Chart 1.5
Reform progress by sector, 2006-07



Source: EBRD.
Note: The chart reports the number of upgrades in each area of reform (see Table 1.1) in CEB, SEE and the CIS+M. Price liberalisation, small-scale privatisation and governance and enterprise restructuring are not included as there was no change recorded for the year.

Chart 1.6
Three phases of reform, 1989-2007



Source: EBRD.
Note: See Chart 1.2 for a description of transition scores.

Table 1.3
Infrastructure transition scores, 2007

Country	Electric power	Railways	Roads	Telecoms	Water and waste water	Overall infrastructure
Albania	3–	2	2	3+ ↑	2–	2+ ↑
Armenia	3+	2	2+	3–	2+ ↑	2+
Azerbaijan	2+	2+	2+	2–	2–	2
Belarus	1	1	2	2	1	1+
Bosnia and Herzegovina	3	3	3– ↑	2+	2	2+
Bulgaria	4–	3+	3–	4–	3	3
Croatia	3	3–	3	3+	3+	3
Czech Republic	3+	3	3	4+	4	3+
Estonia	3+	4 ↓	2+	4	4	3+
FYR Macedonia	3	2	2+	3+ ↑	2+	2+
Georgia	3+ ↑	3	2	3–	2	2+
Hungary	4	4– ↑	3+	4	4	4–
Kazakhstan	3+	3	2+ ↑	3	2	3–
Kyrgyz Republic	2+	1	1	3	2–	2–
Latvia	3+	4–	2+	3	3+	3
Lithuania	3+	2+	2+	4–	3+	3
Moldova	3	2	2	3	2	2+
Mongolia	3–	2+	2–	3–	2	2
Montenegro	2+	2	1	3+ ↑	2	2
Poland	3+	4	3	4	3+	3+
Romania	4– ↑	4	3	3+	3+	3+
Russia	3	3 ↑	2+	3	2+	3–
Serbia	2+	2+	3–	2+	2–	2
Slovak Republic	4	3	2+	4–	3+	3
Slovenia	3	3	3	3	3+	3
Tajikistan	2	1	1	2+	1	1+
Turkmenistan	1	1	1	1	1	1
Ukraine	3	2	2	3–	2 ↑	2+
Uzbekistan	2+	3–	1	2	2–	2–

Source: EBRD.

Note: ↑ and ↓ arrows indicate a change from the previous year. One arrow indicates a movement of one point (from 4 to 4+, for example). Up arrows indicate upgrades, down arrows downgrades. Past scores for the following have been revised this year: the electric power indicator for Ukraine was upgraded to 3- from 2000 and to 3 from 2001; the roads indicator for Bosnia and Herzegovina was upgraded to 2+ from 2005, resulting in an upgrade of the overall infrastructure indicator to 2+.

Table 1.4
Changes in infrastructure transition scores

Country	Transition indicator	Change in score	Reason for change
Albania	Telecoms	3 to 3+	Completion of the privatisation of incumbent fixed-line operator Albtelcom and significant improvements in sectoral regulation.
Armenia	Water and waste water	2 to 2+	Dramatic improvements in tariff collection discipline, increasingly widespread water metering and successful private sector participation through management contracts in Yerevan and Lake Sevan district.
Bosnia and Herzegovina	Roads	2+ to 3–	Corporatisation of the road agency in both Entities, cost-recovery financing of maintenance through user charges, use of open tenders (including foreign companies) in construction and maintenance contract awards.
Estonia	Railways	4+ to 4	Renationalisation of the railways; buyback of the 66 per cent shareholding of Baltic Rail Services.
FYR Macedonia	Telecoms	3 to 3+	Increase in competition in voice communications, high rates of ownership of mobile phones, reductions in interconnection rates, entry of a fixed-line operator.
Georgia	Electric power	3 to 3+	Privatisation of two regional distribution companies and several generation assets; tariff increases and improved collection of bills.
Hungary	Railways	3+ to 4–	Establishment of independent companies for freight and passenger transport; increased competition in the freight market.
Kazakhstan	Roads	2 to 2+	Cost recovery through user charges, tendering of periodic maintenance contracts, including to private companies.
Montenegro	Telecoms	3 to 3+	Effective competition in voice communications and very high ownership rates for mobile phones.
Romania	Electric power	3+ to 4–	Privatisation of the largest distribution company Electrica Muntenia Sud; cumulative improvements in the regulatory process for the energy sector.
Russia	Railways	3– to 3	Further reforms leading to more competition, particularly in the freight segment; significant private sector involvement in rail transportation.
Ukraine	Water and waste water	2– to 2	New tariff methodology allowing cost recovery, beneficial amendments of the concession legislation, improved collection of water bills.

Source: EBRD.

Note: See Table 1.3 for infrastructure scores for all transition countries.

Outlook and risks

Structural reform has slowed in the transition countries as they face the complex and, at times, politically difficult tasks associated with the more advanced phases of reform. In CEB the remaining challenges are largely confined to second and third-phase reforms. Further progress in reform in SEE will be linked to the deepening of European integration. In the CIS+M, reforms are still needed to boost competitiveness and instil market discipline.

First-phase, "market-enabling" reforms have mostly been completed across the entire transition region. However, second-phase, "market-deepening" reforms are significantly less advanced. Large-scale privatisation and the creation of a well-functioning financial system are far advanced in central eastern Europe and the Baltic states (CEB) but much remains to be done in south-eastern Europe (SEE) and the Commonwealth of Independent States and Mongolia (CIS+M). Third-phase reforms are the least advanced in the region. Some CEB countries have already made substantial progress but in all the Western Balkan and CIS+M countries these reforms have just begun. A total of 20 transition score upgrades were recorded in 2006-07 – the lowest number since transition started. This trend of slower reform is caused by the different patterns of development across the various sub-regions (see Chart 1.6).

Central eastern Europe and the Baltic states

Moving from a planned economy to modern market structures has been overwhelmingly successful in CEB. First-phase, liberalising reforms were swiftly implemented in the early years of transition and most of the second-stage reforms were carried out in the run-up to EU accession in 2004. CEB economies consequently have a strong market basis and a healthy and increasingly strong private sector has developed.

The remaining challenges for CEB countries are largely confined to a number of second and third-phase reforms. Further work needs to be done to complete the transition process, particularly more private sector involvement in infrastructure and a more effective competition authority. Although popular support for private sector involvement in public services remains only modest according to the EBRD/World Bank Life in Transition Survey (see Chapter 5), public spending constraints faced by several CEB countries provide a good opportunity to address macroeconomic and reform challenges by involving the private sector more in infrastructure. Therefore further market reform requires renewed political commitment and stronger support from legislative and executive authorities, combined with appropriate consultation, assessment and dissemination of the reform options.

South-eastern Europe

The process of economic transition in this region has been uneven since the collapse of communism. A decade of conflict and political turbulence in SEE took its toll and much-needed economic reforms were delayed for most of the 1990s. However, over the past few years it has accelerated and, for the second year, the SEE countries have been the fastest reformers of the entire transition region. In Bulgaria, Croatia and Romania – the more advanced countries in SEE – first-phase reforms are largely complete and progress in second-phase reforms is well advanced.

Finishing the second phase of reforms and advancing the third is a key challenge for these countries. As observed over the past two years, economic integration with the European Union is likely to continue to lend support in the early stages of reform, for example in competition policy. However, significant political risks and uncertainties in countries such as Bosnia and Herzegovina and Serbia (including Kosovo) may further divert attention from the much-needed deep structural reforms. Moreover, the Western Balkans are less likely to benefit from the strong anchor of imminent EU accession, which has been such a powerful driver for reform in those transition countries that have acceded to the European Union.

For Bulgaria and Romania the institutional constraints of the European Union and the economic competitive pressure within it may prove a challenge in the short term. However, it may also provide an incentive to advance reforms, particularly the third stage covering governance, competition policy and infrastructure.

Commonwealth of Independent States and Mongolia

Reform has slowed considerably in most CIS+M countries and a large number of reforms remain unfinished. Over the past year efforts were led by countries where governmental and popular support for the market and private sector is very high, such as Georgia and Mongolia, and countries in the western CIS, such as Moldova and Ukraine, where the prospect of closer ties with Europe has generated market reforms. In Russia, reform over the past two years has been modest as the state's role in the economy has grown. However, clarification of the role and boundaries of state involvement in the economy, coupled with the vast investments and development of know-how required to sustain the country's economic growth, could act as a catalyst for more structural reforms to attract the private sector.

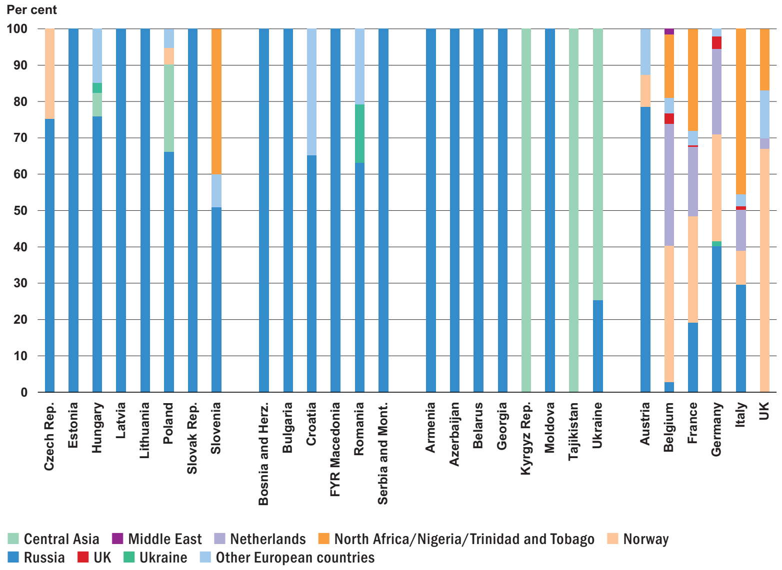
The ongoing tightening international credit markets can exert a great deal of influence on reform in the CIS+M: in the absence of cheap and easy access to external finance, market reforms, particularly in the financial sector, will become more urgent. Similarly, increasing competition in the global commodities markets will pose challenges, particularly for the large industrialised economies of the CIS+M. These challenges can best be addressed through further enterprise restructuring and improvements in infrastructure. In the resource-rich countries, a more market-friendly approach is needed, such as a reduced role of the state in the economy and an end to monopolies in several important sectors, to improve governance and reform infrastructure.

In the Caucasus, Armenia and Georgia have successfully implemented first-stage reforms and privatisation but third-phase reforms are substantially less advanced. Renewed commitments to improve governance and competition policy are required to convert the current unbalanced patterns of growth into sustainable development. For Central Asia and Belarus the immediate hurdle is the first-phase reform of market liberalisation. Stronger government commitment is required to trigger these reforms.

The slow pace of reform in much of this region over the past decade, especially the resource-rich countries and Central Asia, has widened the transition gap with CEB and SEE. Sustainable growth and continued development in these countries will require a stronger commitment to reducing state intervention and increasing private sector involvement.

Box 1.1 The security of gas supply

Chart 1.1.1
Sources of gas imports, 2006



Sources: BP, Energy Information Administration and national authorities.

Note: The chart reports the portfolio of gas imports in selected transition and western European countries. While Serbia and Montenegro have been separate states since June 2006, the chart provides information on the aggregate portfolio of imports of the two countries for that year.

Strong economic growth across the transition region in recent years has translated into sustained increases in energy demand. Apart from a few resource-rich countries in the Commonwealth of Independent states and Mongolia (CIS+M), most of the transition countries are net importers of energy. With the current trend of rising energy prices, concerns about fossil fuel depletion and commitments to tackling climate change, maintaining a secure supply of energy is becoming ever-more important. This is particularly so with natural gas because it represents a large share of the transition countries' energy consumption and there are few suppliers and transit routes for imports. Import dependence across the transition region varies widely: while energy-rich countries are net exporters, Belarus and Moldova import more than 85 per cent of their energy needs.

Transition economies tend to be substantially less efficient in energy use than mature market economies. The legacy of central planning, whereby energy was provided in abundance at well below its true economic value, is an energy-inefficient economic structure. Despite efficiency-inducing reforms, such as higher end-user tariffs for electricity and gas, there is still substantial room for improvement, particularly in the CIS+M.

Energy trade in the transition region is broadly in line with global trends – while sources of oil and coal imports are diverse, natural gas comes from few sources and mainly through pipelines. Furthermore, trading on the gas market is still bound by cross-border transmission capacity: in 2006 about 87 per cent of all the gas traded in Europe was transported through pipelines. The remaining 13 per cent was delivered as liquefied natural gas (LNG), most of which was based on long-term contracts. The market is therefore still largely dominated by rigid long-term contracts, creating barriers for consumers to switch supplier in the short term and increasing the risk of supply being disrupted. However, the diversity of import sources varies across the transition region, though not as much as in western Europe (see Chart 1.1.1).

Risks to energy security

Energy security – the availability of a regular supply of energy at economic cost – is subject to two types of risk: economic risk (variations in the price of energy) and physical risk (interruptions in the flow of energy supply). In the long term, depleting reserves may not be enough to meet growing world energy demand. In the short term, disputes between suppliers and customers could disrupt supply, as could an accidental or deliberate breakdown of the transmission system. Economic risks of energy supply have been studied more extensively,[1] but less is known about the physical risk of supply.

Several factors influence the security of supply. First, domestic production bears mainly technical and distribution risks, whereas imports are subject to additional risks related to disputes between parties to the supply contract and transit risks. Moreover, a more diversified portfolio of import contracts improves the security of supply, just as domestic gas storage can cushion short-term disruption in the supply chain. Therefore, the total supply of gas to an economy can be looked upon as a portfolio of supply contracts subject to risk. A number of scenarios for the security of supply can be examined for the countries in transition and several comparator countries in western Europe.

Chart 1.1.2 looks at the security of supply using 2006 gas supply data for the transition region. Using probabilities of import supply disruption (low, medium and high bilateral supply disruption risks) and assuming a negligible risk of domestic production, two security-of-supply models are presented: the base model is the simplest version of the actual supply portfolio with domestic production and imports. The storage and transit model shows a theoretical case in which countries can make use of their location within the gas transit network to secure their own gas supply and fully use their storage capacity.

The CIS+M and the Baltic states are the most vulnerable. In Georgia, the Kyrgyz Republic, Moldova and Tajikistan up to 40 per cent of the 2006 gas supply is insecure. Vulnerabilities in Ukraine and Belarus are more moderate. Estonia, Latvia and Lithuania remain vulnerable to supply disruption, whereas in central eastern Europe only Poland has moderate exposure. Countries in south-eastern Europe (SEE) are the most secure among the transition countries. However, the gas supply is substantially more secure in western European countries, primarily reflecting more diverse import portfolios.

Policies for mitigating supply risks

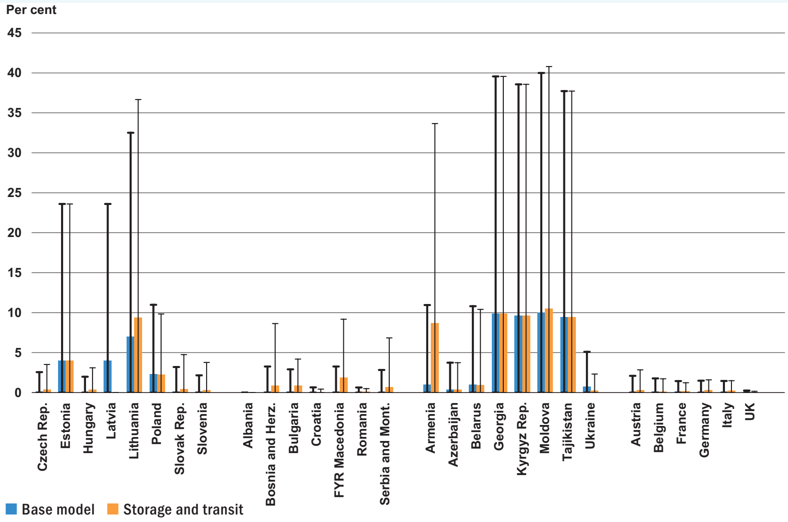
The rapidly growing demand for energy across the transition region and commitments to address climate change call for policy measures to secure adequate provision of energy to support economic growth. Policy-makers can employ a number of strategies to improve the security of supply. The most important among them are the diversification of import sources through the construction of new pipelines, energy efficiency improvements to contain demand, the use of LNG supply chains and the construction or expansion of gas storage facilities.[2]

The import sources and transit routes for natural gas have changed substantially in the Caucasus in 2007. The new pipelines for Azeri oil and gas have started operations and now transport energy towards Turkey and beyond. Armenia can diversify its imports thanks to the new Iran-Armenia pipeline opened in March 2007 and also benefits from the improved energy security of its neighbours. Chart 1.1.3 suggests that there are substantial benefits from diversifying sources of gas imports in the Caucasus. Both Armenia and Georgia more than halved the amount of domestic gas demand that is not securely supplied from 2006 to 2007.

The appropriate policy to mitigate the insecurity of gas supply depends on whether countries have domestic gas resources and their potential to further diversify sources of imports. For countries with domestic gas resources, encouraging energy efficiency can be very effective in improving the security of supply. Energy reforms, particularly charging end-users prices that reflect the full cost of supply, are an important incentive for investment in energy-saving technologies. However, in countries with no domestic gas resources, gas storage or diversification of import sources (for example LNG) may be more effective in tackling energy insecurity. However, it is important to note that gas storage in the absence of domestic gas resources is only a short-term security solution.

In the long term, security of supply is linked to security of demand. Real or perceived risk to supply may lead to countries moving away from risky sources of energy. This in turn discourages suppliers to invest in production and transit capacity, which in itself has a negative effect on the security of supply in consumer countries.

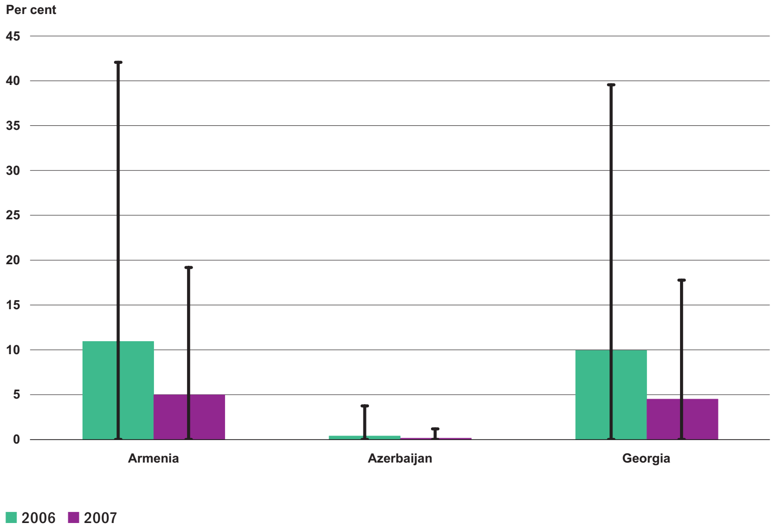
Chart 1.1.2
Security of gas supply, 2006



Source: EBRD.

Note: The coloured bars represent the mean share of the 2006 domestic gas demand in each country that is not securely covered by the supply portfolio. The lines represent one standard deviation around the mean insecurity and thus provide a confidence interval for the estimates. For example, in the base model in Ukraine, a mean of just below 1 per cent of the 2006 domestic demand was not covered securely, but up to 5 per cent of the domestic demand faces supply risks. In other words, the bar shows the average share of annual consumption that is not securely supplied and the line shows the worst-case estimate of risk to that gas supply. The base model represents the current situation. The storage and transit model represents a scenario where countries make greater use of their storage capacity.

Chart 1.1.3
Security of gas supply in the Caucasus, 2006-07



Source: EBRD.

Note: The coloured bars represent the mean share of the domestic gas demand that is not securely covered by the current supply portfolio. The lines represent one standard deviation around the mean insecurity and therefore provide a confidence interval for the estimates. For example, in Georgia, a mean of just below 5 per cent of the 2007 domestic demand is not covered securely by the existing supply portfolio, but up to 17 per cent of the domestic demand faces supply risks. In other words, the bar shows the average share of annual consumption that is not securely supplied and the line shows the worst-case estimate of risk to that gas supply.

Endnotes

1 See, for example, Davis et al (2005), Bacon (2006) and Lysenko and Vinhas de Souza (2007).

2 For a discussion of future scenarios and projections of security of gas supply in the region, see Chirmiciu and Bureau (2007).

Sources

R. Bacon (2006), "The impact of higher oil prices on low income countries and the poor: impacts and policies", World Bank ESMAP Paper No. 37483.

A. Chirmiciu and C. Bureau (2007), "The security of gas supply in the transition region", EBRD Working Paper, forthcoming.

M. Davis, R. Pionkivsky, O. Pindyyuk and D. Ostojic (2005), "Ukraine – the impact of higher natural gas and oil prices", World Bank Working Paper No. 38602.

T. Lysenko and L. Vinhas de Souza (2007), "The effects of energy price shocks on growth and macroeconomic stability in selected energy-importing CIS countries", European Commission Working Paper, forthcoming.

Box 1.2 Financial market turbulence – implications for the transition region

The events in US and European credit markets in summer 2007 are likely to define an important juncture in the international capital market environment in which transition countries operate. Higher funding costs, credit constraints and greater risk aversion on the side of international investors are likely to affect financial sectors throughout the transition region, and ultimately moderate the growth in domestic demand funded by bank credit.

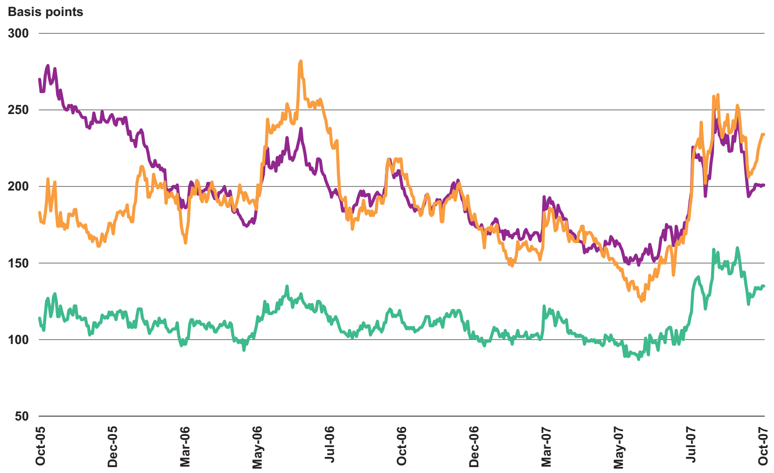
The initial cause of market turmoil lay in the US mortgage markets in which increasingly lax credit standards had led to growing default rates. Mortgages had been traded widely in the form of securitised assets and various other forms of securities. As a result, concerns about counterparty risk escalated and led to a contraction in money market liquidity in August. This coincided with a sharp decline in investors' appetite for risk.

As large commercial banks needed to refinance entities that had traded in mortgage-backed securities, volatility in pricing of credit and illiquidity spread throughout the financial system. The substantial cut in US short-term interest rates in September has helped in the recovery of asset valuations and liquidity. However, credit problems in the US mortgage market are set to persist throughout 2008 and are likely to be aggravated by further falls in US property prices. Most capital market participants therefore expect continued volatility.

It is unclear how severe the impact of these events will be on global growth. Up to summer 2007, growth in corporate earnings was strong in most markets, global growth had been underpinned by robust industrial production in emerging Asian economies, and oil and gas prices suggested little impending weakness in growth. Following events over the summer, projections for US growth are now being revised downwards. Declines in household wealth will continue to depress consumption, and higher financing costs may also affect corporate investment.

However, most forecasters still expect a "soft landing" for the US economy and a slight moderation in world growth and capital flows to emerging markets. By contrast, a US recession would place the transition region in a very different environment of lower demand from trade partners, sharply lower oil and gas prices, curtailed flows in external capital and higher costs of finance from all sources.

Chart 1.2.1
External bond spreads (EMBI indices)



Russia Ukraine All emerging markets (EMBI sovereign global).

Source: JP Morgan Emerging Market Bond Index (EMBI).

Note: The JP Morgan Emerging Market Bond Index (EMBI) tracks the total returns for traded sovereign external debt instruments in emerging markets. The series depict the average for all emerging markets, and the sub-components for Russia and Ukraine, as spreads over US benchmark interest rates for comparable maturities.

Implications for the transition region

The financial openness of the transition region has increased rapidly over recent years; capital in various asset classes now flows both into and out of the transition countries, and there is greater inward investment by foreign bank groups. IMF data suggest that for several years the transition countries have been the largest net recipients of external borrowing of all the major emerging market regions.[1] The events in the financial markets this summer are therefore likely to affect financial sectors and economic growth in the transition region.

The effects will be most pronounced in those transition countries with large external financing needs in the corporate or financial sectors. This is already evident in growing investor concerns about the Kazakh banking sector and current account deficits in the Baltic states. All transition countries will need to contend with higher costs in debt finance. The widening in the index of sovereign emerging market bond spreads by about 50 basis points is as yet small by historical standards (see Chart 1.2.1) but the environment of greater risk aversion will also lead to a widening in the dispersion of yield spreads applied to borrowers of different credit quality, as is already evident with Kazakh banks.

Overall, capital flows to the transition region are likely to fall slightly from the record levels in previous years. The market for eurobonds, for instance, was effectively inaccessible for many issuers in August and September 2007, and an estimated €7 billion in issues have been delayed in Russia. More volatile forms of capital, such as portfolio debt and equity, will be affected most. The types of financing with long lead times for implementation and significant sunk costs (which cannot be recovered), such as FDI, will be less affected. At present, relationship-based financing sources, such as syndicated lending, appear to be withstanding the disruption better than market-based sources, such as external bond issuance. Also, the subsidiaries of foreign bank groups are likely to maintain financial flows to the region, and so are likely to underpin stability in banking sectors. This has already helped the foreign-owned banks in Kazakhstan, where domestically owned banks are severely constrained in their external financing.

A concern is that in the current risk-averse environment the maturities of external finance will shorten and aggravate maturity mismatches on the balance sheets of financial intermediaries. Potential borrowers could also face problems in accessing finance irrespective of price. This will certainly be true for issuers of innovative financial instruments, such as asset-backed securities, for which transparency and valuation will remain problematic in the near future. The originally ambitious programme for the issuance of a large number of asset-backed securities by Russian banks remains on hold. More seriously, this could have an impact on riskier or first-time borrowers. As a response to external funding problems, banks in the transition region have strengthened their domestic deposit base, and in the process passed on higher funding costs in their lending.

A positive effect of the current uncertainty is that banks have been applying higher lending standards, for instance in requiring lower leverage ratios in mortgage lending. As a result, the extremely rapid growth in bank credit to the private sector of recent years is likely to slow down. At the same time this could affect growth in countries with developed financial markets.

In the transition countries with less open capital accounts, such as in the Caucasus, much of Central Asia and the Western Balkans, the effect of the current volatility will be delayed and may spread only through linkages with neighbouring countries, such as through a moderation in remittances from workers abroad or inflows of direct investment. An early effect was already evident in the constraints imposed on the subsidiaries of Kazakh banks elsewhere in the Commonwealth of Independent States and Mongolia (CIS+M), benefiting locally funded financial institutions.

Macroeconomic and financial sector vulnerabilities

The transition region is confronting this adverse external financial shock from an enviable position of record growth rates for the region as a whole. The credit quality of sovereign borrowers and the average private sector borrower has improved substantially over recent years, as has the soundness of public finances and the quality of fiscal and monetary policy.

Nevertheless, important vulnerabilities have built up in a number of transition countries. In central eastern Europe and the Baltic states (CEB) and south-eastern Europe (SEE) external financing requirements are still growing following an overly buoyant increase in domestic demand, often financed by the rapid expansion in bank credit. Based on 2007 projections, the transition region contains the largest number of emerging markets with excessive external financing needs in terms of either current account deficits or gross external borrowing requirements.[2] Moreover, the share of FDI in financing these external balances has declined in favour of more short-term or volatile forms of capital. In Romania, for instance, the end of the privatisation programme has led to a sharp decline in the share of the current account deficit financed by FDI inflows. The transition region is therefore more exposed than countries in Asia or Latin America to continued tight capital market liquidity.

In several countries external debt has risen against the backdrop of slowing growth in productivity and exports. This could lead some investors to question not just countries' ability to finance liabilities as they fall due – external liquidity – but also more broadly the solvency of countries in which future external liabilities grow at rates well above the country's capacity to generate foreign exchange revenue. The combination of slow export growth with large and widening external debt burdens in the Baltic states is a concern in this regard.

Risks are accentuated by financial sector vulnerabilities. Following a period of extremely rapid expansion in bank assets, credit problems could emerge as funding costs rise, the value of assets used as collateral deflates, or the corporate sector enters a period of slower growth and higher default rates. Several countries in the CIS+M have insufficiently addressed poor bank governance or non-transparent financial accounts. In most countries in CEB and SEE, expectations of continued exchange rate stability have contributed to widespread use of foreign currencies in bank credit; such countries are highly vulnerable to a potential exchange rate adjustment.

The rapid expansion of credit to the private sector has stimulated economic growth in recent years. Yet empirical studies have shown that the intermediate level of financial development at which most transition countries remain is highly risky. Financial sectors are large enough to transmit this external turbulence to the real economy, but they are not sufficiently developed to create instruments to counteract such shocks.[3]

In an environment of greater risk aversion and volatility in capital flows, financial sectors in countries with large external financing requirements are most likely to experience a set-back. By contrast, resource-rich countries in the CIS+M – most notably Russia – appear much less exposed, with large stocks of public external assets and limited external financing needs. Sound public and external balance sheets remain a good insurance against downturns in international capital markets. In such an environment, financial sectors are more likely to continue to grow and forge deeper linkages with foreign markets.

Implications for structural reform

Unlike previous crises in emerging markets, present developments originated in mature capital markets in the United States and Europe. Regulators are already examining options for strengthening financial infrastructure in these markets and enhancing the transparency and valuation of key financial instruments. Nevertheless, these developments also call for a policy response by authorities in transition countries to cushion the impact of the current crisis as it unfolds and prevent similar events from recurring.

Clearly, macroeconomic policies will need to address external imbalances that have built up, and which now render growth and stability vulnerable to potential external financing shortfalls. The structural reforms undertaken to date will likely cushion the impact of the current aversion to risk, and the remaining reform agenda has now become even more pressing. Financial supervisors will need to address many of the vulnerabilities that have emerged, such as poor bank governance, prudential risks (such as maturity mismatches) and indirect exposures to exchange rate risks. Some areas of particular vulnerability in banking are largely unregulated, such as lending standards in retail credit. In these areas, banks will need to upgrade their risk management systems and credit standards to best international practice.

Present developments also underline the need for liquidity in domestic money and capital markets as a more stable funding source for private sector borrowers that is less prone to disruptions. Russian money markets, for instance, saw occasional spikes in short-term interest rates, although overall they were a more effective funding source than in previous periods of market stress.

As international liquidity recedes and risk aversion returns, investors in all asset classes will scrutinise risks more carefully, including those that stem from poor corporate governance or business environments.

Endnotes

1 International Monetary Fund (2007), World Economic Outlook, April.

2 Standard and Poor's (2007), *Which Way Now for EMEA Sovereign Ratings, As the Credit Cycle Turns Sour?*

3 H. Wolf (2004), "Volatility: Definitions and consequences" in *Managing Volatility and Crises: A Practitioner's Primer*, World Bank.

Annex 1.1
Securities law and practice

Securities markets are vital to the development and strength of market economies. They finance the exploration of new ideas and facilitate the management of financial risk. Since consumers are placing an increasing proportion of their money in mutual funds and collective investment schemes, securities markets have also become central to individual wealth and retirement planning. Sound and effective securities laws, and the associated confidence in the financial system, are important for the integrity and growth of securities markets.[1]

The EBRD recently performed an in-depth assessment of two main aspects of securities markets legislation in the transition countries. First, the EBRD assessment evaluates the quality of the law on the books and its compliance with the best international standards: the Objectives and Principles of Securities Regulation (the "Principles") of the International Organization of Securities Commissions (IOSCO). Secondly, the assessment aims to gauge how the law works in practice.

Quality of legislation

In 2004 and 2005, the EBRD examined the relevant legislation by way of a checklist of questions reflecting the Principles.[2] In 2007 the checklist was extended and refined, and the initiative repeated.[3] On the basis of the responses received, countries were assessed and each jurisdiction was assigned to a group that indicated its level of adherence to the Principles (see Table A.1.1.1).[4]

Central eastern Europe and the Baltic states

All countries in central eastern Europe and the Baltic states (CEB) have recently joined the European Union and harmonised their legislation with the *acquis communautaire*, the body of EU law that countries must adopt to become EU members. This is extensive and fully reflects the Principles. All countries were found to be in high compliance with the Principles. Latvia and Lithuania showed the best framework, followed by Poland. The Czech Republic and Slovenia have minor weaknesses in their legislation on the secondary market, while in Hungary the regulator's duties and responsibilities are not fully in line with the Principles. The Estonian framework on clearing and settlement and the Hungarian one on derivatives are not comprehensive enough.

South-eastern Europe

Croatia and Romania have the best framework in south-eastern Europe (SEE) and only minor flaws are reported. Both countries have recently introduced new legislation based on EU law and their frameworks have substantially improved. Serbia also has a regime that is generally in line with the Principles, but legislation on bonds and derivatives is not comprehensive. Bosnia and Herzegovina, FYR Macedonia and Montenegro are in the medium compliance category. The legal framework in Bosnia and Herzegovina is quite complex due to the combination of different systems: each Entity – the Federation of Bosnia and Herzegovina and the Republika Srpska – has its own legal system. Republika Srpska was rated slightly higher than the Federation, showing better compliance, especially in the framework on collective investments and market intermediaries. Albania is the laggard in the region with several flaws in a number of areas, but deep reform is currently taking place.

Commonwealth of Independent States and Mongolia

Moldova showed substantial improvements since the last EBRD assessment in 2005, thanks to extensive reforms that are still being implemented. Ukraine has also made improvements since the 2005 assessment with the adoption of a new law on securities and the Stock Exchange in 2006. Russia is very close to the high compliance category with good legislation in place on self-regulatory organisations but incomplete regulation on derivatives. Kazakhstan, Mongolia, Tajikistan, Turkmenistan and Uzbekistan still have weak legislation on money laundering, while Armenia, Belarus, Georgia, the Kyrgyz Republic, Mongolia, Tajikistan and Turkmenistan have a weak or non-existent framework on collective investments. Finally, securities markets legislation in Belarus, Tajikistan and Turkmenistan is in urgent need of overall reform.

How the law works in practice

The EBRD Legal Indicator Survey 2007 (LIS 2007) focused on how the law works in practice:[5] are the laws and relevant regulations affecting market participants' behaviour or are they just "paper tigers"?

Respondents from leading law firms in the region were asked to comment on a hypothetical case study.[6] This concerns an investor who lost his/her savings after buying shares through a bank, having been misled by erroneous information in the IPO prospectus (see Box A.1.1.1). The scenario mirrors genuine securities scandals.[7]

An extensive questionnaire was designed to establish how effective each country's legal system is in protecting investors' interests. This questionnaire partly related to the case study, but also contained additional questions. Firms were instructed to respond to the questionnaire as if they were advising a client on how best to protect his/her rights and preserve the value of the investment. Countries were graded on a scale of 0 to 10, based on the analysis made by the local counsel and an EBRD team of lawyers. In this grading, 0 indicates very low effectiveness and 10 very high effectiveness of the national securities markets legislation.

Measuring the effectiveness of a legal mechanism is a difficult exercise and the findings must therefore be treated with caution. First, they reflect views of a limited number of practitioners within each country. Secondly, they address a very specific set of circumstances and must be considered within the boundaries of the case study. Thirdly, assessing effectiveness is by far a more difficult and subjective exercise than simply analysing "paper" legislation.

With these caveats in mind, the answers give insight into both the quality of legislation and the practice of the law. In particular, respondents were asked to provide information on the legal tools available to obtain compensation and to assess the effectiveness of three of the main pillars of securities markets legislation. These include the IPO prospectus disclosure requirements, the relevant private and public enforcement mechanisms and the authority of the market regulator.

Prospectus disclosure requirements

This indicator assesses how well the principles of disclosure are implemented and the level of transparency. It reflects the breadth and reliability of an IPO prospectus and covers in particular the degree of disclosure, risk identification, quality of financial reporting, institutional oversight and distribution practices.

Private and public enforcement mechanisms

The LIS 2007 covers both private and public enforcement mechanisms. Private enforcement establishes whether an investor can reasonably expect to recover damages through court action. The factors taken into account are the range of legal actions (assessing the best avenue possible); liability standards and burden of proof; recovery chances; and the speed, costs and quality of the institutions that administer the private legal action.

The public enforcement category analyses the capacity and experience of the relevant institutions when pursuing administrative and criminal actions for more serious breaches of laws or rules of conduct, when the initiative of the plaintiff is not required. It considers the effectiveness of actions by the regulator and the prosecutor, their capacity, the liability criteria and the applicable sanctions.

Table A.1.1.1
Quality of securities markets legislation in transition countries

Securities markets legislation assessment			
High compliance	**Medium compliance**	**Low compliance**	**Very low compliance**
Bulgaria	Armenia	Albania	Belarus
Croatia	Bosnia and Herzegovina	Azerbaijan	Tajikistan
Czech Republic	FYR Macedonia	Georgia	Turkmenistan
Estonia	Kazakhstan	Uzbekistan	
Hungary	Kyrgyz Republic		
Latvia	Mongolia		
Lithuania	Montenegro		
Moldova	Russia		
Poland			
Romania			
Slovak Republic			
Serbia			
Slovenia			
Ukraine			

Source: EBRD, Securities Markets Legislation Assessment 2007.

Note: In Bosnia and Herzegovina two distinct assessments were made on the quality of legislation in the Federation of Bosnia and Herzegovina and in the Republika Srpska. The overall result is the average of the two assessments, weighted by population. No countries were included in the "Very high compliance" category.

Box A.1.1.1
Hypothetical case study

A bank established in your country underwrote shares of a well-known national company during its initial public offering (IPO).

The IPO prospectus included audited annual accounts provided by the issuer to the underwriter, but the consolidated financial statements included in the prospectus omitted to account for substantial debts of the affiliated companies of the group.

This omission was due to a mistake in the consolidated financial statements. Shortly after the issue, international newspapers published negative information about the group, the mistake was revealed and the share price plummeted.

Your client bought shares in the local company from the underwriter during the IPO and now asks advice on what can be done to recover the losses. Please advise your client accordingly.

Market regulator

The LIS 2007 assigns a grade to the securities market regulator, based on its independence, impartiality and finally its rule-making, investigative and sanctioning powers.

Legal Indicator Survey results

Central eastern Europe and the Baltic states

All countries in CEB have reasonably well-functioning stock exchanges, in particular those of Budapest, Prague and Warsaw. However, with the exception of Warsaw these markets are still rather small in international perspective and have not yet established themselves as viable platforms for companies to raise equity capital through IPOs and/or secondary offerings. The liquidity of the Bratislava and Riga stock markets is particularly low.

Disclosure practices in the region follow high standards. The documentation included in the IPO prospectus is considered generally reliable and financial reporting practices are good. EC Regulation 809/2004 directly applies detailed prospectus disclosure requirements in all EU countries and is well implemented, especially in Poland (see Chart A.1.1.1).

Private enforcement mechanisms are especially effective in the Czech Republic, Estonia and Hungary. The recovery rate is particularly high in the Czech Republic, while it is below average in Lithuania. In most countries, courts are experienced in corporate cases but they may still lack the expertise for a deep analysis of a complex securities market case.

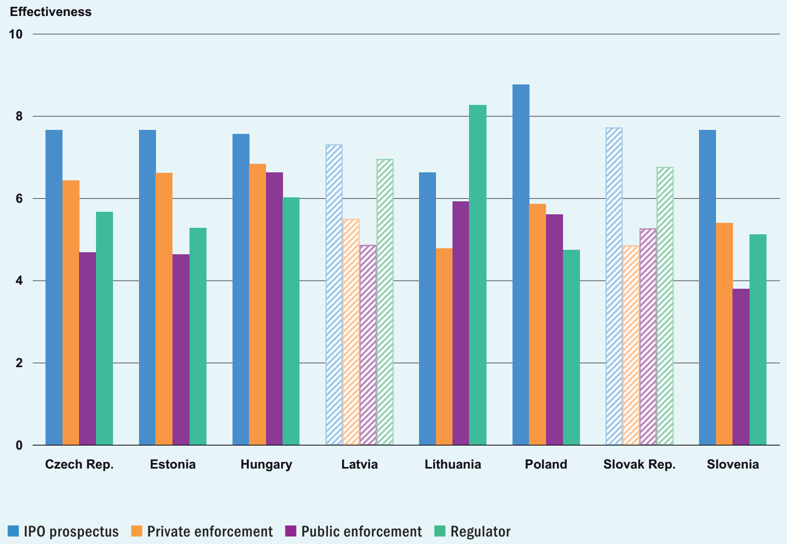
When looking at public enforcement mechanisms, the LIS revealed that regulators are developing their expertise in investigating complex securities cases, but the corresponding capacity of public prosecution remains low. Insider trading is considered a serious risk in all countries, but only in a few countries have sanctions been applied in practice.[8]

For Estonia and Poland there are some concerns as to the market regulators' independence from the government and their lack of rule-making authority.

South-eastern Europe

In SEE, the effectiveness of securities market legislation is on average lower than in CEB (see Chart A.1.1.2). The number of active stock exchanges and their liquidity is lower as well. The market is inactive in Albania and there is low liquidity in Bosnia and Herzegovina. IPOs are not a common vehicle for corporate financing and only in Bulgaria, Croatia and Romania were offerings reported in the last year.

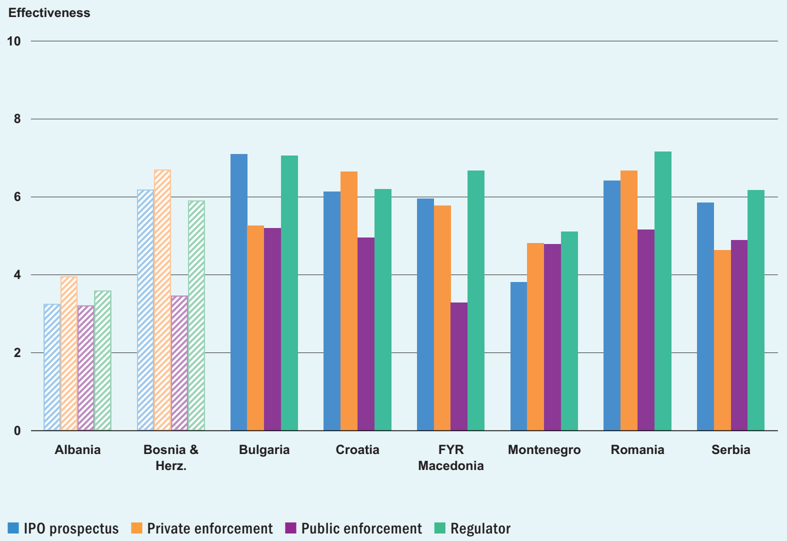
Chart A.1.1.1
Effectiveness of securities markets legislation in CEB, 2007



Source: EBRD, Legal Indicator Survey 2007.

Note: The chart shows the scores for each country in the region regarding the IPO prospectus, the private enforcement mechanisms, public enforcement mechanisms and the regulator. Scores are calculated on a scale of 0 to 10, with 10 indicating full effectiveness. Survey estimates are hypothetical for Latvia and the Slovak Republic (shown with diagonal lines) as the relevant securities market is relatively illiquid or there were no recent IPOs.

Chart A.1.1.2
Effectiveness of securities markets legislation in SEE, 2007



Source: EBRD, Legal Indicator Survey 2007.

Note: The chart shows the scores for each country in the region regarding the IPO prospectus, the private enforcement mechanisms, public enforcement mechanisms and the regulator. Scores are calculated on a scale of 0 to 10, with 10 indicating full effectiveness. Survey estimates are hypothetical for Albania and Bosnia and Herzegovina (shown with diagonal lines) as the relevant securities market is relatively illiquid or there were no recent IPOs.

Bulgaria and Romania implement the highest transparency standards, while in Albania and Montenegro doubts are expressed over the reliability of the IPO prospectus. Financial reporting in the prospectus is sound in all countries with the exception of Albania.

There are several private enforcement mechanisms upon which investors can rely for recovering damages. These mechanisms are considered particularly effective in Bosnia and Herzegovina, Croatia and Romania, where the framework clearly points out which parties are responsible for the correctness of the prospectus, therefore making the litigation less complex. Judgments are less predictable in Albania, Montenegro and Serbia, where the recovery rates are the lowest in the region.

When assessing public enforcement mechanisms, the survey revealed an uneven situation: in Bulgaria, Croatia and Romania the regulator is considered capable of complex investigations, while in Albania, Bosnia and Herzegovina and

FYR Macedonia doubts are expressed over the prosecutor's capacity to investigate insider-trading cases.

Commonwealth of Independent States and Mongolia

The stock exchanges in the CIS and Mongolia (CIS+M) that show some liquidity are limited to Kazakhstan, the Kyrgyz Republic, Mongolia and Russia (see Chart A.1.1.3). IPOs in the last year were reported to take place in Kazakhstan, Moldova, Mongolia and Russia. The liquidity of Russian stock markets is similar to the liquidity of markets in the CEB region. In Tajikistan and Turkmenistan there is no active market. Markets in the sub-region are not free from securities laws violations: a prominent example is the RentenGroup case in the Kyrgyz Republic.[9]

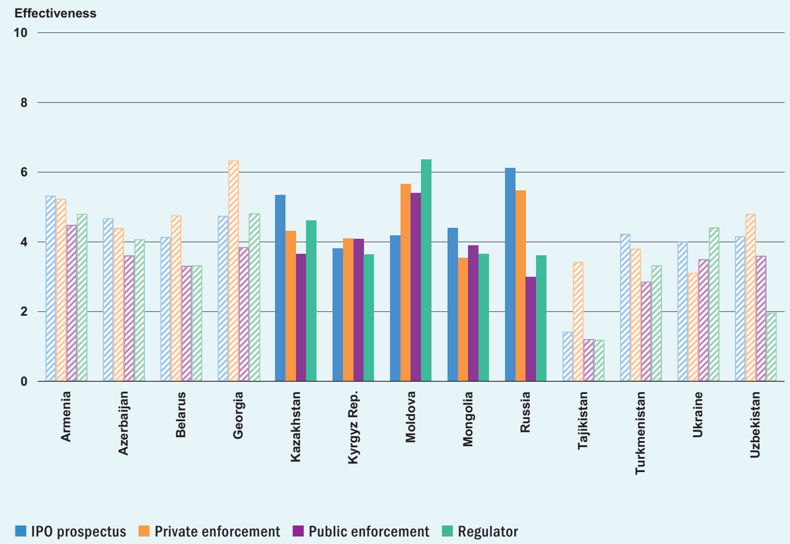
Disclosure practices in the CIS+M are generally of lower standard than in CEB and SEE and IPO prospectuses often omit risk-sensitive information. In Russia, prospectuses cover a broad range of issues but, as in most countries in the region, they do not include the issuer's beneficial ownership. In Kazakhstan, financial reporting is deemed to be in line with IFRS but no official translation of these standards is available.[10] Furthermore, doubts may be cast on the reliability of prospectuses due to the mild sanctions for providing inaccurate or misleading information. Similar doubts are expressed in Ukraine and Tajikistan.

In Georgia, Moldova and Russia, private enforcement mechanisms were found to be relatively effective with an especially high recovery rate in Georgia. In Kazakhstan, the Kyrgyz Republic, Tajikistan and Ukraine available civil actions are deemed complex, while in Mongolia enforcement procedures are not effective. In all CIS+M countries the capacity and competence of courts in corporate cases need to be improved.

In the majority of CIS+M countries, the prosecution authorities have very little experience in securities cases. In several jurisdictions, the regulator does not seem able to offer efficient market oversight. Insider trading is considered a serious risk in all countries, but investigation and prosecution practices are limited.

In most countries in the region the system does not provide the regulator with independence from political pressure. In Russia, the regulator is directly sub-ordinated to the government. Its capacity to supervise the issuers is effective but its authority is seldom exercised. In Turkmenistan, the functions of the securities market regulator are entrusted to the

Chart A.1.1.3
Effectiveness of securities markets legislation in the CIS+M, 2007



Source: EBRD, Legal Indicator Survey 2007.

Note: The chart shows the scores for each country in the region regarding the IPO prospectus, the private enforcement mechanisms, public enforcement mechanisms and the regulator. Scores are calculated on a scale of 0 to 10, with 10 indicating full effectiveness. Survey estimates are hypothetical for Armenia, Azerbaijan, Belarus, Georgia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan (shown with diagonal lines) as the relevant securities market is relatively illiquid or there were no recent IPOs.

Ministry of Finance. Its authority and powers stretch beyond mere supervision. In certain instances, the Ministry can even enquire into the merits of an issue. This form of control is too tight to allow a market to develop. In Moldova, after a lengthy reform, the regulator seems to be able to effectively perform its duties, but further efforts are needed for the market to develop.

Conclusions

The quality of securities markets legislation has improved significantly over the past two years in most transition countries. Sound and effective regulation and, in turn, the confidence it brings is important for the integrity, growth and development of securities markets. All jurisdictions with liquid stock markets have legislation in high or medium compliance with international principles.

In CEB, the implementation of the *acquis communautaire* and the strengthening of the cooperation between regulators have contributed to the creation of an effective framework where investors enjoy a good degree of protection. SEE follows very closely, as a high degree of influence is exerted by the goal of joining the European Union and much effort is dedicated to harmonising national legislation and practices with EU standards.

In the CIS+M much work still needs to be done. Both the quality and effectiveness of regulation need to be improved in order to strengthen investors' confidence and trust in the markets.

Endnotes

1 Objectives and Principles of Securities Regulation of the International Organization of Securities Commissions, page 1 (www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf).

2 The assessments are available on the EBRD web site: www.ebrd.com/law.

3 Questions in the checklists related to 10 areas: (i) powers of the regulator(s) of securities markets, (ii) self-regulatory organisations, (iii) issuers and their disclosure obligations, (iv) collective investment schemes, (v) market intermediaries, (vi) secondary markets, (vii) clearing and settlement, (viii) accounting and auditing standards for financial disclosure, (ix) money laundering and (x) variety of financial instruments.

4 "High compliance" jurisdictions have legislation considered relatively sound in the majority of areas. Countries with "Medium compliance" have significant areas where improvements are needed. "Low compliance" means that the quality of legislation is in need of extensive improvement and "Very low compliance" characterises a legal system that needs overall reform. No countries were placed in the "Very high compliance" category, which indicates that international principles are fully transposed in the national legislation.

5 The methodology of the assessment was developed by the EBRD internally and builds on the paper "What Works in Securities Laws?" by Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer in *The Journal of Finance*, Vol. LXI, No. 1, February 2006.

6 Among others, the following law firms contributed to and supported the 2007 securities market legislation assessment and the 2007 LIS: Studio Legale Tonucci (Albania); OMNI Consultants (Azerbaijan); Borovtsov & Salei Law Firm (Belarus); Advokat Branko Maric (Bosnia and Herzegovina); CMS Cameron McKenna (Bulgaria, Czech Republic, Hungary, Poland and Romania); Wolf Theiss (Croatia, Serbia, the Slovak Republic and Slovenia); Luiga Mody HŠŠI Borenius (Estonia, Latvia and Lithuania); Polenak Law Firm (FYR Macedonia); Mgaloblishvili, Kipiani, Dzidziguri (MKD) Law Firm (Georgia); Chadbourne & Parke LLP (Kazakhstan, Russia, Ukraine and Uzbekistan); Kalikova & Associates (Kyrgyz Republic); Turcan & Turcan (Moldova); Mahoney and Lynch (Mongolia); Vujacic Law Firm (Montenegro); and Akhmedov, Aziziv & Abdulhamidov, Attorneys (Tajikistan).

7 For instance, the Italian CIRIO case in 2002 or the ABN Amro-Coopag Finance BV case that occurred in the Netherlands in 1987-88.

8 For example, the Polish Financial Supervisory Authority (former Polish Securities and Exchange Commission) is quite active and has taken several actions in reaction to (alleged) violations, including: withdrawal of intermediaries' licences, suspension of share trading (in connection with breaches of disclosure obligations) and imposition of fines in connection with insider trading and market manipulation.

9 The case involved a public issue of more than US$ 6 million in debt securities. The violations resulted in criminal prosecution and demonstrated that disclosure obligations were not effective; in addition, the effectiveness of the audit has been questioned.

10 International Financial Reporting Standards.


USD
ПОКУПКА
31·60
ПРОДАЖА
31·69

02
Macroeconomic overview

Average economic growth in the transition region reached 6.9 per cent in 2006 (compared with 5.8 per cent in 2005), the highest level since the start of transition. This has been underpinned by strong domestic demand, high FDI and significant remittances from workers abroad, along with a rapid expansion in lending by foreign and domestic banks. Global demand and oil and gas prices remained high, as reflected in strong export growth. As a result, unemployment rates and poverty levels have fallen. In most central European countries, unemployment levels are now below the average EU level. Throughout the transition region, rising prosperity has become particularly manifest in demand for housing, leading to booming construction and sharp increases in housing prices.

At the same time pressure on the economy is becoming apparent throughout the region in the form of wage and price inflation and rising external imbalances. While exports have remained strong, the competitiveness of the Baltic states and several countries in south-eastern Europe is at risk. Against this background, monetary policy has gradually been tightened, although it remains loose in some cases. Fiscal policy has so far been unable to ease inflationary pressures and widening external imbalances, and is in many countries expected to fuel already overheating economies in 2007.

The global financial turmoil caused by problems in the US sub-prime mortgage market from August 2007 is expected to make external finance dearer, which may help overheated economies in the transition region to cool down. In a less benign scenario, countries with high external funding needs may experience a stronger than expected economic downturn.

Central eastern Europe and the Baltic states

Robust domestic demand continues to underpin economic activity. While fixed capital formation remains the main driver, private consumption picked up strongly in the Baltic states. This is causing unemployment rates to fall and leading to production capacity constraints, as reflected in rising inflation and widening external imbalances.

Economic activity

In 2006, real GDP had its fastest rate of growth since the start of transition. At 6.2 per cent (weighted average), up from 4.9 per cent in 2005, output growth in central eastern Europe and the Baltic states (CEB) was above expectations.

While growth rose in most countries, in the Czech Republic, Hungary and Lithuania it was broadly stable compared with 2005, reflecting constraints on economic production capacity, the effects of fiscal consolidation and an increasing decline in net exports, respectively. Output growth in CEB remained strong in the first half of 2007 and is forecast to remain high at an average of 6.0 per cent in 2007.

The acceleration in real GDP growth in 2006 was due to exceptionally strong growth in investment and, in the Baltic states, high private consumption. While private consumption has been supported by rapid growth in wages, employment and credit, investment was mainly driven by the favourable outlook for demand, high levels of production capacity utilisation and corporate profits, favourable financing conditions and ongoing inflows of FDI and EU structural funds (see also Chart 2.4).

In addition, strong demand in the construction sector, which reflected booming housing markets, drove up investment in several countries (see Box 2.1). Export growth in 2006 was also up in most countries – except Latvia and Estonia – mirroring strong global demand.

In terms of bilateral trade flows, imports of goods from the eurozone have been growing rapidly in recent years (see Chart 2.1). This largely reflects the strong demand for capital goods in CEB, which is partly linked to current and past FDI.

Labour market conditions improved notably in 2006 in all countries but Hungary. Unemployment rates were mostly below the average EU level (8.0 per cent), except in Poland and the Slovak Republic. The decline in 2006 was particularly sharp in the Baltic states, Poland and the Slovak Republic, where unemployment rates dropped between 2 and 4 percentage points. However, long-term unemployment across the sub-region is still above the EU average.

In parallel, many countries are experiencing labour shortages, particularly in high-skilled labour and construction, leading to rising wage pressures. While migration of labour has added to the shortages, many countries (the Czech Republic, Poland, and the Slovak Republic) have seen increased labour inflows of low-skilled workers from countries outside the EU, such as Ukraine, counterbalancing wage pressures.

Inflation

Inflation has been on an upward trend since mid-2006 in all CEB countries except the Slovak Republic. As at July 2007, year-on-year inflation in the Baltic states had risen the most, to 9.5 per cent, 5.8 per cent and 5.1 per cent in Latvia, Estonia and Lithuania, respectively. In Hungary, inflation rose rapidly in the second half of 2006 to 9.0 per cent in early 2007, largely on account of increasing administered prices, such as regulated energy prices, and indirect taxes. In the Slovak Republic, inflation moderated to 2.2 per cent in July 2007, benefiting from moderate wage growth, smaller increases in the price of energy and a strong koruna.

Foreign trade and FDI

Booming consumption and investment in 2006 resulted in wider current account deficits in most CEB countries. The Baltic states saw the most marked widening, reflecting rising merchandise imports. In Latvia, the current account deficit nearly doubled to 21.3 per cent of GDP while in Estonia and Lithuania it widened to 15.7 and 10.9 per cent of GDP, respectively, well above most estimates of sustainable levels. In the Slovak Republic, the current account deficit remained high at 8.3 per cent of GDP, driven by a large trade deficit.

In contrast, both the Czech Republic and Hungary saw an improvement in their trade balances. In these two countries the income balance continued to rise due to high dividend and profit repatriation linked to past FDI. For these countries, the income balance has become the main driver of the current account deficits, pointing to the importance of expanding export capacity in line with FDI inflows in order to counterbalance future capital outflows.

Net FDI inflows, considered the most stable form of external financing, continued to be important for several CEB countries in 2006, including the Czech Republic, Poland and the Slovak Republic (see Chart 2.2). However, the net FDI coverage of the current account deficit fell in most countries except Latvia, Lithuania and the Slovak Republic.

In Hungary and the Baltic states net FDI covered less than half of the current account deficit in 2006, making these countries more dependent on debt-creating capital flows, such as portfolio investment (in the case of Hungary) or financing from foreign banks (the Baltic states). As a result, external debt rose considerably in 2006 in these countries (see Chart 2.3).

Net FDI for the CEB region is expected to fall further in 2007 (to US$ 24.5 billion from US$ 24.8 billion in 2006), partly because major privatisation projects are reaching completion.

Despite some financial turbulence and growing imbalances in many countries, CEB currencies have mostly remained stable against the euro, with some pressures developing in August 2007. Estonia and Lithuania maintain euro-based currency boards while Latvia unilaterally maintains a narrow fluctuation margin to the euro within the Exchange Rate Mechanism (ERM II).

In Latvia, the lat approached the lower end of its unilateral ±1 per cent fluctuation band against the euro at the end of March 2007, amid growing concerns of overheating, forcing the central bank to intervene and raise its interest rates. The central parity rate of the Slovak koruna was revalued within ERM II by 8.5 per cent with effect from 19 March 2007, putting the central rate closer to the market value. Slovenia successfully introduced the euro on 1 January 2007, becoming the 13th eurozone country.

Domestic policies

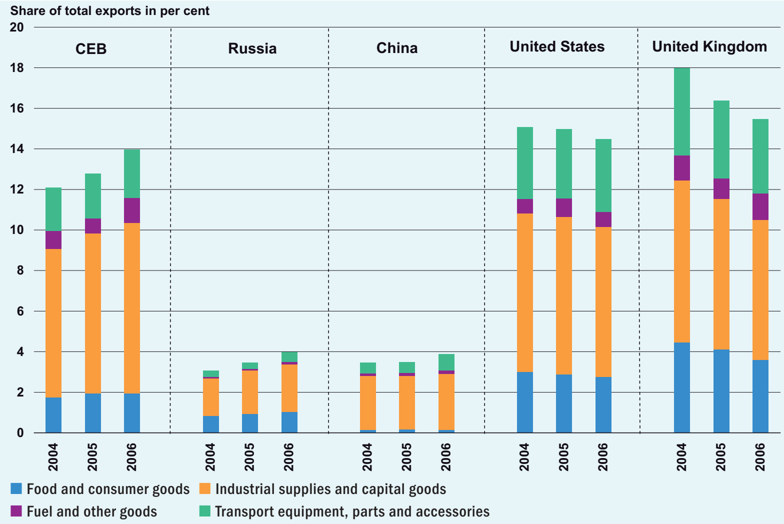
Monetary policy has gradually tightened in most countries in reaction to the risks to price and exchange rate stability posed by rising wages, capacity constraints and rapid credit growth. However, in the Baltic states, the Czech Republic and Slovenia, the monetary policy stance remains loose, with low or negative real interest rates following the pick-up in inflation. Real interest rates are also negative in Hungary where the base rate was reduced slightly in mid-2007 to 7.75 per cent against the background of an improving outlook for inflation and currency stability.

In the Baltic states, having largely failed to curb credit growth by raising reserve requirements, the governments of Latvia and Lithuania plan to fight inflation with fiscal, prudential and administrative measures. In the Slovak Republic, where the currency is appreciating and the outlook for inflation is favourable, rates have been reduced by 50 basis points.

On the fiscal side, the loose overall stance looks unjustified given present cyclical conditions, especially in the larger CEB countries. On average, general government deficits across the region were 2.1 per cent of GDP in 2006, the same as in 2005. The deficits were generally smaller than targeted, which was a result of mainly higher than expected public revenues and relatively cautious fiscal targets in most countries.

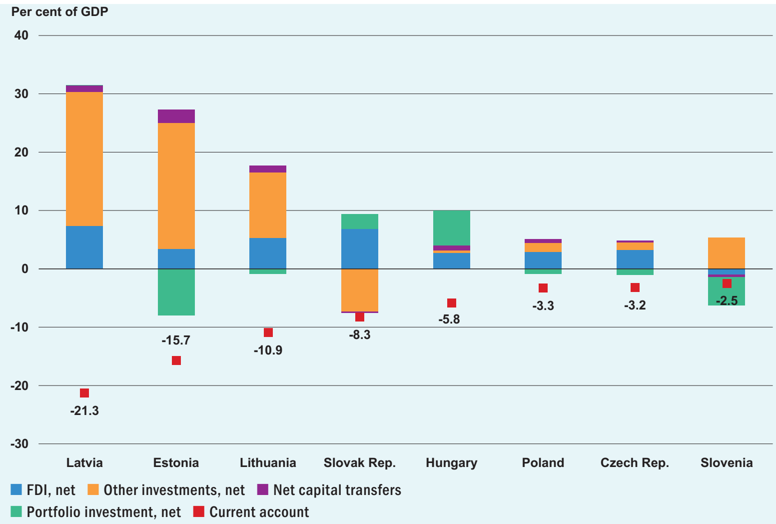
Despite the continuing favourable economic outlook, a number of countries plan an expansionary budgetary stance. This is especially true for the Czech Republic, Estonia and Latvia. Much of this expansion comes from increased expenditure for social security, pensions and public sector wages. In addition, political instability in many countries continues to hamper the prospects of a more far-reaching fiscal consolidation and adjustment to the medium-term objective of the Stability and Growth Pact, which is signed by all EU member states in the Economic and Monetary Union.

Chart 2.1
Eurozone exports to main trading partners, 2004-06



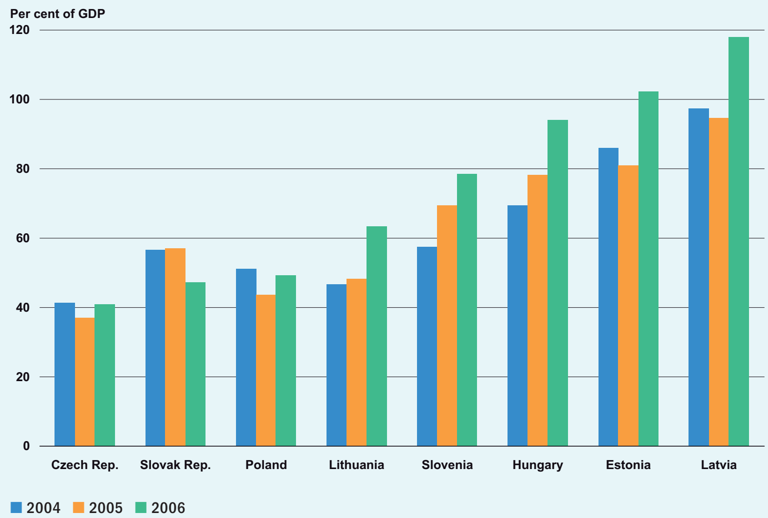
Sources: ECB and COMTRADE.

Chart 2.2
Financing of current account deficits, 2006



Source: EBRD.

Chart 2.3
Total external debt in CEB, 2004-06



Source: EBRD.

South-eastern Europe

Economic growth in south-eastern Europe (SEE) remained strong in 2006 and grew stronger in early 2007. Net FDI inflows reached record levels and for the first time exceeded FDI to central eastern Europe and the Baltic states (CEB). Strong domestic demand is leading to wider external imbalances and is increasing the vulnerability to adverse economic shocks. Rising unit labour costs and fiscal loosening in 2007 are risks to inflation and international competitiveness for several SEE countries.

Economic activity

Real GDP in SEE grew by 6.4 per cent (weighted average) in 2006 compared with 4.8 per cent in 2005. This faster growth mainly reflects developments in Romania, where the fiscal expansion and strong wage growth supported a pick-up in GDP growth to 7.7 per cent from 4.1 per cent in 2005. Output growth is increasingly dependent on private consumption, particularly in Bulgaria and Romania. This followed rising wages and employment and a continuing credit expansion.

Growth accelerated markedly in a number of countries in the first quarter of 2007, especially in Croatia, FYR Macedonia and Serbia. In Serbia, this was partly due to a more loose fiscal policy and rising public sector wages. In Romania, economic growth slowed in early 2007 as domestic demand softened and the negative contribution of net exports rose.

For 2007 as a whole, real GDP growth is expected to strengthen further, except in Romania and Bosnia and Herzegovina where some moderation is forecast. For Bulgaria and Romania, which joined the European Union in early 2007, EU structural funds will help to boost public investment, although the ability to make full use of these funds will take some time to develop. The European Union has committed significant amounts of around 5-6 per cent of GDP annually in the coming years (see Chart 2.4). Care will need to be taken to avoid spending these funds on already "overheated" sectors, such as construction.

In line with robust growth, labour markets continued to recover. However, unemployment is still very high and only in Bulgaria and Romania has it fallen below 10 per cent. In Bosnia and Herzegovina, FYR Macedonia and Serbia, the unemployment rate stayed above 30 per cent. Despite these high unemployment rates, wages rose in 2006 in most countries. In several countries, including Bulgaria and Romania, this was not matched by equivalent increases in labour productivity, which meant that unit labour costs rose and international competitiveness fell.

Inflation

On average, the inflation rate in SEE was stable at 5.7 per cent in 2006, with smaller energy price increases compensating for rising demand and wage increases. Compared with 2005, annual inflation was markedly higher in Bosnia and Herzegovina, Bulgaria and FYR Macedonia due to hikes in excise duties and the introduction of value-added tax in Bosnia and Herzegovina. Inflation in Serbia slowed dramatically and fell below 5 per cent in the second quarter of 2007. However, a recent upturn has reduced the chances of meeting the inflation target (introduced in September 2006) of 4-8 per cent by the end of 2007.

While inflation decelerated to around 4 per cent in Bulgaria and Romania in the first half of 2007, it mainly remained stable at low levels in the other SEE countries. In mid-2007, however, inflation in several countries became heavily affected by higher food prices caused by drought, with inflation in Bulgaria rising to 8.4 per cent year-on-year in July.

Most SEE countries pursue different forms of fixed exchange rate regimes. This implies that prudent fiscal policy is crucial to maintaining price stability as monetary policy is mainly concerned with exchange rate stability. Only Albania, Romania and Serbia have opted for complete freedom and allowed their central banks to set domestic interest rates, by adopting a form of inflation targeting. This clarifies the national bank's responsibility for price stability, but it also allows for greater exchange rate volatility.

Foreign trade and FDI

External imbalances have continued to rise in SEE. The average current account deficit amounted to 12.0 per cent of GDP in 2006, compared with 9.6 per cent of GDP in 2005. Current account deficits ranged from 0.4 per cent of GDP in FYR Macedonia to 29.1 per cent of GDP in Montenegro and are mainly driven by rising trade balance deficits. Despite growing exports, strong domestic demand in SEE resulted in even higher import growth.

Net FDI flows into the region continued to grow rapidly in 2006, rising by close to 75 per cent compared with 2005. Net inflows reached US$ 26.1 billion in 2006 and for the first time exceeded net FDI inflows to CEB (see Chart 2.5).

FDI inflows grew particularly fast in Croatia, FYR Macedonia and Serbia, where they more than doubled. With about 44 per cent of total inflows to the region, Romania was by far the largest recipient in absolute terms. In relation to GDP, however, Montenegro is the biggest recipient of net FDI at nearly 30 per cent of GDP (see Chart 2.5). The surge in FDI inflows in 2006 was mainly related to large privatisations in FYR Macedonia, Romania and Serbia. Net FDI inflows are expected to moderate in 2007 to around US$ 20.2 billion as privatisation activity slows down.

In general, high current account deficits and FDI inflows can be expected in countries that are rapidly catching up with more advanced countries at higher levels of economic development and are experiencing a build-up of production capacity. However, deficits of the magnitude seen in several SEE countries may signify more long-lasting problems with competitiveness. This is particularly relevant for countries with fixed exchange rates. These arrangements prevent exchange rate adjustments and so larger imbalances could build up, which may become harder – in terms of real adjustments to production and employment – to address at a later stage.

FDI inflows have become increasingly concentrated in property, construction and the financial sector, particularly in Bulgaria, Croatia and Serbia (see Chart 2.6). Although FDI is flowing into a broader range of sectors, some of these investments do not have the potential to raise export capacity, which could delay the return to more sustainable external balances. Nevertheless, large capital inflows in SEE have already revived industrial capacity and are pushing up exports to the European

Union and other countries in SEE. As the Central European Free Trade Agreement and the Interim Trade Agreement with the European Union recently entered into force, trade and exports should continue to grow over the medium term.

Domestic policies

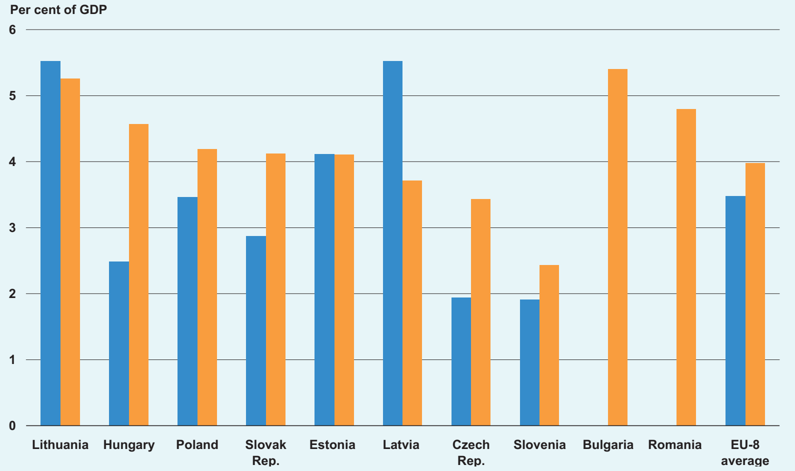
Most countries recorded sizeable budget surpluses, while high deficits remained in Albania (3.2 per cent of GDP) and Croatia (3.0 per cent of GDP) in 2006. Expenditure-to-GDP ratios continued to decline moderately while revenue-to-GDP ratios remained broadly unchanged.

However, these improvements may be largely transitory. Tax reductions and increases in social benefits and public-sector wages are being implemented in 2007, especially in Bosnia and Herzegovina, Romania and Serbia, corresponding to a sizeable pro-cyclical fiscal loosening. These measures will lead to wider external deficits and will have an impact on inflation.

From a longer-term perspective, government spending in relation to GDP still remains high in several countries. Expenditure-to-GDP levels in Bosnia and Herzegovina and Croatia are particularly high and well above the levels of most CEB countries.

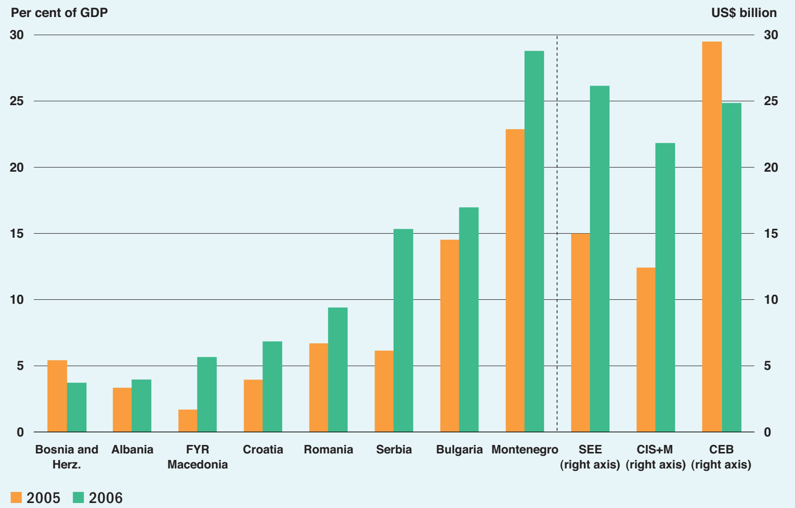
On the monetary side, the inflation outlook has worsened in recent months and some central banks have moved pre-emptively to combat inflationary pressures and excessive credit growth. Further monetary tightening may be required as wage pressures and fiscal loosening unfold. In Romania and Serbia the central banks slashed interest rates in early 2007. However, in August 2007 interest rates were raised again in Serbia against the background of rising inflation and wage pressures, while a number of measures to contain credit growth and domestic demand were introduced in Croatia and Serbia.

Chart 2.4 Average annual commitments of EU structural funds to CEB, Bulgaria and Romania, 2004-13



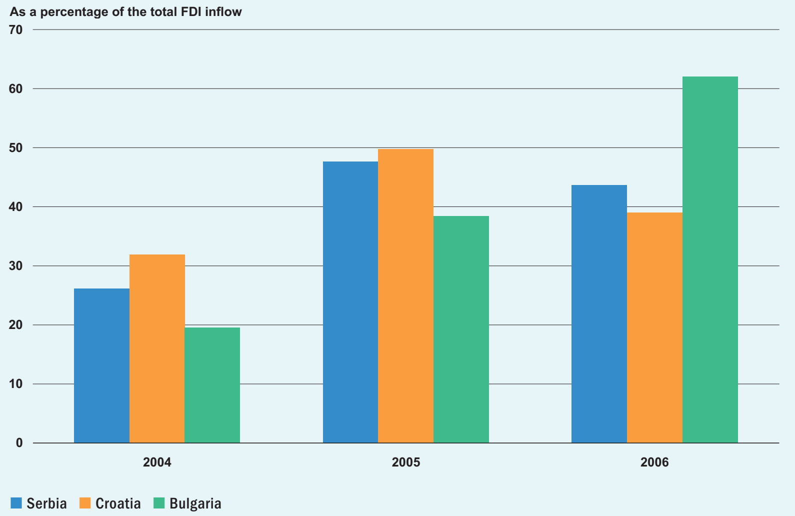
Source: IMF, C. Rosenberg and R. Sierhej, "Interpreting EU Funds data for macroeconomic analysis in the new member states", IMF Working Paper 07/77.

Chart 2.5
Net foreign direct investment, 2005-06



Source: EBRD.

Chart 2.6
Net FDI in construction, property and the financial sector



Source: National authorities.

Commonwealth of Independent States and Mongolia

The economies of the Commonwealth of Independent States and Mongolia (CIS+M) are the most rapidly expanding in the transition region, with growth in many countries underpinned by high oil and gas prices. Construction has been boosted by oil revenues, and in resource-poor countries by remittances from workers abroad. Against this background, poverty levels in Central Asia and the Caucasus have fallen.

Economic activity

Real GDP in the CIS+M grew by a (weighted average) rate of 7.5 per cent in 2006. For 2007 an expansion of 7.8 per cent is forecast. This continuing good growth performance has gradually fed through into lower poverty levels in a range of countries – including Armenia, Azerbaijan, the Kyrgyz Republic, Mongolia and Uzbekistan.

Growth rates varied widely across countries in 2006, from 34.5 per cent in oil-rich Azerbaijan to a modest 2.7 per cent in the Kyrgyz Republic (in the latter country economic growth picked up significantly in 2007). Increasing capacity utilisation of the Baku-Tbilisi-Ceyhan (BTC) oil pipeline in the second half of 2006 and high oil prices bolstered Azerbaijan's export growth to 70 per cent in 2006. In the Kyrgyz Republic, economic growth has started to pick up after the political turmoil surrounding disputed parliamentary election results in 2005 and the associated economic decline. Output increased partly due to sizeable investments from Kazakhstan and large remittance inflows, mainly from Russia.

In Ukraine, strong private consumption, investment growth and high world prices for metal, the country's main export commodity, led to output growth of 7.1 per cent in 2006. Growth is expected to moderate only slightly to 6.8 per cent in 2007. Russia recorded a respectable growth rate of 6.7 per cent, slightly higher than 2005, mainly because of rising investments and continuing high consumption.

In Moldova, growth fell from 7.1 per cent in 2005 to 4.0 per cent in 2006. This was mostly due to Russia's ban on imports of Moldovan wine and the more than doubling of the price of gas imported from Russia. However, the Moldovan economy proved more resilient than expected, with a sharp decline in export growth counterbalanced by a considerable rise in domestic investment. Georgia also withstood a Russian ban on imports of Georgian mineral water, wine and other agricultural products. In the wake of an acceleration in economic reforms in 2004-05, the Georgian economy grew by 9.4 per cent in 2006. It is expected to expand by 10 per cent in 2007.

Inflation

Inflation in 2006 mostly receded in the CIS+M to a mean of 8.7 per cent. Russia's average inflation came down from 12.7 per cent in 2005 to 9.7 per cent in 2006 and a further reduction to 8.5 per cent is expected for this year. More recently, however, inflation has risen, underlining the demand pressures coming from substantial capital inflows and the fiscal relaxation under the new medium-term budget.

In Ukraine, average inflation came down from 13.5 per cent in 2005 to 9.1 per cent in 2006. However, the increasing divergence between the consumer price index (CPI) and the producer price index (PPI) – 11.6 per cent versus 18.9 per cent growth in the year to August 2007 – is a sign of the underlying inflationary pressures in the economy, which may intensify due to expectations of a poor harvest this year.

Armenian prices increased on average by only 2.9 per cent in 2006, the lowest rate across the CIS+M. The central bank's commitment to low inflation has enabled a relatively free appreciation of the dram. This contrasts with Azerbaijan, the fastest growing country in the CIS+M, where the central bank is limiting the appreciation of the manat. As a result, inflation has been persistently high and is expected to increase to 16 per cent this year.

In Kazakhstan, the monetary authorities found it increasingly difficult to contain money growth fuelled by banks' substantial foreign borrowing in 2006 and the first half of 2007. Average inflation consequently increased from 7.6 per cent in 2005 to 8.6 per cent in 2006. In Georgia inflation has also risen, mainly because of increasing energy prices, high domestic demand and large foreign capital inflows.

Foreign trade and FDI

Trade in oil and gas continued to dominate trade patterns in the CIS+M. High prices meant that resource-rich countries generally displayed large trade surpluses, but resource-poor countries showed large trade deficits, particularly Moldova (see Chart 2.7).

As trade balances continue to make up a large part of current account balances, there is a similar contrast in the latter: resource-rich countries have current account surpluses (with the exception of Kazakhstan) whereas resource-poor countries generally posted a current account deficit. In 2006, Ukraine recorded its first current account deficit in eight years, driven by strong domestic demand for imported goods and increased prices for imported oil and gas.

Other items of the current account have started to counterbalance the trade balance. In the resource-rich countries this role is mainly performed by the income balance and the balance of services, which reflect the accrual of oil-related profits and the buying of specialist oil extraction and transport services.

In Kazakhstan, the huge trade surplus of 18.2 per cent of GDP was more than offset by a combination of a negative balance of services (oil specialists and oil transport costs), a negative income balance (high outflow of oil profits) and negative net current transfers (mainly remittance outflows). In the non-resource rich countries, the substantial trade deficits are partly counterbalanced by large inflows of remittances from workers abroad.

Net FDI in the CIS+M more than doubled to US$ 21.8 billion in 2006 compared with an average US$ 10.3 billion per year in the preceding three years. The rise was mainly in Kazakhstan and Russia. In Russia, this net inflow is the sum of inward FDI into Russia of US$ 30.5 billion and outward FDI of US$ 23.2 billion. FDI into Russia is increasingly going into sectors other than energy, in particular production facilities geared towards the strongly growing domestic demand for consumer goods. Rapidly growing outward FDI reflects the increasing appetite of Russian firms to diversify their sources of revenue and acquire assets in vertically related industries.

Finally, Azerbaijan is an exception in the CIS+M in that it recorded a net FDI outflow of almost US$ 1 billion in 2006 and an expected US$ 5 billion for 2007. This mainly reflects the reduced need for FDI into the development of hydrocarbons infrastructure as well as capital repatriation by foreign oil companies.

Despite the rapid increase in FDI inflows, especially to resource-rich countries due to the sharp rise in imported gas prices, net FDI has remained relatively constant as a share of GDP, hovering between 1 and 2 per cent (see Chart 2.8). In oil and gas-poor countries, FDI has increased substantially in relative terms. As a percentage of GDP, net FDI inflow increased from just above 2 per cent in 2000 to 4.3 per cent in 2006.

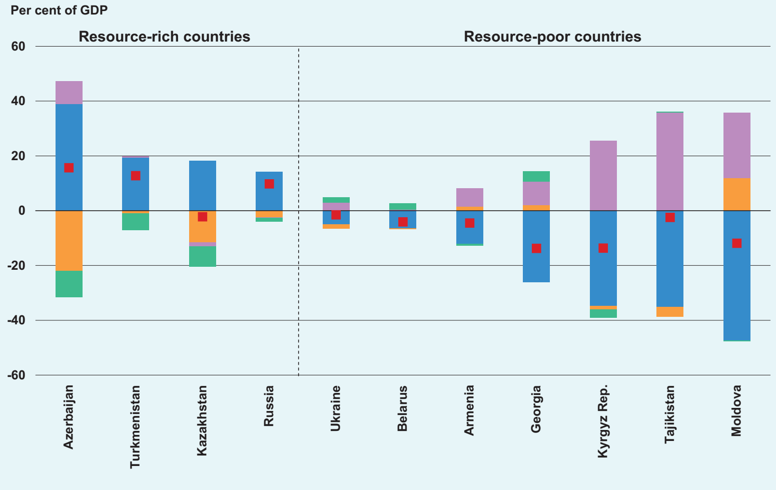
Domestic policies

In 2006 and the first half of 2007, many CIS+M countries continued to benefit from high oil revenues. In Russia, the consolidated budget surplus reached 8.4 per cent of GDP in 2006, while in Kazakhstan oil revenues contributed to a surplus of 7.5 per cent of GDP in 2006. Oil and gas-poor countries generally showed less impressive fiscal results, with Georgia and Armenia recording budgetary deficits of 3 per cent and 2.8 per cent of GDP, respectively.

Chart 2.9 shows the substantial difference between the full budget balance and the non-oil portion (or non-gas part in the case of Turkmenistan). In 2006, Kazakhstan, Russia and Turkmenistan all ran substantial non-oil budget deficits. However, all of these resource-rich countries were able to use their oil and gas profits to turn the non-oil deficits into budget surpluses.

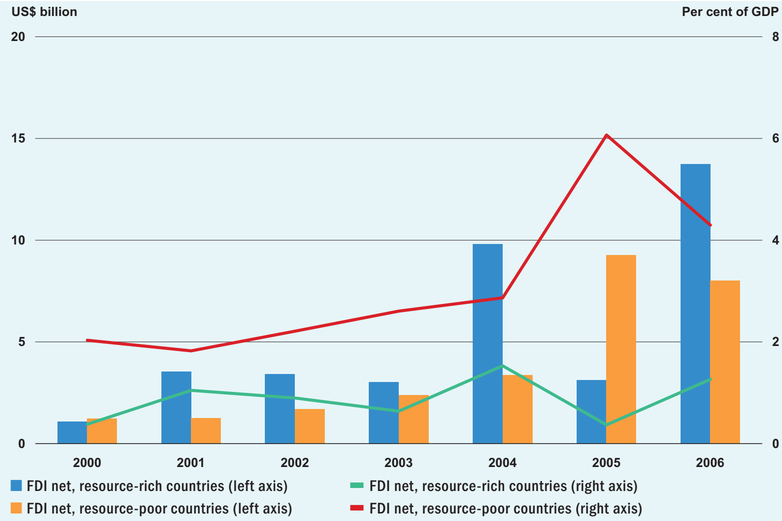
In Azerbaijan, fiscal spending surged the most, leading to a non-oil budget deficit of 32.6 per cent of GDP in 2006. Unlike the Russian Stabilisation Fund, the Azeri Oil Fund does not act as an automatic stabiliser and the authorities do not set explicit targets for the level of the non-oil budget balance.

Chart 2.7
Components of the current account, 2006



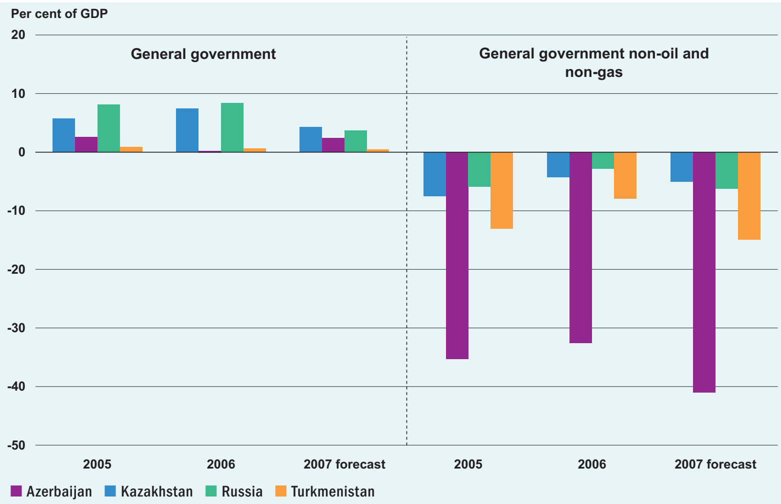
Source: EBRD.

Chart 2.8
FDI in resource-rich and resource-poor countries, 2000-06



Source: EBRD.

Chart 2.9
Fiscal balances in resource-rich CIS+M countries, 2005-07



Sources: IMF and Russia's Ministry of Finance. Note: Data for Azerbaijan refer to the central government fiscal balance. For Turkmenistan the data refer to the non-gas portion of the full budget balance.

Medium-term outlook and vulnerabilities

The outlook for the transition countries remains favourable in the medium term, reflecting strong domestic demand and increasing international trade. However, in many countries there are still risks of external imbalances, increased indebtedness and rising inflation. The volatility in global financial markets is expected to dampen growth slightly in 2007.

Central eastern Europe and the Baltic states

Despite the recent turmoil in the global financial markets, medium-term growth prospects remain favourable in central eastern Europe and the Baltic states (CEB). Real GDP growth will moderate only slightly in 2007 and 2008, in line with world demand. Domestic demand is expected to remain the main engine for growth, supported by growing employment and disposable incomes. Continued high investment growth should gradually improve supply conditions. In most CEB countries labour costs are expected to remain high. In addition, rising food prices, following the summer droughts in many parts of Europe, will push up inflation.

Current account deficits are forecast to remain very high in 2007 and 2008 in all of the Baltic states. Weakening price and cost competitiveness, low FDI and rising external debt all call for urgent action to moderate above-potential growth. Although private sector credit growth in the Baltic states has slowed, it remains very high (above 30 per cent). Without more decisive policy action, currency adjustments will become more likely and this would negatively affect the quality of bank assets given the high share of euro-denominated loans.

In Hungary, the large share of loans in foreign currencies and the high current account deficit are concerns, especially as they are combined with a large budget deficit. Investor concerns over public sector financing needs made the forint relatively sensitive to the recent financial market volatility (see Chart 2.10).

Higher inflation and weak progress with fiscal consolidation have stalled some countries' plans to adopt the euro. After Slovenia successfully introduced the euro in January 2007, only the Slovak Republic is likely to follow suit in the next few years (the Slovak authorities aim to meet the fiscal criteria in 2007 and enter the eurozone on 1 January 2009).

South-eastern Europe

Prospects for south-eastern Europe (SEE) over the medium term remain favourable. With competitive wage levels and an improving economic and institutional framework, FDI inflows are likely to remain high. Increased political stability and EU accession prospects have also encouraged domestic reform and foreign investment in recent years.

However, there are a number of risks in the near term. These relate mainly to the high current account deficits and concerns over competitiveness (especially in Montenegro and Romania), risks to inflation stemming from rapidly rising wages (in particular in Romania and Serbia), fiscal loosening and rising food prices. In addition, the accumulation of household debt resulting from rapid credit growth constitutes a risk in most countries. A slowdown in the housing market could have negative implications for growth given that the share of construction in economic output has grown markedly in recent years (see Chart 2.11).

Several countries, in particular Romania and Serbia, are combining lax fiscal and income policies. While Bulgaria has taken firm policy measures, its external and domestic imbalances have kept growing. This risks a market-imposed adjustment that could disrupt growth and credit quality, especially as capital markets are set to become more discriminating.

With Bulgaria and Romania becoming EU members in January 2007, the question remains as to how soon other countries in SEE can be expected to join. Potential accession "fatigue" on the part of current EU members is a risk. Nevertheless, SEE governments need to pursue sustainable economic policies by reining in excessive public spending and keeping inflation under control in order to reduce external vulnerability. The increased availability of EU funds and aid should improve the prospects for this. Continued political stability is crucial to make SEE attractive to investors, along with improvements in the business environment, which would lead to further FDI inflows.

Commonwealth of Independent States and Mongolia

Growth in the Commonwealth of Independent States and Mongolia (CIS+M) is forecast to remain high at around 7.8 per cent (weighted average) in 2007 and 7.0 per cent in 2008, as long as oil and gas prices remain high. On average, inflation is expected to remain about the same in 2007 as last year, with some potential for further declines in 2008. However, Azeri inflation is expected to rise considerably to 16 per cent in 2007, and in Russia and Ukraine inflation remains one of the main worries from a macroeconomic perspective.

Within the CIS+M, only Kazakhstan, Russia and Ukraine have regular access to international capital markets and so are most directly exposed to the current volatility. A reduction in liquidity inflows to Russia is expected to moderate the growth in money supply and credit to the private sector, thereby slightly dampening growth in domestic investment and consumption next year, although overall growth is likely to remain at about 6.5 per cent in 2008. The substantial fiscal expansion in 2007 and 2008 and a monetary policy that will constrain the nominal appreciation of the rouble may lead to a resurgence of inflation.

So far, Ukraine's domestic financial market has been resilient to the increase in risk premiums throughout the emerging markets. There are no apparent pressures on the exchange rate nor were there any disruptions on the interbank refinancing market. International reserves reached an all-time high of US$ 29 billion by the end of August 2007 (equivalent to above five months of imports). Although private external debt is growing rapidly, external debt is moderate at 51 per cent of GDP at the end of 2006. However, the current turbulence in international financial markets may adversely affect the country's growth prospects. Over the medium term, growth is clouded by the repricing of Ukrainian risk and the likelihood of further price increases for imported gas.

Of all the transition countries with access to the capital markets, Kazakhstan has the largest amount of external financing flows into its banking sector: 50 per cent of banking sector liabilities are financed abroad. This resulted in a rapid widening of sovereign spreads and a hike in domestic money market rates (see Chart 2.12). Pressure on the tenge was countered by central bank intervention in the currency market. Foreign exchange reserves seem adequate to finance the current account deficit and to service the outstanding external private debt over the medium term.

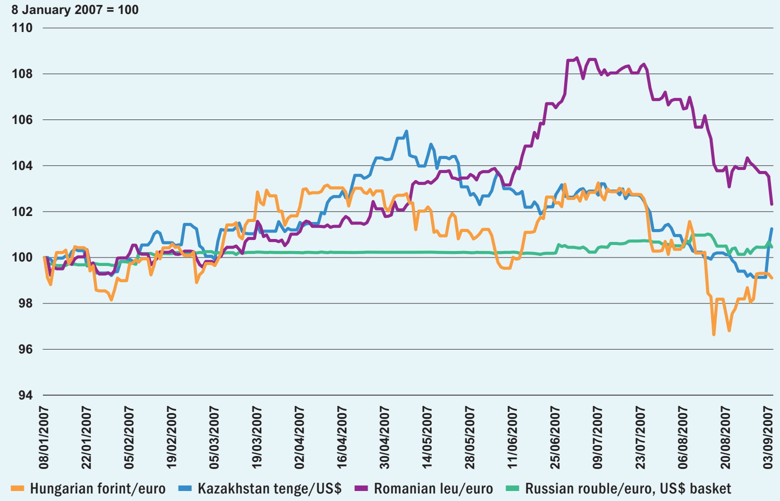
In the other countries in the CIS+M, either FDI or official financing predominates. Strong oil and gas prices, trade with a robustly growing Russia and remittances from workers living in Russia mean that external financing requirements are likely to remain modest. A potential problem would be reduced FDI or financial flows from Kazakh and Russian banks to other CIS+M countries.

Excluding Kazakhstan, Russia and Ukraine, macroeconomic vulnerabilities in the CIS+M primarily stem from high public external debt in the less-developed countries, although debt indicators in some countries have recently improved. Armenia, the Kyrgyz Republic and Moldova are currently following poverty reduction programmes of the International Monetary Fund and Georgia has just completed the final review under its three-year Poverty Reduction and Growth Facility. This mitigates concerns over the accrual of new external debt, although newly emerging official creditors such as China may to some extent undermine previous efforts by international financial institutions to relieve debt.

In the resource-poor countries, the difficulty in generating fiscal and export revenues raises concerns over the sustainability of public external debt, and the potential impact of exchange rate corrections.

In the medium term, economic production across the CIS+M needs to be further diversified. In the resource-rich countries, such as Kazakhstan and Russia, this would result in less vulnerability to oil and gas price fluctuations and a broader supply base underpinning growth. This is particularly urgent in countries such as Azerbaijan, where hydrocarbon production is likely to reach its peak by 2013. Diversifying the economies of the resource-poor countries would make them less dependent on remittances from workers abroad, which increasingly drive economic growth mainly through financing property booms.

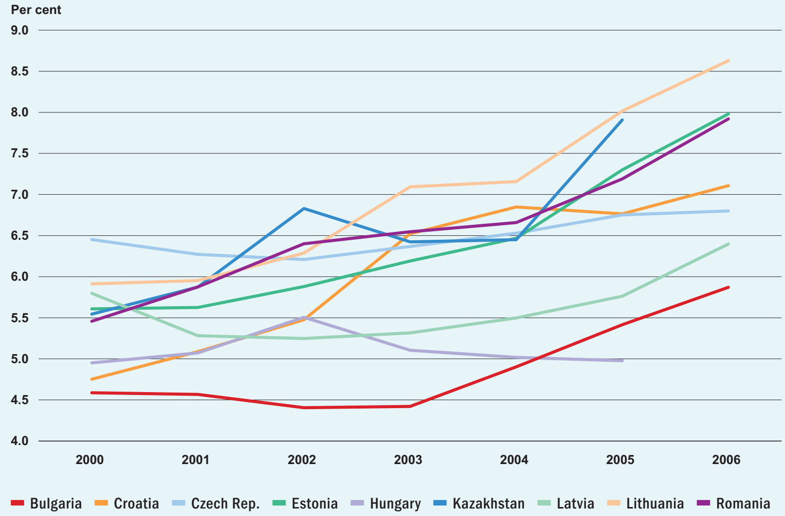
Chart 2.10
Exchange rate developments, 2007



Source: Bloomberg.

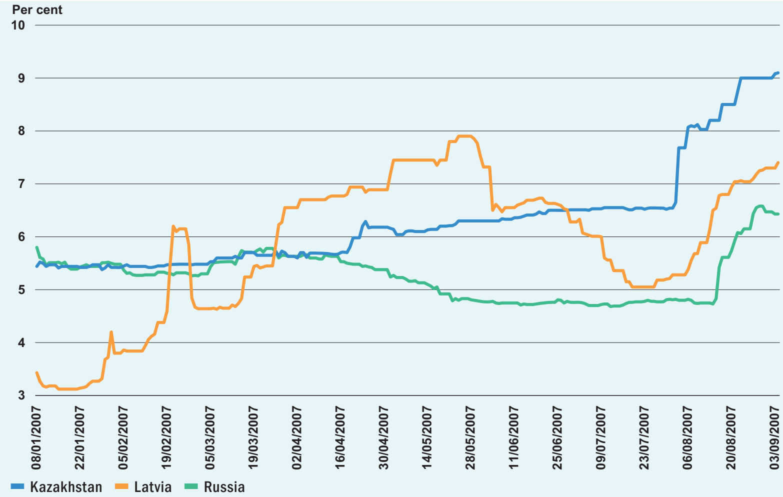
Note: Nominal exchange rate indices (8 January 2007 = 100).

Chart 2.11
Share of construction sector in economic output



Source: EBRD.

Chart 2.12
Short-term interest rates, 2007



Source: Bloomberg

Note: Short-term interest rates: Russia - MosPrime 3m; Kazakhstan – KazPrime; Latvia – RIGI3M Index.

Box 2.1 Booming housing markets

In many transition countries over the past few years, house prices have risen and mortgage debt has grown rapidly. Chart 2.1.1 shows the average annual growth rate of real house prices and real per capita GDP for 2004 to 2006. Price increases have been the highest in Ukraine, followed by Romania, Latvia, Estonia, Lithuania, Bulgaria, Russia and Armenia – running at an average real growth rate of more than 20 per cent per year, well above real income growth. Price increases have been concentrated in large cities and coastal areas.

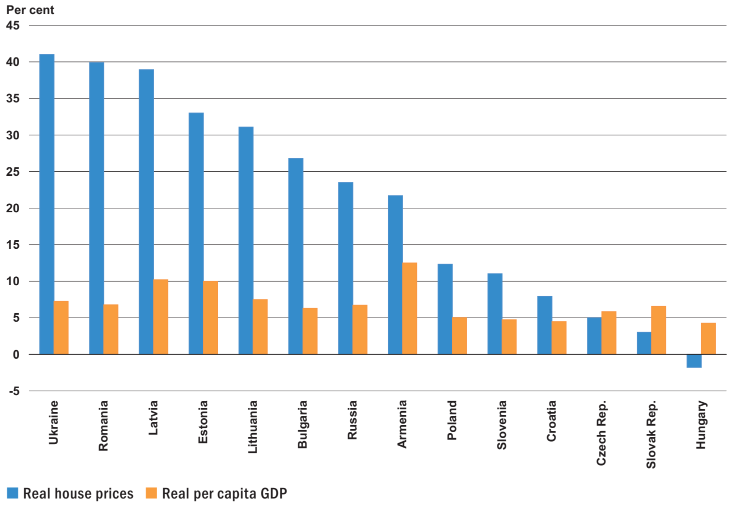
According to estate agents, similar developments are apparent in a number of countries in south-eastern Europe (SEE), Central Asia and the Caucasus. For instance, in the Ferghana Valley, a densely populated region spreading across eastern Uzbekistan, Tajikistan and the Kyrgyz Republic, prices of apartments have increased rapidly over the past few years, fuelled by fast population growth and inflows of remittances from workers in Russia and Kazakhstan.

For other transition countries, such as Hungary and the Slovak Republic, the rise in house prices has largely been in line with or below income growth. This follows an earlier period of strong growth in house prices, partly linked to EU accession. The recent period of slow or negative growth, for example in Hungary, reflects adjustments in housing supply.

More recent price developments have started to diverge. A few countries experienced price increases during the first half of 2007 (Bulgaria and the Slovak Republic). However, in Estonia and Latvia – two booming property markets in recent years – prices stabilised or even decreased and mortgage lending slowed down. This reflects rising interest rates, stricter lending practices by banks and a moderation in house price expectations, leading to less investment in the housing market by property speculators and a larger supply of housing.

Household income (and expectations of future income) is the most important determinant of house price growth in the medium term. Rising incomes generate more demand for living and recreational space. Combined with a limited housing supply in the short term, this has driven up the price of construction, land and housing in many transition countries. Chart 2.1.2 shows the relationship between income levels and house prices (in capital cities) and indicates the affordability of housing. Based on the data in Chart 2.1.2, it could be argued that price-to-income levels in Bucharest, Kiev,

Chart 2.1.1
Average annual increase in real house prices and real per capita GDP, 2004-06



Sources: National statistical offices and central banks. For Armenia, Hungary, Lithuania and Ukraine (and Czech Republic and Poland in 2006), property companies.

Note: Data for Armenia, Estonia, Hungary, Romania and Ukraine refer to capital. Real house price change is defined as the annual average nominal price change of dwellings per square metre adjusted by annual average CPI.

Riga, Vilnius and Warsaw are relatively high compared with other capital cities in and outside the transition region. However, price comparisons are not straightforward, especially for transition countries, as the quality and supply of housing varies across countries. Furthermore, the rapid increase in income and property prices tends to be more concentrated in the capitals in transition countries than in more developed countries.

All transition economies have enjoyed favourable financing conditions in recent years, in terms of the price and availability of borrowing. The abundance of global liquidity, combined with the increased macroeconomic stability in the transition region itself, resulted in historically low interest rates. In Romania, for instance, annual mortgage interest rates decreased from 46 per cent in 2001 to about 11 per cent in mid-2007. In many countries, especially those with fixed exchange rate regimes to the euro, the very low or negative real interest rates have further supported domestic demand and house price increases. Efforts to contain the growth of credit have in practice often just led to increased foreign currency lending, given the perceived low risk of exchange rate volatility.

A number of transition-specific factors have also led to the rapid rise in house prices and the timing of these increases.[1] At the start of transition, state housing was sold to occupiers at no or very little cost, which probably led to an initial undervaluation. The huge improvement in the quality of recent residential construction is also likely to have influenced house prices in recent years. Moreover, the increased presence of foreign banks with a focus on households, the (related) increase in bank competition, and improvements in legal systems have all increased the availability of mortgage financing. Despite having grown rapidly since 2002, mortgage lending in relation to GDP still lags behind the eurozone, as shown in Chart 2.1.3. However, household financial liabilities in relation to total household wealth have already surpassed eurozone levels in several countries. Mortgages represent a significant share of liabilities.

Many central European and Baltic states (CEB) and SEE countries also experienced a growing demand for housing from foreigners as property sales to non-residents were gradually liberalised. In several early transition countries, rising oil income and/or substantial inflows of remittances from workers living abroad – combined with limited alternative investment opportunities outside property – have sustained house prices. Finally, the persistent period of increasing house prices has fuelled expectations about future prices and potential capital gains, leading to increased speculation. In Kazakhstan and Ukraine, for instance, there are signs that many residents have been investing in apartments with the sole purpose of selling them on in order to generate a profit.

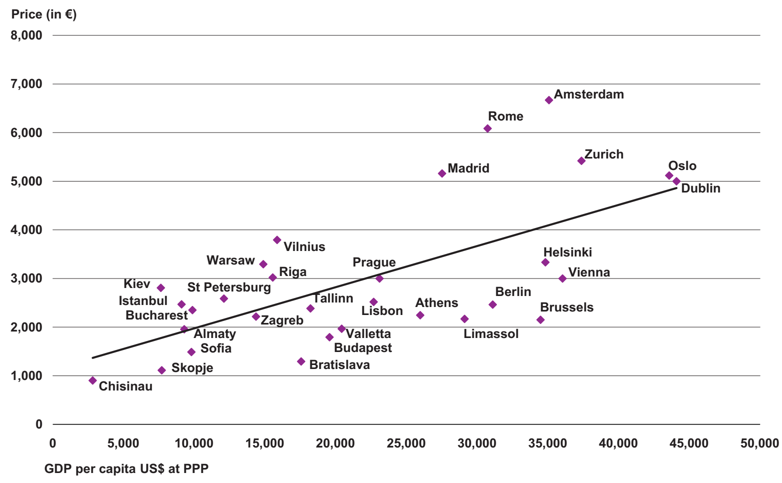
Policy-makers pay considerable attention to the housing market because of its importance for the overall economy. Changes in house prices, rents and mortgage interest rates affect household expenditure and wealth and can therefore affect demand, inflation and external (im)balances. While there is scarce evidence of consumption being affected by wealth, it is likely to be even less important in the transition countries where mortgage equity withdrawal is not well developed. Nevertheless, it cannot be ruled out that large groups of young, first-time property owners with few other assets may reduce their consumption disproportionately if there is a downturn in house prices.

Another channel through which housing markets affect economic activity is the construction sector. Booming construction is creating considerable implications for demand via wage and employment growth, especially in undiversified economies where construction makes up a substantial share of fixed capital formation. In the Baltic states, labour shortages in construction have led to rapidly rising wage costs, risking knock-on effects on wage increases in other parts of the economy. Strong demand in the construction and housing markets also has implications for the external balances via housing- and construction-related consumption (for example, building material and furniture), given that many of these goods are imported.

In summary, on the basis of income levels in 2006, house prices appear on the high side only in a few capitals. However, the speed of price increases in recent years looks unsustainable in many countries as continued growth would soon lead to overvaluation. As housing supply improves and credit conditions become tighter in the coming years, some moderation in house price growth is likely. This is mainly expected to affect investment in construction, while the effects on consumption should be relatively limited.

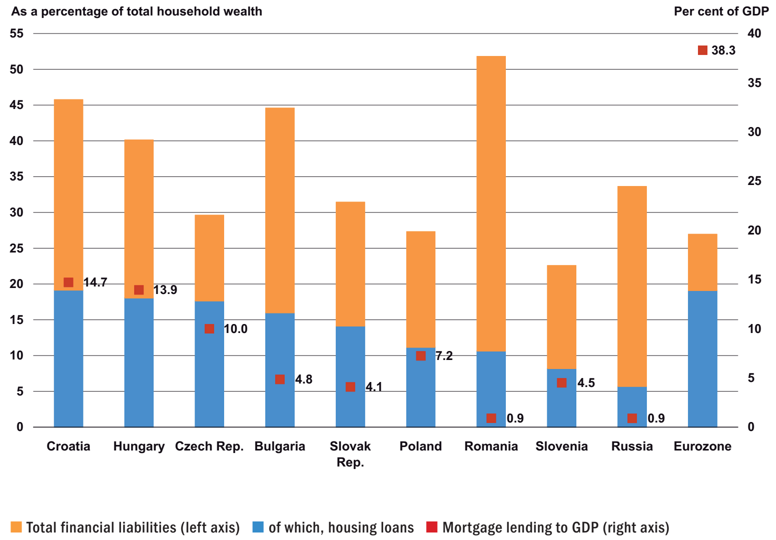
Although the level of debt in relation to GDP is still low on average in the transition region, the lack of other household financial wealth (or financial diversification), which could act as a buffer to sustain consumption, is a cause for concern. How households react to larger declines in house prices, leading to negative equity, is largely untested in the transition region and so there may be a significant impact on the real economy.

Chart 2.1.2
Housing affordability in selected cities, 2006



Source: Global Property Guide Research, IMF.
Note: Prices relate to average price per square metre in euros of a 120m² apartment in the city centre.

Chart 2.1.3
Households' financial liabilities and housing loans, 2006



Sources: UniCredit New Europe Research Network, EBRD and ECB.
Note: Share of mortgage lending in Bulgaria refers to 2005.

Endnote

1 Égert and Mihaljek (2007), *Focus on European Economic Integration* 1/07, Oesterreichische Nationalbank.

Box 2.2 China's role in world trade and how this affects transition countries

China's role in world trade has grown extraordinarily in the last five years. This has affected the trade flows of the transition countries – directly through bilateral trade and indirectly through growth in global demand.

China's fast growing economy has also exerted upward pressure on world commodity prices and increased competition in global markets. Resource-rich countries in the Commonwealth of Independent States and Mongolia (CIS+M) have benefited from this increase in energy prices and rising energy demand from China. Furthermore, China has a growing interest in investing in energy and infrastructure in the CIS+M.

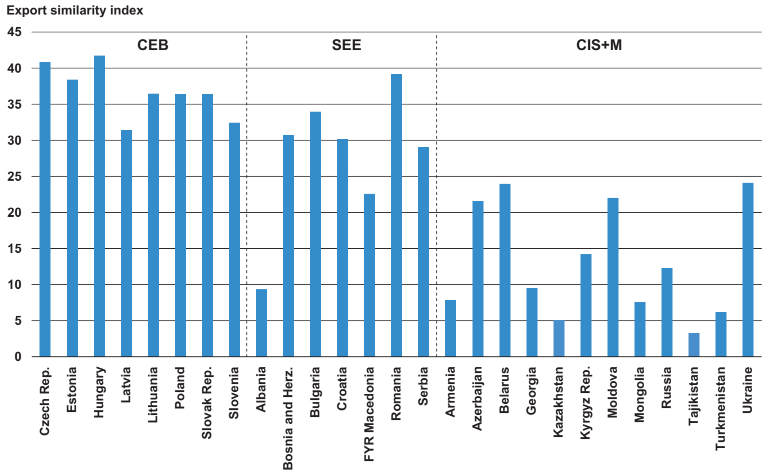
In contrast, manufacturing exports from central eastern Europe and the Baltic states (CEB) and south-eastern Europe (SEE) have been exposed to increased competition from China, although so far they have been able to withstand this competition in most sectors. Looking forward, as labour costs are increasing in CEB and SEE, investments to upgrade technology and enhance productivity and quality are key in the face of growing competition from China.

The importance of China as a trading partner has increased sharply across the transition region. At US$ 74 billion in 2006, total trade in goods between China and the transition countries was more than five times higher than in 2000.[1] This is not surprising as both regions have been increasingly integrated into the world economy. Also, their growth in total trade has significantly outperformed growth in global trade and their respective shares in world trade have grown.

In spite of this, of total exports from the transition region in 2006, only 3 per cent went to China, with no signs of an increase in China's share during the period 2000-06. In contrast, transition countries have become more important for China as a destination for exports, increasing their share in China's total exports from just over 2 per cent in 2000 to around 5 per cent in 2006.

Trade with China is more important for the CIS+M than it is for CEB or SEE. In 2006, China accounted for around 10 per cent of total imports into the CIS+M and 5 per cent of its total exports. This is partly because some of the resource-rich CIS+M countries (Kazakhstan, Russia and Uzbekistan) are meeting China's growing demand for energy and raw materials.[2] For that reason, a number of large Chinese companies have started investing in the extraction and transportation of natural resources in the CIS+M, mainly in Russia and Kazakhstan, and more recently in Turkmenistan.

Chart 2.2.1
Similarity of export structures among China, CEB, SEE and CIS+M, 2006



Sources: COMTRADE and EBRD calculations.

Note: The index shows the extent to which the export structure of the transition countries is similar to China's export pattern. See calculation methodology in endnote 4. The index includes only merchandise exports. Data for Bosnia and Herzegovina, Bulgaria, Czech Republic, Hungary, Poland and the Slovak Republic relate to 2005. Data for Tajikistan and Turkmenistan relate to 2000. Detailed data for Montenegro and Uzbekistan are not available.

For CEB and SEE, China is not such a significant export destination (less than 1 per cent of total exports from both sub-regions in 2006). However, CEB and SEE are starting to import more from China (4 and 3 per cent, respectively, of total imports in 2006). A large portion of the trade between CEB and China is in electrical and mechanical machinery and equipment. In 2006, this accounted for 56 per cent of CEB's total exports to China and 57 per cent of China's total exports to CEB. Products exported from SEE to China are more diverse but imports from China are concentrated in clothing.

There are a few goods that transition countries supply which make up a significant share of Chinese imports. In 2006, exports of fertilisers from the CIS+M (primarily from Belarus and Russia) accounted for over half of China's total imports, whereas the export of ships from SEE (primarily from Bulgaria, Croatia and Romania) accounted for 8.2 per cent.

Another key issue regarding China's increasing presence in global trade is whether its exports may displace exports from transition countries to the world markets. The export performance of China and the transition countries in the past seven years indicates that China's emergence as a major exporter has not necessarily displaced exports from transition countries to the world market, as both regions have gained market shares.[3] However, exposure to Chinese competition varies significantly across the transition countries.

In principle, those countries that have similar export structures to China are likely to be more exposed to Chinese competition, although a closer similarity indicates only a potential risk of exports being displaced by Chinese competition. Chart 2.2.1 shows how the export structure of transition countries compares with that of China using the export similarity index. A higher number indicates closer similarity.[4] The higher values for the index are found for CEB and SEE countries (except Albania and FYR Macedonia). Most countries in the CIS+M have a complementary export structure with China, which is underlined by low levels of similarity.

At the product level, China continues to specialise in light manufacturing goods, such as textiles, clothing, leather goods, toys, footwear, furniture, food and beverages, although products with higher technological components, such as machinery and electrical equipment, are gaining importance. These are the types of products that transition countries tend to export. But does such an overlap undermine exporters in the transition countries?

The EU-15 is the main export market for most transition countries (see Table 2.2.1 for the shares of selected exported products from the transition countries to this market). Therefore the change in market shares of transition countries and China in specific product groups in that market is examined from 2000 to 2006. Chart 2.2.2 shows that for many products, both China and the transition countries gained shares in the EU-15 market. Interestingly, China and the transition countries sharply increased their shares in the high and medium-high technology segment, such as electrical equipment and machinery. In road vehicles, the transition countries gained a noticeable share in EU-15 imports (9 per cent of total imports in 2006) whereas China's share remains marginal (less than 1 per cent).

Clothing is the sector in which transition countries lost their larger share of the market, seemingly to the benefit of Chinese exporters. As a result of China's accession to the World Trade Organization (WTO) in 2001 and the subsequent termination of the Agreement on Textiles and Clothing (which allowed WTO member countries to restrict imports of textiles and clothing) as of 1 January 2005, EU-15 imports of clothing and textiles from China have markedly increased. China's share of clothing exports grew from 5 per cent in 2000 to 15 per cent in 2006, while the transition countries' share fell from 13 to 11 per cent, with the loss concentrated in CEB countries.[5]

In summary, China's growing importance in world trade poses significant challenges for the transition countries. So far, countries in CEB and SEE have responded positively to these challenges and have successfully increased their shares in important export markets, fully exploiting their integration with the European Union. The process has been supported by large amounts of FDI from EU countries that relocated part of their manufacturing facilities into CEB and SEE to take advantage of lower labour costs. Countries in the CIS+M increasingly benefit from complementarities with China's trade by focusing on exporting natural resources and importing a wide range of manufacturing products. Trade between the CIS+M and China is likely to increase further, reflecting growing Chinese investment in the sub-region, especially in natural resources and financial support for infrastructure development.

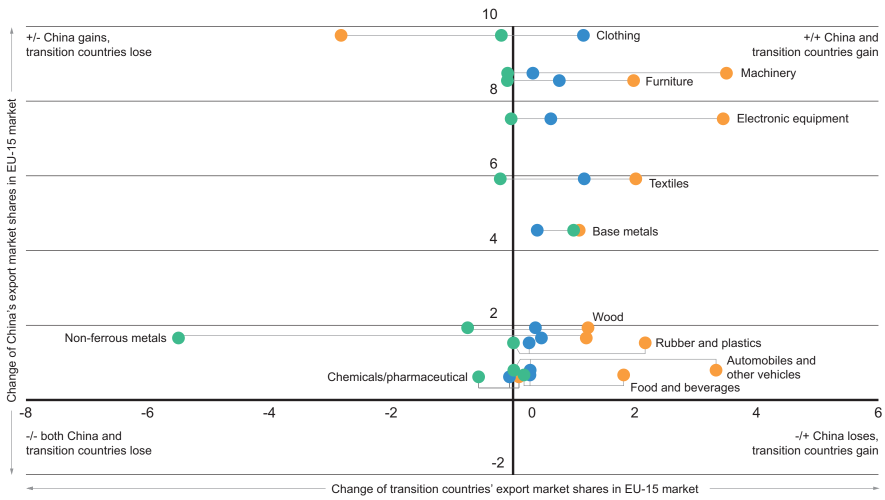
Table 2.2.1
Relative importance of selected products exported to EU-15, 2006

	CEB	SEE	CIS+M	China
Machinery	16.9	6.7	0.5	24.8
Electronic equipment	16.3	10.8	0.6	20.8
Automobiles and other vehicles	15.4	3.5	0.1	1.8
Base metals	6.9	9.1	6.5	6.4
Food and beverages	5.0	4.9	1.4	2.2
Rubber and plastics	4.8	3.3	0.3	2.6
Furniture	4.4	3.9	0.2	3.4
Wood	4.3	4.0	1.2	1.7
Non-ferrous metals	3.9	8.7	6.6	2.4
Clothing	3.0	28.8	0.9	12.1
Chemicals/pharmaceuticals	2.7	2.0	1.4	3.8
Textiles	1.3	2.1	0.5	2.1
Other	15.0	12.3	79.9	16.0
TOTAL	100.0	100.0	100.0	100.0

Sources: COMTRADE and EBRD.

Note: The values show, in per cent, the share of total exports from the transition region and China to the EU-15. For example, of all CEB's exports to the EU-15, machinery accounts for 16.9 per cent.

Chart 2.2.2
Change of export market shares of China and transition countries to EU-15 market, 2000-06



Sources: COMTRADE and EBRD.

Note: The circles represent the transition countries' market shares (in per cent) of selected products exported to the EU-15. Their positions indicate whether the transition countries and China have gained or lost shares in those export markets.

Endnotes

1 Figures are based on trade reported by transition countries. The trade value reported by China was slightly higher at US$ 14 billion and US$ 80 billion in 2000 and 2006, respectively.

2 The share of natural resources in the total exports from the CIS+M to China increased from around 10 per cent in 2000 to 44 per cent in 2006.

3 Transition countries increased their market share in global trade from 5 per cent in 2000 to 7 per cent in 2006, whereas China's shares increased from 4 per cent to 8 per cent during the same period.

4 The export similarity index is defined as: XS t,c = sum [min (Xit, Xic) * 100]; where Xit is industry i's export shares in a transition economy and Xic is industry i's share in China's exports. The index varies between 0 and 100, with 0 indicating complete dissimilarity of export structure and 100 representing identical export pattern.

5 In June 2005, the European Union introduced restrictions until the end of 2007 on imports from China in 10 product categories in textiles and clothing, partially shielding EU producers from Chinese competition.

Annex 2.1
Macroeconomic performance tables

The tables in this annex provide the most up-to-date information available at the time of publication. The cut-off date was mid-September 2007. There is still considerable variation in data quality across countries, and between different economic indicators. The data are based on a wide variety of sources, including national authorities, other international organisations and EBRD staff estimates. Data for 2007 are projections. Figures are subject to revision by national authorities, and tables will be updated as necessary in the *Transition Report Update,* issued electronically in May 2008.

Table A.2.1

Growth in real GDP (in per cent)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection	Estimated level of real GDP in 2006
Central eastern Europe and the Baltic states														*(1989=100)*
Czech Republic	5.9	4.2	-0.7	-0.8	1.3	3.6	2.5	1.9	3.6	4.6	6.5	6.4	5.5	**130**
Estonia	4.5	4.4	11.1	4.4	0.3	10.8	7.7	8.0	7.1	8.1	10.5	11.4	8.5	**145**
Hungary	1.5	1.3	4.6	4.9	4.2	5.2	4.1	4.4	4.2	4.8	4.1	3.9	2.5	**134**
Latvia	-0.9	3.9	8.4	4.7	3.3	8.4	8.0	6.5	7.2	8.5	10.2	11.9	9.0	**113**
Lithuania	3.3	5.1	8.5	7.5	-1.5	3.9	7.2	6.9	10.3	7.3	7.6	7.5	7.2	**108**
Poland	7.0	6.2	7.1	5.0	4.5	4.3	1.2	1.4	3.9	5.3	3.6	6.1	6.5	**158**
Slovak Republic	5.8	6.1	4.6	4.2	1.5	2.0	3.2	4.1	4.2	5.4	6.0	8.3	8.5	**137**
Slovenia	4.1	3.7	4.8	3.9	5.4	4.1	3.1	3.7	2.8	4.4	4.1	5.7	5.5	**141**
Average [1]	*5.5*	*4.8*	*5.1*	*3.9*	*3.5*	*4.3*	*2.5*	*2.6*	*4.2*	*5.3*	*4.9*	*6.2*	*6.0*	***142***
South-eastern Europe														
SEE-3														
Bulgaria	2.9	-9.4	-5.6	4.0	2.3	5.4	4.1	4.5	5.0	6.6	6.2	6.1	6.0	**101**
Croatia	6.8	5.9	6.8	2.5	-0.9	2.9	4.4	5.6	5.3	4.3	4.3	4.8	5.5	**105**
Romania	7.1	3.9	-6.1	-4.8	-1.1	2.1	5.7	5.1	5.2	8.5	4.1	7.7	6.5	**113**
SEE-5														
Albania	13.3	9.1	-10.9	8.6	13.2	6.5	7.1	4.3	5.7	6.2	5.6	5.0	6.0	**143**
Bosnia and Herzegovina	20.8	86.0	37.0	15.6	9.6	5.5	4.3	5.3	3.0	6.0	5.5	6.2	6.0	**75**
FYR Macedonia	-1.1	1.2	1.4	3.4	4.3	4.5	-4.5	0.9	2.8	4.1	4.1	3.2	5.5	**91**
Montenegro	6.2	13.9	4.2	4.0	-6.7	3.1	-0.2	1.7	1.5	3.7	4.1	6.5	7.0	**73**
Serbia	6.1	7.8	10.1	1.9	-18.0	5.2	5.1	4.5	2.4	9.3	6.3	5.7	6.0	**64**
Average [1]	*6.0*	*2.1*	*1.3*	*0.6*	*-2.2*	*3.7*	*4.7*	*4.9*	*4.7*	*7.0*	*4.8*	*6.4*	*6.1*	***104***
Commonwealth of Independent States and Mongolia														
Russia	-4.0	-3.6	1.4	-5.3	6.4	10.0	5.1	4.7	7.3	7.1	6.4	6.7	7.2	**93**
Western CIS and the Caucasus														
Armenia	6.9	5.9	3.3	7.3	3.3	5.9	9.6	13.2	13.9	10.1	14.0	13.4	8.5	**126**
Azerbaijan	-11.8	0.8	6.0	10.0	11.0	11.1	9.9	10.6	11.2	10.2	26.4	34.5	30.0	**136**
Belarus	-10.4	2.8	11.4	8.4	3.3	5.8	4.7	5.0	7.0	11.4	9.4	9.9	8.5	**135**
Georgia	2.4	10.5	10.6	2.9	3.0	1.9	4.7	5.5	11.1	5.9	9.6	9.4	10.0	**53**
Moldova	-1.4	-5.9	1.6	-6.5	-3.4	2.1	6.1	7.8	6.6	7.3	7.1	4.0	5.0	**49**
Ukraine	-12.2	-10.0	-3.0	-1.9	-0.2	5.9	9.2	5.2	9.6	12.1	2.6	7.1	6.8	**63**
Central Asia														
Kazakhstan	-8.2	0.5	1.7	-1.9	2.7	9.8	13.5	9.8	9.3	9.6	9.7	10.6	9.5	**125**
Kyrgyz Republic	-5.4	7.1	9.9	2.1	3.7	5.4	5.3	0.0	7.0	7.0	-0.2	2.7	7.5	**87**
Mongolia	6.3	2.4	4.0	3.5	3.2	1.1	1.0	4.0	5.9	10.1	7.3	8.6	8.0	**139**
Tajikistan	-12.5	-4.4	1.7	5.3	3.7	8.3	10.2	9.1	10.2	10.6	6.9	7.6	8.5	**79**
Turkmenistan	-7.2	-6.7	-11.3	6.7	16.5	18.6	20.4	15.8	17.1	17.2	9.6	9.0	10.0	**177**
Uzbekistan	*-0.9*	*1.6*	*2.5*	*4.3*	*4.3*	*3.8*	*4.1*	*4.0*	*4.2*	*7.7*	*7.0*	*7.3*	*9.3*	**137**
Average [1]	*-5.0*	*-3.5*	*1.4*	*-3.9*	*5.3*	*9.1*	*6.1*	*5.3*	*7.8*	*8.0*	*6.7*	*7.5*	*7.8*	***94***
All transition countries														
Average [1]	***0.0***	***0.2***	***2.7***	***-0.8***	***3.6***	***6.1***	***4.4***	***4.1***	***5.9***	***6.8***	***5.8***	***6.9***	***7.0***	***105***

Note: Data for 1995-2005 represent the most recent official estimates of outturns as reflected in publications from the national authorities, the IMF, the World Bank and Eurostat. Data for 2006 are preliminary actuals, mostly official government estimates. Data for 2007 represent EBRD projections.

[1] Weighted averages. The weights used for the growth rates are EBRD estimates of nominal dollar-GDP lagged by one year; those used for the index in the last column are EBRD estimates of GDP converted at PPP US$ exchange rates in 1989.

Table A.2.2

GDP growth by components in selected countries (real change, in per cent)

	2003	2004	2005	2006 Estimate
Bulgaria				
Real GDP growth	5.0	6.6	6.2	6.1
Private consumption	6.3	5.3	5.5	7.1
Public consumption	3.1	6.8	4.1	1.7
Gross fixed capital formation	13.9	13.5	23.3	17.6
Exports of goods and services	10.7	12.7	8.5	9.0
Imports of goods and services	16.4	14.5	13.1	15.2
Croatia				
Real GDP growth	5.3	4.3	4.3	4.8
Private consumption	4.6	4.8	3.4	3.5
Public consumption	1.3	-0.3	0.8	2.2
Gross fixed capital formation	24.7	5.0	4.8	10.9
Exports of goods and services	11.4	5.7	4.6	6.9
Imports of goods and services	12.1	4.6	3.5	7.3
Czech Republic				
Real GDP growth	3.6	4.6	6.5	6.4
Private consumption	6.0	2.9	2.4	4.4
Public consumption	7.1	-3.1	2.3	1.1
Gross fixed capital formation	0.4	3.9	2.3	7.6
Exports of goods and services	7.2	20.7	11.8	15.9
Imports of goods and services	8.0	17.9	5.0	15.2
Estonia				
Real GDP growth	7.1	8.1	10.5	11.4
Private consumption	6.9	6.9	8.2	15.7
Public consumption	0.3	2.2	1.1	2.8
Gross fixed capital formation	7.0	13.5	12.7	19.7
Exports of goods and services	7.6	17.1	21.5	10.0
Imports of goods and services	10.6	15.2	15.9	14.7
Hungary				
Real GDP growth	4.2	4.8	4.1	3.9
Private consumption	7.8	3.2	3.8	1.2
Public consumption	5.3	0.0	0.2	-5.5
Gross fixed capital formation	2.1	7.7	5.6	-1.8
Exports of goods and services	6.2	15.7	11.6	18.0
Imports of goods and services	9.3	14.1	6.8	12.6
Latvia				
Real GDP growth	7.2	8.5	10.2	11.9
Private consumption	8.2	9.5	11.5	19.8
Public consumption	1.9	2.1	2.7	4.0
Gross fixed capital formation	12.3	23.8	23.6	18.3
Exports of goods and services	5.2	9.4	20.3	5.3
Imports of goods and services	13.1	16.6	14.8	17.5
Lithuania				
Real GDP growth	10.3	7.3	7.6	7.5
Private consumption	11.1	9.7	10.4	12.6
Public consumption	3.8	7.5	5.6	6.6
Gross fixed capital formation	11.4	12.3	11.2	12.7
Exports of goods and services	6.9	4.2	14.3	14.0
Imports of goods and services	10.3	14.8	15.9	16.0
Poland				
Real GDP growth	3.9	5.3	3.6	6.1
Private consumption	1.9	4.3	2.0	5.1
Public consumption	4.9	3.1	5.2	3.9
Gross fixed capital formation	-0.1	6.4	6.5	16.5
Exports of goods and services	14.2	14.0	8.0	14.5
Imports of goods and services	9.3	15.2	4.7	15.8
Romania				
Real GDP growth	5.2	8.5	4.1	7.7
Private consumption	8.5	14.5	9.7	14.1
Public consumption	7.5	-3.2	8.7	2.4
Gross fixed capital formation	8.6	11.1	12.6	16.1
Exports of goods and services	8.4	13.9	8.1	10.6
Imports of goods and services	16.0	22.1	16.6	23.0
Russia				
Real GDP growth	7.3	7.1	6.4	6.7
Private consumption	7.5	12.1	12.7	11.2
Public consumption	2.2	2.1	2.2	4.2
Gross fixed capital formation	12.8	12.6	8.3	13.9
Exports of goods and services	12.5	11.8	6.4	7.2
Imports of goods and services	17.7	23.3	17.0	21.7
Slovak Republic				
Real GDP growth	4.2	5.4	6.0	8.3
Private consumption	0.2	4.2	7.0	6.1
Public consumption	3.9	2.0	-0.6	4.1
Gross fixed capital formation	-2.3	5.0	17.5	7.3
Exports of goods and services	15.9	7.9	13.8	20.7
Imports of goods and services	7.6	8.8	16.6	17.8
Slovenia				
Real GDP growth	2.8	4.4	4.1	5.7
Private consumption	3.4	3.0	2.7	4.0
Public consumption	1.9	3.1	3.2	4.4
Gross fixed capital formation	7.4	7.3	2.5	8.4
Exports of goods and services	3.1	12.5	10.1	12.3
Imports of goods and services	6.7	13.3	6.7	12.2

Note: Data for 2003-05 represent the most recent official estimates of outturns as reflected in publications from the national authorities, the IMF, the World Bank and Eurostat. Data for 2006 are preliminary actuals, mostly official government estimates.

Table A.2.3

Inflation (change in annual average consumer price level, in per cent)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
												Estimate	*Projection*
Central eastern Europe and the Baltic states													
Czech Republic	9.6	8.9	8.4	10.6	2.1	4.0	4.7	1.8	0.2	2.8	1.9	2.5	2.7
Estonia	29.0	23.1	11.2	8.1	3.3	4.0	5.8	3.6	1.3	3.0	4.1	4.4	6.0
Hungary	28.2	23.6	18.3	14.3	10.0	9.8	9.2	5.3	4.7	6.8	3.6	3.9	7.8
Latvia	35.9	25.0	17.6	8.4	4.7	2.4	2.6	2.5	1.9	2.9	6.2	6.5	8.0
Lithuania	39.6	24.6	8.9	5.1	0.8	1.0	1.5	0.3	-1.2	1.2	2.7	3.7	4.4
Poland	27.8	19.9	14.9	11.8	7.3	10.1	5.5	1.9	0.8	3.5	2.1	1.0	2.4
Slovak Republic	9.9	5.8	6.1	6.7	10.6	12.0	7.3	3.3	8.5	7.5	2.7	4.5	2.5
Slovenia	13.5	9.9	8.4	8.0	6.2	8.9	8.4	7.5	5.6	3.6	2.5	2.5	3.2
Median [1]	*28.0*	*21.5*	*10.1*	*8.3*	*5.5*	*6.5*	*5.7*	*2.9*	*1.6*	*3.3*	*2.7*	*3.8*	*3.8*
Mean [1]	*24.2*	*17.6*	*11.7*	*9.1*	*5.6*	*6.5*	*5.6*	*3.3*	*2.7*	*3.9*	*3.2*	*3.6*	*4.6*
South-eastern Europe													
SEE-3													
Bulgaria	62.0	123.0	1,082.0	22.2	0.7	9.9	7.4	5.9	2.3	6.1	5.0	7.3	8.0
Croatia	2.0	3.5	3.6	5.7	4.0	4.6	3.8	1.7	1.8	2.1	3.3	3.2	2.3
Romania	32.3	38.8	154.8	59.1	45.8	45.7	34.5	22.5	15.3	11.9	9.5	6.6	7.0
SEE-5													
Albania	7.8	12.7	33.2	20.6	0.4	0.1	3.1	5.2	2.4	2.9	2.3	2.5	3.0
Bosnia and Herzegovina	na	na	na	-0.3	3.4	5.0	3.2	0.3	0.6	0.4	4.0	7.0	2.5
FYR Macedonia	16.4	2.3	2.6	-0.1	-0.7	5.8	5.5	1.8	1.2	-0.4	0.5	3.2	2.5
Montenegro	97.0	80.2	23.4	32.4	67.6	97.1	22.6	18.2	6.7	2.2	2.6	3.0	3.0
Serbia	78.6	94.3	21.3	29.5	37.1	60.4	91.1	21.2	11.3	9.5	17.2	12.5	7.0
Median [1]	*32.3*	*38.8*	*23.4*	*21.4*	*3.7*	*7.9*	*6.5*	*5.6*	*2.4*	*2.6*	*3.7*	*4.9*	*3.0*
Mean [1]	*42.3*	*50.7*	*188.7*	*21.1*	*19.8*	*28.6*	*21.4*	*9.6*	*5.2*	*4.3*	*5.6*	*5.7*	*4.4*
Commonwealth of Independent States and Mongolia													
Russia	197.7	47.8	14.7	27.6	86.1	20.8	21.6	15.7	13.7	10.9	12.7	9.7	8.5
Western CIS and the Caucasus													
Armenia	175.8	18.7	14.0	8.7	0.7	-0.8	3.1	1.1	4.7	7.0	0.6	2.9	3.5
Azerbaijan	412.0	19.7	3.5	-0.8	-8.5	1.8	1.5	2.8	2.2	6.7	9.6	8.3	16.0
Belarus	709.3	52.7	63.9	72.9	293.7	168.6	61.1	42.5	28.4	18.1	10.3	7.0	7.5
Georgia	162.7	39.4	7.1	3.6	19.2	4.1	4.6	5.7	4.9	5.7	8.4	9.2	8.5
Moldova	30.2	23.5	11.8	7.7	39.3	31.1	9.6	5.2	11.6	12.5	12.0	12.8	11.4
Ukraine	377.0	80.0	15.9	10.6	22.7	28.2	12.0	0.8	5.2	9.0	13.5	9.1	11.5
Central Asia													
Kazakhstan	176.3	39.1	17.4	7.1	8.3	13.2	8.4	5.9	6.4	6.9	7.6	8.6	8.5
Kyrgyz Republic	43.5	31.9	23.4	10.5	35.9	18.7	6.9	2.0	3.1	4.1	4.3	5.6	7.0
Mongolia	56.8	46.9	36.6	9.4	7.6	11.6	8.0	0.3	5.1	8.3	12.7	5.1	5.3
Tajikistan	609.0	418.0	88.0	43.2	27.6	32.9	38.6	12.2	16.3	7.1	7.0	10.0	10.1
Turkmenistan	1,005.3	992.4	83.7	16.8	24.2	8.3	11.6	8.8	5.6	5.9	10.7	10.5	11.1
Uzbekistan	304.6	54.0	70.9	29.0	29.1	25.0	27.3	27.3	11.6	6.6	10.0	14.2	12.2
Median [1]	*197.7*	*46.9*	*17.4*	*10.5*	*24.2*	*18.7*	*9.6*	*5.7*	*5.6*	*7.0*	*10.0*	*9.1*	*8.5*
Mean [1]	*327.7*	*143.4*	*34.7*	*18.9*	*45.1*	*28.0*	*16.5*	*10.0*	*9.1*	*8.4*	*9.2*	*8.7*	*9.3*
All transition countries													
Median [1]	***50.2***	***28.5***	***16.7***	***10.5***	***8.3***	***9.9***	***7.4***	***5.2***	***4.9***	***6.1***	***5.0***	***6.5***	***7.0***
Mean [1]	***169.6***	***84.3***	***66.6***	***16.8***	***27.2***	***22.2***	***14.8***	***8.0***	***6.3***	***6.0***	***6.5***	***6.5***	***6.7***

Note: Data for 1995-2005 represent the most recent official estimates of outturns as reflected in publications from the national authorities, the IMF, the World Bank and Eurostat. Data for 2006 are preliminary actuals, mostly official government estimates. Data for 2007 represent EBRD projections. Estimates of inflation from parts of Bosnia and Herzegovina (for the Federation and Republika Srpska separately) are provided in the selected economic indicators at the back of this Report.

[1] The median is the middle value after all inflation rates have been arranged in order of size. The mean (unweighted average) tends to exceed the median, due to outliers caused by very high inflation rates in certain countries.

Table A.2.4

General government balances (in per cent of GDP)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Central eastern Europe and the Baltic states													
Czech Republic	-13.4	-3.3	-3.8	-5.0	-3.7	-3.7	-5.7	-6.8	-6.6	-2.9	-3.5	-2.9	-4.0
Estonia	-1.2	-1.5	1.9	-0.3	-3.7	-0.6	0.3	0.4	2.0	2.3	2.3	3.8	2.8
Hungary	-6.7	-5.0	-5.9	-8.0	-5.5	-3.0	-3.5	-8.2	-7.2	-6.4	-7.8	-9.2	-6.4
Latvia	-3.5	-1.7	0.7	-0.6	-4.9	-2.8	-2.1	-2.3	-1.6	-1.0	-0.2	0.4	-1.3
Lithuania	-4.2	-4.4	-1.1	-3.0	-5.6	-2.5	-2.0	-2.2	0.3	-0.4	0.9	-0.3	-0.5
Poland	-3.1	-3.3	-4.6	-4.3	-1.8	-3.0	-5.1	-5.0	-6.3	-5.7	-4.3	-3.9	-2.4
Slovak Republic	0.4	-1.3	-5.2	-5.0	-7.1	-12.2	-6.5	-7.7	-2.7	-2.4	-2.8	-3.4	-2.9
Slovenia	0.0	0.3	-1.1	-0.7	-0.6	-3.8	-4.0	-2.5	-2.7	-2.3	-1.4	-1.4	-1.5
Average [1]	*-4.0*	*-2.5*	*-2.4*	*-3.4*	*-4.1*	*-4.0*	*-3.6*	*-4.3*	*-3.1*	*-2.4*	*-2.1*	*-2.1*	*-2.0*
South-eastern Europe													
SEE-3													
Bulgaria	-5.6	-10.3	-0.3	1.7	0.4	-0.5	1.9	0.1	-0.9	2.2	1.9	3.3	2.3
Croatia	-0.7	-0.4	-1.3	-3.5	-8.2	-7.5	-6.8	-5.0	-6.2	-4.8	-4.0	-3.0	-2.6
Romania	-2.5	-3.9	-4.5	-3.2	-4.5	-4.6	-3.3	-2.0	-1.5	-1.5	-1.4	-1.9	-2.5
SEE-5													
Albania	-10.1	-9.7	-12.4	-11.8	-12.1	-9.2	-8.5	-7.2	-4.3	-5.2	-3.6	-3.2	-3.9
Bosnia and Herzegovina	-3.3	-3.9	-0.4	-3.6	-6.4	-8.3	-4.5	-3.3	-2.2	-0.6	0.8	2.9	-1.4
FYR Macedonia	-1.0	-1.4	-0.4	-1.7	0.0	2.5	-6.3	-5.6	-0.1	0.7	0.3	-0.4	-1.0
Montenegro	na	na	na	na	na	-6.9	-4.0	-3.8	-4.9	-2.6	-1.7	3.6	3.0
Serbia	na	na	na	na	na	-1.0	-4.9	-8.3	-3.4	0.0	0.9	2.7	-2.3
Average [1]	*-3.9*	*-4.9*	*-3.2*	*-3.7*	*-5.1*	*-4.4*	*-4.6*	*-4.4*	*-2.9*	*-1.5*	*-0.9*	*0.5*	*-1.1*
Commonwealth of Independent States and Mongolia													
Russia	-6.6	-9.4	-8.5	-8.1	-3.1	3.2	2.7	0.6	1.4	4.9	8.1	8.4	3.7
Western CIS and the Caucasus													
Armenia	-9.0	-8.5	-5.8	-4.9	-7.2	-6.4	-3.8	-0.4	-1.1	-1.8	-2.6	-2.8	-2.6
Azerbaijan	-3.1	-2.4	-4.0	-3.9	-4.7	-0.6	-0.4	-0.5	-0.8	1.0	2.6	0.1	2.4
Belarus	-2.7	-1.5	-0.7	-1.0	-2.0	-0.1	-1.9	-2.1	-1.7	0.0	-0.6	0.5	0.5
Georgia	-5.3	-7.3	-6.7	-5.4	-6.7	-4.0	-1.9	-2.0	-2.5	2.3	-1.5	-3.0	-1.3
Moldova	-6.7	-8.0	-10.5	-7.4	-6.2	-1.8	-0.3	-2.2	1.0	0.4	1.5	-0.3	-0.5
Ukraine	-4.7	-3.2	-5.4	-2.5	-2.3	-1.1	-0.9	0.1	-0.7	-4.4	-2.3	-1.3	-2.7
Central Asia													
Kazakhstan	-3.4	-5.3	-7.0	-8.0	-5.2	-1.0	1.8	1.0	2.7	2.5	5.8	7.5	4.3
Kyrgyz Republic	-17.3	-9.5	-9.2	-9.5	-12.7	-11.4	-5.6	-5.3	-5.2	-4.0	-3.7	-2.1	-2.2
Mongolia	-4.5	-6.5	-7.9	-12.4	-10.6	-6.1	-4.7	-5.2	-3.7	-1.9	2.6	8.1	-2.8
Tajikistan	-6.1	-5.8	-3.8	-3.8	-3.1	-5.6	-3.2	-2.5	-1.8	-2.4	-2.9	1.7	-14.1
Turkmenistan	0.4	0.3	-0.2	-2.6	0.0	-0.3	0.6	0.2	-1.3	0.0	0.9	0.6	0.5
Uzbekistan	-4.1	-7.3	-2.2	-3.3	-2.6	-2.5	-1.3	-1.9	0.1	0.6	1.2	5.2	2.3
Average [1]	*-5.6*	*-5.7*	*-5.5*	*-5.6*	*-5.1*	*-2.9*	*-1.5*	*-1.6*	*-1.0*	*-0.2*	*0.7*	*1.7*	*-1.0*
All transition countries													
Average [1]	***-4.7***	***-4.6***	***-4.1***	***-4.5***	***-4.8***	***-3.6***	***-2.9***	***-3.1***	***-2.1***	***-1.2***	***-0.5***	***0.3***	***-1.3***

Note: Data for 1995-2005 represent the most recent official estimates of outturns as reflected in publications from the national authorities, the IMF, the World Bank and Eurostat. Data for 2006 are preliminary actuals, mostly official government estimates. Data for 2007 represent EBRD projections.

[1] Unweighted average for the region.

Table A.2.5

General government expenditure (in per cent of GDP)

	2000	2001	2002	2003	2004	2005	2006 Estimate
Central eastern Europe and the Baltic states							
Czech Republic	41.8	44.5	46.3	47.3	43.8	43.6	42.3
Estonia	36.5	35.1	35.6	35.3	34.2	33.2	33.2
Hungary	46.5	47.4	51.2	49.1	48.9	50.0	53.0
Latvia	36.7	34.6	35.3	34.6	34.7	35.5	37.0
Lithuania	32.5	31.0	31.4	30.9	32.3	32.5	32.9
Poland	41.1	43.7	44.2	44.6	42.5	43.3	43.3
Slovak Republic	63.1	43.8	43.3	40.3	37.8	38.0	37.3
Slovenia	47.4	48.1	47.1	47.2	46.5	46.0	45.2
Average [1]	*43.2*	*41.0*	*41.8*	*41.2*	*40.1*	*40.3*	*40.5*
South-eastern Europe							
SEE-3							
Bulgaria	39.7	38.3	37.1	38.1	36.7	37.5	35.5
Croatia	52.7	50.7	50.8	51.3	49.7	48.5	47.7
Romania	35.3	33.3	32.3	30.9	31.1	31.0	32.3
SEE-5							
Albania	31.8	31.5	31.0	27.7	29.7	28.5	28.4
Bosnia and Herzegovina	58.0	53.2	48.0	52.9	50.4	49.4	47.9
FYR Macedonia	33.7	40.3	40.5	38.5	35.8	36.8	34.1
Montenegro	36.5	39.9	37.3	45.6	43.3	42.0	41.9
Serbia	40.4	43.8	51.8	46.7	45.3	43.1	42.1
Average [1]	*41.0*	*41.4*	*41.1*	*41.5*	*40.3*	*39.6*	*38.7*
Commonwealth of Independent States and Mongolia							
Russia	33.7	34.6	37.1	35.7	33.6	31.6	31.3
Western CIS and the Caucasus							
Armenia	25.9	20.9	19.3	18.9	17.1	17.6	16.6
Azerbaijan	20.8	18.7	27.7	28.5	25.9	22.7	28.9
Belarus	45.9	46.8	46.6	47.7	46.0	48.0	48.0
Georgia	19.1	18.2	17.8	18.7	19.4	24.9	29.2
Moldova	34.5	29.4	31.5	33.1	35.1	37.0	40.8
Ukraine	34.5	34.4	35.6	37.2	39.5	42.0	43.0
Central Asia							
Kazakhstan	23.2	23.0	21.0	22.6	22.1	22.3	20.4
Kyrgyz Republic	29.9	26.0	28.1	27.4	27.4	28.4	28.7
Mongolia	36.0	38.2	39.0	37.1	35.0	27.5	28.5
Tajikistan	19.2	18.4	19.2	19.1	20.3	23.0	21.7
Turkmenistan	23.9	21.1	18.1	19.4	19.6	18.8	17.9
Uzbekistan	38.9	35.8	37.6	38.4	31.6	29.5	29.2
Average [1]	*29.7*	*28.1*	*29.1*	*29.5*	*28.7*	*28.7*	*29.6*
All transition countries							
Average [1]	***36.5***	***35.3***	***35.9***	***36.0***	***35.0***	***34.9***	***35.1***

Note: Data for 2000-05 represent the most recent official estimates of outturns as reflected in publications from the national authorities, the IMF, the World Bank and Eurostat. Data for 2006 are preliminary actuals, mostly official government estimates. General government expenditure includes net lending.

[1] Unweighted average for the region.

Table A.2.6

Current account balances (in per cent of GDP)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 *Estimate*	2007 *Projection*
Central eastern Europe and the Baltic states													
Czech Republic	-2.5	-6.7	-6.3	-2.1	-2.4	-4.7	-5.3	-5.7	-6.3	-5.2	-1.5	-3.2	-3.9
Estonia	-4.2	-8.6	-11.4	-8.6	-4.4	-5.2	-5.5	-9.8	-11.6	-11.1	-10.0	-15.7	-16.2
Hungary	-3.7	-4.0	-4.5	-7.2	-7.8	-8.4	-6.0	-7.0	-8.5	-8.6	-7.4	-5.8	-4.1
Latvia	-0.3	-4.9	-5.5	-9.7	-9.0	-4.8	-7.5	-6.7	-8.1	-12.8	-12.5	-21.3	-24.0
Lithuania	-9.6	-9.0	-10.0	-11.7	-11.0	-5.9	-4.7	-5.2	-6.9	-7.7	-7.0	-10.9	-12.3
Poland	0.6	-2.1	-3.7	-4.0	-7.4	-5.8	-2.8	-2.5	-2.1	-4.2	-1.6	-3.3	-4.3
Slovak Republic	2.0	-10.1	-9.2	-9.3	-5.3	-3.4	-8.3	-7.8	-0.8	-3.6	-8.5	-8.3	-5.2
Slovenia	-0.5	0.3	0.3	-0.7	-4.1	-3.2	0.2	1.1	-0.8	-2.7	-1.9	-2.5	-2.6
Average [1]	*-2.3*	*-5.6*	*-6.3*	*-6.7*	*-6.4*	*-5.2*	*-5.0*	*-5.5*	*-5.6*	*-7.0*	*-6.3*	*-8.9*	*-9.1*
South-eastern Europe													
SEE-3													
Bulgaria	-1.5	1.7	10	-0.5	-5	-5.6	-5.9	-2	-5.1	-6.8	-12.2	-15.8	-20.8
Croatia	-7.6	-5.0	-12.6	-6.8	-7.0	-2.4	-3.6	-8.6	-7.1	-5.1	-6.4	-7.8	-8.3
Romania	-5.0	-7.3	-6.1	-6.9	-3.6	-3.6	-5.8	-3.4	-5.8	-8.4	-10.2	-11.3	-8.8
SEE-5													
Albania	-7.1	-7.3	-11.5	-6.7	-7.6	-7.4	-6.3	-9.7	-7.9	-4.8	-6.6	-7.3	-9.9
Bosnia and Herzegovina	na	-24.0	-26.6	-8.5	-16.8	-16.4	-18.8	-22.3	-22.5	-20.2	-21.1	-11.7	-12.5
FYR Macedonia	-6.7	-7.7	-7.7	-7.5	-0.9	-1.9	-7.1	-9.5	-3.2	-7.8	-1.4	-0.4	-1.0
Montenegro	na	na	na	na	na	-4.5	-15.2	-12.9	-7.4	-7.8	-8.6	-29.1	-23.0
Serbia	na	-9.8	-6.5	-4.2	-4.4	-5.1	-5.0	-17.5	-16.4	-14.8	-10.0	-12.9	-12.0
Average [1]	*-5.6*	*-8.5*	*-8.7*	*-5.9*	*-6.5*	*-5.9*	*-8.5*	*-10.7*	*-9.4*	*-9.5*	*-9.6*	*-12.0*	*-12.0*
Commonwealth of Independent States and Mongolia													
Russia	2.2	2.8	0.0	0.1	12.6	18.0	11.1	8.4	8.2	10.2	11.0	9.8	6.2
Western CIS and the Caucasus													
Armenia	-17.0	-18.2	-18.0	-22.1	-16.6	-14.6	-9.4	-6.2	-6.7	-4.5	-4.2	-4.5	-3.0
Azerbaijan	-13.2	-25.8	-23.1	-30.7	-13.1	-3.5	-0.9	-12.3	-27.8	-29.8	1.3	15.6	19.8
Belarus	-4.3	-3.6	-6.1	-6.7	-1.6	-3.2	-3.3	-2.2	-2.4	-5.2	1.7	-4.1	-6.2
Georgia	-7.5	-9.1	-10.6	-8.9	-7.7	-4.4	-6.5	-5.8	-7.4	-8.3	-9.8	-13.8	-15.9
Moldova	-8.0	-11.1	-14.2	-19.7	-5.8	-7.6	-1.7	-4.0	-6.6	-2.2	-8.1	-11.9	-9.2
Ukraine	-3.1	-2.7	-2.7	-3.1	5.2	4.7	3.7	7.5	5.8	10.5	2.9	-1.5	-3.7
Central Asia													
Kazakhstan	-1.3	-3.6	-3.6	-5.5	-1.4	2.0	-6.3	-4.2	-0.9	0.8	-1.9	-2.2	-3.3
Kyrgyz Republic	-15.7	-23.3	-7.8	-22.2	-14.7	-5.7	-1.6	-1.9	-2.2	1.3	-1.2	-13.7	-17.2
Mongolia	1.7	-2.8	4.7	-6.7	-5.8	-5.0	-6.6	-8.5	-6.8	1.5	1.3	5.6	-7.7
Tajikistan	-15.2	-7.8	-4.0	-7.3	-0.9	-5.9	-5.0	-3.6	-1.3	-4.0	-2.5	-2.5	-15.2
Turkmenistan	0.7	0.1	-24.8	-34.3	-23.3	13.6	3.2	13.0	5.2	1.2	7.4	12.7	7.1
Uzbekistan	-0.2	-7.8	-5.4	-0.9	-2.0	2.4	-1.5	1.4	8.9	9.9	13.1	18.8	20.0
Average [1]	*-6.2*	*-8.7*	*-8.9*	*-12.9*	*-5.8*	*-0.7*	*-1.9*	*-1.4*	*-2.6*	*-1.4*	*0.8*	*0.6*	*-2.2*
All transition countries													
Average [1]	***-4.9***	***-7.8***	***-8.1***	***-9.4***	***-6.1***	***-3.4***	***-4.6***	***-5.1***	***-5.3***	***-5.2***	***-4.0***	***-5.5***	***-6.8***

Note: Data for 1995-2005 represent the most recent official estimates of outturns as reflected in publications from the national authorities, the IMF, the World Bank and Eurostat. Data for 2006 are preliminary actuals, mostly official government estimates. Data for 2007 represent EBRD projections.

[1] Unweighted average for the region.

Table A.2.7

Foreign direct investment (net inflows recorded in the balance of payments)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection	Cumulative FDI inflows 1989-2006	Cumulative FDI inflows per capita 1989-2006	FDI inflows per capita 2005	FDI inflows per capita 2006	FDI inflows 2005	FDI inflows 2006
Central eastern Europe and the Baltic states						(in US$ million)								(in US$ mln)	(US$)	(US$)		(in per cent of GDP)	
Czech Republic	2,531	1,280	1,259	3,575	6,220	4,942	5,474	8,282	1,814	3,941	11,630	4,667	5,200	57,922	5,650	1,135	455	9.3	4.2
Estonia	199	111	130	574	222	324	343	153	763	703	2,252	569	600	6,790	5,048	1,672	423	16.1	3.5
Hungary	4,772	3,335	3,715	3,070	3,060	2,151	3,573	2,722	479	3,542	5,412	3,055	3,000	45,738	4,545	537	304	4.9	2.7
Latvia	245	379	515	303	331	400	114	250	256	596	603	1,487	1,100	5,807	2,531	261	648	3.8	7.4
Lithuania	72	152	328	921	478	375	439	714	142	510	689	1,585	1,000	6,467	1,902	201	466	2.6	5.3
Poland	3,617	4,445	4,863	6,049	7,239	9,327	5,804	3,901	4,284	12,259	7,013	10,037	10,000	81,665	2,142	184	263	2.3	2.9
Slovak Republic	194	199	84	374	701	1,897	1,520	4,130	737	1,403	1,951	3,797	2,600	17,544	3,255	363	705	4.1	6.7
Slovenia	161	167	303	221	59	71	226	1,508	-174	281	-88	-377	1,012	2,652	1,333	-44	-189	-0.2	-0.9
Total	*11,790*	*10,068*	*11,196*	*15,086*	*18,309*	*19,486*	*17,492*	*21,659*	*8,300*	*23,234*	*29,462*	*24,819*	*24,512*	*224,583*	*3,082*	*404*	*341*	*5.4*	*4.0*
South-eastern Europe																			
SEE-3																			
Bulgaria	98	138	507	537	802	998	803	876	2,070	2,879	3,938	5,331	5,389	19,225	2,497	510	692	14.5	16.9
Croatia	101	466	348	842	1,393	1,075	1,188	580	1,932	732	1,551	3,170	3,845	13,623	3,067	349	714	4.1	7.5
Romania	417	415	1,267	2,079	1,025	1,051	1,154	1,080	2,156	6,368	6,587	11,430	5,131	35,550	1,636	303	526	6.7	9.4
SEE-5																			
Albania	89	97	42	45	51	143	207	135	178	344	277	360	450	2,098	656	87	113	3.3	3.9
Bosnia and Herzegovina	0	0	0	100	90	146	119	266	382	608	550	420	1,500	2,680	705	145	111	5.4	3.7
FYR Macedonia	10	11	30	128	32	175	441	78	96	156	97	350	170	1,628	814	49	175	1.7	5.6
Montenegro	na	na	na	na	na	na	10	84	44	63	474	650	750	1,326	2,009	719	985	22.8	28.7
Serbia	na	0	740	113	112	25	165	475	1,360	966	1,481	4,400	3,000	9,837	1,312	197	587	6.1	15.3
Total	*715*	*1,127*	*2,933*	*3,844*	*3,505*	*3,614*	*4,088*	*3,574*	*8,218*	*12,116*	*14,956*	*26,112*	*20,235*	*85,966*	*1,684*	*293*	*512*	*8.1*	*11.4*
Commonwealth of Independent States and Mongolia																			
Russia	1,460	1,656	1,681	1,492	1,102	-463	216	-72	-1,769	1,662	119	7,387	20,000	14,879	105	1	52	0.0	0.8
Western CIS and the Caucasus																			
Armenia	25	18	52	221	122	104	70	111	121	217	255	291	316	1,615	502	78	90	5.2	4.5
Azerbaijan	330	627	1,115	1,023	510	149	299	1,048	2,353	2,351	458	-926	-4,963	9,360	1,114	55	-110	3.5	-4.7
Belarus	15	105	350	201	443	119	96	453	170	163	303	351	1,225	2,795	288	31	36	1.0	1.0
Georgia	6	54	236	221	62	153	80	122	335	420	529	1,115	1,542	3,342	740	117	247	8.3	14.3
Moldova	25	23	78	75	38	127	102	132	71	146	199	223	300	1,281	377	59	66	6.7	6.6
Ukraine	257	516	581	747	489	594	769	698	1,411	1,711	7,533	5,336	5,500	21,451	455	160	113	8.7	5.0
Central Asia																			
Kazakhstan	964	1,137	1,320	1,143	1,468	1,278	2,861	2,164	2,213	5,436	2,123	6,556	5,103	30,694	1,993	140	426	3.7	8.2
Kyrgyz Republic	96	47	83	87	38	-7	-1	5	46	132	43	182	50	797	155	8	35	1.7	6.5
Mongolia	10	16	20	19	34	40	43	78	132	129	258	290	994	1,085	405	97	108	11.2	9.2
Tajikistan	10	18	18	25	21	24	9	36	32	272	55	66	70	615	93	8	10	2.4	2.3
Turkmenistan	233	108	108	62	125	131	170	276	226	354	418	731	753	3,124	481	64	112	5.0	7.2
Uzbekistan	-24	90	167	140	121	75	83	65	70	187	88	195	260	1,387	53	3	8	0.6	1.1
Total	*3,407*	*4,414*	*5,809*	*5,456*	*4,574*	*2,323*	*4,796*	*5,116*	*5,410*	*13,179*	*12,379*	*21,797*	*31,150*	*92,425*	*329*	*44*	*78*	*4.5*	*4.8*
All transition countries																			
Total	**15,912**	**15,608**	**19,938**	**24,386**	**26,388**	**25,423**	**26,376**	**30,349**	**21,928**	**48,529**	**56,797**	**72,727**	**75,897**	**402,974**	**996**	**140**	**180**	**5.7**	**6.4**

Sources: IMF, central banks and EBRD estimates.

Note: Regional FDI inflows per capita are weighted averages (by population). Regional FDI in per cent of GDP is an unweighted average.

Table A.2.8

GDP growth forecasts for 2007 (in per cent)

	Average[1]	Range[2]	EBRD (Sep 2007)	Official forecasts[4]	European Union (May 2007)	IMF (Oct 2007)	OECD (Sep 2007)	United Nations DESA[5] (Sep 2007)	CSFB[6] (Sep 2007)	Dun & Bradstreet (Aug 2007)	Economist Intelligence Unit (Aug 2007)	Global Insight, Inc.[7] (Aug 2007)	IWH[8] (Sep 2007)	JP Morgan (Aug 2007)	Kopint-Tárki[9] (Sep 2007)	Vienna Institute[10] (July 2007)	Business Monitor Online (Aug 2007)
Central eastern Europe and the Baltic states																	
Czech Republic	5.4	1.1	5.5	5.8	4.9	5.6	5.5	5.0	na	5.0	5.2	5.3	6.0	5.8	5.7	5.0	5.6
Estonia	8.6	2.0	8.5	8.1	8.7	8.0	na	7.5	na	8.9	7.9	9.3	9.5	na	8.2	9.5	9.2
Hungary	2.6	1.3	2.5	2.2	2.4	2.1	2.5	2.5	2.4	2.8	2.4	3.3	2.5	2.8	2.2	2.7	3.4
Latvia	9.5	1.8	9.0	9.5	9.6	10.5	na	9.0	na	9.5	9.6	10.7	9.5	na	9.0	8.9	9.5
Lithuania	7.6	1.2	7.2	7.2	7.3	8.0	na	7.4	na	7.5	7.8	8.2	7.8	na	8.0	7.0	7.8
Poland	6.5	1.6	6.5	6.5	6.1	6.6	6.7	6.0	6.5	7.6	6.5	6.8	6.5	6.5	6.3	6.0	6.6
Slovak Republic	8.5	1.2	8.5	8.8	8.5	8.8	8.7	7.8	na	8.5	8.0	8.4	8.8	9.0	8.6	8.5	8.5
Slovenia	5.2	1.5	5.5	4.7	4.3	5.4	na	5.2	na	4.8	5.6	5.5	5.5	na	5.8	5.0	4.7
Average	*6.7*	*1.5*	*6.7*	*6.6*	*6.5*	*6.9*	*5.9*	*6.3*	*4.4*	*6.8*	*6.6*	*7.2*	*7.0*	*6.0*	*6.7*	*6.6*	*6.9*
Weighted average [3]	*6.0*	*1.4*	*6.0*	*5.9*	*5.6*	*6.0*	*na*	*5.6*	*na*	*6.4*	*5.9*	*6.3*	*6.1*	*na*	*5.9*	*5.6*	*6.2*
South-eastern Europe																	
SEE-3																	
Bulgaria	6.0	0.8	6.0	5.8	6.1	6.0	na	6.0	5.7	5.9	6.2	6.0	6.5	6.4	6.2	6.0	5.7
Croatia	5.4	1.2	5.5	6.0	4.8	5.6	na	5.5	5.9	4.8	5.7	5.4	4.8	na	5.2	5.0	5.5
Romania	6.3	0.7	6.5	6.1	6.7	6.3	na	6.3	6.2	6.2	6.5	6.5	6.2	6.5	6.0	6.0	6.5
SEE-5																	
Albania	5.6	1.0	6.0	6.0	na	6.0	na	5.0	na	6.0	5.0	5.8	na	na	na	5.0	6.0
Bosnia and Herzegovina	6.0	1.8	6.0	7.0	na	5.8	na	5.2	na	6.1	5.5	6.1	na	na	na	6.0	6.2
FYR Macedonia	4.8	2.0	5.5	6.0	4.3	5.0	na	4.5	na	4.5	4.6	4.0	na	na	na	4.0	5.7
Montenegro	5.9	2.0	7.0	6.0	na	na	na	5.8	na	na	6.0	5.2	na	na	na	5.0	6.0
Serbia	6.2	2.0	6.0	7.0	na	6.0	na	6.0	6.5	6.8	6.5	6.0	na	na	6.4	5.0	6.0
Average	*5.8*	*1.4*	*6.1*	*6.2*	*5.5*	*5.8*	*na*	*5.5*	*6.1*	*5.8*	*5.7*	*5.6*	*5.8*	*6.5*	*6.0*	*5.3*	*5.9*
Weighted average [3]	*6.0*	*1.0*	*6.1*	*6.2*	*na*	*na*	*na*	*5.9*	*na*	*na*	*6.2*	*6.1*	*na*	*na*	*na*	*5.6*	*6.1*
Commonwealth of Independent States and Mongolia																	
Russia	6.9	1.1	7.2	7.2-7.5	6.8	7.0	6.5	7.2	7.3	6.2	6.9	7.0	7.0	7.2	6.7	6.9	7.3
Western CIS and the Caucasus																	
Armenia	9.5	5.1	8.5	6.0	na	11.1	na	10.5	na	na	10.5	10.0	na	na	na	na	10.2
Azerbaijan	29.7	6.7	30.0	26.3	na	29.3	na	30.0	na	33.0	28.3	30.8	na	na	na	na	30.2
Belarus	7.8	2.5	8.5	8.5	na	7.8	na	8.0	na	8.2	7.8	6.0	na	na	na	na	7.5
Georgia	9.4	2.9	10.0	10.0	na	11.0	na	8.5	na	8.1	10.0	8.9	na	na	na	na	8.5
Moldova	5.2	1.0	5.0	5.0	na	5.0	na	6.0	na	na	5.0	5.2	na	na	na	na	5.0
Ukraine	6.8	1.5	6.8	6.5	na	6.7	na	7.2	7.0	7.4	6.8	7.5	na	7.0	6.5	6.5	6.0
Central Asia																	
Kazakhstan	9.4	1.3	9.5	na	na	8.7	na	10.0	9.0	8.9	9.8	9.9	na	na	na	na	9.2
Kyrgyz Republic	7.9	6.5	7.5	8.0	na	7.5	na	8.5	na	12.0	6.5	8.0	na	na	na	na	5.5
Mongolia	8.6	1.9	8.0	9.9	na	8.5	na	na	na	na	na	8.1	na	na	na	na	8.6
Tajikistan	7.4	1.9	8.5	na	na	7.5	na	7.0	na	7.5	7.0	6.6	na	na	na	na	7.5
Turkmenistan	10.8	11.0	10.0	12.1	na	10.0	na	10.0	na	9.5	7.0	18.0	na	na	na	na	9.5
Uzbekistan	8.4	1.8	9.3	na	na	8.8	na	8.0	na	8.0	8.2	9.0	na	na	na	na	7.5
Average	*9.8*	*3.5*	*9.9*	*10.3*	*6.8*	*9.9*	*6.5*	*10.1*	*7.8*	*10.9*	*9.5*	*10.4*	*7.0*	*7.1*	*6.6*	*6.7*	*9.4*
Weighted average [3]	*7.5*	*1.4*	*7.8*	*na*	*na*	*7.5*	*na*	*na*	*na*	*na*	*na*	*7.7*	*na*	*na*	*na*	*na*	*7.7*
All transition countries																	
Average	*7.9*	*2.4*	*7.8*	*7.8*	*6.2*	*8.0*	*6.0*	*7.7*	*6.3*	*8.1*	*7.6*	*8.2*	*6.7*	*6.4*	*6.5*	*6.0*	*7.8*
Weighted average [3]	*6.9*	*1.4*	*7.0*	*na*	*na*	*na*	*na*	*na*	*na*	*na*	*na*	*7.0*	*na*	*na*	*na*	*na*	*7.0*

Note: All forecasts quoted here were published or reported to the EBRD between April and September 2007. The dates in brackets indicate the months in which the forecasts were reported or published by each institution. There may in some instances be substantial delays between preparation and publication of forecasts.

1 The number at the bottom of this column is calculated as the mean of all the average forecasts shown in this column.

2 Data show the difference between the highest and the lowest of the forecasts.

3 Weighted average based on EBRD estimates of nominal US dollar GDP in each country in 2006.

4 Forecasts used by the governments in their budget process as usually published by the Ministry of Finance or the Ministry of Economy.

5 United Nations, Department of Economic and Social Affairs (DESA).

6 Credit Suisse First Boston.

7 Global Insight Inc, formerly DRI-WEFA.

8 Institute for Economic Research, Halle, Germany.

9 Kopint-Tárki is the Institute for Economic and Market Research Information, Hungary.

10 Vienna Institute for International Economic Studies (WIIW).

Table A.2.9

GDP growth forecasts for 2008 (in per cent)

	Average[1]	Range[2]	EBRD (Sep 2007)	Official forecasts[4]	European Union (May 2007)	IMF (Oct 2007)	OECD (Sep 2007)	United Nations DESA[5] (Sep 2007)	CSFB[6] (Sep 2007)	Dun & Bradstreet (Aug 2007)	Economist Intelligence Unit (Aug 2007)	Global Insight, Inc.[7] (Aug 2007)	IWH[8] (Sep 2007)	JP Morgan (Aug 2007)	Kopint-Tárki[9] (Sep 2007)	Vienna Institute[10] (July 2007)	Business Monitor Online (Aug 2007)
Central eastern Europe and the Baltic states																	
Czech Republic	4.8	1.5	4.6	5.0	4.9	4.6	5.0	4.5	na	4.0	4.0	4.8	4.8	5.5	5.0	5.2	4.8
Estonia	7.3	3.2	6.5	7.3	8.2	6.0	na	6.0	na	7.6	5.8	8.4	9.0	na	6.8	8.4	7.1
Hungary	3.0	0.9	3.5	2.6	2.6	2.7	3.1	2.8	2.8	3.2	3.0	3.4	3.2	3.3	3.0	3.1	2.9
Latvia	7.5	2.2	7.5	7.5	7.9	6.2	na	7.0	na	7.2	7.5	8.4	8.0	na	7.2	8.0	7.1
Lithuania	6.5	1.9	6.5	5.3	6.3	6.5	na	6.5	na	7.2	6.9	6.9	7.0	na	6.8	6.5	6.1
Poland	5.5	0.8	5.5	5.5	5.5	5.3	5.5	5.0	5.7	5.8	5.1	5.8	5.5	5.8	5.7	5.5	5.5
Slovak Republic	7.0	2.4	7.0	6.8	6.5	7.3	7.6	5.6	na	7.9	6.0	6.2	7.5	7.5	7.0	8.0	7.0
Slovenia	4.5	1.2	4.6	4.4	4.0	3.8	na	4.3	na	4.4	4.6	4.7	5.0	na	4.7	5.0	4.2
Average	*5.8*	*1.8*	*5.7*	*5.6*	*5.7*	*5.3*	*5.3*	*5.2*	*4.2*	*5.9*	*5.3*	*6.1*	*6.3*	*5.5*	*5.8*	*6.2*	*5.6*
Weighted average [3]	*5.2*	*1.3*	*5.2*	*5.1*	*5.1*	*4.9*	*na*	*4.7*	*na*	*5.3*	*4.8*	*5.4*	*5.4*	*na*	*5.3*	*5.5*	*5.1*
South-eastern Europe																	
SEE-3																	
Bulgaria	5.7	1.6	6.0	6.0	6.2	5.9	na	5.6	5.2	5.8	5.5	5.7	6.3	4.7	6.0	6.0	5.6
Croatia	4.9	1.8	5.2	6.1	4.5	4.7	na	5.0	4.7	4.6	5.4	4.3	5.0	na	5.0	5.0	4.6
Romania	5.9	1.5	6.5	6.5	6.3	6.0	na	5.0	5.5	5.7	5.5	6.5	6.5	6.0	5.7	5.5	5.0
SEE-5																	
Albania	6.0	0.9	6.0	6.0	na	6.0	na	5.5	na	6.3	6.0	6.4	na	na	na	5.5	6.0
Bosnia and Herzegovina	6.1	2.0	5.0	7.0	na	6.5	na	5.5	na	6.2	6.0	6.0	na	na	na	6.0	6.5
FYR Macedonia	4.8	2.0	4.5	6.0	5.3	5.0	na	4.0	na	4.5	4.2	4.1	na	na	na	4.0	6.0
Montenegro	5.6	1.0	6.0	6.0	na	na	na	5.5	na	na	6.0	5.5	na	na	na	5.0	5.3
Serbia	5.7	1.5	5.0	6.0	na	5.0	na	5.6	5.0	6.5	6.0	5.8	na	na	6.2	5.0	6.1
Average	*5.6*	*1.5*	*5.5*	*6.2*	*5.6*	*5.6*	*na*	*5.2*	*5.1*	*5.7*	*5.6*	*5.5*	*5.9*	*5.4*	*5.7*	*5.3*	*5.6*
Weighted average [3]	*5.7*	*1.6*	*6.0*	*6.3*	*na*	*na*	*na*	*5.1*	*na*	*na*	*5.5*	*5.9*	*na*	*na*	*na*	*5.4*	*5.2*
Commonwealth of Independent States and Mongolia																	
Russia	6.3	1.6	6.5	6.1	6.5	6.5	5.8	6.8	6.5	5.8	6.3	6.6	6.8	6.8	6.2	5.2	6.5
Western CIS and the Caucasus																	
Armenia	8.2	4.0	8.0	6.0	na	10.0	na	9.0	na	na	8.0	8.0	na	na	na	na	8.4
Azerbaijan	20.5	10.0	25.0	16.9	na	23.2	na	22.0	na	15.0	16.0	20.9	na	na	na	na	24.6
Belarus	6.1	3.0	6.5	8.0-9.0	na	6.4	na	6.5	na	7.6	5.0	4.6	na	na	na	na	6.0
Georgia	7.9	2.0	8.0	7.5	na	9.0	na	7.0	na	8.2	8.5	7.1	na	na	na	na	7.5
Moldova	5.6	2.4	6.0	7.0	na	5.0	na	5.5	na	na	6.0	5.2	na	na	na	na	4.6
Ukraine	6.3	1.8	6.0	7.2	na	5.4	na	6.7	6.4	6.5	6.1	6.8	na	6.5	6.2	6.0	5.5
Central Asia																	
Kazakhstan	8.5	2.2	8.5	na	na	7.8	na	9.0	7.0	8.3	9.2	8.9	na	na	na	na	9.1
Kyrgyz Republic	6.6	4.3	7.0	8.0	na	7.0	na	7.5	na	9.0	5.0	4.7	na	na	na	na	4.7
Mongolia	8.3	3.0	7.5	10.1	na	7.5	na	na	na	na	na	7.1	na	na	na	na	9.5
Tajikistan	7.4	3.7	9.0	na	na	8.0	na	7.5	na	7.9	7.2	5.3	na	na	na	na	6.9
Turkmenistan	10.3	7.7	10.0	11.2	na	10.0	na	10.0	na	9.8	8.0	15.5	na	na	na	na	7.8
Uzbekistan	7.6	1.6	7.5	8.0	na	7.5	na	7.3	na	8.3	7.2	8.4	na	na	na	na	6.8
Average	*8.4*	*3.6*	*8.9*	*8.8*	*6.5*	*8.7*	*5.8*	*8.7*	*6.7*	*8.6*	*7.7*	*8.4*	*6.8*	*6.7*	*6.2*	*5.6*	*8.3*
Weighted average [3]	*6.8*	*1.9*	*7.0*	*na*	*na*	*6.9*	*na*	*na*	*na*	*na*	*na*	*7.1*	*na*	*na*	*na*	*na*	*6.9*
All transition countries																	
Average	*6.9*	*2.5*	*7.1*	*7.0*	*5.7*	*7.0*	*5.4*	*6.7*	*5.4*	*6.9*	*6.4*	*7.0*	*6.2*	*5.8*	*5.8*	*5.7*	*6.8*
Weighted average [3]	*5.9*	*1.6*	*6.1*	*na*	*na*	*na*	*na*	*na*	*na*	*na*	*na*	*6.1*	*na*	*na*	*na*	*na*	*5.8*

Note: All forecasts quoted here were published or reported to the EBRD between April and September 2007. The dates in brackets indicate the months in which the forecasts were reported or published by each institution. There may in some instances be substantial delays between preparation and publication of forecasts.

1 The number at the bottom of this column is calculated as the mean of all the average forecasts shown in this column.

2 Data show the difference between the highest and the lowest of the forecasts.

3 Weighted average based on EBRD estimates of nominal US dollar GDP in each country in 2006.

4 Forecasts used by the governments in their budget process as usually published by the Ministry of Finance or the Ministry of Economy.

5 United Nations, Department of Economic and Social Affairs (DESA).

6 Credit Suisse First Boston.

7 Global Insight Inc, formerly DRI-WEFA.

8 Institute for Economic Research, Halle, Germany.

9 Kopint-Tárki is the Institute for Economic and Market Research Information, Hungary.

10 Vienna Institute for International Economic Studies (WIIW).

Table A.2.10

Average annual inflation forecasts for 2007 (change in the average consumer price level, in per cent)

	Average[1]	Range[2]	EBRD (Sep 2007)	Official forecasts[3,4]	European Union (May 2007)	IMF (Oct 2007)	OECD (Sep 2007)	United Nations DESA[5] (Sep 2007)	CSFB[6] (Sep 2007)	Dun & Bradstreet (Aug 2007)	Economist Intelligence Unit (Aug 2007)	Global Insight, Inc.[7] (Aug 2007)	IWH[8] (Sep 2007)	JP Morgan (Aug 2007)	Kopint-Tárki[9] (Sep 2007)	Vienna Institute[10] (July 2007)	Business Monitor Online (Aug 2007)
Central eastern Europe and the Baltic states																	
Czech Republic	2.6	0.7	2.7	2.3	2.4	2.9	2.5	2.5	na	2.8	2.6	2.5	2.8	2.7	2.4	3.0	2.6
Estonia	5.7	1.2	6.0	6.1	5.1	6.0	na	6.2	na	5.3	6.0	6.2	6.0	na	5.0	5.5	5.6
Hungary	7.2	2.3	7.8	7.0	7.5	7.6	7.2	7.0	5.5	7.4	7.5	7.7	7.2	7.3	7.5	7.0	6.2
Latvia	8.0	2.1	8.0	8.8	7.2	9.0	na	7.8	na	8.1	8.3	9.1	7.4	na	7.0	7.5	7.7
Lithuania	4.7	0.9	4.4	4.3	4.7	5.2	na	4.8	na	4.6	4.6	4.9	5.0	na	4.6	5.0	4.3
Poland	2.4	1.2	2.4	2.2	2.0	2.2	1.8	2.5	2.9	2.5	2.3	2.5	3.0	2.3	2.3	2.3	2.2
Slovak Republic	2.4	1.3	2.5	2.4	1.7	2.4	2.3	2.3	na	2.1	2.7	2.5	2.5	2.5	2.6	3.0	2.5
Slovenia	2.8	1.1	3.2	3.0	2.6	3.2	na	3.0	na	2.2	3.0	3.3	2.5	na	2.8	2.6	2.5
Average	*4.5*	*1.3*	*4.6*	*4.5*	*4.2*	*4.8*	*3.5*	*4.5*	*4.2*	*4.4*	*4.6*	*4.8*	*4.6*	*3.7*	*4.3*	*4.5*	*4.2*
South-eastern Europe																	
SEE-3																	
Bulgaria	5.8	5.6	8.0	4.4	4.2	8.2	na	6.0	9.8	4.7	6.0	5.3	5.0	4.7	4.8	5.0	5.4
Croatia	2.5	0.6	2.3	2.3	2.3	2.3	na	2.5	2.3	2.8	2.3	2.7	2.8	na	2.2	2.8	2.7
Romania	4.7	4.2	7.0	4.3	4.6	4.3	na	4.1	8.2	4.1	4.0	4.0	4.5	4.2	4.2	4.0	4.5
SEE-5																	
Albania	2.7	0.7	3.0	3.0	na	2.5	na	2.6	na	2.3	2.5	2.6	na	na	na	2.5	2.9
Bosnia and Herzegovina	2.3	2.4	2.5	2.0	na	2.5	na	2.5	na	3.2	1.5	1.3	na	na	na	3.7	1.8
FYR Macedonia	2.3	1.5	2.5	3.0	2.0	2.0	na	1.5	na	2.2	1.6	3.0	na	na	na	3.0	2.6
Montenegro	2.8	1.4	3.0	3.4	na	na	na	2.7	na	na	3.0	2.3	na	na	na	3.0	2.1
Serbia	6.2	4.1	7.0	6.5	na	6.4	na	6.0	8.0	3.9	5.6	5.8	na	na	5.5	8.0	5.9
Average	*3.7*	*2.6*	*4.4*	*3.6*	*3.3*	*4.0*	*na*	*3.5*	*7.0*	*3.3*	*3.3*	*3.4*	*4.1*	*4.5*	*4.2*	*4.0*	*3.5*
Commonwealth of Independent States and Mongolia																	
Russia	8.2	1.1	8.5	8.0	na	8.1	7.5	8.5	8.2	8.1	8.2	8.3	7.8	8.2	8.4	8.0	8.6
Western CIS and the Caucasus																	
Armenia	4.1	2.0	3.5	3.0	na	3.7	na	5.0	na	na	4.5	4.5	na	na	na	na	4.7
Azerbaijan	14.5	8.5	16.0	9.0	na	16.6	na	17.5	na	10.7	15.5	15.5	na	na	na	na	14.9
Belarus	8.4	2.5	7.5	8.5	na	8.1	na	8.5	na	10.0	8.3	7.7	na	na	na	na	8.6
Georgia	8.3	2.6	8.5	8.5	na	8.5	na	9.5	na	8.6	6.9	8.6	na	na	na	na	7.3
Moldova	11.1	1.6	11.4	10.6	na	11.2	na	12.0	na	na	11.7	10.4	na	na	na	na	10.6
Ukraine	10.8	2.9	11.5	9.6	na	11.5	na	12.5	10.5	11.1	10.6	11.1	na	11.0	10.0	10.0	10.8
Central Asia																	
Kazakhstan	8.3	4.2	8.5	na	na	8.6	na	8.5	9.8	8.2	8.7	8.4	na	na	na	na	5.6
Kyrgyz Republic	6.6	2.7	7.0	5.0-6.0	na	7.0	na	5.5	na	7.5	5.5	5.8	na	na	na	na	8.2
Mongolia	5.8	1.4	5.3	5.8	na	6.7	na	na	na	na	na	5.8	na	na	na	na	5.5
Tajikistan	12.2	10.2	10.1	na	na	9.9	na	18.5	na	14.5	14.0	9.8	na	na	na	na	8.3
Turkmenistan	8.8	5.1	11.1	6.0	na	6.5	na	7.5	na	9.3	11.0	10.3	na	na	na	na	9.1
Uzbekistan	11.8	9.5	12.2	na	na	12.2	na	8.0	na	13.0	16.0	6.5	na	na	na	na	15.0
Average	*9.2*	*4.2*	*9.3*	*7.7*	*na*	*9.1*	*7.5*	*10.1*	*9.5*	*10.1*	*10.1*	*8.7*	*7.8*	*9.6*	*9.2*	*9.0*	*9.0*
All transition countries																	
Average	*5.8*	*2.3*	*6.7*	*5.3*	*3.9*	*6.3*	*4.3*	*6.1*	*7.1*	*5.6*	*5.7*	*5.8*	*4.7*	*5.4*	*4.9*	*4.6*	*5.6*

Note: All forecasts quoted here were published or reported to the EBRD between April and September 2007. The dates in brackets indicate the months in which the forecasts were reported or published by each institution. There may in some instances be substantial delays between preparation and publication of forecasts.

1 The number at the bottom of this column is calculated as the mean of all the average forecasts shown in this column.

2 Data show the difference between the highest and the lowest of the forecasts.

3 Forecasts used by the governments in their budget process as usually published by the Ministry of Finance or the Ministry of Economy. Forecasts of the inflation rates are sometimes provided by monetary authorities, in cases where the governments do not formulate their own inflation forecasts.

4 End-of-the-year inflation forecast for Azerbaijan.

5 United Nations, Department of Economic and Social Affairs (DESA).

6 Credit Suisse First Boston.

7 Global Insight Inc, formerly DRI-WEFA.

8 Institute for Economic Research, Halle, Germany.

9 Kopint-Tárki is the Institute for Economic and Market Research Information, Hungary.

10 Vienna Institute for International Economic Studies (WIIW).

Table A.2.11

Average annual inflation forecasts for 2008 (change in the average consumer price level in per cent)

	Average[1]	Range[2]	EBRD (Sep 2007)	Official forecasts[3,4]	European Union (May 2007)	IMF (Oct 2007)	OECD (Sep 2007)	United Nations DESA[5] (Sep 2007)	CSFB[6] (Sep 2007)	Dun & Bradstreet (Aug 2007)	Economist Intelligence Unit (Aug 2007)	Global Insight, Inc.[7] (Aug 2007)	IWH[8] (Sep 2007)	JP Morgan (Aug 2007)	Kopint-Tárki[9] (Sep 2007)	Vienna Institute[10] (July 2007)	Business Monitor Online (Aug 2007)
Central eastern Europe and the Baltic states																	
Czech Republic	3.2	1.8	3.5	3.4	2.9	4.4	3.4	2.6	na	2.6	3.2	2.9	3.0	4.0	3.0	2.8	3.5
Estonia	5.8	3.4	6.5	7.4	5.3	7.0	na	6.5	na	4.7	6.8	6.9	4.0	na	4.2	5.0	5.9
Hungary	4.0	1.5	4.7	3.5	3.8	4.5	3.7	5.0	3.5	3.8	4.1	3.6	5.0	3.5	3.7	3.5	3.9
Latvia	6.4	3.7	6.0	5.2	6.2	8.9	na	5.5	na	6.5	6.1	7.0	6.0	na	5.6	7.0	6.8
Lithuania	4.4	1.8	5.5	3.9	4.4	4.6	na	4.0	na	4.3	4.4	4.6	3.8	na	3.7	5.0	4.1
Poland	2.7	1.3	2.7	2.3	2.5	2.7	2.3	2.9	2.5	2.3	3.0	3.6	2.5	2.8	2.5	2.5	2.7
Slovak Republic	2.3	0.5	2.3	2.0	2.4	2.0	2.1	2.5	na	2.3	2.5	2.3	2.5	2.3	2.5	2.0	2.3
Slovenia	2.7	1.1	2.7	2.7	2.7	3.1	na	3.0	na	2.4	2.7	3.4	2.3	na	2.6	2.3	2.6
Average	*3.9*	*1.9*	*4.2*	*3.8*	*3.8*	*4.7*	*2.9*	*4.0*	*3.0*	*3.6*	*4.1*	*4.3*	*3.6*	*3.2*	*3.5*	*3.8*	*4.0*
South-eastern Europe																	
SEE-3																	
Bulgaria	4.7	4.4	3.5	3.7	4.3	7.9	na	4.8	7.3	4.1	4.4	3.7	4.8	3.8	4.2	5.0	4.2
Croatia	2.6	1.0	2.8	2.2	3.0	2.8	na	2.5	2.7	2.8	2.5	2.2	3.0	na	2.0	2.3	3.0
Romania	4.5	3.3	3.5	4.2	4.5	4.8	na	4.0	6.8	4.0	4.3	4.2	4.5	5.1	4.0	4.5	4.4
SEE-5																	
Albania	2.9	1.2	3.0	3.0	na	3.3	na	2.5	na	2.1	2.5	3.3	na	na	na	3.0	3.2
Bosnia and Herzegovina	2.3	1.5	2.5	1.5	na	1.9	na	2.5	na	3.0	2.1	2.5	na	na	na	2.0	2.5
FYR Macedonia	2.5	1.0	2.5	2.5	2.5	3.0	na	2.0	na	2.0	2.4	2.7	na	na	na	3.0	2.5
Montenegro	2.9	1.0	3.0	3.0	na	na	na	3.0	na	na	3.0	3.0	na	na	na	3.0	2.1
Serbia	6.0	5.3	6.5	6.0	na	8.8	na	6.0	7.0	3.5	5.9	5.5	na	na	4.9	6.0	6.4
Average	*3.5*	*2.3*	*3.4*	*3.3*	*3.6*	*4.6*	*na*	*3.4*	*6.0*	*3.1*	*3.4*	*3.4*	*4.1*	*4.5*	*3.8*	*3.6*	*3.5*
Commonwealth of Independent States and Mongolia																	
Russia	7.5	2.3	8.8	7.6	na	7.5	6.5	7.3	6.8	7.5	7.8	7.8	7.2	7.2	7.8	7.0	7.9
Western CIS and the Caucasus																	
Armenia	3.6	1.9	3.0	3.0	na	4.9	na	3.5	na	na	3.6	3.2	na	na	na	na	3.8
Azerbaijan	12.5	9.0	16.0	8.0	na	17.0	na	15.5	na	8.2	10.5	11.7	na	na	na	na	13.1
Belarus	9.5	9.2	8.0	6.5-8.0	na	10.0	na	10.0	na	9.0	15.0	5.8	na	na	na	na	8.5
Georgia	7.2	2.7	7.0	5.0-7.0	na	8.1	na	8.5	na	6.9	6.1	7.7	na	na	na	na	5.8
Moldova	9.6	3.6	9.5	9.3	na	8.9	na	10.0	na	na	11.5	7.9	na	na	na	na	9.9
Ukraine	9.6	3.7	11.7	8.0	na	10.8	na	10.0	9.5	10.5	9.0	8.8	na	10.0	9.0	9.0	9.3
Central Asia																	
Kazakhstan	8.0	1.7	8.2	na	na	7.8	na	7.0	8.5	8.3	8.7	8.0	na	na	na	na	7.7
Kyrgyz Republic	6.4	3.1	7.6	na	na	7.0	na	4.5	na	7.0	6.5	6.8	na	na	na	na	5.4
Mongolia	5.7	2.2	5.0	5.5	na	7.2	na	na	na	na	na	5.2	na	na	na	na	5.5
Tajikistan	10.3	7.8	7.8	na	na	12.6	na	15.0	na	10.5	10.0	9.1	na	na	na	na	7.2
Turkmenistan	9.2	6.0	12.0	6.0	na	9.0	na	7.0	na	8.9	12.0	10.0	na	na	na	na	8.6
Uzbekistan	10.7	8.1	12.0	6.0-8.0	na	9.8	na	7.5	na	12.0	14.5	6.4	na	na	na	na	12.9
Average	*8.4*	*4.7*	*9.0*	*6.8*	*na*	*9.3*	*6.5*	*8.8*	*8.2*	*8.9*	*9.6*	*7.6*	*7.2*	*8.6*	*8.4*	*8.0*	*8.1*
All transition countries																	
Average	*5.8*	*3.3*	*6.1*	*4.5*	*3.7*	*6.8*	*3.6*	*5.9*	*6.1*	*5.6*	*6.3*	*5.5*	*4.1*	*4.8*	*4.3*	*4.2*	*5.7*

Note: All forecasts quoted here were published or reported to the EBRD between April and September 2007. The dates in brackets indicate the months in which the forecasts were reported or published by each institution. There may in some instances be substantial delays between preparation and publication of forecasts.

1 The number at the bottom of this column is calculated as the mean of all the average forecasts shown in this column.

2 Data show the difference between the highest and the lowest of the forecasts.

3 Forecasts used by the governments in their budget process as usually published by the Ministry of Finance or the Ministry of Economy. Forecasts of the inflation rates are sometimes provided by monetary authorities, in cases where the governments do not formulate their own inflation forecasts.

4 End-of-the-year inflation forecast for Azerbaijan.

5 United Nations, Department of Economic and Social Affairs (DESA).

6 Credit Suisse First Boston.

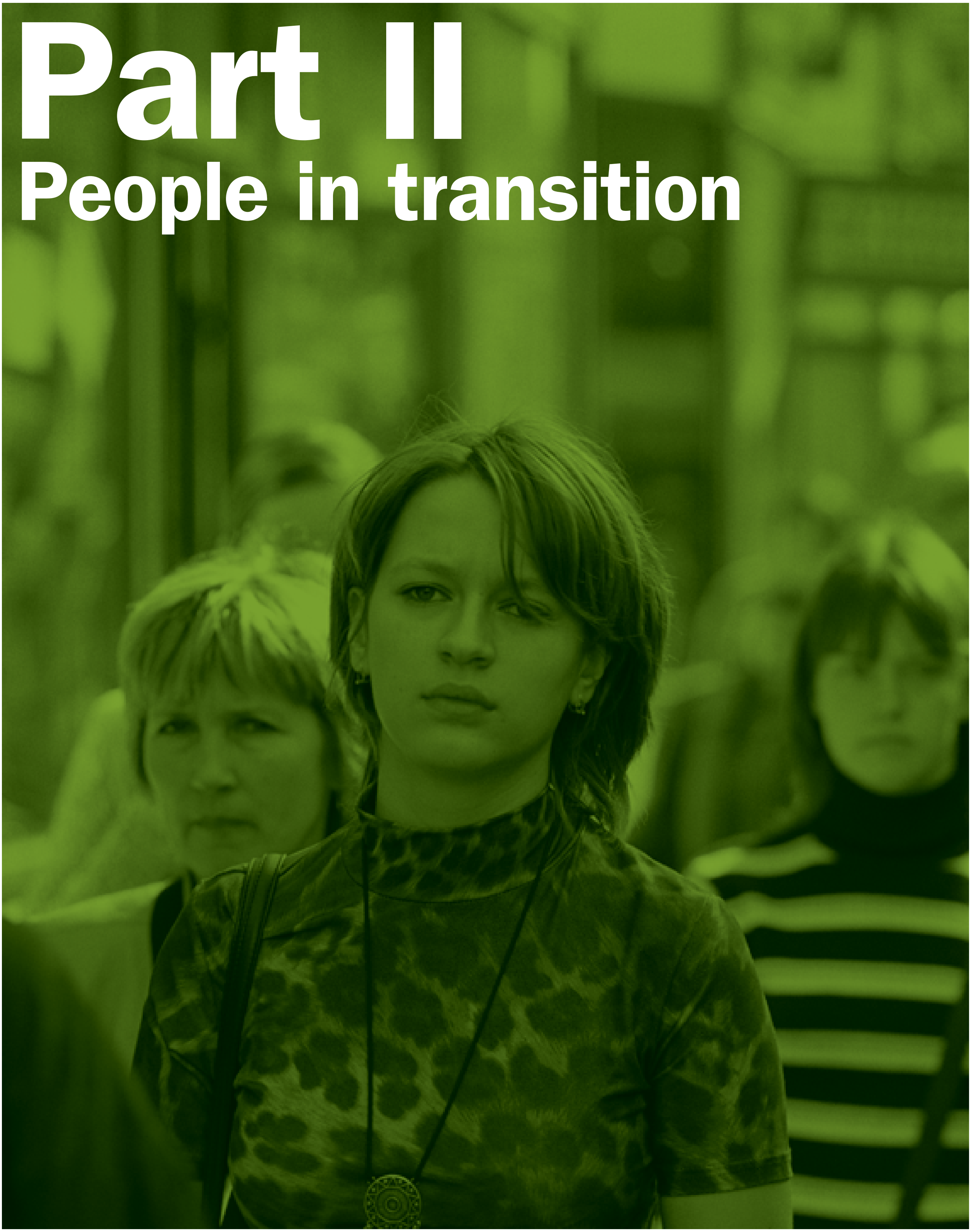
7 Global Insight Inc, formerly DRI-WEFA.

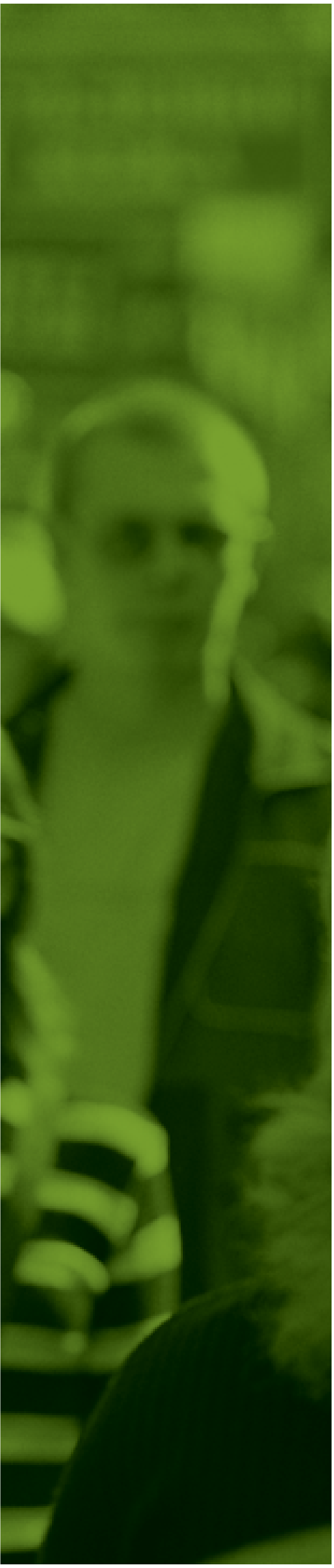
8 Institute for Economic Research, Halle, Germany.

9 Kopint-Tárki is the Institute for Economic and Market Research Information, Hungary.

10 Vienna Institute for International Economic Studies (WIIW).

Part II
People in transition





The seismic shifts that have reshaped the political and economic landscape of the post-communist transition region over 17 years have been well documented. The impact that this massive restructuring has had on individuals' lifestyles, livelihoods, perceptions and expectations has, however, received far less attention. The EBRD/World Bank Life in Transition Survey (LiTS) was a response to this dearth of data, and its detailed findings form the basis of this year's *Transition Report*.

Chapter 3 explores how transition has affected living standards and measures of life satisfaction across and within countries, identifying the groups that have benefited or suffered most from the process. It also investigates how this relative change in people's well-being affects their attitudes towards both markets and democracy and their support for further reform. Annex 3.1 provides details on how the LiTS was undertaken.

In Chapter 4 the focus is on the dramatic changes that have taken place in the labour market, from the mass unemployment that accompanied the closure of lumbering state-run enterprises to the loss of job security and to the opportunities that opened up as the private sector and new service industries took root. The LiTS provides a unique window into the employment history of people in the region from the onset of transition and makes it possible to track how the massive changes over the past 17 years have influenced levels of satisfaction, trust and expectations for government policy.

Chapter 5 examines how public services can be improved and modified to meet some of these expectations – most people in the region see health care and education as priorities for reform. The pros and cons of alternative forms of finance, including public-private partnerships, are evaluated, using case studies from within the transition region and beyond. Annex 5.1 looks at attitudes towards the environment.

03
People's attitudes to transition

The favourable economic changes that have swept across many transition countries in recent years have brought profound improvements to many aspects of life. Democracies and market economies have taken root, businesses and entrepreneurship have flourished and much of the physical infrastructure has been renewed. Yet rapid growth rates can also conceal less positive features; for example, across countries and cities there are large variations in levels of income and opportunities. Indeed, there is evidence that levels of life satisfaction are lower than in other parts of the world, and in many places there is a pervasive sense of dissatisfaction with some of the consequences of transition.

This chapter attempts to paint a clear picture of people's views and values across the region, charting how they have changed since the upheaval of the early 1990s. The analysis draws on the results of the 2006 EBRD/World Bank Life in Transition Survey (LiTS), which provides detailed information on people's experiences and perceptions (see Annex 3.1 for a discussion of the LiTS methodology). Analysis of the responses allows an evaluation to be made of how people feel about existing institutions and policies.

Satisfaction with life

After more than 17 years of transition, how satisfied are people in the region with their lives as a whole? Individuals in the LiTS were asked to rate their overall level of life satisfaction on a scale of 1 to 5, with 1 representing most dissatisfied and 5 most satisfied. A related question asked people about their satisfaction with the present economic situation in the country, along a similar 5-point scale. The inclusion of these questions reflects a growing interest in the link between psychological and economic behaviour. It is increasingly recognised that responses to questions about life satisfaction or "happiness" can contain valuable information about individual welfare, and that these answers may be linked to more objective measures of well-being and status.[1]

There are a couple of reasons why the responses may be important. First, in many countries reliable data on variables such as income and employment are difficult to obtain, given the large size of the informal sector and the weakness of statistical agencies. Responses to questions about life satisfaction can, in some cases, give a better picture of an individual's well-being than official data on income or employment status. Secondly, there has been limited research to date on life satisfaction in the region, although earlier evidence from the World Values Survey (see page 52) paints a fairly bleak picture. At the turn of the millennium, transition countries, especially in the Commonwealth of Independent States and Mongolia (CIS+M), typically came near the bottom of the scale in world comparisons of average happiness, scoring below not only rich OECD countries but also many countries in Asia and South America.[2]

The LiTS allows an expanded analysis of life satisfaction to be undertaken, being the first survey to contain information on subjective well-being across virtually the entire transition region. Chart 3.1 shows the percentage of those who are "satisfied" (score of 4 or 5) or "dissatisfied" (1 or 2). There is large variation across countries. On a regional basis, the results largely conform to expectations. In all countries in central eastern Europe and the Baltic states (CEB), except Hungary, more than 50 per cent of people are satisfied with their lives, and more than 70 per cent in Slovenia, the richest country (in terms of GDP per head) in the region.

In contrast, levels of unhappiness are particularly high in south-eastern Europe (SEE), especially in former Yugoslav republics such as Bosnia and Herzegovina, FYR Macedonia, Montenegro and Serbia. This can be partly explained by the very high levels of unemployment in those countries (see Chapter 4) and also by the fact that, while people lived comparatively well in this region pre-1989, GDP is still below 1989 levels even today (see Chapter 2, Table A.2.1). The picture is more mixed in the CIS+M – there are high levels of dissatisfaction in Armenia and Georgia, for example, but relatively high levels of satisfaction in Belarus, Tajikistan and Uzbekistan. Overall, however, the average share of happy or satisfied people across the region is still significantly below that in western Europe or North America, where typically 80-90 per cent report themselves as happy or satisfied.[3]

Views on living standards

Chart 3.2 shows the share of individuals by country who reported that their living standards have either improved or declined since 1989. In most countries (and on average over the whole sample) a majority of respondents think that their living standards have improved over this period (see Box 3.1 on the rise of the middle class). The results are particularly striking in Albania, where around 75 per cent feel that their living standards have improved. Albania suffered under one of the most extreme forms of totalitarian rule during the communist period.

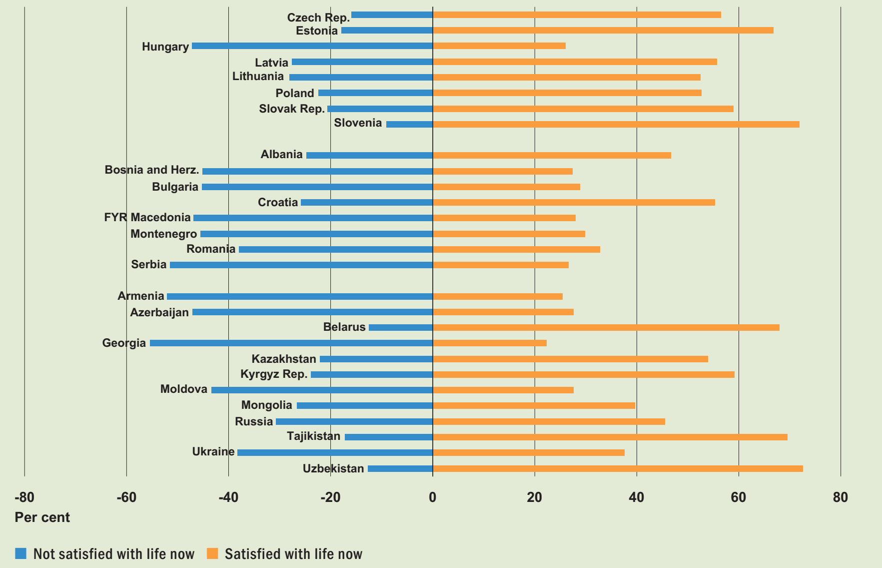
However, in a significant minority of countries – mostly but not exclusively in SEE and the CIS+M – a majority of respondents claim that their living standards have deteriorated. In Ukraine, for example, a clear majority of respondents believe that their living standards have fallen. This is also the case in Bosnia and Herzegovina, Croatia, Montenegro and Serbia, all of which experienced conflict in the 1990s.

Changes in household wealth

While people's views about their absolute living standards are informative, a sense of well-being is also likely to be affected by how people perceive their household wealth to have changed compared with others. The LiTS asked people whether their household's relative wealth has changed since the beginning of transition; respondents were asked to place themselves on an ascending ten-step ladder increasing in wealth from poorest to richest. Chart 3.3 shows the proportion of respondents who believe that their household's position has improved or declined in terms of relative wealth. The picture that emerges is rather different from the evidence of rising absolute living standards generally.

With the exception of Albania, where perceptions are generally more positive than in the rest of the transition region, in all countries a majority responded that their relative position has deteriorated in spite of strong growth in most transition countries over the last decade. The growth of income inequality may have fed the perception that people were worse off in relative terms. Income inequality appears to have risen particularly sharply in Russia and the rest of the CIS+M but this trend also applies to the region as a whole. As many individuals feel that they have fared worse than others, this is also likely to be reflected in their views about the economic system.

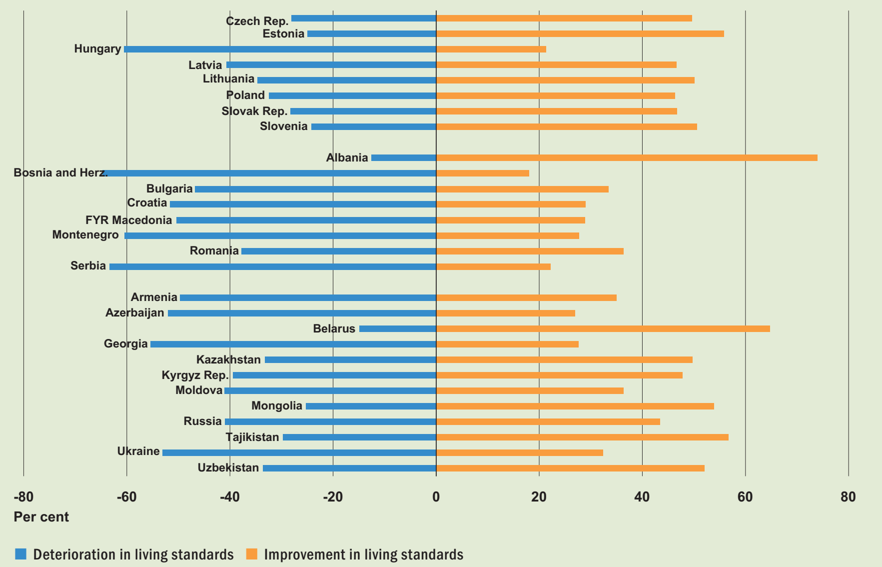
Chart 3.1
Satisfaction with life



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Respondents were asked "To what extent do you agree with the following statement: all things considered, I am satisfied with my life now". Answers included: "strongly disagree", "disagree", "neither agree nor disagree", "agree", "strongly agree", "not applicable", and "don't know". The chart reports the combined totals for "agree" and "strongly agree" on the right-hand side and "disagree" and "strongly disagree" on the left-hand side.

Chart 3.2
Views on living standards compared with 1989



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Respondents were asked "To what extent do you agree with the following statement: my household lives better today than around 1989". Answers included: "strongly disagree", "disagree", "neither agree nor disagree", "agree", "strongly agree", "not applicable", and "don't know". The chart reports the combined totals for "agree" and "strongly agree" on the right-hand side and "disagree" and "strongly disagree" on the left-hand side.

Changes in the political and economic situation

The LiTS asked people whether the economic and political situation had improved or deteriorated since 1989. The answers, as shown in Charts 3.4 and 3.5, betray considerable reservations about how beneficial the process of transition has been. In CEB, for example, 40 per cent of people believe that the political situation is worse than it was in 1989. Disenchantment is particularly severe in Hungary, where around 75 per cent believe that the political situation has deteriorated since 1989.[4] In the Czech Republic and Poland a small majority are also of the same view.

In SEE more than 50 per cent consider the situation to have deteriorated. Countries that have experienced conflict and domestic turmoil – such as Bosnia and Herzegovina and Serbia – report particularly high levels of disenchantment with the political system.

In the CIS+M there is a wide variation in responses. In the Kyrgyz Republic and Ukraine there is a clear negative view of political developments, while in Azerbaijan, Belarus, Kazakhstan, Tajikistan and Uzbekistan a majority consider that the political situation has moved in a positive direction.

Regarding the economic situation, a striking feature in Chart 3.5 is that in CEB a solid 40 per cent of respondents consider the economic situation to have deteriorated, despite the strong growth that has been experienced over that period. The most dramatic example is again Hungary, where around 75 per cent of respondents consider that the economic situation has deteriorated. In Poland, views are evenly distributed, while in the Czech Republic a narrow majority view economic developments as positive.

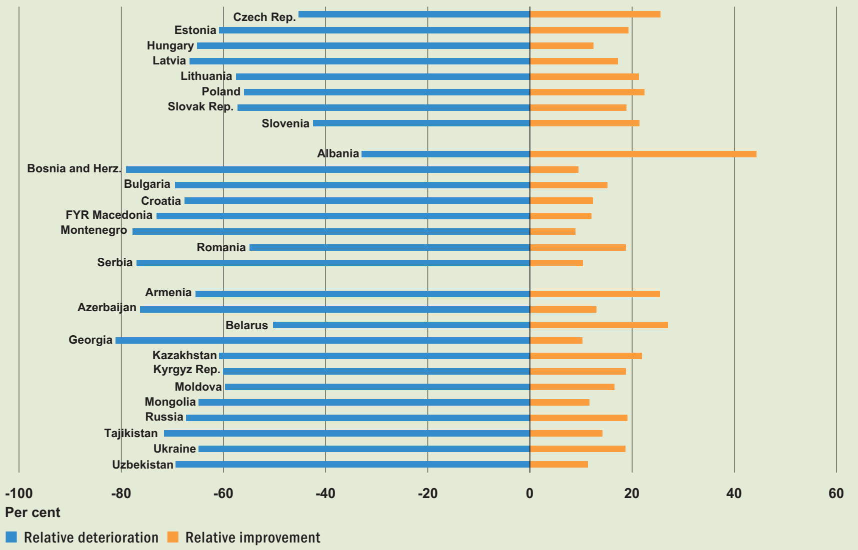
In SEE the view is unreservedly negative. Around 65 per cent of respondents in SEE think that the economic situation is worse than in 1989. In parts of former Yugoslavia very large majorities of people believe that the economy is in worse shape now, although this is also true for Bulgaria and Romania. In some respects, this is surprising, especially for Bulgaria and Romania, where annual growth rates have been strong since 2000.

In the CIS+M the picture is again quite varied. In Kazakhstan, which has experienced a boom based on natural resources, a sizeable majority of more than 60 per cent think that the economic situation now is better than in 1989. In Ukraine the opposite is the case, with nearly 70 per cent of the view that the economic situation has deteriorated. In Russia the picture is more mixed, with roughly equal shares reporting positive and negative perceptions of the economy.

Views on democracy and authoritarianism

The LiTS asked people whether they had a preference for democracy or whether, under some circumstances, an authoritarian government might be

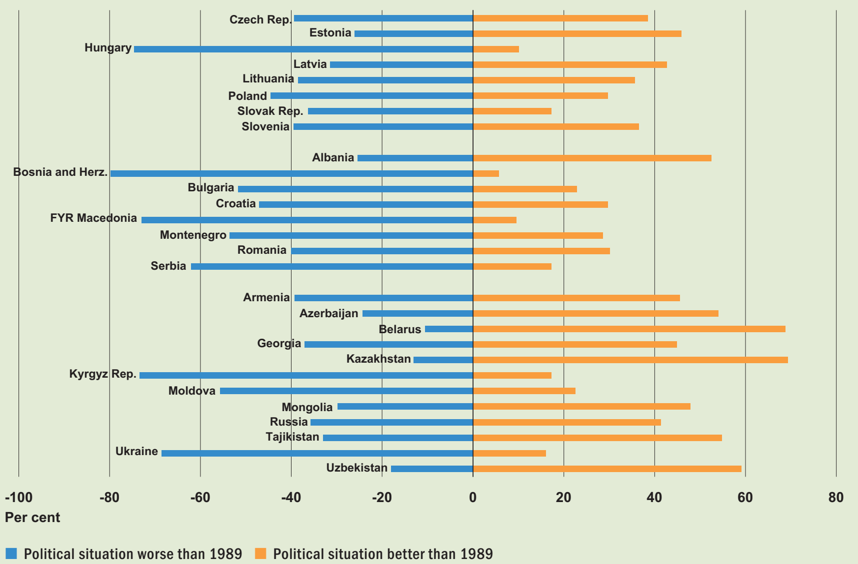
Chart 3.3
Views on changes in household wealth since 1989



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Respondents were asked "Please imagine a ten-step ladder where on the bottom, the first step, stand the poorest people and on the highest step, the tenth, stand the richest. On which step of the ten is your household today?" and "Now imagine the same ten-step ladder around 1989, on which step was your household at that time?" The chart reports the proportion of respondents whose self-placement today is higher than their self-placement in 1989 on the right-hand side, and the proportion of respondents whose self-placement today is lower than their self-placement in 1989 on the left-hand side.

Chart 3.4
Views on present political situation compared with 1989



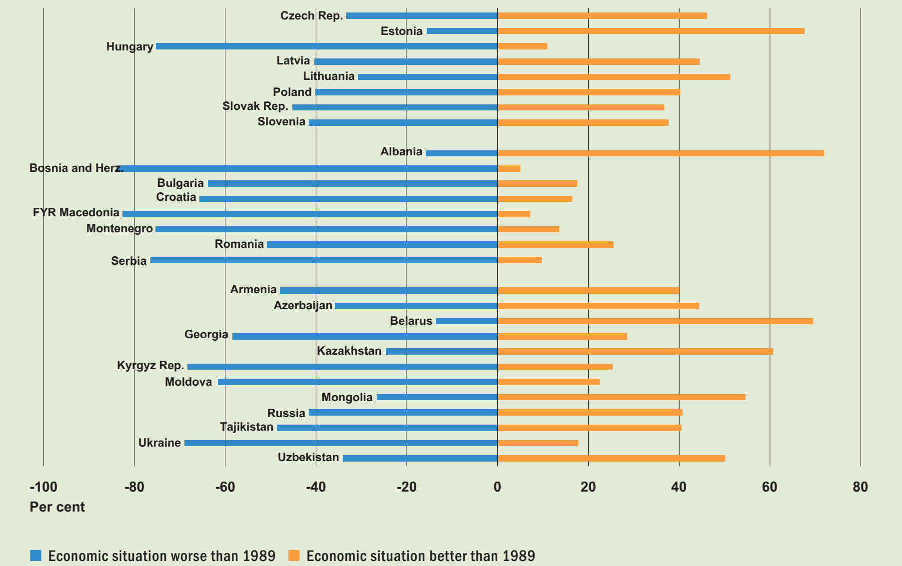
Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Respondents were asked "To what extent do you agree with the following statement: the political situation in this country is better than around 1989". Answers included: "strongly disagree", "disagree", "neither agree nor disagree", "agree", "strongly agree", "not applicable", and "don't know". The chart reports the combined totals for "agree" and "strongly agree" on the right-hand side and "disagree" and "strongly disagree" on the left-hand side.

preferable. It can be seen from Chart 3.6 that support for democracy is quite strong in the region, despite rather greater tolerance of authoritarianism in much of the CIS+M. In most countries, support for democracy is above or around 50 per cent. Russia has the lowest support with just over 36 per cent. Interestingly, respondents in other CIS+M countries do not generally have lower support for democracy than in CEB or SEE. Support for democracy in Georgia, the Kyrgyz Republic and Ukraine is, for example, stronger than in either Romania or Bulgaria.

It is important to stress that weaker support for democracy does not automatically mean support for authoritarianism. Support for authoritarianism is everywhere much lower than support for democracy. It is generally below 20 per cent except for

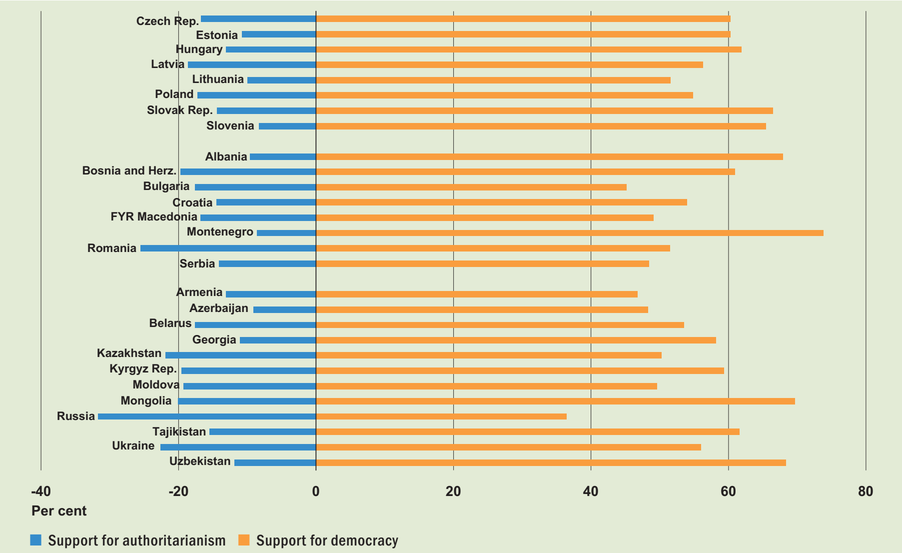
Chart 3.5
Views on present economic situation compared with 1989



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Respondents were asked “To what extent do you agree with the following statement: the economic situation in this country is better than around 1989”. Answers included: “strongly disagree”, “disagree”, “neither agree nor disagree”, “agree”, “strongly agree”, “not applicable”, and “don’t know”. The chart reports the combined totals for “agree” and “strongly agree” on the right-hand side and “disagree” and “strongly disagree” on the left-hand side.

Chart 3.6
Support for democracy versus authoritarianism



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Respondents were asked “With which one of the following statements do you agree most?”. Statements included: “democracy is preferable to any other form of political system”, “under some circumstances, an authoritarian government may be preferable to a democratic one”, and “for people like me, it does not matter whether a government is democratic or authoritarian”. The chart reports the proportion of respondents supporting “democracy is preferable” on the right-hand side and “an authoritarian government may be preferable” on the left-hand side.

Russia (33 per cent), Romania (27 per cent), Ukraine (24 per cent) and Kazakhstan (22 per cent). For the rest, there is no strong regional pattern. Responses are also quite consistent: countries that have more support for democracy tend to have less support for authoritarianism. There is no strong correlation – positive or negative – between economic and political evolutions in the various transition countries. Tendencies towards authoritarianism are not generally associated with a country’s economic performance, suggesting no simple or predictable relationship between the extent or pace of reform and political preferences.

Why is support for democracy lower in Russia than in other countries? One reason might be that the word “democracy” tends to be associated with the Boris Yeltsin regime of the 1990s. The term democracy may therefore be commonly associated with the economic decline and political and institutional disarray of that decade. While subsequent years have seen an acceleration of growth – associated with strong rises in natural resource prices – and an apparent resurgence of state control over the natural resource industries, this has occurred alongside limitations on democratic rights.

However, it is important to note that other questions in the LiTS show that there is strong support in Russia for some of the fundamental components of democracy, such as an independent and fair court system. Russians – like people in other transition countries – place a very strong emphasis on the importance of law and order and of peace and stability. However, there is comparatively less support in Russia for free and fair elections, freedom of speech, a free press, a strong political opposition, protection of minority rights and the freedom to travel abroad than there is in many other transition countries.

There appear to be notable differences, therefore, in underlying values in Russia compared with other transition countries regarding the importance of democracy. Although Russians are less inclined to support democracy than in most other transition countries, they are broadly more in favour of democracy than authoritarianism (see Box 3.2 on the lives of ordinary Russians).

While individuals clearly have views about the desirability of types of political systems, an obvious question to explore is whether this is reflected in their actual political behaviour or participation. One measure that is widely used is voting in elections. Here the evidence from the transition countries suggests that voting is in general quite high, with a turnout rate of between 60 and 85 per cent in most countries. But this is not necessarily a good indicator of the vitality of a political system. An alternative approach is to look at forms of participation in political issues. Using data from the LiTS, an index of participation has been constructed, which adds together the number of times that people have actually taken part in demonstrations or strikes, signed a petition or joined a political party. The index ranges, therefore, from 0 for people who have done none of these things, to 4 for those who have done all of them.

Participation in political issues, as measured by the index, appears to vary widely across countries. It is particularly high in former Yugoslavia, reflecting the fact that those who experience losses in a conflict tend to display higher political participation afterwards.[5] Participation is low in the CIS+M, where around 92 per cent of respondents have never participated in any of the activities listed above, compared with the EU member states, where this is the case for 80 per cent of respondents. While this difference may partly help to explain different political choices, the fact remains that participation in politics has remained rather low throughout the region.[6]

Views on the market economy and central planning

The LiTS asked specific questions about the economic system. In particular, people were asked whether they preferred a market economy, or under some circumstances, a planned economy.

Chart 3.7 shows that support for the market economy is strong throughout much of the transition region, though not as strong as people's support for democracy. In most countries, support for the market economy is below 50 per cent. Support is lowest in Russia, where it is below 30 per cent. It is also low in Armenia, Bosnia and Herzegovina, FYR Macedonia and Kazakhstan. Support is generally slightly higher in the new EU member states but there is no particularly striking pattern in the other countries.

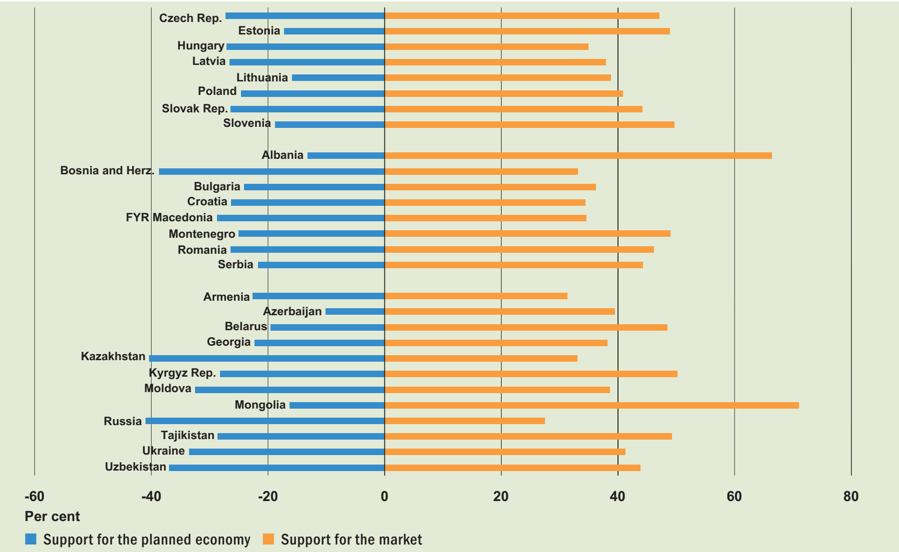
As was the case for democracy and authoritarianism, where support for the market economy is weak, it does not necessarily mean that support for central planning is strong. It was preferred by less than 30 per cent of respondents in most countries. However, in some countries the percentage of positive answers was higher than the percentage supporting the market economy, as in Bosnia and Herzegovina, Kazakhstan and Russia. Countries where there is more support for authoritarianism tend also to have more support for central planning but support for authoritarianism is weaker than support for central planning.

Support for democracy and the market economy is stronger on average than for authoritarianism and central planning. Countries that report a stronger backing for the market economy have in general a lower level of support for central planning and a higher level for democracy.

Views on the role of government

People in the transition economies have a strong appetite for government intervention. Using the LiTS responses, an index was constructed that measures positive responses to the following questions: whether the state should be "strongly" involved in guaranteeing employment; whether it should guarantee low prices for basic goods and food; and

Chart 3.7
Support for the market versus planned economy



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Respondents were asked "With which one of the following statements do you agree most?". Statements included: "a market economy is preferable to any other form of economic system", "under some circumstances, a planned economy may be preferable to a market economy", and "for people like me, it does not matter whether the economic system is organised as a market economy or as a planned economy". The chart reports the proportion of respondents supporting "a market economy is preferable" on the right-hand side and "a planned economy may be preferable" on the left-hand side.

whether it should own large companies. This index ranges, therefore, from 0 to 3. The average value of the index is above 2, which means that on average, people favour "strong" state intervention in at least two of the above areas.

The index is slightly lower in CEB (an average of 1.8 as against 2.18 in the CIS+M and 2.16 in SEE). There is also evidence that support for government intervention to redistribute income is significantly higher in transition countries than in the West. In the LiTS, 64 per cent think that the state should be strongly involved in the reduction of inequalities whereas in the British Social Attitudes Survey for 2005, only 32 per cent of respondents agreed or strongly agreed that the government should redistribute income from the better-off to the less well-off.

Although there is significant variation in responses between countries, support for state ownership of large companies tends to be consistently high. A total of 55 per cent of respondents favoured "strong" intervention of the state in the ownership of large companies while only 11 per cent thought that the state should not be involved in such ownership. More specifically, 62 per cent of respondents in the whole sample favoured "strong" state intervention in the ownership of gas and electricity companies.

However, countries where demand for state intervention was higher did not exhibit more support for central planning. Countries where there was on average more demand for state intervention also exhibited less tolerance for income inequality and more support for the view that poverty was attributable to injustice. In other words, there appears to be an underlying view that state intervention – including in the ownership of assets – should be used to achieve a fairer distribution of income.

Having seen how 17 years of transition has affected people's attitudes to markets and democracy, it is worth asking whether these attitudes have in fact changed over time and whether they are converging towards norms in developed market democracies in the West. The next section uses results of the World Values Survey to examine these questions.

Are transition economies different?

The World Values Survey (WVS), which provides some background on people's views on political and economic matters during the early stages of transition, allows a comparison to be made with other parts of the world. Administered in up to 18 transition countries between 1990 and 2002, when many of the key structural and institutional reforms had been implemented,[7] the WVS asks a range of questions relating to both economic and political views. The results allow the transition countries to be compared with western Europe and North America.

Aside from providing a detailed snapshot of people's views at the start of transition, the WVS also offers an opportunity to see how these views evolved in the first ten years of transition. As such, it provides a useful background to the findings from the more up-to-date LiTS.

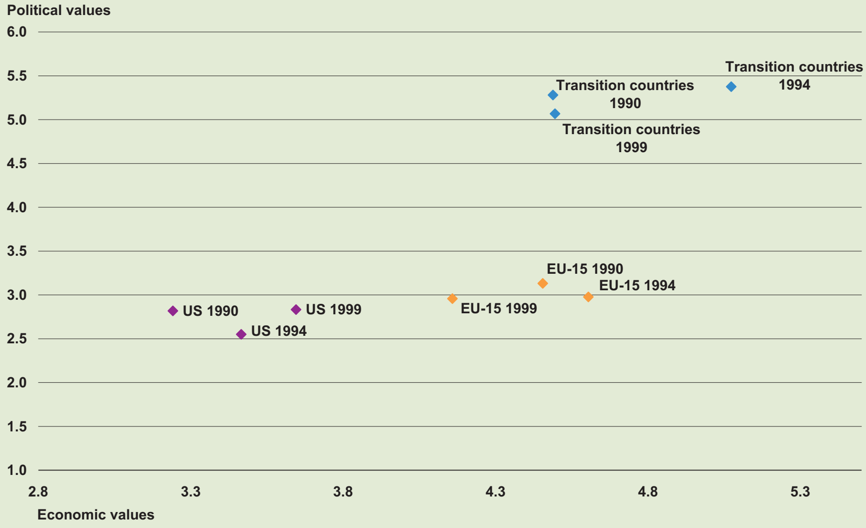
Regarding the economy, the WVS contains questions about attitudes towards income inequality, competition and the role of private versus state ownership.[8] The responses indicate that not only were people in the transition countries more egalitarian in their views at the start of transition compared with people in other parts of the world but they also tended to become even more so over the course of the 1990s. While the trend towards more egalitarianism can also be observed in the European Union and the United States, it is very pronounced in a significant number of transition countries.[9]

People in transition countries also tend to be more cynical in their beliefs on the sources of wealth creation; those who think that people get rich only at the expense of others (as opposed to the view that overall wealth can grow and be spread among everyone) have in fact increased over the 1990s. Individuals have also become more sceptical about the idea that hard work brings success. By 2000, transition countries in this respect had begun to look more like western Europe than the United States.

Regarding the desirability of competition, the WVS indicates that there has been a clear strengthening of the view that competition is harmful. There is a similar trend against competition in the European Union and in the United States but it has been less pronounced. Opinions in transition countries regarding private versus government ownership of enterprises also seem to differ markedly. There is more support for state ownership than in either western Europe or the United States, both at the beginning and end of the 1990s. There is no sign of a turnaround in views over the 1990s. Consequently, in 1999, opinions in favour of more government responsibility were, if anything, stronger than in 1990.

Regarding political beliefs, the WVS includes questions about the main objective of government, the desirability of a democratic system, the role of experts in designing policy and the attractiveness of having a strong leader without the need to respond to parliament and elections.[10] What emerges is that in the transition countries the proportion of respondents who say that the main aim of government should be to maintain order is much higher than elsewhere. Support for democracy is high in most transition countries even though that support did not increase in all countries during the 1990s. As to having a strong and politically unconstrained leader, people in the transition countries tend to have greater faith in authoritarian-style leadership than in either western Europe or the United States, where there is little support.

Chart 3.8
Political and economic beliefs in the transition countries, EU-15 and United States, 1990-99



Source: World Values Surveys, 1990–99.

Note: The horizontal axis measures economic values. This is constructed as a simple average of the answers to seven questions about the economy (see endnote 8). Answers have been normalised so that a higher number means values in favour of more government intervention and a lower number indicates a desire for less government intervention. On the vertical axis, the political values are a simple average of the answers to five questions (see endnote 10). A higher number means more authoritarian values and a lower number means more anti-authoritarian values.

Chart 3.8 shows how views have changed in the transition countries compared with the EU-15 and the United States.[11] People's views in the United States are clearly anti-authoritarian and have remained consistently so. In terms of economic policy, they clearly favour less government intervention although this trend decreased slightly between 1990 and 1999. While the EU-15 shows similar results regarding political views, there is more taste for government intervention in the economy. However, by 1999, the EU-15 is getting closer to the US views.

The group of transition countries is clearly different, with more pro-authoritarian views throughout the 1990s and a greater preference for government intervention in the economy. In short, clear differences in views among the three regions persisted during the 1990s. This suggests that fundamental beliefs are slow to change, at least when compared with political and even legal institutions.[12]

Factors influencing people's views

Individuals' views about government intervention, democracy, the market economy and political participation are likely to be influenced by factors such as their cultural and parental background, their education, age, gender, occupation and wealth. Furthermore, the experience of individuals throughout the course of transition – for example, their job history or whether their living standards have improved or deteriorated – is likely to influence strongly their attitudes towards the economic and political system as well as their beliefs and sense of satisfaction.

Tables 3.1 and 3.2 report the results of a multiple regression analysis that seeks to isolate the contribution of different factors to attitudes regarding politics, markets and democracy and views on state intervention and social mobility. An attempt is also made to assess whether attitudes are influenced by factors such as poverty or unemployment.

Life satisfaction

Previous research on life satisfaction has identified a number of strong links between perceptions of well-being and various socio-economic indicators. For example, studies from around the world and for different time periods show that satisfaction tends to be positively linked with income, education and being married, and negatively linked with unemployment

Table 3.1
Attitudes to political/economic systems and policies

Category	Pro-democracy	Pro-authoritarian	Pro-market	Pro-planned economy	Pro-state intervention	In favour of less inequality	Voted last election	Civil participation[1]
Adult				+**			+**	–*
Middle-aged			–**	+**		+**	+***	–***
Old			–***	+**	+*	+***	+***	–***
Poor	–***		–***				–***	–***
Rich	+**		+***		–**	–***		+**
Gender[2]	+***		+***		–***	–***		+***
Educated to tertiary level	+*	+***	+***		–***	–*	+***	+***
Unemployed								+***
Self-employed			+***	–***			–**	
White-collar worker	+***				–***	–**	+***	+***
Blue-collar worker								
Service sector worker	+***				–***		+***	
Farm worker	+***						+***	
Student	+***	–**	+*		–**	–***	–***	
Housewife		–*		–**	–**			
Rural inhabitant				+*			+***	
Number of jobs held since transition began				+**				+**
Educated father			+*		–**		–***	
Educated mother	–***					–**		
Father's job is skilled								+**
Mother's job is skilled		–**			–***			
Member of an ethnic minority	–***	+*					–**	
Moved up relative income scale						–*		
Moved down relative income scale								
Standard of living has improved	+***	–***	+***	–***	–**	–***		
Standard of living has deteriorated	–**		–***		+***			+***
Respondents	25,683	25,572	25,664	25,683	25,676	25,687	25,701	23,976

Source: Life in Transition Survey, EBRD and World Bank, 2006.
[1] Civil participation includes taking part in demonstrations or strikes, signing a petition or joining a political party.
[2] Gender is a dummy variable with female equal to 0 and male equal to 1. The results in the table report whether being male is positively or negatively associated with each of the attitudes and behaviours listed.
Note: + and - signs indicate whether this category was positively or negatively associated with the attitudes and behaviours listed at the top of each column.
* indicates significance at the 10 per cent level; ** 5 per cent level; and *** 1 per cent level.

and ill-health. Women often report higher levels of happiness than men, and satisfaction scores typically decline with age up to a point (usually around the early 40s) and rise thereafter. Evidence from the WVS shows that most of the same patterns are generally observed in transition countries, although there are some differences.[13]

The question of whether these patterns emerge in the LiTS is examined using similar techniques to those used in most of the previous studies.[14] Several interesting results stand out. First, women report significantly lower satisfaction than men. Secondly, the relation between satisfaction and factors such as income, education and employment status all conform to expectations. Not only are the unemployed significantly less happy than those in work, those who have changed jobs frequently report lower levels of well-being than those who have had more stability in terms of employment (see Chapter 4). Thirdly, students show particularly high levels of satisfaction.

Lastly, those at the opposite ends of the age scale (the young and the old) report the highest degree of happiness, which is again consistent with evidence from other countries. In summary, the LiTS demonstrates that the factors determining happiness in the transition countries appear to be relatively unchanging and broadly similar to those in other countries.

Democracy and the market

Support for democracy and the market is influenced by a wide range of individual characteristics. Democracy is favoured by a wide range of professional groups and students. Richer people and those whose living standards have improved in transition tend to support both the market and democracy. Support also tends to increase with education. By contrast, the poorer and those whose living standards have deteriorated tend to hold a relatively sceptical view of both democracy and the market.

In contrast to support for democracy and the market economy, support for authoritarianism and central planning is not strongly influenced by particular factors. The only consistent finding is that those whose living standards have improved tend to be less in favour of either. Those who have gained from transition tend not to favour a planned economy but nor do those who have lost from transition. Ethnic minorities are more likely to be pro-authoritarian while people in rural areas are more in favour of the planned economy.

Table 3.2
Attitudes to wealth and poverty

Category	Wealth is achieved through effort	Wealth is achieved through intelligence	Wealth is achieved through corruption and political connections	Poverty is the result of laziness	Poverty is the result of injustice	Poverty is inevitable
Adult			+**			
Middle-aged	+***	–**			+*	
Old	+***			+**		
Poor	+***	–***				–*
Rich				+*		
Gender[1]		–***			–***	+***
Educated to tertiary level	–***	+***	+**	–***		+***
Unemployed		–*		–***	+***	–***
Self-employed				+***	–***	
White-collar worker	–***				–**	
Blue-collar worker	+***	–**			+***	
Service sector worker						
Farm worker	+***	–**	–***			
Student		+**				
Housewife		–***				
Rural inhabitant					–*	
Number of jobs held since transition began	–*		+**	–**	+**	
Educated father	–***	+***			–***	+*
Educated mother	–**					–**
Father’s job is skilled			+**			
Mother’s job is skilled						+**
Member of an ethnic minority					+*	
Moved up relative income scale		+**				–*
Moved down relative income scale	–***			+***	+***	
Standard of living has improved		+**	–***	–***	–***	+***
Standard of living has deteriorated	–*	–**			+***	–**
Respondents	25,713	25,713	25,700	25,701	24,887	25,681

Source: Life in Transition Survey, EBRD and World Bank, 2006.
[1] Gender is a dummy variable with female equal to 0 and male equal to 1. The results in the table report whether being male is positively or negatively associated with each of the attitudes and behaviours listed.
Note: + and - signs indicate whether this category was positively or negatively associated with the attitudes and behaviours listed at the top of each column.
* indicates significance at the 10 per cent level; ** 5 per cent level; and *** 1 per cent level.

Unsurprisingly, the self-employed are less in favour of a planned economy, and students are clearly opposed to authoritarianism.[15]

Political participation and state intervention

Regarding political participation – an important indicator of how well the political system is working – cultural, educational and socio-economic characteristics are important.[16] Political participation, as measured by voting in the last election and participation in political issues (as defined above), is stronger among the older, the educated, white-collar and service workers and among rural inhabitants. It is lower among the poor, ethnic minorities, students and the self-employed, but no specific pattern emerges. While it does appear that people who fall into the category of a traditional middle class – in terms of education, employment and income – are more politically active, in other respects these results do not confirm prior expectations about levels of political participation and socio-economic status.

Support for state intervention in the economy and demand for redistribution appear to be clearly influenced by social and economic factors. Higher-income individuals and winners from transition, including the educated and the children of the educated, white-collar and service workers, students and the self-employed, tend to support less state intervention while the opposite is true for the old and those whose living standards have deteriorated.

Social mobility, poverty and wealth

People’s beliefs about how the market should work, what brings success, and what is just and unjust are further explored in the LiTS by asking about the factors that have helped people succeed in society and the reasons why poverty exists.

The rich, winners from transition, white-collar workers and the self-employed tend to believe that poverty is largely self-induced. The poor, losers from transition and those in less-well-paid professions tend to think that poverty is unjust. This is also true for members of ethnic minorities. Regarding the factors behind success or wealth, the first group tends to believe more in the role of intelligence or aptitude, the second group subscribes to the view that success is mainly down to effort.

Those who have held many jobs in the transition period tend to believe less in the role of individual effort and more in the role of criminal and corrupt ties for economic success. However, the results shown in Table 3.2 are not particularly strong, suggesting that transition may not have shaped people's beliefs in a fundamental way.

Regional variations

Being located in a particular region does not appear to affect individuals' attitudes and beliefs. Regional characteristics, such as average income per head, levels of unemployment, age breakdown and range of professional categories, do not play a significant role. Nevertheless, support for state intervention is stronger in regions where unemployment has risen and is weaker in regions with more winners from transition and where there are more white-collar workers.

The demand for the redistribution of wealth is lower in areas where many people have become self-employed over the transition period. Furthermore, in regions where inequalities are large, people tend to believe that the rich have achieved their wealth through criminal activity. However, those who live in a region with relatively unequal distribution of wealth but in a country where wealth is relatively evenly distributed tend not to favour redistribution.

Conclusions

After 17 years of transition, most people broadly feel satisfied with their lives. Nevertheless, levels of happiness across the region remain considerably lower than in western Europe and the United States. Dissatisfaction is high in south-eastern Europe, particularly in parts of former Yugoslavia. A substantial number of people believe that their household's relative wealth has declined since the beginning of transition despite their perception that absolute living standards have improved. Tackling growing inequality is clearly perceived as a priority for governments and policy-makers.

Support for democracy is fairly strong in the transition countries. Russia is a notable exception, partly because the term "democracy" is closely associated with the economic pain and corruption that it experienced in the 1990s. Although voting levels are fairly high across the transition region, other forms of political participation, such as joining a political party or taking part in demonstrations, are generally low. The former Yugoslav republics are exceptions. The educated middle class, which has grown rapidly across the region since 1989, is more likely to participate in politics than other groups.

Support for the market economy is less strong than for democracy, although it is slightly higher in the new EU member states. However, just as weaker support for democracy does not necessarily mean stronger support for authoritarianism, weaker support for the market is not generally associated with stronger support for central planning.

Support for democracy and the market is stronger among the educated middle class and those who have gained most from transition.

The evidence presented in this chapter signals a robust appetite among people in the region for state intervention, from guaranteeing low prices for basic goods and food to ownership of large companies and maintaining law and order. This may be a backlash against some of the privatisation and other policies of the 1990s but it also reflects a belief that governments can and should provide a framework for a fairer distribution of resources.

Endnotes

1 See Layard (2005) for a useful overview of the literature on happiness.

2 See Sanfey and Teksoz (2007).

3 See the diagram in Layard (2005, p. 32). It should be noted, however, that the percentages at the extreme ends of the scale are rather similar to those reported in EU-15 countries in the eurobarometer survey of 2001. A direct comparison must be made cautiously because the questions were worded differently in the two surveys.

4 It should be noted that the survey took place at a time of deep political crisis in Hungary, which may have affected the results on this question.

5 See Blattman and Annan (2007) and Bellows and Miguel (2006).

6 See Bruszt et al (2007).

7 Note that not all countries were represented in all waves (1990–93, 1995–97 and 1999–2002) and not all questions were asked in all the surveys.

8 The questions about the economy are:

- "We need larger income differences as incentives" (1) vs "Incomes should be made more equal" (10).
- "Competition is good. It stimulates people to work hard and develop new ideas" (1) vs "Competition is harmful. It brings out the worst in people" (10).
- "Imagination is an important quality that children can be encouraged to learn at home."
- "Private ownership of business should be increased" (1) vs "Government ownership of business should be increased" (10).
- "People should take more responsibility"(1) vs "The government should take more responsibility" (10).
- "When jobs are scarce, employers should give priority to nationals over immigrants."
- "When jobs are scarce, men should have more right to a job than women."

9 The countries that have seen the largest egalitarian trend are not necessarily those where inequality has increased the most.

10 The questions regarding political values are:

- "Maintaining order in the nation is the first aim."
- "Having a democratic system is very good/fairly good/fairly bad/very bad."
- "Having experts, not government, make decisions according to what they think is best for the country is very good/fairly good/fairly bad/very bad."
- "Having a strong leader who does not have to bother with parliament and elections is very good/fairly good/fairly bad/very bad."
- "Democracies are not good at maintaining order (agree strongly/agree/disagree/strongly disagree)."

11 The responses for the EU-15 and the transition countries are weighted by population in Chart 3.8. While there is some variation between countries, in the transition countries it is striking how closely bunched the results are, with the large majority falling in the range of 4.3–5.3 for both political and economic values.

12 See Roland (2004).

13 See Sanfey and Teksoz (2007).

14 In technical terms, an ordered probit regression was estimated with life satisfaction as the dependent variable and various socio-economic variables, such as age, gender, education and employment status, as independent variables.

15 Support for authoritarianism also increases with education. It appears inconsistent that support for both democracy and authoritarianism increases with education. However, note that people were given the possibility to answer "For people like me, it does not matter whether a government is democratic or authoritarian" and the answer is much lower among the educated. Educated people tend in general to have stronger views in either direction, something that is also found in other answers to the LiTS.

16 See Dahl (1989) and Putnam (1993).

References

A. Alesina and E. La Ferrara (2005), "Preferences for redistribution in the land of opportunities", *Journal of Public Economics*, Vol. 89, Nos 5–6, pp. 897–931.

J. Bellows and E. Miguel (2006), "War and institutions: New evidence from Sierra Leone", *American Economic Review*, Papers and Proceedings, Vol. 96, No. 2, pp. 394–99.

R. Benabou and E. Ok (2001), "Social mobility and the demand for redistribution: The Poum hypothesis", *The Quarterly Journal of Economics*, MIT Press, Vol. 116, No. 2, pp. 447–87.

C. Blattman and J. Annan (2007), "The consequences of child soldiering", Working Paper, Berkeley Economics Department.

L. Bruszt, N. Campos, J. Fidrmuc and G. Roland (2007), "Civil society and institutional change: The great transition", Working Paper, Berkeley Economics Department.

R. Dahl (1989), *Democracy and its Critics*, Yale University Press, New Haven.

EBRD (2007), *Life in Transition: A Survey of People's Experiences and Attitudes*.

R. Layard (2005), *Happiness: Lessons from a New Science*, Allen Lane, London.

R. Putnam (1993), *Making Democracy Work. Civic Traditions in Modern Italy* (with R. Leonardi and R. y. Nanetti), Princeton University Press, Princeton.

G. Roland (2004), "Slow-moving and fast-moving institutions", Studies in Comparative Institutional Development.

P. Sanfey and U. Teksoz (2007), "Does transition make you happy?" *Economics of Transition*, Vol. 15, No. 4, pp. 707–31.

Box 3.1 The middle class in transition

For decades, social scientists have held the view that the middle class plays an important role in economic and political development, and a great deal of empirical research supports this contention.[1] People in the middle class are seen to be more likely to support fundamental market institutions, such as protection of property rights and the even-handed application of laws governing state regulation of the economy.

Middle-class people are also assumed to derive from their income and social position a growing preference for democratic government, including political contestation, a limited and accountable state and guarantees of universal human rights and freedoms. Those with sufficient income and social status are believed to have the resources to organise themselves and to engage in political activity to promote their collective interests. In this popular conception, the middle class, once it reaches a certain size, becomes the bulwark of market-based democracy.

However, data on the transition region that would make it possible to identify who is in the middle class while also surveying their attitudes and policy preferences has been lacking, making it difficult to test the hypothesis that the middle class supports markets and democracy. The 2006 EBRD/World Bank Life in Transition Survey (LiTS) helps to fill this gap.

Using the LiTS, it is possible to get a picture of the size and composition of the middle class in the transition countries and to see whether their economic and political values accord with conventional wisdom. For the purposes of this analysis, the population is divided into two groups: the middle class and the non-middle class, which refers to the group of people who fall below the middle-class threshold.[2]

What is the middle class?

There is no generally agreed-upon approach for measuring the middle class. Education and profession are clearly important factors, which can be derived from the LiTS. Income is also an important feature. However, the LiTS lacks a reliable measure of household or individual income. Therefore, household asset ownership is used as a stand-in for income. To be classified as middle class, individuals must have the following attributes:

- ownership per household of two or more of the following: a car, a secondary residence, a computer and/or internet access at home;

  and *either*

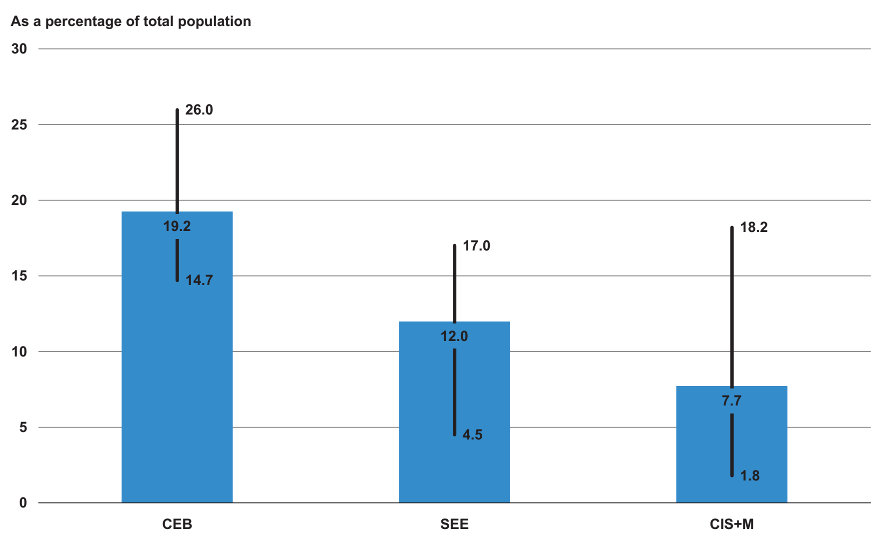
- a post-secondary degree (university/college or post-graduate)

  or

- experience in a skilled professional occupation during their working life.[3]

Using these criteria, the middle class in the transition region make up just under 12 per cent of the population, with significant variation between and within regions. The bars in Chart 3.1.1 show the size of the middle class as a proportion of the total population by region.

Chart 3.1.1
Size of the middle class by region



Source: Life in Transition Survey, EBRD and World Bank, 2006.
Note: The bar shows the average size of the middle class in each sub-region. The line indicates the countries with the lowest and highest percentage in each sub-region.

In central eastern Europe and the Baltic states (CEB), the middle class ranges from 26 per cent of the population in Slovenia to 15 per cent in Poland and Hungary, while in south-eastern Europe (SEE) the range is between 17 per cent of the population in Croatia and 5 per cent in Albania. In the Commonwealth of Independent States and Mongolia (CIS+M), the middle class ranges from 18 per cent of the population in Belarus and Russia to just 2 per cent in Azerbaijan, Tajikistan and Uzbekistan.

Within this middle-class cross-section of the population, 53 per cent are women, 33 per cent are under the age of 35, 42 per cent of those currently working are employed in the private sector and 78 per cent live in urban areas. Not surprisingly, 42 per cent of the middle class are "winners" from transition (that is, people who state that their household lives are better today than when the transition began); by contrast, only 26 per cent of people below the middle-class threshold agree with that statement. Around 68 per cent of middle-class individuals have travelled abroad for business or pleasure since 1989, compared with just 24 per cent of those who are not middle class.

Middle class views on markets and democracy

The middle class tends to support the market and democracy more strongly than those below the middle-class threshold. For example, as illustrated in Chart 3.1.2, 57 per cent of middle-class respondents favour markets over other types of economic systems, while only 41 per cent of non-middle class respondents support markets; 71 per cent of middle-class individuals prefer democracy to non-democracy, compared with 55 per cent of non-middle class individuals. Of the middle class, 49 per cent prefers both markets and democracy, but only 34 per cent of non-middle class respondents support both. People below the middle-class threshold are far more likely to be non-committal when it comes to the form of economic and political system that they prefer.

Furthermore, middle-class respondents are more supportive of individual democratic institutions than non-middle class individuals – particularly such crucial institutions as an independent press and a strong political opposition, which are often weak in autocratic and quasi-democratic regimes. For markets, a similar pattern emerges. A large proportion of non-middle class respondents favour strong state involvement in the economy, including through setting prices, reducing inequality and expanding state ownership of strategic industries. A strikingly high number – 47 per cent – support renationalisation of privatised firms. Middle-class individuals are only one-third as likely as non-middle class individuals to support these forms of state interference in the economy.

Civic and political activism

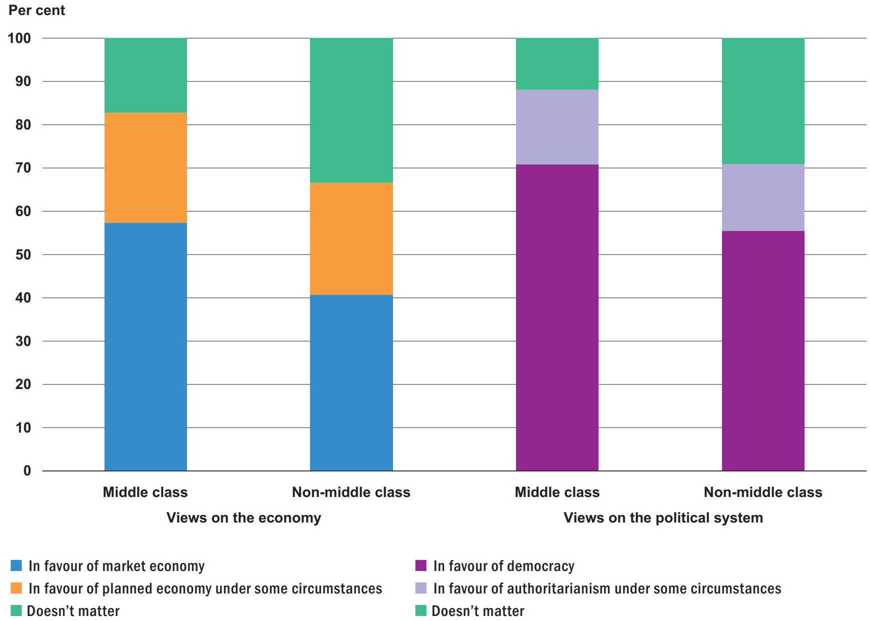
People in the middle class are more likely to join a political party or voluntary organisation than non-middle class individuals. Among the middle class, around 19 per cent are members of either voluntary civic organisations or political parties, whereas for those outside the middle class the figure is only 10 per cent. Middle-class individuals are 10 per cent more likely to vote in national elections and over 60 per cent more likely to participate in political and civic activities, such as lawful demonstrations, strikes, signing petitions and joining political parties.

Greater civic and political activism among the middle classes, combined with stronger support for the institutions of democracy and a market economy, could be seen as the key ingredients for social change. However, the historical record is much less clear on this subject. Middle-class social movements are hardly unknown, but they do not occur automatically once the middle class reaches a certain size. Other factors are also important. Similarly, countries around the world have adopted democratic systems of government, some with only fleeting success, well before the middle class reaches a sizeable portion of the population.

As the LiTS has only been conducted once, it is impossible to investigate whether growth of the middle class over time is associated with greater demand for democracy and higher levels of democratic achievement. However, using the Nations in Transit scores for 2006 published by Freedom House, the correlation between the size of the middle class and the level of democracy is striking (see Chart 3.1.3). Only Russia and Belarus stand out as countries with a relatively large middle class but lower ratings for democracy than their peers.

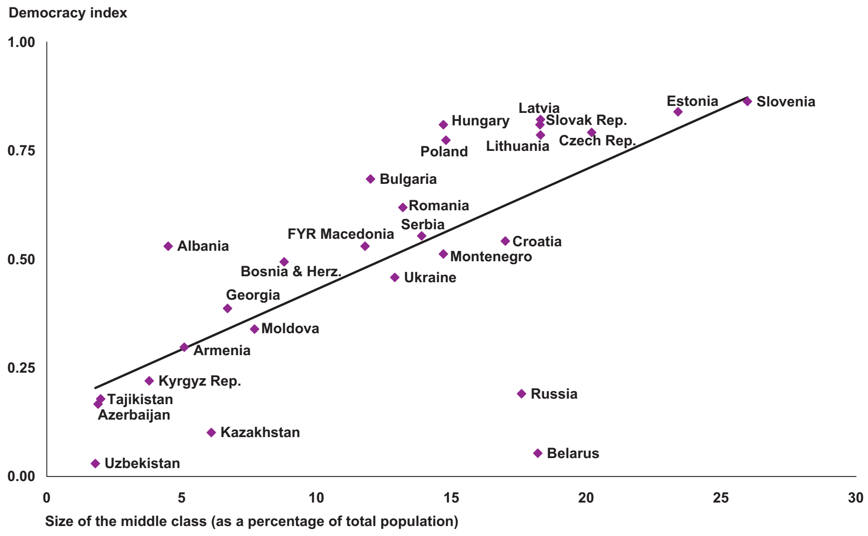
While there is no clear size threshold for the middle class that pushes countries ineluctably towards democracy, the pattern suggests that over time and assuming a steady trend of a growing middle class, the social and governmental consensus for democratic change is likely to strengthen in the transition region.

Chart 3.1.2
Views on markets and democracy



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Chart 3.1.3
The middle class and democracy



Sources: Freedom House, 2006 and Life in Transition Survey, EBRD and World Bank, 2006.
Note: The democracy index uses the Nations in Transit scores for 2006 published by Freedom House. The higher the index, the greater the level of democracy.

Endnotes

1 See, *inter alia*, Johnson (1958), Lipset (1959), Moore (1966), Lipset (1981), Huber and Stephens (1993), Przeworski et al (2000), Easterly (2001), Acemoglu and Robinson (2006).

2 The LiTS did not include in its sample a sufficient number of households that can be considered wealthy or above middle class.

3 Skill levels are based on reported occupations, which follow the 1-digit International Standard Classification of Occupations, ISCO-88. Skilled professions include ISCO-88 categories 1–3 (1 – legislator, senior official and manager; 2 – professionals; 3 – technicians and associated professionals).

Sources

D. Acemoglu and J. A. Robinson (2006), *Economic Origins of Dictatorship and Democracy*, Cambridge University Press.

W. Easterly (2001), "The middle class consensus and economic development", *Journal of Economic Growth*, Vol. 6, pp. 317–35.

E. Huber and J. D. Stephens (1993), "The impact of economic development on democracy", *Journal of Economic Perspectives*, Vol. 7, pp. 71–85.

J. Johnson (1958), *Political Change in Latin America: Emergence of Middle Sectors*, Stanford University Press.

S. M. Lipset (1959), "Some social requisites of democracy: Economic development and political legitimacy", *American Political Science Review*, Vol. 53, pp. 69–105.

S. M. Lipset (1981), *Political Man: The Social Basis of Politics*, expanded and updated ed., Baltimore, MD: John Hopkins University Press.

B. Moore (1966), *The Social Origins of Dictatorship and Democracy*, Boston: Beacon.

A. Przeworski, M. Alvarez, J. A. Cheibub and F. Limongi (2000), *Democracy and Development: Political Institutions and Material Well-being in the World, 1950-1990*, Cambridge University Press.

D. Rueschemeyer, E. H. Stephens and J. D. Stephens (1992), *Capitalist Development and Democracy*, University of Chicago Press.

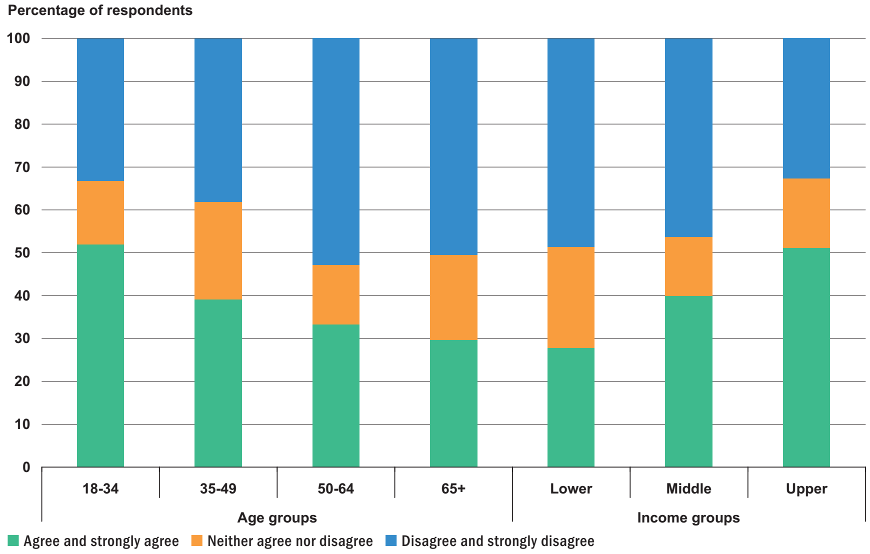
Box 3.2 The lives of ordinary Russians

The Life in Transition Survey (LiTS) showed that a substantial number of respondents in Russia perceived a deterioration in their living standards: 40 per cent of the Russian population thinks that their financial situation was better in 1989 than it is now, 28 per cent think that it is better now, and 36 per cent are uncertain.

As for the economic situation, Russians can be divided into three almost equal groups: around 40 per cent of respondents believe that the country's general economic situation is better now than in 1989; the same percentage thinks that it is worse while 20 per cent are undecided. Older people and the less well-off tend to be more pessimistic (see Chart 3.2.1).

Why? What have been the range of experiences of the Russian people during transition and how has this shaped their concerns, problems, needs and hopes? To answer these questions, a qualitative research project was conducted by Russia's Institute for Comparative Social Research (CESSI) in spring 2007 as a follow-up to the LiTS. The results of the survey are based on a total of 34 focus groups conducted in nine Russian cities, from St Petersburg to Vladivostok. The stories gleaned from focus-group discussions add a layer of depth and richness to the statistics found in the LiTS.

Chart 3.2.1
Economic situation is better today than around 1989 (Russia)



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Respondents were asked "To what extent do you agree with the following statement: the economic situation in this country is better today than around 1989". Answers included: "strongly disagree", "disagree", "neither agree nor disagree", "agree", "strongly agree", "not applicable", and "don't know". The chart reports the combined totals for "agree and strongly agree", "neither agree nor disagree", and "disagree and strongly disagree".

Why are many Russians sceptical about the impact of reforms?

Young Russians and the older generation, successful people as well as those who fared less well all agree that transition has eroded their sense of stability, predictability and certainty about the future that existed before. Russians experience this in a variety of areas – from concerns about making ends meet in the family budget to fear of reaching old age without financial support or the inability to work because of possible illness. Russians have lost faith in the notion that society or the state will help them in times of need or trouble. A serious concern for most Russians is the increasing cost and decreasing quality of medical care and education.

Besides everyday problems, the reforms have brought a large number of social problems. People believe that the change in Russian economic and political systems brought about an increase in individualism and a decline in collective values – people are more alienated from each other, more self-centred and communicate less. Russians also see an overall decline in respect for law and order, viewing laws as unpredictable and unevenly enforced, with the rich and powerful living according to different rules than ordinary people. These changes have resulted in a reduced level of general trust in others, in the authorities and in law enforcement agencies.

What do Russians see as better or more advantageous in their personal lives?

The reforms have brought a range of positive changes in the day-to-day lives of ordinary Russians, especially the move from oppressive control of all aspects of daily life to a society of freedom and possibility. Russians value, first and foremost, the opportunity to earn money and to choose their own direction in life and career, as well as the abundance of goods and availability of consumer choice.

Over the last decade, the reforms, coupled with the rapid growth of communications technology, have made possible a leap forward in access to information. Among the civil liberties brought by the process of reform, Russians value freedom of movement, particularly the ability to travel abroad. Other civil liberties – freedom of speech, the freedom to organise or to be in opposition, the freedom of conscience – are generally considered to be important to a small group of intellectuals; however, these freedoms are not seen as especially important to most Russians who participated in the focus groups.

How do people feel about how life has changed in Russia's cities?

People in big and small cities across Russia feel that their lives have changed in many ways. In the focus-group discussions, people talked about the transformation of their surroundings and the enormous amount of construction, from new apartment buildings to shopping centres and entertainment complexes.

In cities such as Ekaterinburg in the Urals, Krasnodar in Southern Russia, Moscow, St Petersburg and Vladivostok in the Far East, life has become more varied and dynamic. Old buildings are being restored and new lighting is making commercial streets more attractive. But people in these cities complain that this has also brought the rapid rise of rent and prices, traffic jams and over-used and under-maintained roads and infrastructure. People are also concerned about environmental problems, dwindling green spaces and low water quality (see Annex 5.1 for a more detailed discussion of environmental issues).

How do Russians live today? What are people's major concerns and expectations?

The focus-group research led to the definition of a number of stylised groups of Russians, differentiated by way of life, goals and priorities, views of the reform process and future expectations.

The first group are the "well-adapted participants in the new market economy". This group consists of entrepreneurs, professionals in new economic areas (top and mid-level managers working in the wholesale and retail trade or business services such as advertising, marketing, information technologies, tourism, property and insurance), successful professionals in more traditional areas (doctors, teachers, accountants), and students. These people work hard, sometimes 60 hours a week or more.

They are very much career-oriented. Most of them are young although some are middle-aged. The reforms and the new economic conditions have allowed them to develop and make best use of their talents, abilities and knowledge. They value education and are prepared to invest a lot in order to receive an education for themselves and for their children. People in this group were able to satisfy their basic material needs rapidly, and their overall material circumstances improved markedly compared with how their families lived before the reform process.

The second group could be labelled the "followers or survivors" and consists of people who are motivated more by family concerns than career progression (many are single women with children). They work as office clerks, low-level civil servants or people in the service sector, for example.

A career and education is not the most important thing for these people. Their greatest desire is to have a stable, secure job together with a stable salary that will cover their basic needs. These people see their most important goal as earning enough to pay for a good education for their children, and to improve their usually poor living conditions. For people of this group, the purchase of a foreign car is a great achievement. In their free time, the new entertainment centres and cafés are the focal point, although these are not an option in the smaller cities and towns.

The third, rather large group consists of those who have essentially lost out on the reform process, those who, in their own words, have "missed the boat". Pensioners are part of this group, as are those forced to live on state social welfare payments (the handicapped, single mothers, the unemployed) as well as people in industries that pay poorly. The latter includes less successful professionals, especially in smaller cities: doctors, teachers in state institutions, employees of the municipal housing authorities, certain sectors of industry, refuse collectors and agricultural workers.

A large proportion of this group lives in small cities although there are many such people in large cities. To make ends meet, many in this group have to maintain two or three jobs, looking constantly for the occasional odd job. The main goal of the people In this group is to meet their basic needs: food, rent and medicine.

Lyudmila: a career-oriented Russian

Lyudmila is 35 years old and lives in Ekaterinburg. Once the reforms began, she did not follow on from her technical education to start work as an engineer but instead took up work as a manager in a small tailor's shop. At a certain point, she felt that she could set up her own independent business. She and a friend borrowed money from friends and acquaintances, purchased a professional sewing machine and rented a small room. In two months, they were able to buy a second sewing machine. Within two years, they had seven machines and eight employees. Her work is demanding and she has little time for leisure activities. Lyudmila is worried that she rarely has time to go out with people – she can only manage to visit her parents once a month.

Vadim: a survivor

Vadim works as a window installer for a successful private producer of glass and glass-products in Vladivostok. He has a wife and two children; the older child is finishing secondary school and the younger is still in primary school. The family's efforts and financial resources are devoted to the children's education – for private tutors, informal payments to state schools and higher education fees. Vadim's family is constantly borrowing money – without credit, Vadim would not have been able to buy a computer for his daughter, a mobile phone for himself and a new washing machine for the family.

Paying back the loans is really difficult; in fact almost his entire salary is devoted to this but at least he has everything that he needs and he can enjoy it to the full. Although Vadim's company is successful, he always has the feeling that everything could go wrong, that the company could be closed or the laws changed and he would be without work.

Alexander: struggling to make ends meet

Alexander is a pensioner in St Petersburg. A career military man, he currently lives with his daughter in a small apartment on the edge of the city. His daughter works as a doctor in the regional clinic and her salary is about as small as his pension. Nothing has been repaired in their apartment for more than 30 years. Their small "dacha" near Vyborg can be used only in the summer since they have not been able to afford to connect it to mains gas and water. The small garden at the dacha is a great support, supplying tomatoes, preserves and other foods, which help them through the winter.

Alexander spends the day at the city's grocery markets looking for bargain items. He hopes for a time when he will simply go to the nearest supermarket, put what he needs into his shopping basket and go home – and not spend hours in an over-crowded bus carrying heavy shopping bags from market to market. He would also like to be able to telephone his brother in Kharkiv, Ukraine, more frequently; even better, he would like to travel to Kharkiv, but he has not been able to afford a trip like that for over 10 years.

The time when he could travel to Lake Baikal in Siberia with friends on just half of his monthly military salary is long gone. But the most important thing for him is to receive the free medication he needs from the chemist, although it is often out of stock. The medication is too expensive for Alexander to buy and he hopes that he will manage to avoid more serious illnesses.

Annex 3.1
Life in Transition Survey

The EBRD/World Bank Life in Transition Survey (LiTS) was undertaken in 28 transition countries plus Turkey. In each country, a sample of 1,000 individuals was selected randomly for face-to-face interviews, making a total of 29,000 interviews across the whole region. The interviews were conducted between September and November 2006. The questionnaire and full dataset are available at www.ebrd.com/economics.

Sampling methodology

The sampling methodology used for the Life in Transition Survey was designed to make the sample nationally representative. To achieve this, a two-stage sampling procedure was used.

First stage

In all countries, the most recent available sample frame of Primary Sampling Units (PSUs) was selected. In the cases of Armenia, Azerbaijan, Kazakhstan, Serbia and Uzbekistan, Census Enumeration Areas (CEAs) were used. A similar methodology was employed in Croatia and Montenegro, in which adjoining CEAs were merged to construct a sample of a manageable number of merged enumeration areas. In Estonia, Hungary, Lithuania, Poland and the Slovak Republic, Eurostat's NUTS area classification system was used.[1]

In Albania, Bulgaria, the Czech Republic, Georgia, Moldova and Romania, the electoral registers were used as the basis for the PSU sample frame. In the other countries, the PSU sample frame was chosen using either local geographical or administrative and territorial classification systems. The total number of PSU sample frames per country varied from 182 in the case of Mongolia to over 48,000 in the case of Turkey. From among these, 50 PSUs were selected, with probability of selection proportional to size, where the measure of size was either the population or the number of households in the area.

Second stage

The second stage in sampling consisted of selecting households within each of the PSUs. The selected PSUs were first sub-divided into smaller segments, of which four segments/areas were chosen. In each of the four chosen segments, five interviews were conducted to bring the total number of interviews per PSU to 20.

For the purpose of selecting households to be interviewed in each segment, a list of all eligible households within each sampling unit was developed. From this list, households to be interviewed were systematically selected with equal probability sampling.

Selection of respondents within households

Within the selected household, either one or two respondents were sampled. The first respondent – either the head of the household or another household member with knowledge of the household expenses – was responsible for section 1 (household) and section 2 (housing and expenses).

The remainder of the survey was conducted with a randomly selected household member, aged 18 and over. That is, once the household was selected for inclusion in the sample, there was a further stage of randomisation in order to determine the respondent to sections 3 to 7, without excluding the possibility that respondents 1 and 2 could be the same person.

The final stage of randomisation was achieved through the last birthday method: every household member and their birthdays were listed in the household roster and the one who had last celebrated a birthday was selected as the respondent, with no replacements possible. In cases where this was not possible – particularly

Table A.3.1.1

Profile of respondents to the Life in Transition Survey (in per cent)

Country	Gender		Age				Location		OECD equivalised per capita income		
	Male	Female	18-34	35-50	51-64	65+	Urban	Rural	US$ 0 – 1,999	US$ 2,000 – 3,999	US$ 4,000+
Albania	44.2	55.8	30.2	34.4	23.9	11.5	60.0	40.0	49.0	37.6	13.4
Armenia	37.6	62.4	29.6	31.5	17.9	21.0	60.3	39.7	80.1	14.0	5.9
Azerbaijan	31.5	68.5	37.7	39.4	13.2	9.7	56.0	44.0	88.8	9.9	1.3
Belarus	44.0	56.0	31.9	32.5	16.9	18.7	68.0	32.0	55.9	33.3	10.8
Bosnia and Herzegovina	41.9	58.1	36.6	26.1	18.9	18.4	44.0	56.0	40.7	44.9	14.4
Bulgaria	43.4	56.6	20.8	22.4	28.6	28.2	72.0	28.0	62.3	29.7	8.0
Croatia	44.1	55.9	21.4	21.6	24.5	32.5	60.0	40.0	16.7	28.6	54.7
Czech Republic	44.0	56.0	26.5	26.1	25.8	21.6	64.0	36.0	10.0	43.3	46.7
Estonia	35.7	64.3	17.9	19.6	26.3	36.2	70.0	30.0	23.6	42.2	34.2
FYR Macedonia	53.3	46.7	31.3	32.7	24.9	11.1	54.0	46.0	52.9	37.4	9.7
Georgia	38.2	61.8	27.0	28.2	21.2	23.6	56.0	44.0	83.4	14.7	1.9
Hungary	39.3	60.7	21.1	20.4	29.9	28.6	70.0	30.0	30.8	44.7	24.5
Kazakhstan	40.9	59.1	35.4	29.8	19.7	14.9	58.0	42.0	65.1	28.1	6.8
Kyrgyz Republic	42.7	57.3	39.4	33.1	17.8	9.7	36.0	64.0	92.7	6.1	1.2
Latvia	38.9	61.1	22.0	22.5	23.9	31.6	68.0	32.0	35.6	33.5	30.9
Lithuania	33.5	66.5	19.7	20.9	21.2	38.2	66.0	34.0	42.2	34.9	22.9
Moldova	45.1	54.9	21.2	30.0	26.9	21.9	40.0	60.0	82.9	13.6	3.5
Mongolia	45.2	54.8	38.4	36.8	17.7	7.1	58.0	42.0	88.5	10.0	1.5
Montenegro	49.9	50.1	41.2	27.3	19.2	12.3	62.0	38.0	14.8	42.6	42.6
Poland	37.1	62.9	26.8	25.2	26.9	21.1	60.0	40.0	24.2	45.0	30.8
Romania	47.3	52.7	24.3	25.4	24.3	26.0	56.1	43.9	58.1	29.0	12.9
Russia	32.1	67.9	31.3	28.4	20.3	20.0	68.0	32.0	42.5	33.4	24.1
Serbia	43.1	56.9	30.7	24.0	24.2	21.1	56.0	44.0	42.2	39.9	17.9
Slovak Republic	41.5	58.5	25.0	26.6	25.8	22.6	54.0	46.0	23.4	49.9	26.7
Slovenia	43.6	56.4	28.1	23.9	23.6	24.4	52.0	48.0	4.5	22.8	72.7
Tajikistan	40.2	59.8	43.2	36.8	12.9	7.1	24.0	76.0	97.7	2.1	0.2
Turkey	47.7	52.3	38.2	30.4	20.2	11.2	66.0	34.0	47.6	36.2	16.2
Ukraine	38.7	61.3	33.8	26.0	17.6	22.6	68.0	32.0	54.9	30.1	15.0
Uzbekistan	39.3	60.7	41.2	35.3	14.6	8.9	36.0	64.0	98.0	1.9	0.1

Source: Life in Transition Survey, EBRD and World Bank, 2006.

because the respondent to the first two sections of the survey could not remember everyone's birthday – another standard method, the kish grid, was used to achieve randomisation. In practice, the last birthday method was feasible in 92.6 per cent of cases.

The standard interview method called for each selected household to be visited at least three times before being replaced. In the majority of cases (79 per cent), however, the interviews were completed on the first visit. In 60 per cent of cases, the head of the household and the principal respondent were the same person; in the remaining 40 per cent, two different interviews were required to be carried out in the same household.

The profile of the principal respondents is depicted in Table A.3.1.1. In the majority of countries, there is a preponderance of females and relatively older people in the sample. This may have resulted from the fact that household members who were away from home on a permanent basis, either for work or studies, were excluded from the sample.

In order to correct for this problem, a weighting scheme was introduced. In the first step, the weighting scheme identified target populations in each country broken down by age and gender, and assigned weights in order for the sample to reproduce the gender and age breakdown within the country's population. They were inversely proportional to the number of eligible persons in each household.

Endnotes

1 The NUTS (Nomenclature of Territorial Units for Statistics) is a uniform and consistent system that divides the territories into five different hierarchical levels. NUTS 1 covers areas with a population of 3 to 7 million, NUTS 2 areas with a population of 800,000 to 3 million and NUTS 3 areas with a population of 150,000 to 800,000.

04
People's attitudes and their experiences in the labour market

Transition has been a story of massive reallocation and restructuring of resources and people. Given the conditions of virtually full employment in the planned economy, it was inevitable that jobs would be lost, new jobs would be created and workers would have to relocate and change their type of employment. People's individual experience of this upheaval has clearly had an impact on what they think about the transition process and themselves.

This chapter looks at the broad structural changes that have occurred in the work landscape and uses the findings of the Life in Transition Survey (LiTS) to explore the impact that labour market changes may have had on how people view transition and themselves. Since a significant share of respondents to the LiTS are not satisfied with how their lives have unfolded and are often dissatisfied with the policies – such as privatisation – pursued by their governments (see Chapter 3), these views clearly carry important information that has been little explored up to now. The policy implications for governments are examined in detail.

In 1989 most of the transition countries had unsustainably large manufacturing sectors and small service sectors. The bulk of employment was in the state sector, which was characterised by low productivity and pervasive labour hoarding. Currently, the private sector accounts for the greatest share of employment in all regions, having risen to almost three-quarters of total employment in central eastern Europe and the Baltic states (CEB). Manufacturing accounts for less than 15 per cent of GDP for the region as a whole,[1] while services account for 55 per cent of the region's GDP. In the three Baltic states, services account for more than 70 per cent of GDP. For this to happen, large numbers of people have changed jobs. In recent years, this has also included a large increase in the numbers of workers moving within countries and across international borders, including to western Europe.

The rise of unemployment

Unemployment rose rapidly in the early years of transition mostly as a result of lay-offs and company closures in the manufacturing sector (see Table 4.1). In much of CEB and south-eastern Europe (SEE) it climbed particularly sharply in the first decade of transition. In the Commonwealth of Independent States and Mongolia (CIS+M), job destruction was more restrained early on in transition and unemployment rose more gradually.[2]

However, unemployment in many transition countries has tended to stay high or decline at a slow pace. The share of workers in long-term unemployment – more than one year – accordingly rose sharply in many countries during the early stages of transition, and has not generally decreased to a significant extent. In CEB this share currently averages over 50 per cent of the unemployed (compared with 10 per cent in the United States and 42 per cent in the EU-15). This suggests that there have been factors impeding an efficient reallocation of workers and jobs.

Unemployment rates started to decline in most countries in central eastern Europe in 2005 (earlier in the Baltic states), partly as a result of strong growth throughout the region. With the exception of Poland and the Slovak Republic, unemployment rates in CEB are currently at or below western European levels (EU-15).[3] In Poland the unemployment rate (measured using the Labour Force Survey) fell by almost four percentage points year on year to around 11.3 per cent in the first quarter of 2007. Increased domestic demand for labour appears to have been the main reason.

However, it seems likely that substantial migration across borders has also affected the unemployment rate. Although information on the volume and nature

Table 4.1
Employment and unemployment rates

	1990–94		1995–99		2000–06	
	Employment rate	Unemployment rate	Employment rate	Unemployment rate	Employment rate [1]	Unemployment rate
CEB						
Czech Republic	71.7	3.2	66.7	5.3	64.9	7.9
Estonia	72.8	4.0	61.3	10.3	63.1	9.9
Hungary	55.2	8.3	50.1	8.7	61.5	6.4
Latvia	70.4	6.1	53.5	16.4	60.7	10.8
Lithuania	73.1	1.9	57.6	15.2	56.7	12.0
Poland	56.4	13.1	52.6	12.9	52.9	17.8
Slovak Republic	na	9.8	na	13.0	64.4	17.5
Slovenia	59.1	6.8	60.6	7.6	57.5	6.4
SEE						
Albania	na	15.4	na	14.7	na	15.0
Bosnia and Herzegovina	na	na	na	15.3	na	41.2
Bulgaria	59.8	12.4	49.5	14.8	53.1	14.1
Croatia	52.3	13.0	52.5	11.9	50.4	13.9
FYR Macedonia	na	25.0	na	35.5	na	38.3
Montenegro	na	25.0	na	32.1	na	31.7
Romania	64.1	6.5	63.5	7.0	59.2	7.4
Serbia	na	22.3	na	24.8	na	30.0
CIS+M						
Armenia	na	3.3	na	9.5	na	9.6
Azerbaijan	na	3.3	na	0.9	na	1.3
Belarus	na	0.8	na	2.8	na	1.8
Georgia	na	3.6	na	8.1	na	11.9
Kazakhstan	na	1.8	na	10.2	na	9.4
Kyrgyz Republic	na	na	na	3.8	na	7.5
Moldova	na	na	na	4.2	na	7.5
Mongolia	na	7.1	na	6.0	na	3.8
Russia	69.8	3.8	59.0	10.8	61.4	8.5
Tajikistan	na	0.6	na	2.7	na	2.4
Turkmenistan	na	19.5	na	23.9	na	20.9
Ukraine	73.9	0.2	69.6	2.4	63.0	3.5
Uzbekistan	na	0.1	na	0.4	na	0.3

Sources: EBRD, Faggio (2007) and Eurostat.
[1] With the exception of CEB, Bulgaria and Romania, the rates refer to 2000–03. Na means data were not available.

of this migration remains limited, a sense of its scale can be seen by considering that recorded migration since May 2004 from the new EU member states to the United Kingdom alone has been over 700,000, two-thirds of whom are from Poland. Furthermore, this is likely to be an under-estimate, as the total number of migrants has not been recorded.

Unemployment rates in the CIS+M have, on average, been below those in the EU-15. As already noted, much of the increase came later than in CEB as firms were slower to restructure or close. In SEE, with the exception of Romania, unemployment rates have been generally high, particularly in Bosnia and Herzegovina (41.2 per cent) and FYR Macedonia (38.3 per cent), although these numbers could be exaggerated given the size of the informal sector. Part of this is due to the massive economic disruption associated with the break-up of former Yugoslavia.

The decline in employment

The rise in unemployment since the start of transition has been accompanied by a sharp decline in aggregate employment rates (see Table 4.1). Across the sub-regions, employment rates have dropped to the range of 50-65 per cent.[4] These remain significantly below the rates in the United States (72 per cent) and western Europe (about 67 per cent).

The growth in numbers of those not seeking work (non-participation) is partly the result of unemployed workers becoming discouraged and ceasing to search for work. Evidence from a range of sources suggests that women have been more likely than men to withdraw from the labour force in all three sub-regions. This was especially pronounced during the early years of transition (see Box 4.1).

Changes in the labour market: evidence from the LiTS

The LiTS provides information that can give a sense of how restructuring and reallocation have taken place during transition. Chart 4.1 shows the evolution of employment, self-employment (broadly speaking, this encompasses entrepreneurs and people working in the informal economy) and non-employment (comprising unemployment and non-participation in the labour force). The chart confirms that there has been a pronounced decline in the share of the labour force in employment, with much of that decline concentrated in the first decade of transition.

Therefore, by the end of 2006, non-employment accounted for roughly an equivalent share of employment in both SEE and the CIS+M. In particular, the decline in employment has been most pronounced among women. Although the chart does not report unemployment, the LiTS did ask questions about unemployment but only for the period between September and November 2006. At that time, unemployment according to the LiTS was around 13 per cent in SEE, 10 per cent in CEB and 7 per cent in the CIS+M.

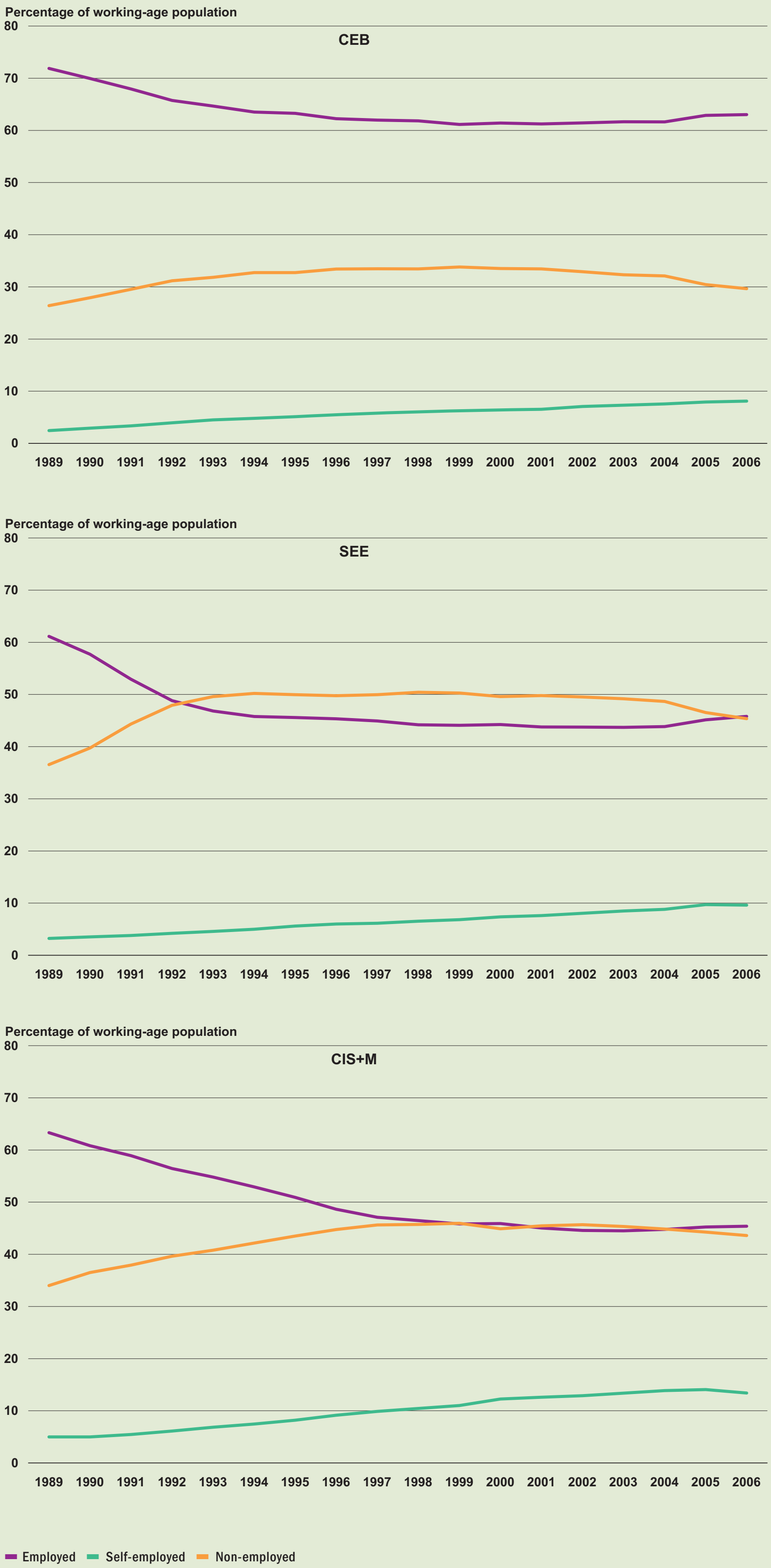
Chart 4.1 indicates that there has been a clear increase in the share of the self-employed, particularly in SEE and the CIS+M. Self-employment accounted for over 10 per cent in both sub-regions by the end of 2006, up from around 3 per cent in 1989. The LiTS evidence suggests that in general men have been more likely than women to become self-employed; in SEE and the CIS+M the share of men in self-employment has been roughly double that for women.

Chart 4.2 shows that there has been a predictable decline in the state sector, although the rate of decline has varied substantially both regionally and between countries.[5] As shown by the chart, the point at which private sector employment exceeded the state sector was earlier in CEB than elsewhere. The LiTS also reveals that there have been major sectoral shifts. In all regions, the share of people employed in industry has declined while the proportion in services has increased. Analysing employment by skill level,[6] it is clear that the share of skilled employment has remained fairly stable throughout the entire transition period, indicating that job losses have occurred mostly among the unskilled.[7]

In addition to measuring the distribution and different types of employment, the LiTS reveals the number of workers who have changed jobs, switched to self-employment or removed themselves from the labour market.

Table 4.2 shows selected flows between the different segments of the labour market.[8] Flows from both state and private employment into non-employment have

Chart 4.1
Evolution of employment by labour market status



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Working-age population is defined as those aged between 18 and 60. Self-employed encompasses entrepreneurs and people working in the informal economy. Non-employed comprises the unemployed and those not seeking work.

been relatively large, especially in the early years of transition. Flows from private employment to non-employment and vice versa have increased over time. This suggests greater flexibility in labour markets and is characteristic of more advanced market economies. Flows from self-employment to private employment have also increased. Flows from non-employment to private employment have been large compared with other types of flows, particularly in 2000–06, while flows from non-employment to self-employment have also increased, especially in SEE and the CIS+M.[9]

While the figures in Table 4.2 suggest positive changes since 2000, losing a job and changing to a new one will often have been a stressful experience, with new employment not necessarily bringing comparable pay, conditions or status. The figures therefore conceal numerous, complex life histories and experiences, many of which will have been disruptive. However, the LiTS allows these changes in the labour market to be analysed in more detail.

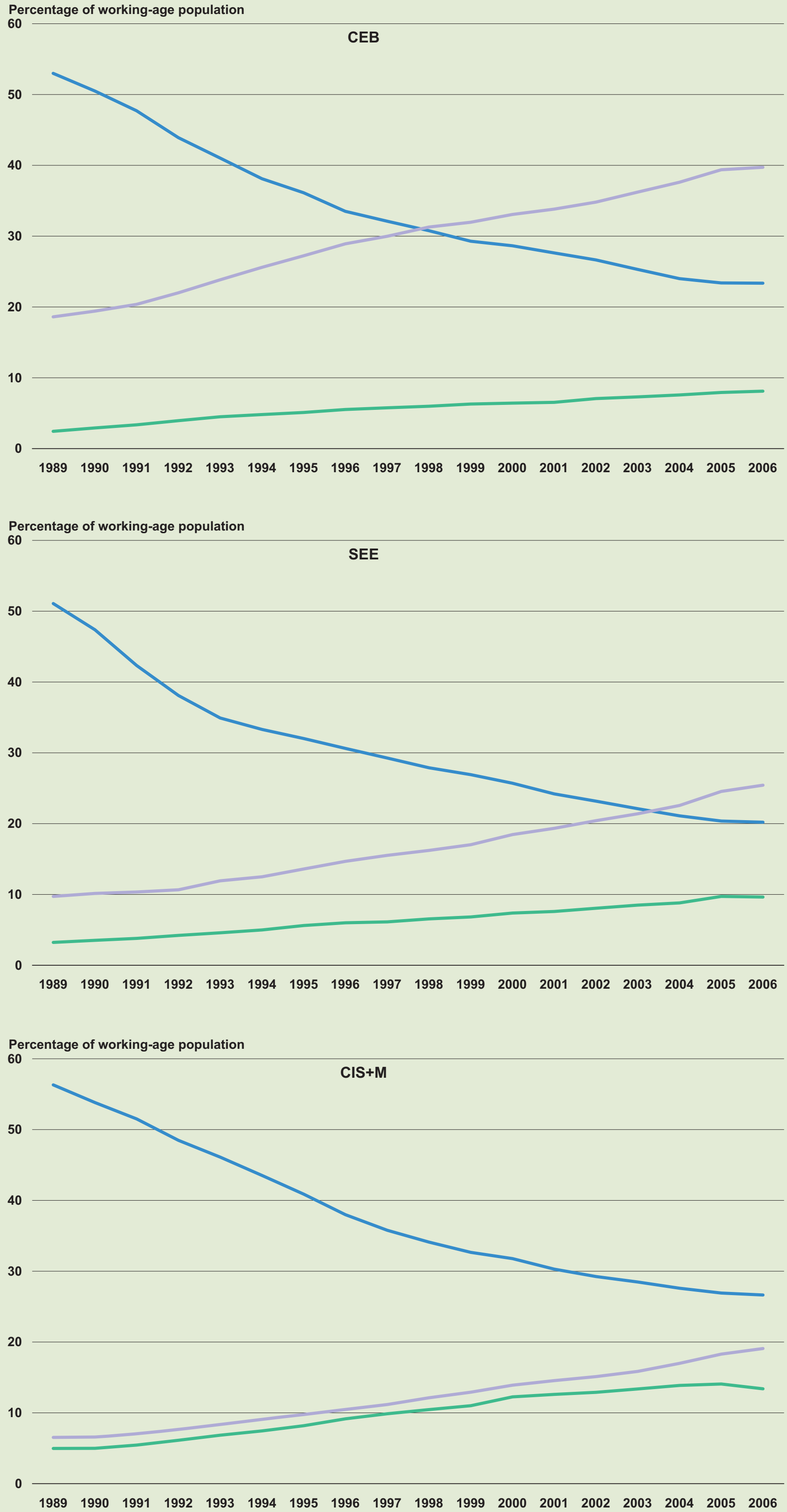
Table 4.3 illustrates how individuals making a change in employment – either to another job (in state or privately owned companies) or to/from self-employment – between 1990 and 2006 have viewed that experience. Those indicating that they had to accept a job below their qualifications are grouped as having had a negative experience (move to a "bad" job) while those reporting a move to a better ("good") job are classed as positive.[10] What emerges is that between 1995 and 2006 the share of individuals experiencing a negative move rose compared with the previous five years, particularly in CEB. However, this was also the case for those experiencing a positive move where the increase was noticeably larger.

The pattern is slightly different for moves to jobs in state-owned companies, where the share of individuals experiencing a negative move decreased over time. Between 26 and 28 per cent of individuals who changed employment between 2000 and 2006 viewed this change as positive, with about 80 per cent (64 per cent in the CIS+M) of them making a move to a job in a privately owned company or to self-employment. This suggests that matching workers to jobs has improved.

In terms of the characteristics of those jobs that were deemed either "good" or "bad", the LiTS draws no simple picture. Indeed, the majority of both "good" and "bad" jobs were found in the services sector, with the shares of both "good" and "bad" jobs at around the same level.

Chart 4.2

Evolution of employment by type of firm



State employment / Private employment / Self-employed

Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Working-age population is defined as those aged between 18 and 60. The share of working-age population in non-employment is not included in this chart. Self-employed encompasses entrepreneurs and people working in the informal economy.

The exception is SEE, where the share of "good" jobs in the services sector was higher than the share of "bad" jobs. "Good" as well as "bad" jobs were more often found in privately owned companies, with the exception of more "good" jobs being in state-owned companies in the CIS+M until 1999, when factors such as the size of non-monetary benefits were a relevant consideration.[11]

Over time, "good" jobs have been increasingly likely to be in privately owned companies, with the largest increase in the CIS+M. Less skilled individuals were more likely to have a negative view of their job changes than highly skilled individuals. In particular, individuals with vocational education had a relatively negative view of their job changes.[12]

Individuals' experiences and attitudes

Labour market experiences might be expected to have an impact not only on happiness and/or satisfaction (people experiencing unemployment might be expected to be less satisfied than those without that experience) but also on trust (in other people and in institutions) as well as on individuals' views about key policies, such as privatisation and the extent of desired state involvement in the economy. While there has been a growing interest in exploring these topics, the absence of data has been a major constraining factor, particularly in the transition countries.

There is, however, some evidence that a recent adverse experience in the labour market can decrease the level of trust. For example, East Germans who experienced unemployment in the post-reunification period have been found to have lower levels of trust in people (social trust) than at the time of the reunification, although the same effect was not found for the level of trust in institutions (institutional trust).[13]

The conjecture being tested here is that those individuals with more fraught work histories and experiences will tend to have a more pessimistic view of their own status, a more negative view of the situation in their country and, possibly, a more negative view of the market economy than others. As such, the analysis looks at the relationship between a person's current labour market status – whether they are, for example, unemployed – and their perceptions. In addition, employment histories are taken into account. In particular, information on the number of times an individual has changed jobs and labour market status over the course of transition is analysed. Further emphasis is also placed on looking at whether moving

Table 4.2
Selected flows between state/private employment, self-employment and non-employment

(as a percentage of working-age population)

	1990-94	1995-99	2000-06
From state employment to non-employment			
CEB	6.6	5.8	5.4
SEE	9.5	4.9	5.4
CIS+M	6.7	6.2	4.9
From private employment to non-employment			
CEB	3.0	3.6	4.3
SEE	5.1	3.7	5.0
CIS+M	4.5	3.3	4.3
From self-employment to private employment			
CEB	0.2	0.2	1.2
SEE	0.2	0.4	0.7
CIS+M	0.3	0.4	1.2
From non-employment to state employment			
CEB	4.7	3.1	3.2
SEE	2.1	1.8	1.9
CIS+M	6.0	3.7	3.9
From non-employment to private employment			
CEB	4.0	5.5	7.5
SEE	1.6	2.7	4.7
CIS+M	1.6	1.8	3.7
From non-employment to self-employment			
CEB	0.5	0.5	0.9
SEE	0.5	0.7	1.2
CIS+M	0.9	1.3	2.2

Source: Life in Transition Survey, EBRD and World Bank, 2006.
Note: Working-age population is defined as those aged between 18 and 60.

Table 4.3
Negative and positive perceptions of changes in employment

(as a percentage of people who have changed employment)

	Negative view			Positive view		
All moves	1990-94	1995-99	2000-06	1990-94	1995-99	2000-06
CEB	9.0	15.7	15.8	10.5	16.4	27.3
SEE	16.1	15.5	20.2	12.2	16.8	26.2
CIS+M	10.7	16.2	16.9	11.0	15.4	26.1
Move to a job in a state-owned company	1990-94	1995-99	2000-06	1990-94	1995-99	2000-06
CEB	4.1	3.9	2.0	4.6	3.4	5.3
SEE	6.0	4.3	2.6	3.5	4.0	5.5
CIS+M	3.6	5.8	5.3	7.2	7.9	9.4
Move to a job in a privately owned company or self-employment	1990-94	1995-99	2000-06	1990-94	1995-99	2000-06
CEB	5.2	11.7	13.2	5.8	13.4	22.7
SEE	10.9	11.9	17.1	8.8	12.8	21.5
CIS+M	7.0	10.4	11.4	3.8	7.9	16.8

Source: Life in Transition Survey, EBRD and World Bank, 2006.
Note: A job move is characterised as negative if the individuals report that they had to accept a job below their qualifications. Similarly, a job move is characterised as positive if the individuals report that they found a better job. A job move is characterised as neutral if the respondents said that they did not have to accept a job below their qualifications and that they did not find a better job. The percentages of moves to a job in a state-owned company and moves to a job in a privately owned company do not add up to percentages of all moves as ownership information is not available for all moves.

Table 4.4
Effect of job status and work experience on individuals' attitudes

	Economic self-ranking		Life satisfaction		In favour of renationalisation		Less trust in 2006 than in 1989		Poverty is due to laziness		Poverty is due to injustice in society		State involvement	
	Employed	All	Employed	All	Employed	All	Employed	All	Employed	All	Employed	All	Employed	All
Self-employed	+**	+*	+***	+***	–	–	–	–	+	+*	–**	–***	–**	–**
Unemployed		–***		–***		+		+		–***		+**		–
Not working		–***		–		+		–		–		–		–
Skilled	+		+**		–***		+		+***				–***	
Number of switches from employment to employment	+	–	+	–	+	+	–	+	–	–	+	+	+	+
Number of switches from employment to self-employment	+	+	–	–	–*	–*	–	+	–	+	–	–	+	+
Number of switches from employment to non-employment	–***	–**	–	–	–	+	+	+*	–	+	+	–	+**	+*
Number of moves to a better job	+*	+*	+	+	–***	–***	–*	–*	–	+	+	+	+	–
Number of moves to a worse job	–*	–	–***	+***	+	+**	+	+	–	–	+	+	+	+***
Number of voluntary job switches	–	–	–	+	–	–	+	+	+	–	–	+	–	–
Number of involuntary job switches	–***	–**	–***	–	+	+	+	+	–	–	+	+	–	+
Number of years in state-sector employment	–**	–	–	+	+*	+	+	+	–***	–	–	–	+***	+***
Number of years receiving unemployment benefits	–***	–***	–	–***	+	–	+**	+*	+*	+	–*	+	+	–

Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: The table details the final results of econometric estimates that have been run for the whole sample as well as for the employed only, using weights. Ordered probit was used in the estimations with economic self-ranking and life satisfaction as dependent variables. Ordinary probit was used in the estimations regarding renationalisation. Probit was used in the estimations regarding trust and reasons for poverty as dependent variables. State involvement is measured as the first component of the principal component analysis on five measures of the degree of state involvement, namely guaranteeing employment, guaranteeing low prices for food and basic goods, guaranteeing low prices for gas and electricity, ownership of gas and electricity companies and ownership of large companies. Ordinary least squares (OLS) is used in the estimation with state involvement as a dependent variable. All estimations include individual attributes and country-fixed effects. Standard errors are clustered by country. + or – indicates whether this job status was positively or negatively associated with the attitudes listed in the columns. * indicates significance at the 10 per cent level; ** 5 per cent level; and *** 1 per cent level.

to a "good" or "bad" job affects perceptions as well as whether leaving a job voluntarily or involuntarily has had any significant impact.

The analysis examines seven perceptions or attitudes, ranging from satisfaction with life and views about the role of government to the factors explaining poverty and – of importance in policy terms – views about renationalisation. The analysis has been undertaken for the whole sample as well as only for the employed. Individuals' views about whether social trust has declined since 1989 were also examined. The analysis takes into account individuals' characteristics, notably their age, highest level of education attained, gender, household size, income and other specific features. It then concentrates on the particular impact of labour market experiences once these individual attributes are accounted for. To simplify presentation of the results, only those for current labour market status and labour market experiences are contained in Table 4.4.[14]

An individual's labour market status clearly has an impact on his/her attitudes; not surprisingly, the unemployed are less likely to be satisfied with their lives than the employed.[15] They also rank themselves low in terms of where they stand on a ten-step ladder, with the poorest people on the first step and the richest people on the tenth step, and tend to believe that poverty is the result of injustice in society. Being unemployed has no significant impact on views about the extent of state involvement in the economy or the need for renationalisation.

The self-employed, on the other hand, tend to rank themselves highly on the poor/rich ladder and were more likely to be satisfied with their lives than the employed.[16] In addition, they were less likely to believe that poverty is caused by injustice in society. Self-employed people were also not generally in favour of greater state involvement or renationalisation. Skilled workers also tended to be more satisfied with their life than the unskilled, more likely to prefer less state intervention in the economy and less likely to attribute poverty to injustice or to favour renationalisation.

Given that skilled workers have generally been the winners from transition – at least in terms of employment – this obviously reinforces the impression that dissatisfaction has tended to be greater among those types of workers whose prospects have deteriorated through the transition. They include the unskilled, those employed in state firms and workers in manufacturing. Indeed, individuals with longer work experience in the state sector since 1990 have ranked themselves lower in terms of wealth and were less satisfied while also showing a strong preference for more state intervention.

Individuals' labour market histories since 1990 are found to be related to their views or attitudes in a number of ways.[17] For example, moving to a "bad" job or leaving employment involuntarily – not surprisingly – has a negative impact on how people rank themselves and their level of satisfaction. The reverse holds for those making a move to a "good" job. They tend neither to favour renationalisation nor believe that trust has deteriorated. Going from employment to non-employment is linked to a lower self-ranking and satisfaction regardless of whether that move occurred relatively early in transition or at a later stage. These individuals, as well as those who have switched jobs more frequently, are more likely to believe that trust has deteriorated since 1989.[18]

Box 4.1 Women's labour market experiences and attitudes to transition

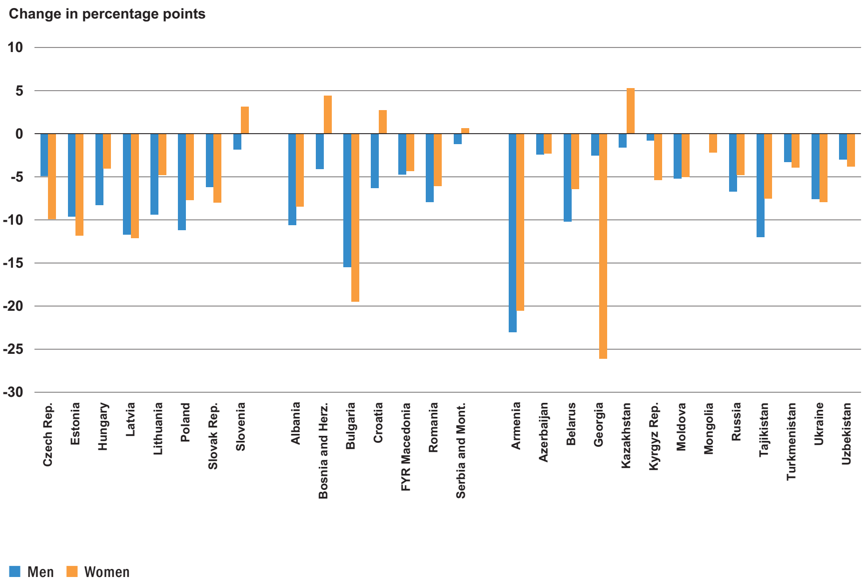
At the onset of transition, the participation of women in the labour force was higher in transition countries than in western Europe. It is therefore not surprising that participation rates decreased more significantly for women than men in most of the transition countries. For example, in the Czech Republic the labour-force participation rate for women decreased by 9.5 percentage points between 1989 and 1994, compared with a 1.8 percentage point decrease for men over the same period. In Georgia the participation rate for women decreased by 3.8 percentage points while it increased by 0.4 percentage points for men.

The trend of decreasing participation in the labour force for both men and women has continued in most countries, as Chart 4.1.1 illustrates. There are, however, some exceptions: by 2005 participation rates for women had exceeded 1989 levels in most of the former Yugoslav republics and in Kazakhstan. In short, while women dropped out of the labour force at a greater rate than men in most countries in the early years, they have since recovered and are re-joining the labour force at a faster pace than men.

Women who stayed in the labour force during these turbulent years did not experience significantly higher unemployment rates than men; indeed the gap between male and female unemployment in most of the transition regions was smaller than in the EU-15 between 1998 and 2005. Men tended to experience higher unemployment rates than women in Estonia, Hungary, Latvia, Lithuania and Romania in the same period. Once restructuring began, women tended to drop out of the labour force whereas men became unemployed.

The Life in Transition Survey (LiTS) shows that men who lost their jobs were more likely than women to start their own business.[1] There is some evidence that firms managed by women have a lower probability of obtaining bank loans than firms managed by men, and are charged higher interest rates when loan applications are approved. This could partly explain the finding.[2] Furthermore, the survey reveals that men began to take up private-sector employment earlier, and private-sector employment exceeded state-sector employment at a much earlier point for men than for women: the difference is about six years in CEB (1995 versus 2001) and three years in SEE (2002 versus 2005). In the CIS+M private-sector employment has not yet exceeded state-sector employment for women.

Chart 4.1.1
Change in labour force participation rates, 1989-2005



Source: World Development Indicators, 2007.
Note: The change in labour force participation rates is calculated as the participation rate in 2005 minus the participation rate in 1989.

The LiTS indicates significant differences in attitudes. Women have a stronger concern for social issues, such as poverty and inequality, and generally prefer more state involvement than men. Furthermore, women are more likely than men to agree that the gap between the rich and the poor today should be reduced and to think that the state should be strongly involved in reducing this gap. They are more likely than men to think that poverty is a result of injustice in society, as opposed to a lack of luck, laziness or it being an inevitable part of modern life. Women also prefer state involvement in guaranteeing low prices for electricity and gas as well as for basic goods and foods. Moreover, they are more likely than men to believe that privatised companies should be renationalised.

Women's preference for strong state involvement can partly be explained by a nostalgia for the generous childcare arrangements associated with most state-owned enterprises in the era of the planned economy. Since many private-sector employers were either unable or unwilling to provide adequate childcare facilities, particularly in the early stages of transition, women have tended to leave the labour force to care for their children.[3]

Women tend to have a more pessimistic view of themselves and the world around them. They are less likely to be satisfied with their life and less likely to believe that children born now will have a better life than their generation. They are also less likely to agree that the political situation is better today than around 1989 or be satisfied with the present state of the economy. Furthermore, they are less likely to think they have done better than most of the colleagues they had around 1989.

In conclusion, while women may have fared worse in the early years of transition and took longer to adjust to changes, they have been catching up with men. There is little evidence of greater discrimination against women in the labour market in recent years in CEB and in Bulgaria, Croatia and Romania compared with the EU-15. However, their experiences during the course of transition have had a significant impact on their attitudes and views of themselves. Their views in a number of key areas differ significantly from those of men.

Endnotes

1 This finding is consistent with the analysis of UNICEF (1999).

2 See Muravyev, Schaefer and Talavera (2007).

3 See UNICEF (1999).

Sources

A. Muravyev, D. Schaefer and O. Talavera (2007), "Entrepreneurs' gender and financial constraints: evidence from international data", mimeo, June.

UNICEF (1999), *Women in Transition*, MONEE Project CEE/CIS/Baltics, Regional Monitoring Report No. 6, UNICEF International Child Development Centre, Florence, Italy.

In addition, those with more frequent shifts from employment to non-employment were more likely to prefer stronger government involvement.

While it is clear that labour market status and experience affect how individuals feel about themselves and the wider framework of transition, there also appears to be some consistent association with views on policy. With respect to a key aspect of transition – privatisation – it is clear that a significant share of people favoured revision of privatisation and, in many cases, outright renationalisation. It is striking that individuals with "bad" labour-market experiences and/or skills inappropriate for a market economy were more likely to favour revisions.[19] "Bad" labour market experiences have influenced people's views of the fairness of transition while inappropriate skills have similarly affected individuals' prospects.

The LiTS findings are echoed by the Russia Longitudinal Monitoring Survey (RLMS),[20] which shows strong links between yearly changes in income, assets, employment status, job security and life satisfaction among Russians.[21]

Policy options for the labour market

A significant number of people who feel that they have not done well in transition tend to mirror that sentiment in their views of the world around them, particularly regarding issues such as the role of government. This sentiment has tended to run in one direction. People who feel that they have fared poorly and/or experienced bad labour market conditions generally consider that this can be attributed to combinations of injustice and ill-fortune. The correctives to this, they tend to hold, lie with government actions, mostly of a more interventionist nature. This ranges from guarantees of employment – a favourite among those who have experienced unemployment – to preferences for the renationalisation of privatised firms.

The main challenge that emerges from this chapter is the need to improve the employment and income-earning chances of individuals in most transition countries. One component of this is the need to reduce the high unemployment rates that continue to plague the region. High unemployment – it should be emphasised – has been a feature of many countries, irrespective of the pace and degree of reform. While there are welcome signs that unemployment rates are falling (see Chapter 2), the fact remains that the share of the long-term unemployed continues to be substantial and has often been growing. Significant numbers of workers have, as yet, little chance of re-entering the labour market.

Explanations for why unemployment has remained persistently high in transition countries have focused on a number of factors. Differences in labour market institutions – such as the generosity of unemployment benefits or rules regarding hiring and firing of workers – do not appear to fully explain differences in either unemployment rates or labour flows, as they do in western Europe.[22] Indeed, the generosity of benefits and the eligibility for these benefits have tended to decline at the same time that unemployment rates have tended to rise. Part of this may be attributable to the role of macroeconomic policy, as with the severe tightening in monetary policy in Poland after 1996. It seems likely that there are other more structural factors at work. The large gap between the demand and supply of available skills is one such factor.

As already mentioned, unskilled and low-skilled workers have been the main losers from transition and they account for the majority of the unemployed throughout the region.[23] Recent evidence from Poland, where unemployment has begun to decline sharply, shows that employers are reporting significant skill shortages at a time when unemployment remains above 11 per cent.

The large number of unskilled or inappropriately trained people in unemployment not only reflects the changing structure of labour demand but also the quality of educational systems in many countries and their failure to adapt to current needs (see Chapter 5). Clearly, serious rethinking of educational and training programmes remains a priority if unemployment is to be addressed.

The limited mobility of the workforce continues to be a problem. Many of the unemployed in transition countries have been unable or unwilling to find work outside their immediate region.[24] Worker mobility within countries remains low, especially when compared with much of western Europe.[25] This naturally limits the options for individuals who, for one reason or another, may have poor job prospects in their immediate neighbourhood. Policies to address this – whether in terms of providing better information, mobility grants or changes to the rental-housing market – are clearly needed. Strikingly, these generally low levels of mobility within countries have been accompanied by large increases in the volume of international migration.

Both the United Kingdom and the Republic of Ireland have experienced very large inflows of workers from the new EU member states since 2004 and there is also increasing evidence of large movements of workers from the CIS+M, such as Ukraine, in a westerly direction. While it is too early to identify the full consequences of these external migrations, there are many reasons for supposing that they will benefit not only individual workers and recipient countries but also, ultimately, many home countries. In any event, evidence of international mobility contrasts sharply with the limited mobility in domestic labour markets. It shows that people are prepared to move if the incentives are large enough.

The other major characteristic of the labour market has been the large and sustained rise in non-employment (the share of the labour force that is, for one reason or another, not choosing to work). As already mentioned, this share has on average grown rapidly and now exceeds by a significant margin the ratios in either western Europe or North America, especially in CEB and SEE.[26] Although this can partly be attributed to a predictable decline following very high employment rates in the previous planned economies, this is by no means the whole story.

Workers cast into unemployment have often become discouraged and have stopped looking for work. In some cases, the rise in non-employment has been compounded by institutions being slow to adapt to changing circumstances. For example, in Hungary the very low activity rate for those over 50 years of age can be attributed to the design and implementation of the old-age and disability pension schemes provided by the government. For many reaching the minimum retirement age, such benefits are relatively attractive compared with continuing in employment.[27] This is particularly true for people with low skills or skills no longer in demand, whose earning capacity has consequently declined or been limited. In Poland, take-up of disability benefits was widespread in the early years of transition, although it was subsequently restricted after 1997.

In the case of Hungary, the initial attraction of providing relatively generous retirement benefits as a way of dealing with excess labour in the earlier years of transition now seems to have passed. Yet – as is so often the case with institutions – arrangements have not adapted with the times, contributing not only to low employment rates but also to a growing fiscal pressure.

Although the Hungarian experience is particular, it is clear that throughout the region, governments need to re-examine not only the design of their benefits systems but also to look more seriously at a range of positive incentives – from training, wage subsidies and tax breaks to benefits for working beyond the mandatory retirement age – to encourage individuals back into work. There is also scope for using negative incentives, such as penalties for early retirement, to reduce the flow of workers into non-employment.

If the situation is not addressed, the very low employment rates seen in the transition countries will have an adverse impact on the longer-term capacity of these economies to grow. It will also have a material impact on the choice of technology by firms and, in particular, the mix between capital and labour used in production.

Conclusions

Transition has brought sweeping changes to the region's labour market, initially bringing job losses as inefficient state-owned enterprises were restructured or closed down. Although unemployment rates are now declining in many countries, the fact remains that significant shares of the labour force in all regions are without work and, in many instances, without the serious prospect of employment. As such, the share of long-term unemployed in total unemployment has risen. Unemployment has remained highest among the unskilled and low-skilled.

Rates of non-participation in the workforce have risen sharply and remain high across the region. Indeed, the share of the labour force in employment is now significantly lower in most transition countries than in western Europe or the United States. Part of this can be traced to voluntary withdrawal from the labour force but it is partly due to people giving up on searching for jobs when faced with bleak prospects. In the longer term, there is an urgent need to raise employment rates throughout the region.

Individuals' experiences in the labour market over the course of transition have been found to have a powerful impact on the way they see themselves and the world. Unsurprisingly, moving to a job perceived as "bad" or losing employment involuntarily have a negative impact on individuals' sense of satisfaction and where they rank themselves on a ten-step ladder, with the poorest people on the first step and the richest people on the tenth step. Similarly going from employment to non-employment is associated with lower levels of satisfaction and self-ranking. Individuals making more job changes also tend to have a relatively bleak view of their circumstances and the world.

There is a clear pattern with respect to skills. Those with less education and lower skills have tended to face relatively poor prospects and to have a more negative view of themselves and their environment. People who have fared poorly under transition tend to favour greater government involvement.

The evidence presented in this chapter shows that there has been growth in the number of self-employed people. They tend to be relatively satisfied with their lives, and they are less likely than the unemployed or other employees to be in favour of government involvement.

In policy terms, while there are considerable differences across countries, the main challenges are the reduction of unemployment and increased participation in the labour market. To achieve these objectives, a mix of policies is required, not least regarding reform of the educational system. Mobility of individuals across regions and countries has improved but it remains more limited than it should be. Greater mobility would help to match workers with jobs more efficiently.

Endnotes

1 Manufacturing accounted for over 30 per cent and services for around 35 per cent of value added in GDP in 1990.

2 See Faggio (2007).

3 The population-weighted unemployment rate for the EU-15 is, of course, heavily influenced by France and Germany where unemployment has remained relatively high.

4 Based on the countries within each region for which such data are available.

5 State employment encompasses both employment in state-owned companies and employment in the rest of the state sector, as the LiTS does not allow us to distinguish between the two types.

6 Skill levels are based on the reported occupations, which follow the 1-digit International Standard Classification of Occupations, ISCO-88. Individuals with occupations in the first three categories (legislator, senior official and manager; professionals; technicians and associated professionals) are considered to be skilled, and the rest are considered to be unskilled.

7 This finding is consistent with Kollo (2007).

8 More detailed information is available in Commander, Hitaj and Schweiger (2007).

9 It should also be noted that the level of flows in the LiTS has been lower than that normally found using administrative data. See Boeri and Terrell (2002) and Duryea et al (2007).

10 Individuals who reported neither a move to a better job nor having to accept a job below their qualifications are grouped as having a neutral experience.

11 See Rein et al (1997).

12 Throughout the chapter, education always refers to the highest level of education attained.

13 See Alesina and La Ferrara (2002) and Rainer and Siedler (2006).

14 More detailed results are available in Commander, Hitaj and Schweiger (2007).

15 This confirms the result of a number of existing studies. See Frey and Stutzer (2002) for an overview.

16 See also Blanchflower, Oswald and Stutzer (2001) and Benz and Frey (2003).

17 Changes in labour market status were looked at over the full period from 1990 to 2006 but also for sub-periods, including in the recent past. In general, there were no significant differences in results when using different time periods.

18 This is in line with findings by Rainer and Siedler (2006).

19 See Commander, Hitaj and Schweiger (2007) and Denisova et al (2007) who use the LiTS to analyse who wants to revise privatisation and why.

20 The RLMS is a series of nationally representative surveys that have been administered 13 times between 1992 and 2006. For this analysis, a panel of around 2,500 individuals that has been present in every round since 1995 has been put together.

21 In particular, a test was undertaken for first-period differences in satisfaction levels between individuals that remained employed in consecutive periods and individuals that became unemployed in the second of two consecutive periods. The difference in the decrease in satisfaction between individuals that become unemployed and those that remain in employment was positive for all nine consecutive year pairs and significant for six of them. The hypothesis that to-be-unemployed individuals were inherently dissatisfied, hence more prone to becoming unemployed, was also tested and discounted. See Commander, Hitaj and Schweiger (2007).

22 See Commander and Heitmueller (2007).

23 See Kollo (2007).

24 See Munich and Svejnar (2007) and Jurajda and Terrell (2007).

25 See Bornhorst and Commander (2006).

26 There is considerable variation across countries. In the CIS+M, the non-participation rates in 2005 ranged from 23.3 per cent in Kazakhstan to 42.5 per cent in Tajikistan. In the less advanced countries of SEE, the range was from 25.6 per cent in Bosnia and Herzegovina to 39.4 per cent in FYR Macedonia and in CEB, the range was from 29.3 per cent in Slovenia to 38.7 per cent in Hungary.

27 See Cseres-Gergely (2007).

References

A. Alesina and E. La Ferrara (2002), "The determinants of trust", *Journal of Public Economics*, Vol. 85, pp. 207–34.

M. Benz and B. S. Frey (2003), "The value of autonomy: evidence from the self-employed in 23 countries", Institute for Empirical Research in Economics, University of Zurich, Working Paper No. 173 (Nov).

D. Blanchflower, A. Oswald and A. Stutzer (2001), "Latent entrepreneurship across nations", *European Economic Review*, Vol. 45, No. 4–6, (May), pp. 680–91.

T. Boeri and K. Terrell (2002), "Institutional determinants of labor reallocation in transition", *Journal of Economic Perspectives*, Vol. 16, No. 1, (Winter), pp. 51–76.

F. Bornhorst and S. Commander (2006), "Regional unemployment and its persistence in transition countries", *Economics of Transition*, Vol. 14, No. 2, (Apr), pp. 269–88.

S. Commander and A. Heitmueller (2007), "Does unemployment insurance help explain unemployment in transition countries?", EBRD and London Business School, mimeo (June).

S. Commander and J. Kollo (2007), "The changing demand for skills: evidence from the transition", *Economics of Transition*, forthcoming.

S. Commander, E. Hitaj and H. Schweiger (2007), "Experiences in the labour market and their impact on attitudes", mimeo.

Z. Cseres-Gergely (2007), "Inactivity in Hungary – the persistent effect of the pension system", Budapest Working Papers on the Labour Market, Vol. 1 (Mar).

I. Denisova, M. Eller, T. Frye and E. Zhuravskaya (2007), "Who wants to revise privatisation and why?", mimeo (Aug).

S. Duryea, G. Marquez, C. Pages and S. Scarpetta (2007), "Jobs and earnings mobility in a sample of developing and emerging economies", mimeo (Mar).

G. Faggio (2007), "Job destruction, job creation and unemployment in transition countries: what can we learn?", London School of Economics, mimeo (June).

B. S. Frey and A. Stutzer (2002), "What can economists learn from happiness research?" *Journal of Economic Literature*, Vol. 40, No. 2, (June), pp. 402–35.

S. Jurajda and K. Terrell (2007), "Regional labour markets and human capital in transition economies", mimeo.

J. Kollo (2007), "Workplace literacy requirements and unskilled employment in east-central and western Europe", Evidence from the International Adult Literacy Survey (IALS), Institute of Economics.

D. Munich and J. Svejnar (2007), "Unemployment and worker-firm matching: theory and evidence from east and west Europe", mimeo (June).

H. Rainer and T. Siedler (2006), "Does democracy foster trust?", ISER Working Paper No. 2006–31 (June), University of Essex, Colchester.

M. Rein, B. Friedman and A. Worgotter (1997), *Enterprise and Social Benefits after Communism*, Cambridge University Press.

World Bank (2007), *World Development Indicators 2007.*

05
Delivering public services

Traditionally, the delivery of public services has been the responsibility of the government. However, the pressing need to upgrade infrastructure and to improve the quality and efficiency of public services has led to a global wave of restructuring, privatisation and use of complex public-private partnerships alongside the traditional government-funded approach. Involving the private sector helps governments to control costs and to provide the level of consumer service that responds to people's needs. The challenge is to build structures that introduce efficiency gains while continuing to meet the twin objectives of access for all and affordability.

In some transition countries, particularly those benefiting from high oil and gas revenue, investment programmes are under way to improve public services, such as health care, education, energy, transport, water and telecoms. The scale of the programmes will put a strain not only on government resources but also on the capacity of the relevant organisations to manage this process. Private capital is often seen as a way to relieve some of this pressure. As well as bringing financial resources, private investors are able to introduce more efficient practices. The downside for the consumer is that private investment is driven by profit motives rather than the social objectives of broad access and affordability. Finding the appropriate role for private capital is a key challenge in deciding how public services should be delivered.

This chapter discusses the difficult choices facing policy-makers as they respond to the pressure of delivering better public services. Many aspects of public services are discussed but the main focus is on health care. The 2006 EBRD/World Bank Life in Transition Survey (LiTS) reveals that people in transition countries care deeply about the successes and failures of the health sector. In view of the high level of regulation and the institutional pressures for government in this sector, it provides ample illustration of the challenges facing all public services in introducing private capital.

The chapter starts by taking an in-depth look at people's views about public services. It identifies priority areas, examines how public views compare with the actual situation and discusses ways of addressing the main shortcomings. It highlights how partnerships between the public and private sectors have brought improvements to public services in many countries, particularly where there are institutional weaknesses. The chapter also identifies areas where the strengthening of public authorities is particularly needed.

Easy and affordable access

Before the start of transition, the aim was to provide easy and affordable access to basic public services, such as health care, primary and secondary education and water supply. However, the quality of public services was often poor, with widespread rationing and corruption, despite the large share of public expenditure devoted to these services.

The failure of central planning to deliver a wide range of high-quality public services contrasted sharply with the situation in western Europe. It also contributed to people's dissatisfaction with their living standards in the late 1980s, leading to increasing demands for democratic and market reforms at that time. Paradoxically, it is the failure of the state in a number of transition countries to preserve universal and affordable access to basic public services that now appears to be contributing to dissatisfaction with the economic and political situation (see Chapter 3).

Priorities, satisfaction and use of services

The LiTS asked people to give their views on the priorities for government investment (see Chart 5.1). Dominating the answers are education and health care, which were chosen as the first priority by around two-thirds of respondents. Housing and pensions jointly account for about one-third of responses while public infrastructure was chosen as a priority by less than 5 per cent of people.

Public infrastructure is more than three times as important for the self-employed and business entrepreneurs as it is for other respondents but the share of entrepreneurs who see it as the top priority is still only about 10 per cent.[1]

Entrepreneurs are almost 5 percentage points more likely than other people to identify education as the top priority for investment but most view health care as more of a priority.

There is almost no difference between men and women when selecting health, education or infrastructure as a first priority for extra investment. Health becomes a greater concern for both men and women as they get older while education becomes a lower priority with age. Those reporting health as their first priority are equally likely to be wealthy as poor.

Chart 5.2 shows levels of satisfaction with public services according to the LiTS. For education and health care there is more satisfaction than dissatisfaction, particularly in central eastern Europe and the Baltic states (CEB). However, people are generally more satisfied with education than with health. In CEB and the Commonwealth of Independent States and Mongolia (CIS+M) satisfaction levels for education are over twice as high as they are for health and the results are only slightly lower in south-eastern Europe (SEE).

This contrasts with findings for the EU-15, where people are generally more satisfied with health than with education, according to Eurobarometer data.[2] The level of satisfaction with education is very similar for both the EU-15 and CEB whereas satisfaction with health in CEB countries is only half as high as it is in the EU-15.

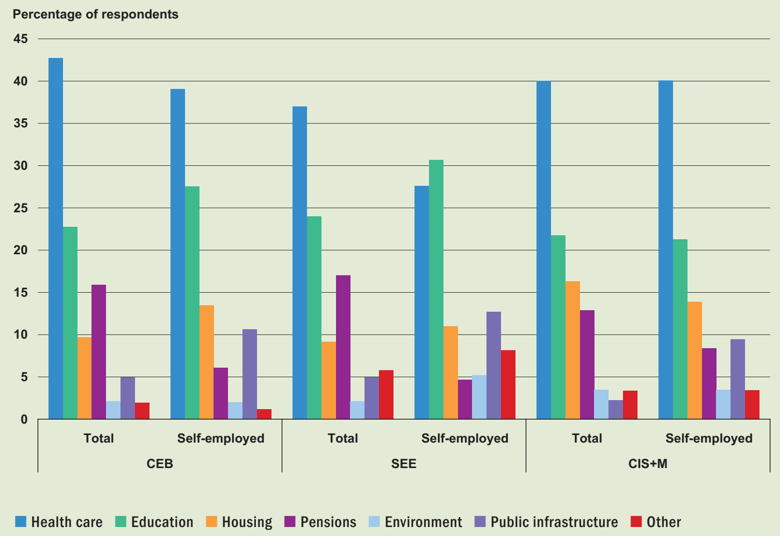
Those who are better educated are more likely to be satisfied with their country's health care and educational systems. Satisfaction with education also increases if a person is in the top third of wage earners. There are also close links between people's satisfaction with public services and their use of these services.

The estimated probability of using health care services is shown in Chart 5.3.[3] It is no surprise that usage is expected to increase with age. The chart shows how highly educated people (men in particular) are more likely to make use of health care services and that this disparity increases significantly with age.

Households with a higher level of education are more likely to make use of both health and education services. Similarly, people earning above-average income tend to make use of health and education facilities more than poorer people. Finally, women are more likely to use health services than men of a similar age even if the data are adjusted for the number and age of children in the family.

In many transition countries the use of health services is commonly associated with petty corruption and the need for people to make "unofficial" payments. Chart 5.4 shows that these payments are widespread; on average, around half of the survey respondents expect to pay unofficial payments for health care services. There are sharp differences between countries; for example, almost 75 per cent of those questioned in Estonia do not expect to make unofficial payments whereas over 60 per cent of Lithuanians do expect to make payments. Wealthier individuals are more likely to make unofficial payments for health services than poorer people.[4]

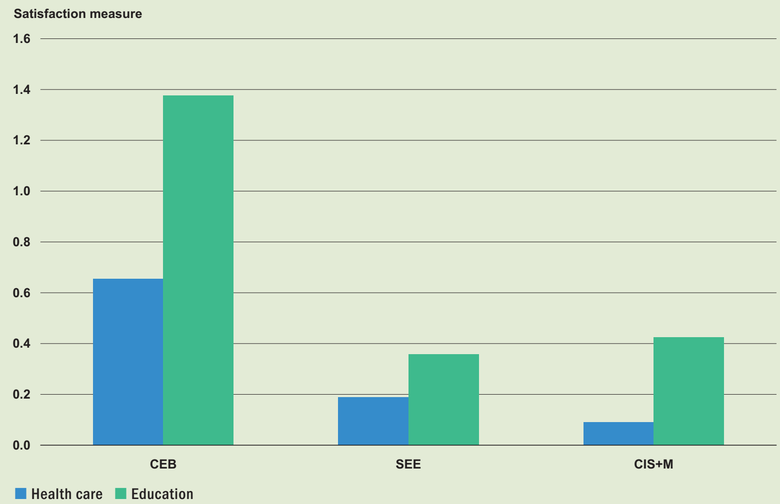
Chart 5.1
Views about priorities for government investment



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: Respondents were asked "In your opinion, which of these fields should be the first priority for (extra) government investment?"

Chart 5.2
Levels of satisfaction with health care and education



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: To rank their satisfaction with health care and education, people were asked to choose from the following: very unsatisfied, unsatisfied, indifferent, satisfied, very satisfied. A satisfaction measure has been generated by attaching a value ranging from -2 (for very unsatisfied) to +2 (for very satisfied). The chart shows the average value for each sub-region.

Trends in public services

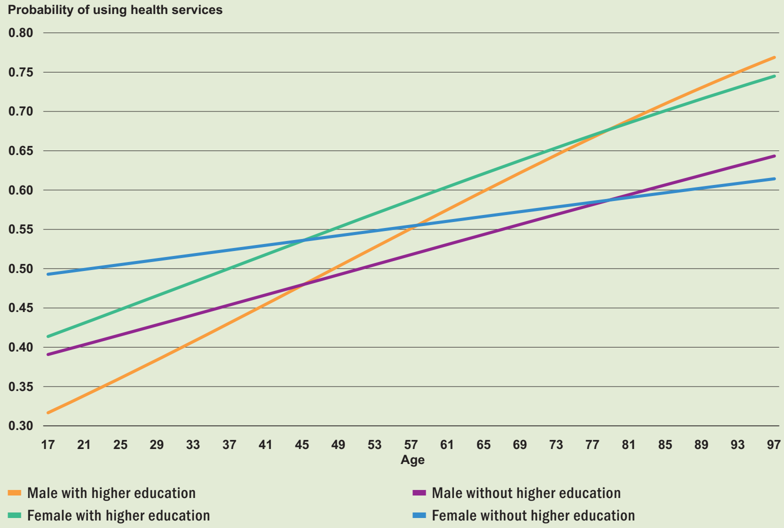
Despite the relatively low levels of satisfaction with health care and other public services, delivery of these services has been comparatively good in the transition countries and in many cases has improved during the transition process. In general, most public services were well-developed at the start of transition compared with countries at similar levels of gross domestic product per head.[5] For example, the share of the population with access to good sanitation facilities was reported to be above 95 per cent in the transition region as a whole in 1990 compared with less than 50 per cent in middle-income countries.[6]

Enrolment rates for secondary education at the start of transition were, on average, around 90 per cent, which compares favourably with less than 70 per cent in upper-middle income countries and about 50 per cent in lower-middle income countries. Literacy rates were above 90 per cent, which again compares favourably with middle-income countries, where literacy rates were less than 80 per cent. Immunisation rates against measles and other diseases were also reported to be comparatively high compared with middle-income countries.[7]

In the 1990s, however, changes in fiscal discipline and in spending priorities tended to limit the resources available for providing public services in the transition countries. By liberalising utility prices far more slowly than the prices of consumer goods, governments limited the financial resources available to public utilities, restricting investment in new facilities and spending on regular maintenance. To avoid taking responsibility for the deteriorating services, governments frequently decentralised the delivery of public services to local authorities but failed to provide them with adequate financial resources.

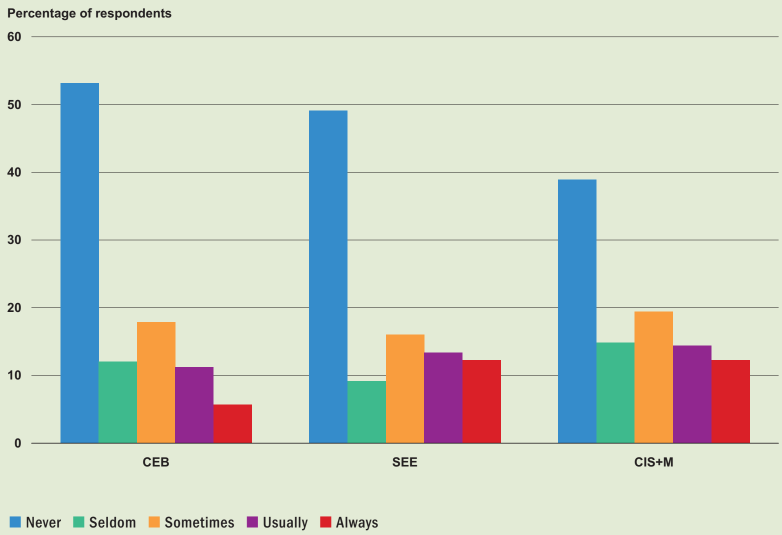
To increase the financing available for health and education services, local authorities began to introduce official charges or to accept an increase in the scope and size of unofficial payments. As a result, the poorest households ended up spending a significant part of their income on health care and education. At the same time, many education services in poorer countries, notably in Central Asia, suffered acute staff shortages as skilled professionals left for wealthier countries, such as Russia, to take advantage of better pay and career opportunities in the expanding private sector.

Chart 5.3
Use of health care services



Source: Life in Transition Survey, EBRD and World Bank, 2006.
Note: The lines on the chart show the probable use of health services by a hypothetical person of a given gender and level of education, whose other characteristics, such as income level and family characteristics, are those of an average respondent with increasing age.

Chart 5.4
Views about the need for unofficial payments in health care



Source: Life in Transition Survey, EBRD and World Bank, 2006.
Note: The survey asked people how often they were expected to make unofficial payments for health care services.

Currently, health care and education remain predominately state-funded across the transition region and formally free at the point of delivery. The largest changes in ownership have been in public utilities, particularly in telecoms and electricity. The dominant telecoms operators and power-sector companies have been privatised, especially in the more advanced transition countries. However, these sectors are only slowly opening to competition and there is a varying degree of access to independent service providers. Independent and effective regulation needs to be established in the less advanced transition countries and strengthened in the new EU member states.

Chart 5.5 shows household access to public utilities in the transition countries. It shows almost universal access to electricity, with slightly lower access to mains water and waste-water services.[8] However, there are significant regional differences, with households in the poorer countries of the CIS+M having significantly less access to public utilities than households in CEB.

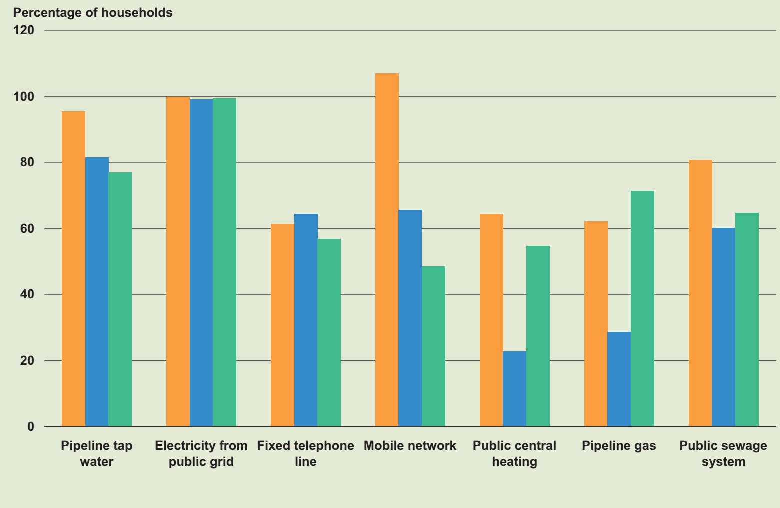
Table 5.1 shows the share of household expenditure (including unofficial payments) devoted to health services, education, telecoms and transport, electricity and water. Despite tariff increases during the transition period, the share of average household expenditure for telecoms, transport and water has remained small, at less than 5 per cent of total household expenditure for the three services. Electricity, by contrast, accounts for up to 8.5 per cent (FYR Macedonia) of average household expenditure in the transition region. The share of expenditure on health and education is large compared with the amount devoted to telecoms and transport, electricity and water.

Life expectancy and infant mortality in transition countries provides an indication of how effective health care is. In some countries, life expectancy has experienced dramatic changes during transition, most notably in Russia, where it fell from 69.7 years in 1989 to 64 years in 1994. It has recovered only slightly since then, to 65.4 years in 2005.

Chart 5.6 shows changes in life expectancy in the transition region and the EU-15. Life expectancy has increased in CEB and SEE in line with the EU average, albeit remaining lower than the EU by about four years throughout the transition period. In the CIS+M, life expectancy declined sharply in the mid-1990s and the recovery has been slow. Average life expectancy for the transition region has risen to 71.8 years, compared with 70.0 in 1990.[9]

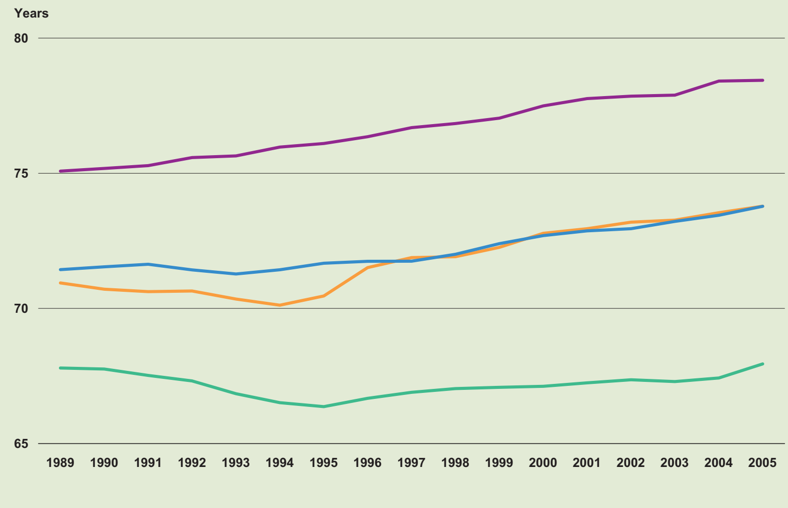
On another measure of the overall effectiveness of health services, infant mortality has declined enormously and is much closer to rates in the EU-15. Chart 5.7 shows that infant mortality in CEB fell from 13.2 to 7.2 per thousand live births between 1991 and 2001, compared with a decline of 7.7 to 4.6 for the EU-15 in the same period. Even in the CIS+M there has been a rapid decline since its peak in 1993.

Chart 5.5
Access to public utilities



Source: Life in Transition Survey, EBRD and World Bank, 2006.
Note: The percentage of households with a mobile network can be more than 100 per cent if households have more than one mobile phone.

Chart 5.6
Life expectancy, 1989-2005



Source: European health for all database (HFA-DB), World Health Organization, 2007.
Note: Data for Uzbekistan were not available.

Standards of health care

Compared with countries with equivalent levels of economic development, the level of health care provision in the transition region is high. Chart 5.8 shows the number of doctors per 1,000 people compared with GDP per head for a wide range of countries at various stages of development. The line in the chart represents the full sample of countries. Most transition countries (apart from Albania, Bosnia and Herzegovina and Slovenia) are above the line, indicating that they have more doctors per head than would be expected for a country with their level of GDP.

Among countries with an average GDP per head of around US$ 10,000 (at PPP) transition countries boast double the number of doctors per head.[10] Similarly the number of hospitals per 100,000 people and the number of hospital beds per 1,000 compare favourably with the EU-15; levels for CEB and the CIS+M are above the EU-15 and SEE countries are not far below.

Despite these positive points, much of the existing infrastructure in the health sector is neither in good condition nor well-managed.[11] A large number of hospital beds are empty while long-term in-patient care is inadequate. Many smaller hospitals aim to provide specialist care even though there is insufficient local demand while the cost of pharmaceuticals as a share of total spending on health care exceeds the levels in advanced market economies by a large margin.

There is no guarantee, therefore, that people are benefiting from the extensive nature of the transition region’s “health infrastructure”. Indeed, the large number of ageing hospitals may simply represent a drain on limited resources, given that hospital care has traditionally formed the largest part of health expenditure in transition countries. The LiTS suggests that

Table 5.1

Share of average household expenditure devoted to public services (in per cent)

	Water	Electricity	Telecoms and transportation	Health care	Education
Czech Republic	1.0	3.1	1.1	5.5	3.1
Estonia	1.2	3.2	1.5	5.3	4.1
Hungary	3.1	3.2	1.3	8.0	5.0
Latvia	2.0	5.8	1.2	5.4	5.8
Lithuania	1.1	2.8	1.1	6.5	3.8
Poland	2.1	3.6	1.0	6.9	6.6
Slovak Republic	1.0	6.2	1.2	5.9	4.4
Slovenia	1.0	2.6	1.5	6.9	6.6
CEB average	***1.6***	***3.8***	***1.2***	***6.3***	***4.9***
Albania	0.8	4.0	1.0	6.5	6.6
Bosnia and Herzegovina	0.6	3.2	0.9	8.5	9.0
Bulgaria	1.8	6.9	1.1	8.7	6.7
Croatia	1.2	3.9	1.2	3.9	5.7
FYR Macedonia	1.5	8.5	1.2	5.4	9.2
Montenegro	na	na	0.9	4.2	10.3
Romania	1.6	3.0	1.0	9.1	7.4
Serbia	na	na	0.8	8.3	9.6
SEE average	***1.2***	***5.3***	***1.1***	***6.6***	***7.8***
Armenia	0.4	4.1	1.0	5.7	6.0
Azerbaijan	2.3	6.7	0.8	11.6	4.6
Belarus	0.7	1.2	0.7	3.2	5.0
Georgia	0.2	2.8	1.0	8.7	6.5
Kazakhstan	1.7	1.4	0.8	5.0	7.9
Kyrgyz Republic	0.7	2.4	0.9	3.6	3.9
Moldova	0.4	3.5	0.9	8.5	7.1
Mongolia	na	na	1.0	4.2	9.3
Russia	3.5	1.0	0.8	4.6	6.5
Tajikistan	1.4	1.4	0.7	2.6	2.3
Turkmenistan	0.0	0.1	na	na	na
Ukraine	1.2	2.1	0.9	6.7	6.4
Uzbekistan	0.5	1.7	0.8	5.4	3.5
CIS+M average	***1.1***	***2.4***	***0.9***	***5.8***	***5.7***

Sources: Data for telecoms and transportation, health care and education come from the Life in Transition Survey, EBRD and World Bank, 2006. Data for water and electricity come from the countries' statistical offices; 2005 or the latest year available.

a large number of doctors per head is linked to greater levels of satisfaction with health care but a large number of hospital beds per head does not show the same link.

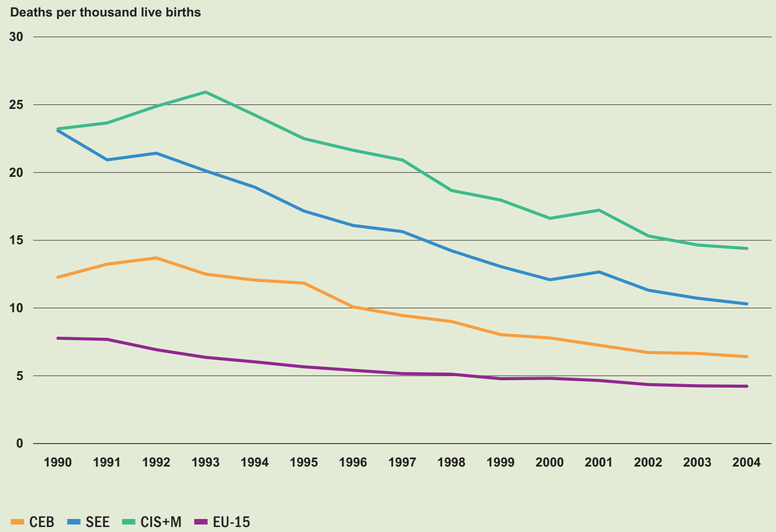
In view of the general improvements in life expectancy and infant mortality, the identification of health as a priority for extra government investment does not necessarily indicate a belief that the government is failing to deliver an adequate service. Instead, it may reflect an awareness that the introduction of expensive new treatments will require additional government spending. It may also reflect the fact that the population in the transition countries is ageing more rapidly than elsewhere, and consequently there is an increasing demand for age-related health expenditure.[12]

Birth rates in most transition countries are very low, well below the level needed to maintain current population levels, except for a few Central Asian countries, according to the most recent World Bank research. Unless current trends change, it is estimated that Russia's population will decline by 12 per cent between 2000 and 2025 while Ukraine's will fall by 24 per cent over the same period. Consequently, the share of the population aged over 65 will increase to 18 and 20 per cent respectively by 2025. Bosnia and Herzegovina, Croatia, the Czech Republic, Estonia, Latvia, Poland and Slovenia will experience the largest increase in those aged over 65 while the level is expected to either fall or moderately increase in the rest of the region.

There is a clear need to improve the efficiency of the health sector. This can partly be achieved through administrative measures. Indeed, government action has already led to a sharp decline in the over-supply of hospital beds, particularly in CEB and the CIS+M, where the number of beds per 100,000 people has declined more quickly than in the EU-15 (see Chart 5.9). In SEE the problem of too many hospital beds has been less acute and the numbers are declining in line with changes in developed countries.

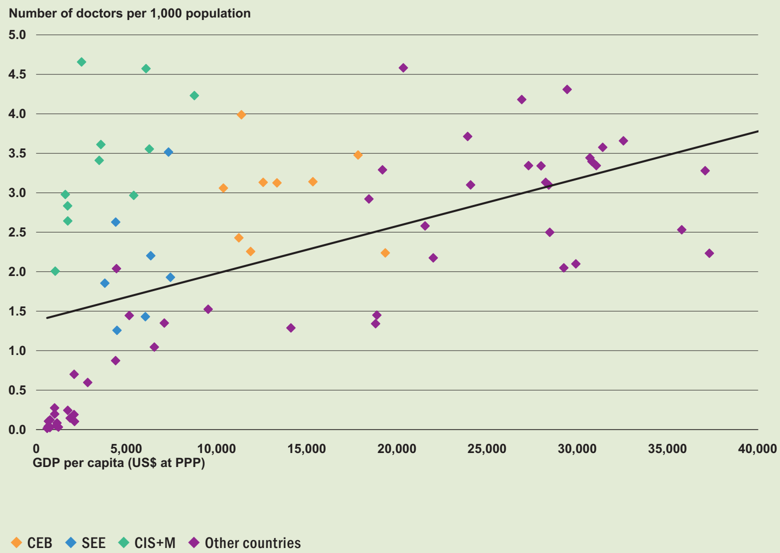
Changes in the distribution of health care spending, including a growing focus on performance-related expenditure, have also led to efficiency gains. Chart 5.10 shows a rapid decline in the average length of time spent in hospital in the transition region. CEB and SEE appear to have achieved efficiency gains in line with those in the EU-15 but the gap between the CIS+M and EU-15 has increased, suggesting that the reforms needed in this sub-region are far more substantial than those in other transition countries.

Chart 5.7
Infant mortality, 1990-2004



Source: European health for all database (HFA-DB), World Health Organization, 2007.
Note: Data for Bosnia and Herzegovina, Mongolia and Turkmenistan were not available.

Chart 5.8
Number of doctors compared with GDP



Source: World Development Indicators, 2007.

Table 5.2
Public expenditure on health care (as a percentage of GDP)

		2000	2001	2002	2003	2004	2005
Transition countries	CEB	4.8	4.9	5.1	5.2	5.0	5.0
	SEE	4.6	4.6	4.6	5.0	4.9	4.9
	CIS+M	2.6	2.6	2.6	2.6	2.6	2.8
Mature market economies	EU-15	6.0	6.2	6.4	6.7	6.7	6.8
	US	5.9	6.3	6.6	6.8	6.9	7.0
Emerging markets	China	1.8	1.6	1.7	1.7	1.8	1.8
	India	0.9	0.9	0.9	0.8	0.9	0.9

Source: World Development Indicators, 2007.

Despite these improvements, health systems in the transition countries continue to struggle to satisfy people's expectations. Although lower than average in mature market economies, in a number of countries, public expenditure on health remains high compared with GDP levels (see Table 5.2). In some countries, it may not be sustainable, as shown by the recent steps to reduce health expenditure in Hungary. As a result, ongoing reforms to health administration and funding may need to be supplemented by further action.

Role of the private sector

A key challenge for governments in the transition countries is to improve the delivery of public services and to provide the levels of investment expected by local people. There are three main options:

- additional government funding of public services to bring about improvements
- privatisation of some activities
- partnerships – marrying the private sector's access to funding and management skills with public funding and some degree of public regulation.

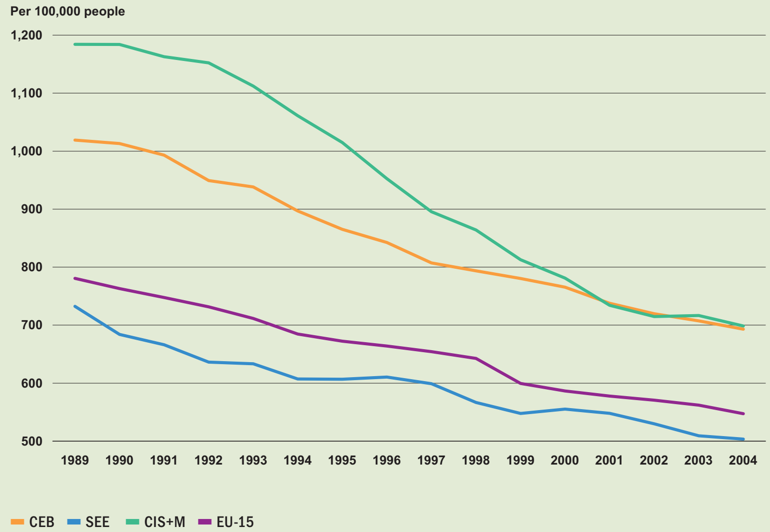
All three options are being pursued in the transition countries. However, finding additional government funding for public services will be difficult given the tight fiscal situation of most countries, even if public spending is diverted from elsewhere. Privatisation can be an effective solution if service fees are high enough to cover both operating costs and investments in new facilities, but the ability of households to pay higher charges imposes a limit on how far this can go. Indeed, privatisation of large health care facilities has not been undertaken in many advanced market economies, and it is an even less attractive option for many of the transition countries. However, if people wish to see rapid restructuring and modernisation, some form of private finance is likely to be needed.[13]

The utility sector has had by far the most experience with private sector involvement in the delivery of public services in the transition countries. This experience has ranged from the private sector providing services without state involvement or regulation to the establishment of tailor-made management contracts with well-defined responsibilities and rewards for the private partner. The first approach has occurred mostly in areas where public authorities were no longer able to provide reliable services and the private sector stepped in to fill the gap, as was the case with municipal transport in many CIS+M countries. Nevertheless, the lack of regulation and competition has often led to a poor service and its gradual replacement by a public-funded service once the country's budgetary situation improved.

The entry of private companies into the telecoms sector has generally been more successful. High entry costs and technological requirements helped to ensure that investors were mainly large, reputable companies. Despite some initial problems and occasional ongoing difficulties, government regulation has generally been sufficient to encourage competition.

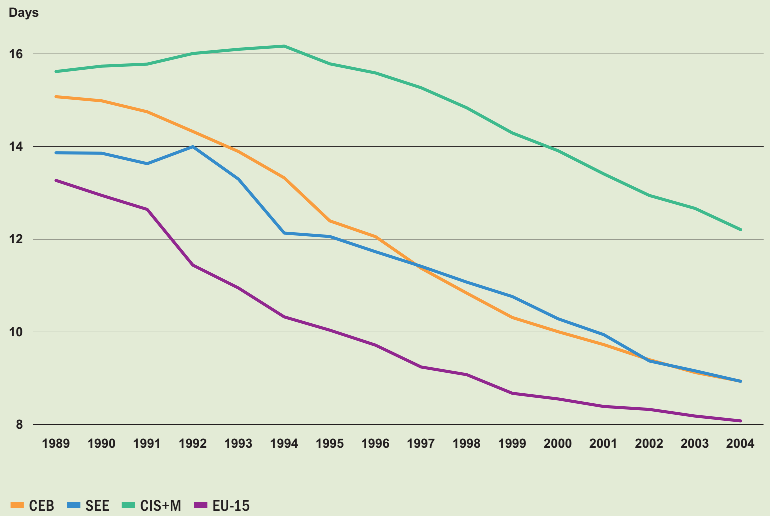
Some success, at least in CEB, has also been achieved with private sector involvement in electricity distribution and generation companies. Private sector investors have generally brought the funding needed to modernise power plants and the management expertise to improve the efficiency of distribution networks. In the power sector, the success of private sector involvement has depended on the quality of the regulatory system and the ability of the regulator to focus on long-term sustainability rather than short-term political considerations.

Chart 5.9
Number of hospital beds, 1989-2004



Source: European health for all database (HFA-DB), World Health Organization, 2007.
Note: Data for Bosnia and Herzegovina, Mongolia, Serbia, Sweden and Turkmenistan were not available.

Chart 5.10
Average length of hospital stay, 1989-2004



Source: European health for all database (HFA-DB), World Health Organization, 2007.
Note: Data for Bosnia and Herzegovina, France, Greece, Luxembourg, Mongolia, Netherlands, Serbia, Turkmenistan and United Kingdom were not available.

Private sector involvement in transport and water has been more controversial. Although there are a growing number of successful private sector airport operators that have invested in restructuring, there is little private sector involvement in roads and railways. Even Hungary, which pioneered private sector road concessions in the transition region, has a mixed record, having had to renegotiate a toll-based motorway concession. Private sector railway operators have mainly entered the cargo market, which remains competitive and straightforward as it requires only regulation of charges for track access.

The mixed record of private sector involvement in water and waste-water services largely concerns disputes about the undefined quality of underground assets at the beginning of the concession and weaknesses in the regulatory system that prevent subsequent revisions to the contract. As a result, public authorities and private partners are often at loggerheads, with no means of finding a favourable resolution of a dispute.[14]

Primary and secondary education is still provided predominantly by the state in all transition countries. Although some private schools have been established, they currently form a niche market. The private sector is, however, involved in providing after-school tuition, language training and other specialist courses. New private universities have been established in a number of transition countries, combining state funding with student fees. These universities now account for up to 30 per cent (in Poland) of enrolment in tertiary education in the transition region.

Private sector involvement in health care

Private sector involvement in health care has been fairly limited so far. At the start of transition, health care facilities and services were both funded by the state. This highly centralised approach was replaced in a number of transition countries by mandatory social health insurance financed by employer and employee contributions. In the Czech Republic, Russia and the Slovak Republic, for example, health systems have allowed the private sector to participate in the provision of health insurance.

However, most transition countries still aim to provide a universal comprehensive health service that is officially free at the point of delivery, even if people may have to contribute to the cost of medication and to make additional payments – on an official or unofficial basis – for specific services. As a result, the financing of health care remains to a large degree dominated by the state.

Despite the scarcity of large-scale projects with private sector involvement, privatisation of health services on a small scale has been introduced in many transition countries. In particular, many pharmacies and dental practices passed into private ownership in the 1990s. By the end of the last century, the number of dentists who worked privately totalled 79 per cent in Lithuania, 90 per cent in Poland and almost 100 per cent in the Czech Republic. A number of spas and rehabilitation facilities (for example, in the Czech Republic) and specialist diagnostic clinics (for example, in Armenia) have also been privatised.

An increasing number of primary health care centres operate privately, particularly in CEB. In some countries, the bulk of such services, including general practices, are delivered by the private sector, albeit under contract to publicly financed insurance funds (for example, in Bulgaria, Croatia, the Czech Republic, Latvia and the Slovak Republic). In other countries, markets are rapidly developing for private services paid out-of-pocket (for example, in Poland and Romania).[15] Some transition countries allow doctors employed by the state to run private practices after their official working hours and to use state medical facilities for a nominal payment. Although several transition countries have allowed private hospitals to be established as well as formal and informal private areas in public hospitals, the vast majority of hospitals throughout the region remain state-owned (see Box 5.1).

In a number of transition countries, the private sector provides some clinical support services, such as diagnostic tests, laboratory work, medical equipment maintenance and specialist clinical services, including dialysis and cosmetic surgery. Health “tourism” has expanded rapidly in Hungary and elsewhere in CEB, whereby specialist clinical services are provided to foreign patients at prices well below those charged by private practices in mature market economies. In addition, the private sector also provides non-clinical services, such as cleaning, catering and laundry contracting.

Nevertheless, in all aspects of health care, the public sector plays an important role as a revenue source for the private sector providers of health services. Frequent experimentation and changes in the payment methods have created uncertainty, however, about this revenue stream.

Voluntary private health insurance plays only a marginal role in nearly all of the transition countries. Both official service charges and unofficial payments are widespread. Official health service charges or co-payments are mostly associated with out-patient services or there can be a nominal fee for in-patient care while unofficial payments are spread across the health sector. In poorer transition countries, direct private payments account for the bulk of total health expenditure in both public and private facilities.

An expansion of the private sector in delivering public services is currently held back by a lack of trained staff in the civil service who are able to organise tenders and to manage the relationship with private sector partners. There is also a lack of coordination between different parts of government and insufficient resources devoted to implementing contracts and monitoring private sector activity. Frequent changes of government and the loss of trained staff have hampered progress with private sector projects. In many transition countries, private sector investors have also found it difficult to raise sufficient revenue from under-developed local capital markets.

Public-private partnerships

In view of the limited availability of public finance and privatisation opportunities, a public-private partnership can help to improve the delivery of health care and other public services. A big advantage of this approach is that private sector finance can be used up-front for modernisation and restructuring while the public sector retains some control over the nature of the service.

In partnerships, control over how services are provided can be easily devolved to local areas, each negotiating different relations with the various private consortia. In practice, however, smaller municipalities often struggle to implement or effectively monitor complex infrastructure projects and need support from a project implementation unit at central government level.

Under public-private partnerships:

- the private sector injects money for restructuring and modernisation immediately
- the private sector either owns or has rights over the assets for a specified period and takes on the associated risk
- the services provided to the general public are purchased by the government

Box 5.1 Private sector participation in health in the Czech Republic

In most transition counties, the private sector has played only a minor role so far in providing health care. This role has mainly involved receiving direct payments for basic out-patient services in some of the poorest transition countries, participating in the privatisation of dental care and providing support clinical services, cosmetic surgery and specialist in-patient facilities targeted at expatriates and the top earners.

As shown in Chart 5.1.1, the share of hospital beds provided by the private sector is still below 10 per cent in all transition countries apart from the Czech Republic, where the proportion is substantially higher (above 25 per cent). However, public health insurance provides more than 90 per cent of the funding for these beds.

The reform of health care in the Czech Republic started in the early 1990s with the introduction of not-for-profit health insurance companies. These companies have a special status and purchase services from independent health service providers, both private and public. The introduction of compulsory health insurance coincided with the liberalisation of health care, whereby patients were allowed to choose their doctor or health facility.

The separation of health care funding from health care provision brought about the emergence of private health care providers, who set up new private practices. They also participated in the privatisation of small and medium-sized health facilities which were not considered to be essential for ensuring universal access to health services. Currently, more than 95 per cent of out-patient services in the Czech Republic and about 30 per cent of in-patient services are provided by private companies.

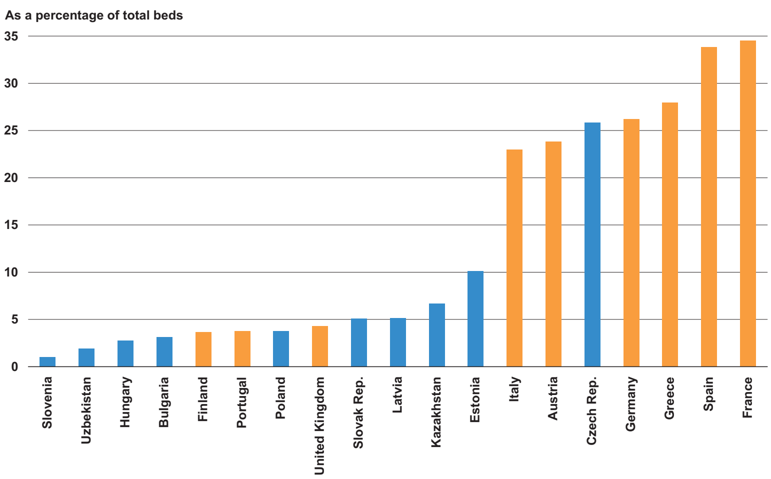
Health insurance companies ensure that health care providers deliver an acceptable quality of service and value for money. Despite the existence of nine competing health insurers, about 65 per cent of the population in the Czech Republic is insured with the general health insurance company in which the state has a major influence. This is partly because the range of services that could be provided by health insurance companies was tightened in the mid-1990s, making it difficult for health insurers to compete with the dominant health insurer.

Decentralisation of the Czech Republic's health sector has resulted in regional authorities gaining greater involvement in local health care decisions and taking responsibility for local health care providers. The role of the Ministry of Health is limited to managing and controlling only the largest hospitals as well as certain health care institutions involved in the protection of public health. The continuing privatisation of smaller health care facilities is the reason for most of the increase in the private sector share of hospital beds.

There are still significant inefficiencies in the health system: the number of out-patient visits to doctors and the number of prescriptions per capita in the Czech Republic continue to be among the highest in Europe. This suggests that many savings could still be achieved in spite of the involvement of private capital and expertise.

The Czech government launched further health care reforms in 2007, aimed at increasing the efficiency of the sector and involving citizens in decision-making. Current reforms include the introduction of user charges (a nominal payment for both in-patient and out-patient services), changes to the payment system for medication, expansion of the scope of health insurance companies to allow them to provide wider coverage, and the introduction of an independent health insurance regulator. In addition, health facilities will continue to be corporatised and privatised.

Chart 5.1.1
Number of private hospital beds



Selected transition countries · Selected western European countries

Source: European health for all database (HFA-DB), World Health Organization Regional Office for Europe, 2007.

Endnotes

1 Private hospital beds are defined as both not-for-profit and for-profit in-patient beds not owned by central or local government or social security establishments. In the Czech Republic, there are also a number of corporatised hospitals owned by the state which are not included in the share of private hospital beds.

- in health care and education, services are usually free at the point of delivery but may include some user charges
- after a specified period the assets are usually returned to the public sector
- efficiency gains from restructuring usually ensure that the ongoing public funding received by the private sector is sufficient to cover the up-front injection of cash (although additional user charges are sometimes considered).

The main argument for partnerships is that, since payment is linked to the level of services provided, the private sector operator has the incentive to ensure that modernisation is efficient and likely to earn a quick return (without cost over-runs and delays). Politically, partnerships can be useful since politicians are often reluctant to commit funds to upgrading public service facilities which will have long-term benefits when the costs have to be borne by current voters.

In public-private partnerships, only private money is used up-front while public payments to the private operator are spread over a long period of time. Partnerships are useful, therefore, when limited public financing is available for up-front costs. Some of the different types of partnership are outlined below:

- Build-operate-transfer (BOT) – the private sector upgrades facilities and leases them back to the public sector for a specified period before they are finally transferred to the government
- Concessions – the private sector upgrades facilities and assumes full responsibility for delivering services, including employing and managing the workforce
- Management contract – the private sector partner manages the delivery of services but does not own or take financial responsibility for the basic infrastructure
- Outsourcing – the private sector partner supplies a service that replaces the service provided by the public sector.

The first two options are most relevant in the transition countries since the last two do not address the financial difficulties that most countries face.

In developing countries there are already a large number of public-private partnerships delivering public services.[16] Some 60 per cent of privately financed projects in these countries are new or "greenfield" projects (typically BOT or similar projects with a ring-fenced financial and risk structure).

A total of 13 per cent are simple divestures, in which the state sells all assets to the private operator and gives up responsibilities for the operation and management of the activity. About 23 per cent are concessions or licences, in which the private sector operators have made significant investments. There are also a small number of management contracts. These are growing relatively fast as private sector operators seem to be less willing to take on big investment risks.

Commitment, regulation and quality of public administration

Public-private partnerships require long-term agreements. Unless additional user charges are introduced, the contract needs to be long enough for the efficiency gains to materialise and for the private sector operator to be reimbursed, both for its initial cash injection and its ongoing costs.

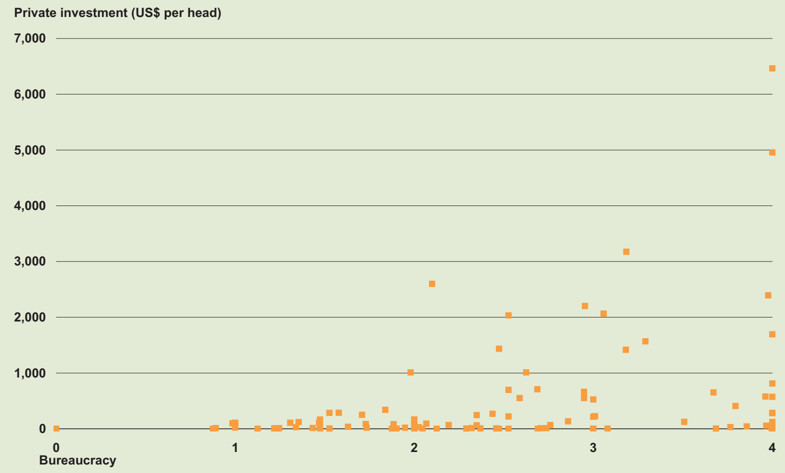
Evidence from developing countries shows that renegotiation is a major problem. This is because in many cases – for example, in the case of water companies where the assets are underground – it is impossible to have a clear view on which assets require renewal. As a result, most contracts now have a re-basing requirement to account for unforeseen changes in the scope of work.[17] For example in Latin America, around 75 per cent of water agreements and 55 per cent of transportation deals are renegotiated, compared with only 1 per cent in telecoms and just under 10 per cent in energy.[18]

Even in advanced economies, such as the United Kingdom, renegotiation occurs frequently, although it is generally due to changes required by the public sector agency. In developing countries, renegotiation is greatest where projects are most dependent on the state purchasing services.

Control by government ministries (rather than an independent regulator) is far more likely to be associated with renegotiation. Unfortunately, in the transition region, particularly in health care, dependence on state revenues and the absence of a regulatory agency are likely to be the norm.[19] Regulatory bodies need to be established, therefore, in parallel with the introduction of public-private partnerships.

Statistical analysis of private sector participation in infrastructure across developing countries shows that differences can be accounted for by factors such as GDP per head (a higher amount of GDP leads to more private sector involvement), levels of bureaucracy (better quality leads to more private participation) and corruption (more corruption leads to less private money). Chart 5.11 shows that there is a positive relationship between privately funded public projects across most countries in the world and high standards of government administration.

Chart 5.11
Private investment in public projects globally and levels of bureaucracy



Source: Public Works Financing database, October 2006, International Country Risk Guide, 2006.
Note: Each square represents a different country. The scores for levels of bureaucracy range from 1 (high) to 4 (low).

Box 5.2 PPPs in western Europe

Most public-private partnerships (PPPs) in western Europe have involved infrastructure projects, notably in transport, where there has been considerable success in terms of projects being delivered on time and without cost over-runs. However, there have also been partnerships in health and education projects.

Education

In the United Kingdom, PPPs for educational facilities are typically undertaken at the local authority level. The private sector partner provides and designs the school buildings to meet local specifications, and the local (public sector) authority manages and pays for teaching staff. For example, Leeds City Council has procured almost £1 billion worth of private sector expertise for PPPs (including many school-building projects). In April 2007 it decided that an additional 14 state-of-the-art schools would be built or modernised through PPPs.

To ensure that procurement is handled properly, Leeds Council created in 1999 a specialist PPP procurement unit, which brings together all PPP projects in the city regardless of sector. As a result, the unit's expertise is applied across a variety of sectors, ensuring that procurement decisions are consistent and well-founded.

In the early years, many of the PPP deals in Leeds involved long periods of negotiation with preferred bidders and cost over-runs. However, more recently deals involving procurement for complex multi-site projects have been conducted efficiently and have remained within budget. The procedures followed by Leeds Council have been identified by the UK National Audit Office as being a particularly successful model.

Health

Portugal has extensive experience of public-private partnerships in health and other sectors but these projects have encountered many problems. This has been mainly due to difficulties with the labour force. In the early years, PPP proposals met with enormous resistance from employees and their trade unions. Indeed, some were abandoned in the face of this opposition. More recently, an alternative model has been introduced, which involves the private sector providing both the infrastructure and the clinical services. This has been received more favourably as it avoids the need for state employees to work within private hospitals.

A similar PPP approach sometimes known as the "Alzira model" has been adopted in Spain. The first example of this involved the construction in Alzira of a 250-bed hospital, which undertakes 20,000 operations per year and handles almost half a million out-patients annually. Under the PPP, a private sector company was contracted to finance the construction of the hospital and to manage services for a 15-year period. The project is seen as being successful so far.

The transition countries are not out of line with countries at similar levels of GDP per head in terms of institutional quality.[20] This suggests that their public services may still be attractive to private finance. Indeed, simple estimates of private sector participation in infrastructure show that, given their levels of GDP, corruption and bureaucracy, the transition countries receive less than might be expected. Therefore, further flows of private investment in public services are entirely possible.

To attract private sector investment, the quality of the legal and political framework is extremely important. The private sector is more likely to invest up-front for modernisation and restructuring if the legal and political processes are transparent and robust. If these processes are weak, there is little scope for complex cash flow structures involving both investment by the private sector and eventual reimbursement by the public sector. Therefore, modernisation possibilities will be far greater in countries that have achieved democratic consolidation and strengthened checks and balances.

In the less advanced countries of the transition region, the process of democratic institution-building is at an early stage or has stalled. Access to political decision-making, at both central and local levels, and the extent of political participation by local people is significantly lower in these countries than in developed democracies, as shown in various indicators including the LiTS. An increase in transparency and greater availability of information – through independent media and non-governmental organisations – could help to reduce bureaucracy, corruption and misuse of funds.

Community-based monitoring, particularly in health care services, has been shown to have a positive effect on the usage and quality of services. For example, a recent field experiment in Uganda showed that community-based monitoring of health care improves both nutrition and infant mortality.[21] Moreover, these improvements could be directly observed in changes in staff behaviour. In a separate study, an assessment of educational funding found that providing information to parents and teachers helps to reduce corruption.[22]

These findings are broadly consistent with results in other parts of the world. They show that greater transparency and more extensive consultation in the design and implementation of public services can be a useful way of increasing external control.

Procurement and competition for projects

Good procurement practices in public-private partnerships are important for two reasons. First, transparent, open competition restricts the possibility of corruption. Secondly, a fair procurement process will make it less likely that the chosen operator will subsequently attempt to abuse its monopoly power and to seek additional payments from the state.

However, procurement has turned out to be a major problem even in countries where corruption is low. When public-private partnerships are created, the people who decide who will "win" the right to supply services have one of the most important jobs. Unfortunately, they do not always have the right skills for such an important role as their responsibilities were previously much less demanding when all services were supplied by the public sector.

Furthermore, a health authority may generally have small procurements duties but once every 10 or 15 years may have to procure a very large project. The staff may therefore lack the experience to make such an important decision. This has proved to be a significant but not insurmountable problem in all countries. Strengthening public administration and training employees to administer procurement and competition processes would yield substantial returns for public-private partnerships.

Cost/delivery

Studies mainly conducted in advanced market economies suggest that public-private partnerships tend to "get the job done" but are not cheaper than other options. Cost over-runs are a major issue for public sector infrastructure projects,[23] but public-private partnerships are not cheaper if the costs of administration, preparation time, negotiations and renegotiations, lawyer fees and the costs of private credit compared with sovereign credit are included.

A recent study of road projects by the European Investment Bank showed that public-private partnerships are 19 per cent more expensive than the projected cost of the publicly funded equivalent but this difference is almost exactly the same as typical public sector cost over-runs for equivalent projects.

Public-private partnership projects are, however, more likely than public sector projects to be delivered on time. For example, in the United Kingdom 47 per cent of traditional public sector hospitals were two months late or more while more than 80 per cent of partnership projects were delivered on time.

Two of the main advantages of private sector participation are the transfer of risk to the private sector and the delivery of value for money. Analysis of EBRD infrastructure projects shows that state guarantees in a project decrease financial discipline.[24]

Insiders

A particular concern in public-private partnerships is the role of "insiders". In certain cases, where governments embark on a close long-term relationship with a specific private sector "partner", there is scope for insiders to exploit this situation. An obvious example might be if a local area decides to use a private sector provider to run its hospitals for the next 15 years. In such cases, senior existing managers of the local health service and local politicians are well-placed to seek illicit payments from the chosen company. However, good procurement procedures, including transparent tendering, can help to minimise insider deals and corruption.

Nevertheless, the need for "local expertise" to ensure the smooth running of the project may create opportunities for corruption even if very transparent procurement procedures exist.

Box 5.3 Hospinvest, Hungary

Hungary's health sector accounts for almost 8 per cent of the country's GDP. This high proportion is partly due to the large number of hospitals, many of which are only three-quarters full. In addition, over 95 per cent of surgical procedures require the patient to stay in hospital overnight compared with only about 50 per cent in advanced market economies.

Three-quarters of spending on health is publicly funded. Two-thirds of this is spent in public hospitals compared with 30-40 per cent in advanced market economies. Downsizing, consolidation and even closure of some hospitals is clearly essential to rationalise the public health system and to reduce the strain on scarce public resources.

To assist in the reform of the country's public hospital network, the EBRD made an equity investment in 2007 of up to €6 million in Hospinvest, a private joint-stock company incorporated in Hungary and owned by local entrepreneurs. The project supports Hospinvest's bid for the management of up to ten public hospitals and hospital pharmacies and will help the company to implement a restructuring and modernisation programme in these hospitals.

Hospinvest will take over the management of a hospital or an out-patient centre on the basis of two contracts signed with the relevant municipality. The first transfers management of the assets from the municipality to Hospinvest while the second contract concerns the provision of health care services. This specifies the coverage area for the hospital, the minimum level of services required and the specialist departments that need to be maintained. The contracts are typically for 20-25 years, with clauses allowing the contract to be broken in specific circumstances. The contracts also specify that Hospinvest's delivery of health care and asset management will be supervised by the municipality and the relevant health authority.

For each hospital, Hospinvest will establish a fully owned subsidiary that will sign the contracts with the municipality and take over all assets and liabilities excluding property. The new subsidiary will obtain the hospital's operating permit and will sign the financing contract with the national health insurance fund.

Hospinvest has developed an arrangement whereby a local commercial bank provides financing for equipment and refurbishment against a payment guarantee by the subsidiary. Hospinvest will generate revenues from hospital operations through a management fee charged by the hospital subsidiary and from a mark-up on medical supplies to the hospital, which allows the company to invest in modernisation work.

Following the takeover of a hospital, the accounting and payroll functions will be transferred to the Hospinvest holding. All supplier and outsourcing contracts are reviewed and all purchasing functions are transferred to the holding centre. Staffing is also controlled by the holding centre through a system that complies with EU standards. The hospital managers will be responsible for the day-to-day activities of the hospitals. Quality will be assured by the Medical Advisory Board.

Concession contracts may be most prone to exploitation. The practice of pooling the procurement process in local areas across a number of services may help to tackle this problem since insiders within a particular service will not find it so easy to seek illicit payments across a variety of services.

Experience

So far, most public-private partnerships have been in infrastructure services, such as transport, energy and water. Most partnerships in health care tend to be either small, such as the national e-health portal (Denmark) and Better IT for Better Health (Germany), or pure infrastructure projects, where the private sector partner designs, builds and finances the hospital and the public sector uses public employees to operate it (for example, the Berlin-Buch hospital in Germany and many UK hospitals, such as the South Manchester NHS Trust Hospital).

Box 5.2 provides examples of partnership projects in health and education services. As the box suggests, a suitable approach for transition countries lacking financial resources is for the private sector to take over the modernisation and delivery of either part of or the entire hospital-based health care service in a region. Examples of this are already being put in place (see Box 5.3 on Hospinvest, Hungary).

Conclusions

The health care sector illustrates many of the issues facing policy-makers as they embark on ambitious programmes to raise the quality of public services. Health care dominates people's concerns about public services; its importance in the transition countries is far larger than in the EU-15. Satisfaction with the quality of services remains low despite the fact that standards of care and levels of public spending appear to be higher in the transition region than in countries with equivalent levels of GDP per head.

The current wave of investments in many of the transition countries needs to be accompanied by organisational changes and management improvements. Some objectives can be achieved through administrative measures and policy changes. For example, some health care services have been shifted away from hospitals, resulting in better use of hospital resources. The lack of progress in the Commonwealth of Independent States and Mongolia (CIS+M) suggests that the need for health care reform in these countries is even greater than in central eastern Europe and the Baltic states (CEB) and south-eastern Europe (SEE).

However, it is unlikely that administrative steps will be sufficient to resolve current problems and to improve the delivery of services. Some of the necessary management changes might require the involvement of the private sector, particularly in a partnership approach, whereby it injects finance up-front for modernisation and reorganisation.

Private funding can be made available at both centralised and local levels but what can be achieved will depend on the quality of the legal and political structures. Good procurement processes need to be in place to minimise corruption. "Insiders" may be in a position to seek illicit payments so vigilance is necessary to avoid a re-run of some of the problems that emerged during the initial wave of privatisations.

Public authorities and regulatory authorities have an important role to play in public-private partnerships. Officials in public administration need to be adequately trained, appropriate incentives need to be in place and they need to be independent from short-term political pressures. This will help to ensure that they select appropriate private sector partners and are capable of monitoring and adjusting the relationship if necessary. This is particularly important in projects where it is difficult to assess the quality of assets or to indicate the level of service required before the contract is signed.

Public-private partnerships allow customers to influence, through public agencies, the type of services provided whereas in privatisations the services are driven by the ability of people to pay directly. Public involvement can be especially beneficial at the local level but this requires central government to be willing to devolve its funding.

Long-term contracts, complex relationships and renegotiations can cause tensions between the private sector and the government but they can also result in better services being delivered. Greater use of public-private partnerships could be of great benefit to the transition region as a whole.

Endnotes

1 This is in line with the findings from the Business Environment and Enterprise Performance Survey undertaken by the EBRD and the World Bank in 2005, which shows that public infrastructure is viewed as a decreasing obstacle to business (EBRD, 2005).

2 See Eurobarometer (2006).

3 This shows the consumption of health services of a hypothetical person whose other characteristics remain the same, save for changes in level of education and age.

4 This view is consistent with evidence presented by Hunt and Laszlo (2007) who show that richer users are more likely to pay bribes to public officials than poor users. Those who bribe are trying to avoid the poor service delivered to clients who refuse to bribe.

5 Some measures may have not been wholly truthful insofar as they aimed to boost notional achievements under the planned system.

6 Connection to a public sewer, connection to a septic system, pour-flush latrine, simple pit latrine, ventilated improved pit latrine. See World Bank (2005).

7 See World Development Indicators (2007).

8 It should be noted that access to a power network or other public utilities does not imply a reliable service without frequent interruptions in service provision. See EBRD (2005).

9 Even so, the transition countries fell behind the EU-15, where there has been a significant improvement in life expectancy from 75.2 years in 1990 to 78.4 in 2005.

10 Taken from a simple regression of doctors per head against a constant, the GDP per head and a dummy if the country is a transition economy.

11 The deterioration of some health care services is described in detail in Suhrcke et al (2007).

12 See Chawla et al (2007).

13 Private finance for public services does not necessarily require direct private user payments if adequate private or even public insurance schemes are in place. The discussion focuses on the private sector participation in service delivery, leaving aside the issue of financing.

14 See *Transition Report* 2004 for a detailed discussion of the extent of private involvement in the provision of public utilities and the associated regulatory arrangements.

15 See Afford (2001).

16 See World Bank and Public-Private Infrastructure Advisory Facility, Private Participation in Infrastructure Projects Database, 2007.

17 Of course, a distinction needs to be made between renegotiations that are caused by a change of circumstances not foreseen in the contract and strategic contract renegotiations caused by shrewd investors or governments.

18 See Guasch (2004).

19 Guasch (2004) also found that competitive bids and a strong legal system help to minimise the likelihood of renegotiation, as do use of companies that are local and have been involved in past concessions although this may simply be because this allows for other routes of compensation and hence implicit renegotiation.

20 See International Country Risk Guide and Kaufmann et al (2006).

21 See Björkman and Svensson (2007).

22 See Reinakka and Svensson (2005).

23 Flyvbjerg et al (2003) suggest that nine out of ten infrastructure projects fall victim to cost escalation and that this problem has not decreased significantly over a long period.

24 Further evidence on delays and the financial performance of infrastructure projects in transition countries is provided by Dobrescu et al (2007).

References

C. W. Afford (2001), *Failing Health Systems: Failing Health Workers in Eastern Europe*, International Labour Organization, Geneva.

M. Björkman and J. Svensson (2007), “Power to the people: Evidence from a randomized field experiment of a community-based monitoring project in Uganda”, CEPR Working Paper 634/4.

M. Chawla, G. Betcherman and A. Banerji (2007), *From Red to Grey. The “Third Transition” of Ageing Populations in Eastern Europe and the Former Soviet Union*, World Bank, Washington D.C.

G. Dobrescu, G. Friebel, P. Grosjean and K. Robeck (2007), “The determinants of infrastructure performance in transition economies”, EBRD Working Paper, forthcoming.

Eurobarometer (2006), “European Social Reality”, Special Eurobarometer 273/-Wave 66.3 – TNS Opinion & Social, European Commission.

EBRD (2004), *Transition Report* 2004.

EBRD (2005), *Transition Report* 2005.

B. Flyvbjerg, N. Bruzelius and W. Rothengatter (2003), *Megaprojects and Risks: an Anatomy of Ambition*, Cambridge University Press.

J. L. Guasch (2004), “Granting and renegotiating infrastructure concessions. Doing it right”, WBI development studies, 28816, World Bank, Washington D.C.

J. Hunt and S. Laszlo (2007), “Is bribery really regressive? Bribery’s costs, benefits, and mechanisms”, mimeo.

International Country Risk Guide (ICRG) (2006), The PRS Group, Inc., www.prsgroup.com/ICRG.aspx.

D. Kaufmann, A. Kraay and M. Mastruzzi (2006), “Governance matters v. governance indicators for 1996–2005”, World Bank Policy Research Working Paper No. 4012, Washington D.C.

R. Reinakka and J. Svensson (2005), “Fighting corruption to improve schooling: Evidence from a newspaper campaign in Uganda”, *Journal of the European Economic Association*, Vol. 3, Nos 2–3, pp. 259–67.

M. Suhrcke, L. Rocco and M. McKee (2007), “Health: a vital investment for economic development in Eastern Europe and Central Asia”, Copenhagen: WHO Regional Office for Europe.

World Bank (2005), *Millennium Development Goals. Progress and Prospects in Europe and Central Asia*, World Bank, Washington D.C.

World Development Indicators (2007), World Bank, Washington D.C.

Annex 5.1
People and the environment

Decades of extensive industrial and agricultural production with no environmental safeguards left most transition countries with a legacy of serious pollution and contamination. Poorly constructed and inadequately maintained infrastructure, notably in waste-water treatment, added to the problem. Although industrial pollution decreased with the onset of economic restructuring and the resulting decline in output, a number of new challenges have emerged. These include an increase in vehicle emissions and a sharp increase in the amount of household waste.

This annex explores people's attitudes towards the environment as reported in the Life in Transition Survey (LiTS), several rounds of the World Values Survey and focus group discussions in the Czech Republic, Georgia and Serbia.

Life in Transition Survey

The LiTS asked people to consider the environment in terms of priorities for government spending; specifically, which areas should be the first and second priorities for extra (government) investment, given a choice among education, health care, housing, pensions, public infrastructure and the environment (including water quality).

As discussed in Chapter 5, the LiTS shows that the top priorities for additional government spending are overwhelmingly health and education. A very small percentage chose the environment as a first priority (see Chart 5.1) and a slightly larger percentage of respondents selected the environment as either their first or second priority (see Chart A.5.1.1). There is no clear pattern among the sub-regions of central eastern Europe and the Baltic states (CEB), south-eastern Europe (SEE) and the Commonwealth of Independent States and Mongolia (CIS+M), and there is wide variation within each sub-region.

In CEB only 7.8 per cent of respondents selected the environment as either a first or second priority, compared with 6.1 per cent in SEE and 8.1 per cent in the CIS+M. The fact that Lithuanians were far less likely to make environmental concerns a high priority than respondents in Tajikistan indicates that concern about the environment has little to do with factors such as a country's wealth, progress in transition or levels of democracy.

Although regional patterns are difficult to discern, it is notable that people in some countries in Central Asia – especially Kazakhstan, Mongolia and Tajikistan – were more likely to put environmental concerns at the top of their list of priorities than people in SEE. Although Central Asia suffered serious environmental damage during the Soviet era, this would not appear to fully explain the survey findings. Generally speaking, there is a relative lack of environmental awareness in Central Asia and a paucity of "green" parties or non-governmental organisations with an ecological mandate. The high levels of concern for the environment may be linked instead to access to water.

The five transition countries with the lowest levels of access to tap water are Moldova, Tajikistan, Mongolia, Uzbekistan and Kazakhstan. In the latter three, access levels have actually declined during transition. In Kazakhstan, for example, nearly half of the 1,000 people interviewed in the LiTS do not have access to mains tap water. Of these, about 19 per cent mentioned the environment as a top priority.

Across the transition countries, it is clear that younger people and those with higher household incomes tend to prioritise environmental issues (see Chart A.5.1.2). Although the LiTS suggests that only a small percentage of people in the transition countries put a high priority on government spending on the environment, this does not necessarily indicate that concern for the environment is abnormally low; it appears that access to quality health care, education and housing are simply higher priorities for government attention.

Changes in attitudes towards the environment

The World Values Survey (WVS) is a useful source of information on how people's concerns about the environment evolved during the early years of transition, although data are available for only CEB and Bulgaria. Conducted in 1990-91 and again in 1999, the WVS asked people if they were willing to spend their own income to improve the environment and if the government should take steps to reduce environmental pollution (see Charts A.5.1.3 and A.5.1.4).

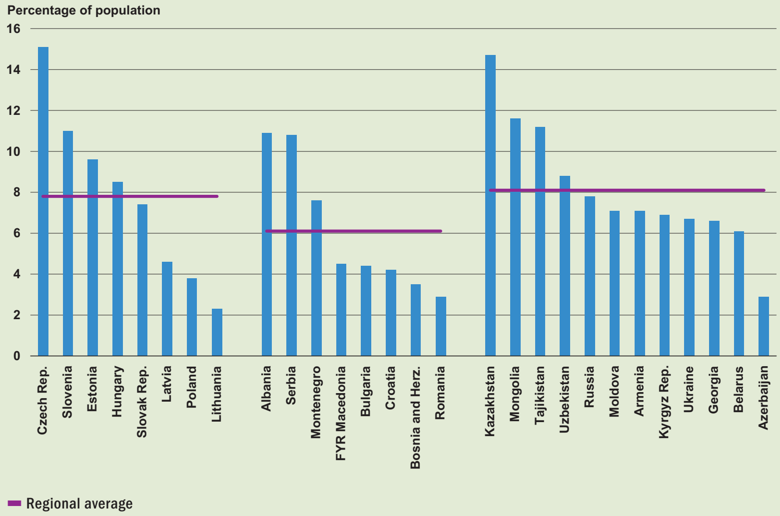
Overall, people's readiness to sacrifice their own income to achieve environmental improvements has been high in CEB compared with Germany and the United Kingdom. However, in every country in the survey the willingness of households to pay for cleaning up the environment fell between 1990-91 and 1999. There was a corresponding rise in the belief that the government should shoulder the responsibility for reducing pollution.

Focus groups in the Czech Republic, Georgia and Serbia

To gain a better understanding of people's views of the environment and how they may have changed since 1989, focus group discussions were held in Prague, Tbilisi and Belgrade during July and August 2007. Each group, of between 8 and 11 people of mixed age, gender and level of education, discussed how transition has affected the environment, and how people view the environment in regards to their quality of life and economic development. They also discussed access to information about environmental issues, involvement at the local level to address environmental problems and the question of who should take responsibility for the environment.

People in the Czech Republic showed greater concern for the environment than those in Georgia or Serbia, where other social and economic problems were regarded as more pressing (see Box A.5.1). The Czech participants uniformly saw environmental degradation as a serious problem although they tended to focus on local issues, such as air and water quality as opposed to global issues, such as climate change. At the same time, they acknowledged that the environment had clearly improved during transition, especially in relation to the cleanliness of water and air quality.

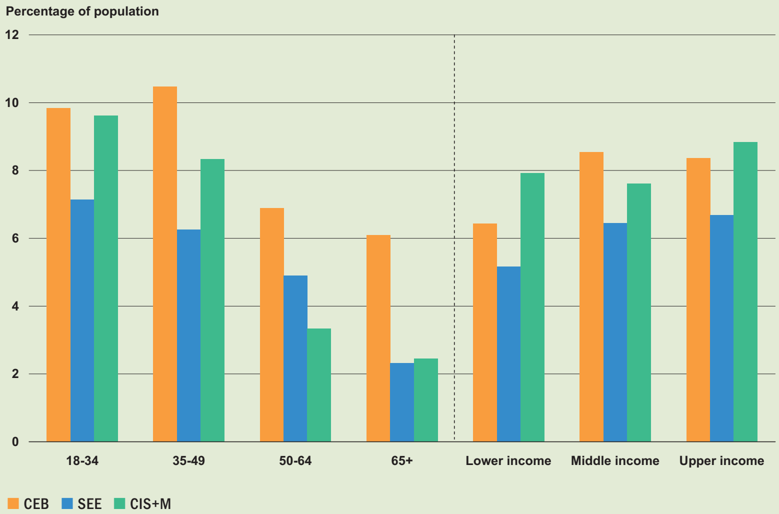
Chart A.5.1.1
Prioritisation of the environment, by country



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: The chart shows the percentage of respondents in each country who view the environment as a first or second priority for additional government spending.

Chart A.5.1.2
Prioritisation of the environment, by age and income



Source: Life in Transition Survey, EBRD and World Bank, 2006.

Note: The chart shows the percentage of respondents in each country who view the environment as a first or second priority for additional government spending.

In Serbia, people felt that the quality of the environment had deteriorated during transition. They thought that economic development, inadequate enforcement of environmental standards and a lack of incentives, such as environmental charges and taxes, were key reasons for this decline.

In Georgia, feelings about how the current situation compares with the communist era were more mixed. Some people insisted that environmental conditions had deteriorated as a result of deregulation and the authorities' lack of concern about the impact of industrial activity on individuals. However, others thought that the environmental situation had broadly improved, principally because of the rapid decline of heavy industry immediately after the fall of the Soviet Union.

The Georgian group felt that increased levels of poverty had put pressure on the environment, citing the energy crisis in the 1990s, when large swathes of woodland around Tbilisi were cut down by people foraging for fuel. As well as destroying the forest that sheltered Tbilisi from wind, widespread logging has reportedly caused increased numbers of avalanches and landslides in mountainous areas of Georgia.

Development brings new environmental challenges

Across the region, the economic expansion of the past few years has brought with it new environmental challenges and new incentives to manage them. The rapid increase in the number of vehicles has clearly increased noise and air pollution, especially in large cities. In Serbia, air pollution was singled out by the focus group as the most pressing issue and attributed to a significant increase in electrical appliances, such as refrigerators, freezers and air conditioners, in addition to increased road traffic. The participants welcomed the idea of congestion charges for the centre of Belgrade but expressed concern about the cost.

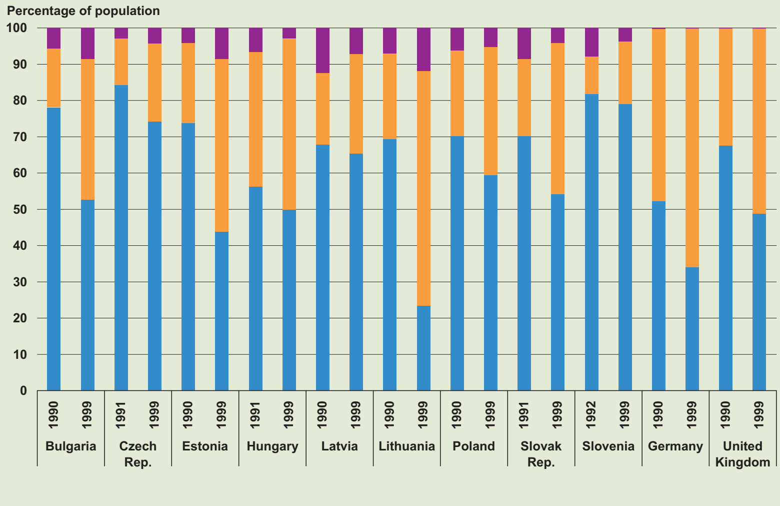
Air pollution in the large cities has increased mainly because of higher volumes of traffic. For example, in Ashgabat, Dushanbe, Moscow, Tashkent and Tbilisi, vehicles produce more than 80 per cent of total air pollution. This is due to a combination of low-quality fuel, ageing vehicles and weak enforcement of emission standards.

Despite the problems of vehicle emissions, overall air quality has improved in many countries since 1989. Sulphur dioxide emissions, which are mainly associated with the burning of fossil fuels, have fallen in line with the decline of heavy industry in the region. As well as being the primary cause of acid rain, sulphur dioxide can be extremely detrimental to the health of the young and the elderly. Between 1980 and 1989 sulphur dioxide emissions in the Czech Republic were above 200 kg per head per year. The level started to fall dramatically in the early 1990s, dropping to around 25 kg per head per year in 2000. There have been similar reductions in the other new EU member states and across the CIS+M.

Water quality is believed to have deteriorated during transition, especially in the less advanced countries. Participants in the Serbia focus group felt that water quality had declined and that it needed to be tackled by the government; plans to privatise the water authority are regarded with suspicion. In Georgia, participants commented that water quality had deteriorated during transition, despite evidence reported in the World Bank's World Development Indicators that suggest access to clean water has actually improved.

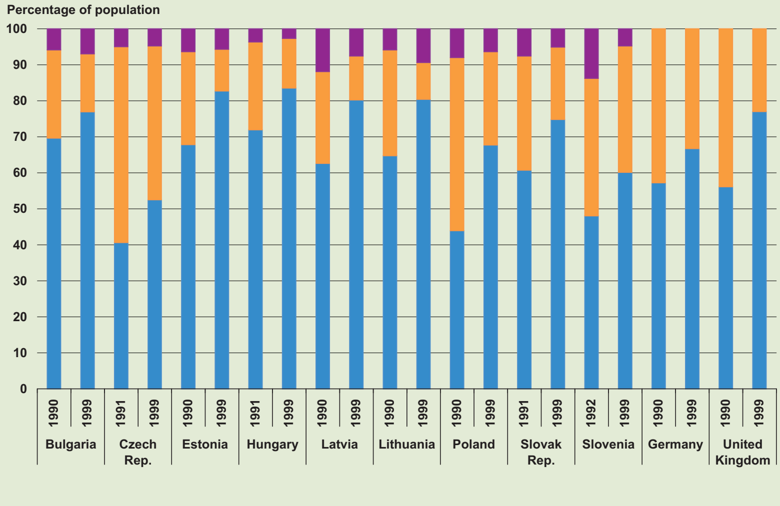
Economic development has resulted in far higher levels of municipal waste compared with 1989, particularly packaging waste, but there are differences in how this is managed. In the Czech Republic people said that they sort household waste for recycling and that adequate waste management was in operation. In Serbia, respondents agreed that there was more household waste but thought that municipal waste management services were able to handle it. Existing arrangements for recycling were criticised as being too inconvenient for residents. The participants in Georgia regarded increased waste as a problem mainly caused by a lack of awareness and concern for the environment. They blamed increased litter on inadequate waste collection services.

Chart A.5.1.3
Willingness to spend own income to improve the environment



Source: World Values Surveys.
Note: The World Values Survey asked people if they were willing to spend their own income to improve the environment.

Chart A.5.1.4
Government responsibility to reduce environmental pollution



Source: World Values Surveys.
Note: The World Values Survey asked people if the government should take steps to reduce environmental pollution.

Who should solve environmental problems?

In the Czech Republic, the focus group felt that the ecological situation was the result of the everyday actions of individuals who should take their share of responsibility for these actions. Furthermore, the participants felt that environmental issues were frequently discussed in the Czech Republic and that this level of environmental awareness and consciousness would continue to be a driving force for future environmental improvements.

Box A.5.1 Differing views on the environment

Focus group discussions in the Czech Republic, Georgia and Serbia, conducted in summer 2007, revealed a wide variety of views on the environment. Generally speaking, the Czech participants were the most positive about how the environment is improving whereas in Georgia and Serbia, views were more negative. A selection of comments from all three groups is provided below.

Czech Republic

"In this town [Usti nad Labem], pollution used to be so bad that if someone went to a hairdresser's to get their hair dyed, the colour would have changed again by the time they got home."

"There have been big improvements all round. And it's all happened so fast. No-one expected things to get better so quickly."

"There's so much more wastage nowadays. Packaging has gone crazy."

"The situation will continue to improve, for sure. I have a ten-year-old daughter and I can see that her generation has not been tarnished by communism. That gives me great hope for the future."

Georgia

"The positive and the negative cancel each other out. Factories are no longer producing as much pollution but there are many more cars than before and the quality of fuel leaves a lot to be desired."

"In towns, people find it hard to breathe. This was always a problem if there was a factory in the area but exhaust fumes from cars have made things much worse."

Serbia

"I spend my whole time struggling to survive. The environment is absolutely the last thing on my mind."

"Wherever you look, things are getting worse. And it's because of development. People have more money to spend but they don't take care of their surroundings."

"It all depends on where you live. If there is pollution near my home, I will complain about it but someone who's a bit further away couldn't care less."

In Serbia, people felt that environmental issues should be the responsibility of the state. They believed that each individual is only a "small player" and that "small players" cannot change anything. They hoped that better enforcement of legislation would improve the situation. However, they also very much doubted that this would happen as they did not trust the government and doubted whether it would treat the environment as a priority. They also stated that they did not feel sufficiently informed about the environment, claiming not to know about environmental non-governmental organisations (NGOs) and suggesting that the media would only cover environmental issues for political purposes.

The feedback was similar in Georgia, where most people believed that the state should take responsibility for environmental protection. People expect the government to address new environmental challenges, such as increased waste production and air pollution from increased car traffic. However, they also thought that the environment was not a priority for either politicians or the media. As in Serbia, they did not feel sufficiently informed about the environment and only a few had heard about activities of NGOs that campaign for nature conservation.

Conclusions

While the large-scale industrial pollution associated with the communist era has declined, other environmental problems, such as air pollution caused by increased road traffic and an expansion of municipal waste, have emerged. Although the volume of municipal waste is still significantly lower than in western Europe, it has increased dramatically in a relatively short space of time. And relative changes can have a profound effect on people's attitudes.

The environment is not seen as a priority by most people in the transition countries, who overwhelmingly see health care and education as most deserving of government spending. Younger and wealthier people are more likely than older and poorer people to see the environment as a priority for government attention.

Concern about the environment is highest in parts of central eastern Europe and the Baltic states and in Central Asia and lowest in south-eastern Europe, particularly in the former Yugoslav republics that have emerged from conflict and which are suffering from high rates of unemployment. The relatively high levels of concern about the environment in Central Asia probably reflects the legacy of Soviet planning and the fact that access to mains water has deteriorated in some countries since the start of transition.

There is a growing belief that governments rather than individuals should shoulder the responsibility of tackling pollution.

Part III
Country assessments

Reform progress and macroeconomic performance vary widely across the transition region. The following country-by-country analysis identifies the key challenges and highlights the main developments over the past year.

This will be the last Report to include an assessment of the Czech Republic, which will "graduate" from the EBRD at the end of 2007. Each of the other seven transition countries that joined the European Union in May 2004 is also expected to graduate before the end of 2010. The EBRD will continue to monitor its portfolio of projects in the Czech Republic following graduation but no new projects will be undertaken. While parts of the Report may continue to refer to the Czech Republic and other countries post-graduation and include them in enterprise or household survey research, the EBRD's Office of the Chief Economist will no longer provide a transition assessment once they have graduated.

The tables for each country offer a quantitative measure of transition progress that complements and underpins descriptions of recent developments. These tables include indicators of structural, institutional and macroeconomic developments that help to describe the transition process in each country. There is still considerable variation in data quality not just across the countries but also between different indicators. The data are based on a wide variety of sources, including national authorities, other international organisations and EBRD staff estimates. To strengthen the degree of cross-country comparability, some of the data were collected through standardised EBRD surveys of national authorities. The source of data and the exact definition of variables are provided in the methodological notes at the end of the Report.

The "cut-off" date for data was mid-September 2007. Data for 2007 are projections.

Albania

Key challenges

- Steps to privatise the power company KESH and key reforms, such as market-based pricing and higher tariff collection rates, are essential for a long-term solution to the regular energy crises and would help to reduce dependency on imports and sustain economic growth.
- Successful improvement of the business climate through effective action against corruption, a better functioning judiciary and more efficient public administration would improve investor sentiment.
- Increasing economic integration within CEFTA and with the EU provide an opportunity to reduce the country's high trade deficit, but improvements to transport networks and implementation capacity will also be needed.

Country data	
Population (in millions)	3.2
Area ('000 sq km)	28.7
GDP (in billion US$, 2006)	9.2
GDP per capita in 2006 at current international US$ (PPP)	5,621
National currency	Lek

Progress in structural reform

Liberalisation and privatisation

Further progress towards regional and European integration has been made as the expanded Central European Free Trade Agreement (CEFTA), which includes Albania, entered into force in July 2007. It covers not only customs but also a wide range of other trade issues and is expected to deepen regional integration. The Stabilisation and Association Agreement (SAA) was signed with the European Union (EU) in June 2006 and is undergoing ratification in EU member parliaments. The Interim Agreement on Trade and Trade-related Matters entered into force on 1 December 2006, providing Albania with practically unlimited duty-free access to the EU market.

The government adopted plans to privatise the insurance company INSIG through an international tender for its 61 per cent stake. The government also plans to privatise the oil refining and marketing company ARMO, and a study to prepare for this is under way. ARMO is the country's only refinery and holds a 20 per cent share in the retail market.

Business environment and competition

A new law on concessions and another on public procurement were adopted in late 2006 to raise standards towards European levels. The provisions include an increase in the length of concession contracts from 20 to 35 years. Public-private partnerships (PPPs) and higher inflows of FDI are expected to result from this legislation, which aims to guarantee transparency of deals, accountability of officials involved and equal treatment for foreign investors.

However, the business environment continues to be hampered by lengthy and opaque judicial procedures, prevailing corruption and the weak enforcement of property rights. According to the World Bank's survey Doing Business 2008, the protection of investors' rights remains a major concern for foreign investors. However, a new National Registration Centre became operational in September 2007, enabling registration in one day for a nominal fee. In August 2007, personal income tax was replaced by a uniform 10 per cent tax rate and from 2008 this rate will also be applied to corporate incomes.

Infrastructure

The long-delayed privatisation of Albtelecom, the dominant fixed-line telecoms operator, was finally approved by the parliament in July 2007. A Turkish consortium of Çalik and Turk Telekom agreed to pay €120 million for the government's 76 per cent stake.

Widespread blackouts continued during the winter of 2006 and throughout 2007, mainly because of drought, which affected hydroelectric production, and lack of available power in the region. The state-owned power utility, KESH, experienced financial difficulties in 2006, necessitating budgetary support for 2007 amounting to 0.5 per cent of GDP. Theft, a low tariff collection rate of around 80 per cent (or less than 50 per cent once unbilled technical and other losses are included), together with high import prices, were the main reasons for these financial problems. Following an 11 per cent increase in tariffs for metered customers in 2006, KESH has not been able to convince the government to increase tariffs for customers without meters. A moderate price hike for metered customers is envisaged only for 2008. As a step towards privatisation, the government decided in December 2006 to divest KESH of its energy distribution business and the new company will become a subsidiary of KESH. A roadmap for privatisation is being developed further (with the assistance of the International Finance Corporation).

Successful airport development under a PPP arrangement led to the opening of the new passenger terminal in March 2007 at the country's sole international airport – "Mother Teresa". This marked the start of the expansion of the airport's capacity, which is expected to increase to 1.5 million passengers per year over the next two years. Improved safety and quality of operations in line with international standards have encouraged several international airlines to start operating at the airport. However, the poor condition of the road network remains a major hindrance to trade. While a number of new regional road links are planned, progress on implementation is slow due to capacity constraints. Unfortunately, several large construction projects, including the expansion of the country's largest port at Durres, also face significant delays.

Financial sector

Bank supervision was strengthened when a new law on the banking sector came into force in June 2007, bringing the country's legislation closer to that of the EU. The law is expected to bring about improvements in surveillance and supervision, licensing, foreign branch regulations, as well as risk and prudential management. In addition, requirements for banks with a high share of non-performing loans or a high rate of credit growth were tightened. A new structure for the Financial Supervisory Authority has been approved, but its administrative capacity needs to be strengthened.

Macroeconomic performance

Real GDP growth was estimated at about 5 per cent in 2006, mainly reflecting strong growth from industry and construction. Some estimates suggest that the power crisis during the winter of 2006-07 reduced GDP growth by half a percentage point, emphasising that a solution to the energy sector's underlying problems is vital for long-term economic development.

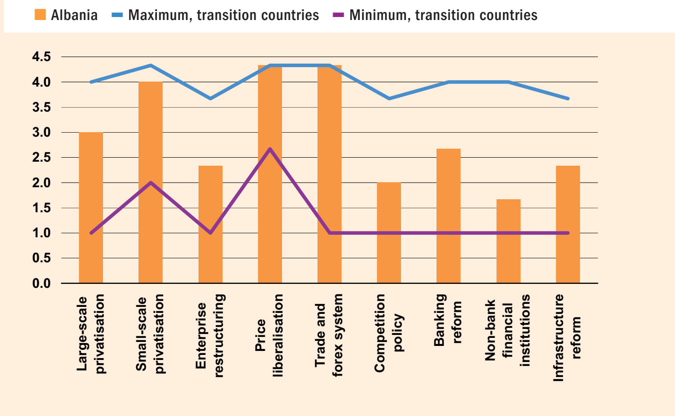
Inflation over the past few years has been within the Bank of Albania's target range of between 2 and 4 per cent. During 2006, inflation rose slightly to 2.5 per cent owing to increased excise taxes on alcohol and tobacco, and higher rent and utility prices. The Bank of Albania maintained its monetary policy to reduce inflationary pressures and to contain credit growth (which was 58 per cent year-on-year as of February 2007), raising the key interest rate gradually to 5.75 per cent in June 2007 and to 6.0 per cent in September. Fiscal policy has remained relatively prudent, with a general government deficit of 3.2 per cent in 2006. However, the introduction of a flat tax rate of 10 per cent on personal income in August 2007 and the plan to apply the same tax rate to corporate incomes from 2008 pose new challenges for the government's fiscal targets. In the first half of 2007, overall tax revenues increased by 6 per cent whereas corporate tax revenues declined by 8 per cent year-on-year, mainly due to tax cuts.

The current account deficit rose to 7.3 per cent of GDP in 2006. Textile and footwear remain the main export goods, accounting for more than half of total exports. Exports and imports grew strongly, but the latter were driven by a significant increase in demand for electricity and fuel imports. Revenues from tourism grew by some 16 per cent last year, while remittances continued to be a stable and vital source of foreign revenue, amounting to €933 million in 2006 (13 per cent of GDP). The new CEFTA is expected to intensify regional competition for many local producers, at least in the short run. Besides institutional barriers, the inadequate transport system is considered to be the main hindrance to an improved trade performance. FDI grew to €260 million in 2006, up from €224 million the year before. The Albania One Euro initiative, launched in 2006, is intended to attract further FDI through the construction of several industrial zones and the sale of land and other state property at symbolic prices. So far, however, inflows remain low.

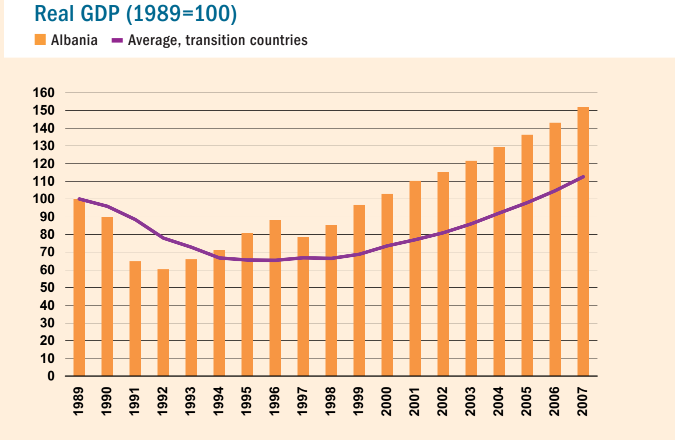
Outlook and risks

The outlook for Albania remains favourable, and the recent assignment by Moody's Investors Service of the country's first sovereign rating – a Ba1 country ceiling for foreign-currency bonds and a B1 rating for government bonds – marks an important step towards its integration into international financial markets. However, while the main macroeconomic indicators are favourable, there remain serious deficiencies regarding infrastructure and the external sector. In particular, electricity and roads still require major investments. Most important, power shortages are a serious risk for businesses, so a solution to the country's energy crisis and KESH's financial difficulties is vital. The high trade deficit, low inflows of FDI and the reliance on remittances continue to pose risks.

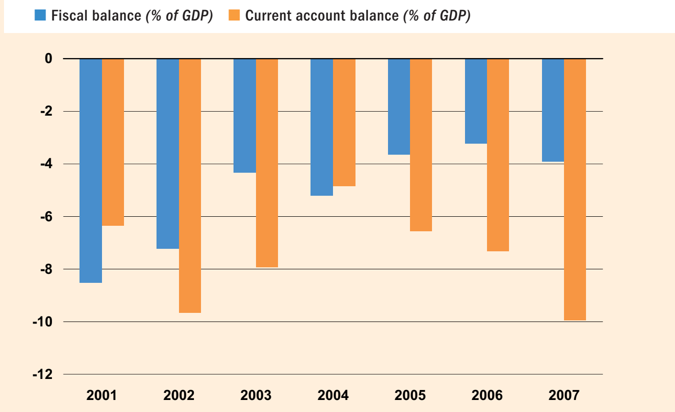
Transition indicators, 2007



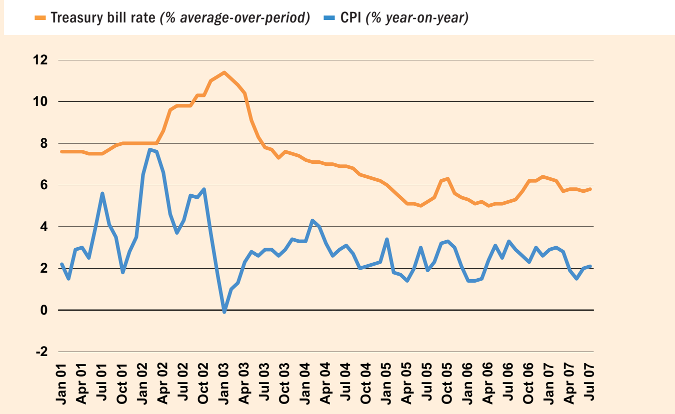
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full**	Competition office – **yes**	Independent telecoms regulator – **fully**	Capital adequacy ratio – **12 per cent**	Share of population living in poverty – **10.0 per cent** (2004)
Controls on inward direct investment – **no**	Quality of insolvency law – **high**	Independent electricity regulator – **partially**	Deposit insurance system – **yes**	Government expenditure on health – **2.9 per cent of GDP** (2005)
Interest rate liberalisation – **full**	Secured transactions law – **advanced**	Separation of railway infrastructure from operations – **no**	Quality of securities market laws – **low**	Government expenditure on education – **3.0 per cent of GDP** (2004)
Exchange rate regime – **managed float**	Quality of corporate governance law – **medium**	Independence of the road directorate – **partially**	Private pension funds – **yes**	Household expenditure on power and water – **5.0 per cent**
Wage regulation – **no**		Quality of concession laws – **low**		
Tradeability of land – **limited de facto**				

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	9.2	9.3	9.4	11.3	11.4	11.8	na
Private sector share in GDP (in per cent)	75.0	75.0	75.0	75.0	75.0	75.0	75.0
Private sector share in employment (in per cent)	80.0	80.0	80.0	80.0	80.0	80.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	1.3	1.0	0.7	0.7	0.5	0.4	na
Share of industry in total employment (in per cent)	6.0	5.3	5.2	5.2	5.3	5.4	na
Change in labour productivity in industry (in per cent)	13.6	3.9	4.8	3.1	1.9	2.4	na
Investment/GDP (in per cent)	27.6	24.5	23.4	23.8	23.6	25.0	na
EBRD index of small-scale privatisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of large-scale privatisation	3.0	3.0	3.0	3.0	3.0	3.0	3.0
EBRD index of enterprise reform	2.0	2.0	2.0	2.0	2.0	2.3	2.3
Markets and trade							
Share of administered prices in CPI (in per cent)	na	na	na	na	na	na	na
Number of goods with administered prices in EBRD-15 basket	0.0	0.0	0.0	0.0	0.0	0.0	na
Share of trade with non-transition countries (in per cent)	91.2	90.6	88.2	87.6	84.2	82.6	na
Share of trade in GDP (in per cent)	39.8	40.3	37.9	38.1	38.3	40.4	na
Tariff revenues (in per cent of imports)	6.7	6.4	6.4	6.2	5.5	5.0	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	1.7	1.7	1.7	2.0	2.0	2.0	2.0
Financial sector							
Number of banks (foreign-owned)	13 (12)	13 (12)	15 (13)	16 (14)	16 (14)	17 (14)	na
Asset share of state-owned banks (in per cent)	59.2	54.1	51.9	6.7	7.7	0.0	na
Asset share of foreign-owned banks (in per cent)	40.8	45.9	47.1	93.3	92.3	90.5	na
Non-performing loans (in per cent of total loans)	6.9	5.6	4.6	4.2	2.3	3.1	na
Domestic credit to private sector (in per cent of GDP)	5.9	6.3	7.3	9.5	15.1	21.7	na
Domestic credit to households (in per cent of GDP)	na	na	na	2.8	4.6	na	na
Of which mortgage lending (in per cent of GDP)	na	na	na	1.4	1.9	na	na
Stock market capitalisation (in per cent of GDP)	na	na	na	na	na	na	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	na	na	na	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	na
EBRD index of banking sector reform	2.3	2.3	2.3	2.7	2.7	2.7	2.7
EBRD index of reform of non-bank financial institutions	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	6.4 (12.7)	7.1 (27.6)	8.3 (35.8)	8.6 (39.5)	8.6 (48.9)	11.3 (na)	na
Internet users (per 100 inhabitants)	0.2	0.4	1.0	2.4	6.0	15.0	na
Railway labour productivity (1989=100)	38.3	39.8	39.4	35.0	28.6	35.5	na
Residential electricity tariffs (USc kWh)	3.4	4.2	5.1	6.2	6.7	6.0	na
Average collection rate, electricity (in per cent)	76	93	92	76	74	68	na
GDP per unit of energy use (PPP in US dollars per kgoe)	7.3	6.9	6.4	5.9	na	na	na
EBRD index of infrastructure reform	2.0	2.0	2.0	2.0	2.0	2.0	2.3
Electric power	2.3	2.3	2.3	2.7	2.7	2.7	2.7
Railways	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Roads	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Telecommunications	3.0	3.0	3.0	3.0	3.0	3.0	3.3
Water and waste water	1.0	1.0	1.0	1.7	1.7	1.7	1.7

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	7.1	4.3	5.7	6.2	5.6	5.0	6.0
Industrial gross output	7.1	-7.9	2.7	3.1	4.0	4.5	na
Agricultural gross output	2.2	2.1	3.0	3.8	3.0	4.0	na
Employment [1]			*(Percentage change)*				
Labour force (end-year)	-3.0	-12.2	-4.9	4.7	-0.2	-0.5	na
Employment (end-year)	-13.8	0.0	0.8	0.4	0.1	0.1	na
			(In per cent of labour force)				
Unemployment (end-year)	14.5	15.8	16.0	14.4	14.2	13.7	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	3.1	5.2	2.4	2.9	2.3	2.5	3.0
Consumer prices (end-year)	3.5	1.7	3.3	2.2	2.0	2.5	3.0
Producer prices (annual average)	-5.8	6.5	6.7	12.4	2.5	1.0	na
Producer prices (end-year)	-4.0	11.2	5.0	12.3	2.4	0.5	na
Gross average monthly earnings in economy (annual average)	24.7	11.7	10.0	6.0	7.3	6.5	na
Government sector			*(In per cent of GDP)*				
General government balance	-8.5	-7.2	-4.3	-5.2	-3.6	-3.2	-3.9
General government expenditure	31.5	31.0	27.7	29.7	28.5	28.4	na
General government debt	66.6	64.7	59.1	57.7	57.1	56.6	na
Monetary sector [2]			*(Percentage change)*				
Broad money (M2, end-year)	15.4	6.4	7.6	12.0	8.9	12.1	na
Domestic credit (end-year)	7.6	10.7	8.7	8.8	16.1	19.6	na
			(In per cent of GDP)				
Broad money (M2, end-year)	51.7	51.4	48.9	52.0	51.8	53.1	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate [3]	7.0	8.5	6.5	5.3	5.0	5.5	na
Treasury bill rate (3-month maturity)	8.0	11.2	7.3	6.1	5.4	6.3	na
Deposit rate (1 year)	6.9	8.0	5.5	4.5	4.1	3.9	na
Lending rate (1 year) [4]	15.3	14.6	11.8	11.0	12.9	12.2	na
			(Leks per US dollar)				
Exchange rate (end-year)	135.9	134.0	106.4	92.6	98.1	94.1	na
Exchange rate (annual average)	143.6	140.2	121.3	102.8	98.1	98.1	na
External sector			*(In millions of US dollars)*				
Current account	-261.0	-435.0	-466.6	-354.0	-549.3	-671.0	-1,040.0
Trade balance	-1,027.0	-1,155.1	-1,336.2	-1,586.0	-1,868.4	-2,122.7	-2,500.0
Merchandise exports	304.6	330.3	447.2	603.3	670.8	792.9	900.0
Merchandise imports	1,331.6	1,485.4	1,783.5	2,189.3	2,539.3	2,915.6	3,400.0
Foreign direct investment, net	207.3	135.0	178.0	343.9	277.1	360.0	450.0
Gross reserves, excluding gold (end-year)	737.0	860.0	1,026.0	1,374.0	1,459.0	1,624.0	na
External debt stock	1,200.0	1,180.0	1,420.0	1,673.0	1,747.0	1,835.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	4.9	5.0	4.8	5.1	4.5	4.3	na
			(In per cent of exports of goods and services)				
Debt service	4.1	6.8	5.0	4.5	4.6	6.1	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	3.1	3.2	3.2	3.2	3.2	3.2	na
GDP (in billions of leks)	590.3	631.3	714.0	752.4	822.0	899.7	982.3
GDP per capita (in US dollars)	1,312.4	1,409.0	1,858.0	2,287.6	2,618.0	2,866.3	na
Share of industry in GDP (in per cent)	7.8	7.7	7.5	7.3	7.1	7.1	na
Share of agriculture in GDP (in per cent)	32.2	28.4	27.6	26.8	26.4	26.3	na
Current account/GDP (in per cent)	-6.3	-9.7	-7.9	-4.8	-6.6	-7.3	-9.9
External debt - reserves (in US$ million)	463.0	320.0	394.0	299.0	288.0	211.0	na
External debt/GDP (in per cent)	29.2	26.2	24.1	22.9	20.9	20.0	na
External debt/exports of goods (in per cent)	142.9	128.9	121.7	104.5	93.6	79.9	na

[1] Figures do not include emigrant workers abroad.

[2] Data up to and including 2001 are based on the previous reporting standard. The new reporting standard, is in accordance with the 2000 Monetary and Financial Statistics Manual.

[3] The figures show the repo rate of the central bank.

[4] The figures show the weighted average monthly rate for new credit in leks for maturities between 6 months and 1 year in December each year.

Armenia

Key challenges

- Barriers to market entry constrain competitiveness and discourage foreign investment in several key industries. To encourage industrial diversification, the business environment needs improving and competition policy should be implemented more effectively.
- Now that financial sector regulation has been improved, following a consolidation of the supervisory bodies, the main challenge is to increase lending to the real sector and diversify overall financial sector activity.
- Economic growth is driven by a construction boom that is mainly financed by remittances from workers living abroad. Given the limited effectiveness of monetary policy instruments in this environment, tighter fiscal discipline and improved tax collections remain essential.

Country data

Population (in millions)	3.2
Area ('000 sq km)	29.8
GDP (in billion US$, 2006)	6.4
GDP per capita in 2006 at current international US$ (PPP)	5,414
National currency	Armenian dram

Progress in structural reform

Business environment and competition

Armenia has been repeatedly ranked among the top countries in the Commonwealth of Independent States and Mongolia (CIS+M) in which to do business, but a recent study by the anti-corruption organisation Transparency International uncovered an increase in perceived corruption over the last three years. Revisions to the government's Anti-Corruption Strategy, scheduled for 2006, have been delayed to the end of 2007.

The Central Bank of Armenia (CBA) hopes to persuade Armenia's largest companies, many of which operate mainly in the shadow economy, to list on the stock exchange as a prelude to selling the exchange to an international investor. As an incentive, the CBA and the Ministry of Finance plan to offer to temporarily reduce the profit tax to encourage these firms to conduct their operations in the formal economy.

Another incentive to shift to the formal economy is the newly enacted credit bureau. Banks are increasingly willing to use this since it has substantially more information on potential clients than the former registry.

Barriers to entry for foreign and domestic firms in key sectors still remain and severely impede fair competition. In particular, the tradeable goods sector lacks competitiveness mainly because of several monopolies that control the import of certain basic commodities.

Infrastructure

The Public Services Regulatory Commission intends to fully liberalise the internet and telecoms markets by the end of 2007. An additional mobile licence is also expected to be sold later this year, increasing the number of licences from two to three. The two current mobile licences are owned by K-Telecom (majority-owned by Russia's MTS) and Russia's Vimpelcom (owning 100 per cent of ArmenTel's mobile operations). This, in turn, is expected to lead to further improvements in tariffs for end-users.

The water and waste-water sector has seen dramatic improvements in collection discipline from around 70 per cent in 2003 to 93 per cent in 2006, despite cumulative tariff increases over the last year. Widespread metering, covering nearly 90 per cent of the country, has improved the overall performance significantly. The government has also secured the participation of the private sector through management contracts in the Yerevan and Lake Sevan districts.

Financial sector

The banking sector was completely privatised and underwent an initial consolidation preceding an increase in minimum capital requirements in mid-2005. Bank and non-bank supervision was consolidated under the CBA in January 2006 and now includes over 400 insurance companies, credit organisations, brokerage firms and exchange offices. This led to increased prudential standards for non-bank financial intermediaries and the revocation of several licences. A deposit insurance scheme was launched in 2006 and banks have adopted International Financial Reporting Standards. Overall, banks are well-capitalised, liquid and profitable and the loan portfolio quality has remained sound. However, the financial sector lacks diversity and the non-bank financial sector remains small. The growth of private credit, in particular consumer and mortgage loans, has increased, although overall credit to the economy remains below 10 per cent of GDP.

Social sector

The CBA, along with the Ministry of Labour, is designing a new pension system that will switch from pay-as-you-go to an individual account system with a simplified flat rate only, indexed by inflation. This multi-pillar pension system is being drafted with technical assistance from the World Bank and other donors and is expected to start operating in January 2009.

The benefits of strong growth in recent years have slowly fed through to those on the lowest income. The latest government household survey shows a decline in overall poverty from over half the population living under the poverty line in 1998 to less than 30 per cent in 2005. The World Bank also approved a Poverty Reduction Support Package in March 2007 to help the government in its poverty reduction strategy. The drop in unemployment from 8.1 per cent in 2005 to 7.2 per cent in June 2007 has also contributed to the decline in poverty. And since the law on employment and social protection was implemented at the beginning of 2006, the reported number of people taking part in employment programmes has risen. While the new labour market legislation supports the creation of more flexible job markets, it is still likely that the true unemployment rate is higher than the official figure.

Macroeconomic performance

GDP rose by 13.4 per cent in real terms in 2006 and by 11.2 per cent (year-on-year) in the first half of 2007. The largest driver of growth was construction, which is predominantly financed by remittances (which have continued to grow over the past year). Output in industry and agriculture stagnated slightly. Overall, the tradeable goods sector remains constrained by the closure of the Turkish and Azeri borders to Armenian trade. The growth of real wages – particularly in manufacturing – has decreased significantly. Compared with other transition economies, Armenian wages remain low. However, while unit labour costs fell in construction, thanks to rapid productivity growth, they have been rising in other sectors, especially in agriculture, financial services and trade. The main exporter, the diamond-processing industry, continues to suffer from supply disruptions, competition from other countries (mainly India and China) and weak global demand.

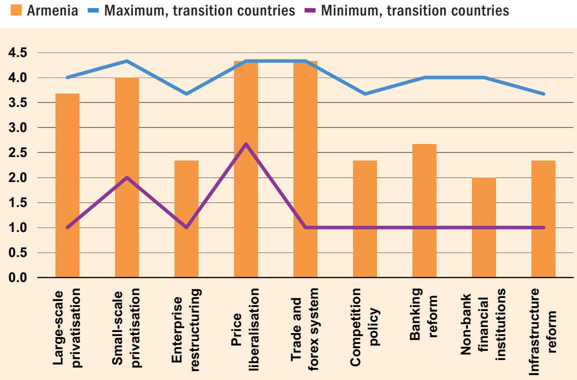
Poor tax collection remains a major concern. Even though tax revenues increased by 19 per cent in 2006, the tax-to-GDP ratio of 15 per cent remains one of the lowest in the region, reflecting low overall tax compliance. The improvements in 2006 are mainly due to the buoyancy of VAT revenues and the large increase in unprocessed VAT refunds. The government aims to increase the tax-to-GDP ratio by two percentage points to 17 per cent of GDP over the medium term. Parliament approved a modest fiscal reform in 2006, which includes expanding the tax base to include construction and gambling. The income tax base calculation was also changed from cash to accrual.

Inflation, as measured by the CPI, averaged 2.9 per cent in 2006 (although it increased to 5.2 per cent in December, mainly reflecting higher food prices). The original target for 2006 of 3 per cent was therefore only just met and the CBA increased the target for 2007 to 4 per cent. Thus the overall switch to inflation targeting seems to have evolved smoothly and the CBA has been able to anchor public inflation expectations. However, the growth of broad money remained high at 33 per cent in 2006, reflecting the high level of monetisation and de-dollarisation (“dramisation”). Reserve money grew by 41 per cent due to a sizeable CBA foreign exchange intervention in 2006. To dampen inflationary pressures, the repurchase rate was raised by 75 basis points in July 2007 to 4.75 per cent. Movements in the refinancing rate have nevertheless only a limited impact, given the underdevelopment of the domestic money market and the low level of banking intermediation.

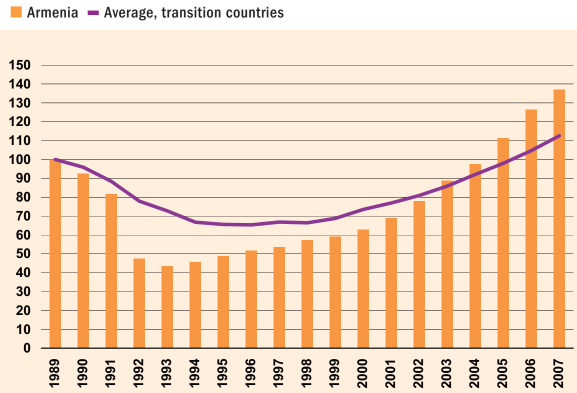
Outlook and risks

Overall economic growth is expected to slow only slightly to between 7 and 9 per cent in the medium term, provided the government continues with prudent macroeconomic policies and intensifies ongoing structural reforms, in particular to foster economic diversification. Competitiveness in the tradeable sectors also needs to be improved to attract foreign investment. One of the key business impediments is the ongoing closure of the Turkish and Azeri borders to Armenian trade. This has not only resulted in the loss of key markets and higher transport costs, but has also increased the dependency on concessional financing from donors and international financial institutions.

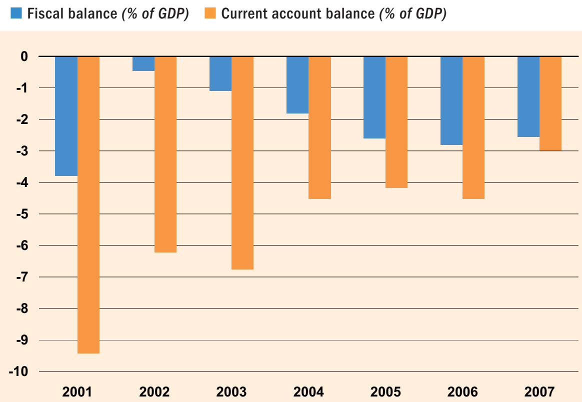
Transition indicators, 2007



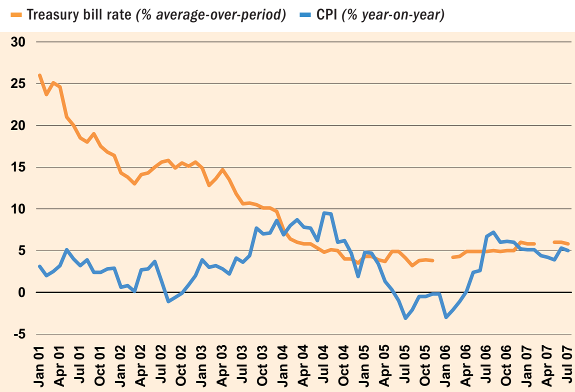
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



No treasury bill rate data were available for December 2005, January 2006, March and April 2007.

Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full**	Competition office – **yes**	Independent telecoms regulator – **partially**	Capital adequacy ratio – **12 per cent**	Share of population living in poverty – **31.1 per cent** (2003)
Controls on inward direct investment – **no**	Quality of insolvency law – **medium**	Independent electricity regulator – **partially**	Deposit insurance system – **yes**	Government expenditure on health – **1.5 per cent of GDP** (2006)
Interest rate liberalisation – **full**	Secured transactions law – **malfunctioning**	Separation of railway infrastructure from operations – **no**	Quality of securities market laws – **high**	Government expenditure on education – **2.7 per cent of GDP** (2006)
Exchange rate regime – **floating**	Quality of corporate governance law – **high**	Independence of the road directorate – **no**	Private pension funds – **no**	Household expenditure on power and water – **6.8 per cent**
Wage regulation – **no**		Quality of concession laws – **na** [1]		
Tradeability of land – **full except foreigners**				

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP) [2]	9.4	9.5	10.2	10.2	na	na	na
Private sector share in GDP (in per cent)	60.0	70.0	70.0	75.0	75.0	75.0	75.0
Private sector share in employment (in per cent)	75.0	74.0	76.0	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	0.6	0.6	0.9	1.0	0.6	na	na
Share of industry in total employment (in per cent)	13.4	12.9	na	na	na	na	na
Change in labour productivity in industry (in per cent)	12.0	36.0	na	na	na	na	na
Investment/GDP (in per cent)	19.8	21.7	24.2	22.0	23.2	na	na
EBRD index of small-scale privatisation	3.7	3.7	3.7	4.0	4.0	4.0	4.0
EBRD index of large-scale privatisation	3.0	3.3	3.3	3.3	3.7	3.7	3.7
EBRD index of enterprise reform	2.0	2.3	2.3	2.3	2.3	2.3	2.3
Markets and trade							
Share of administered prices in CPI (in per cent)	6.3	8.1	8.7	8.0	8.0	8.1	na
Number of goods with administered prices in EBRD-15 basket	1.0	1.0	1.0	1.0	1.0	1.0	na
Share of trade with non-transition countries (in per cent)	79.8	76.4	77.0	73.6	69.3	59.9	na
Share of trade in GDP (in per cent)	53.2	58.8	65.1	54.1	52.0	44.2	na
Tariff revenues (in per cent of imports)	2.3	1.9	1.6	2.0	2.3	na	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.0	4.0	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.0	2.0	2.0	2.0	2.3	2.3	2.3
Financial sector							
Number of banks (foreign-owned)	30 (14)	20 (8)	19 (8)	20 (9)	21 (10)	21 (10)	na
Asset share of state-owned banks (in per cent)	0.0	0.0	0.0	0.0	0.0	0.0	na
Asset share of foreign-owned banks (in per cent)	57.6	54.2	51.8	56.7	48.7	45.8	na
Non-performing loans (in per cent of total loans)	6.8	4.9	4.9	2.1	2.1	2.6	na
Domestic credit to private sector (in per cent of GDP)	7.9	6.9	6.0	7.2	8.1	8.7	na
Domestic credit to households (in per cent of GDP)	na	1.5	1.8	2.6	3.3	4.1	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	0.5	0.9	na
Stock market capitalisation (in per cent of GDP)	1.2	1.0	1.0	0.5	0.9	0.8	na
Stock trading volume (in per cent of market capitalisation)	4.6	5.6	3.9	7.0	3.6	10.1	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	na
EBRD index of banking sector reform	2.3	2.3	2.3	2.3	2.7	2.7	2.7
EBRD index of reform of non-bank financial institutions	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	17.3 (0.8)	17.8 (2.3)	18.6 (3.8)	19.3 (6.7)	19.3 (10.5)	19.7 (na)	na
Internet users (per 100 inhabitants)	1.6	2.0	4.6	5.0	5.3	5.8	na
Railway labour productivity (1989=100)	17.3	20.6	23.5	29.1	26.9	27.6	na
Residential electricity tariffs (USc kWh)	4.4	4.3	4.4	4.5	5.4	5.9	na
Average collection rate, electricity (in per cent) [3]	87	98	95	99	101	99	na
GDP per unit of energy use (PPP in US dollars per kgoe)	4.1	5.0	5.2	5.6	na	na	na
EBRD index of infrastructure reform	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Electric power	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Railways	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Roads	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Telecommunications	2.3	2.3	2.3	2.3	2.3	2.7	2.7
Water and waste water	2.0	2.0	2.0	2.0	2.0	2.0	2.3

[1] Armenia has no specific concession law but generally conforms with internationally accepted principles on concession laws.

[2] Privatisation proceeds are in principle to finance fiscal deficits only. The part saved in the Special Privatisation Accounts is not included.

[3] Numbers greater than 100 reflect collection of arrears.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	9.6	13.2	13.9	10.1	14.0	13.4	8.5
Private consumption	7.5	9.0	6.9	8.9	8.8	9.2	na
Public consumption	4.3	2.2	14.1	11.0	19.0	19.8	na
Gross fixed capital formation	5.3	33.1	27.5	19.0	29.1	26.0	na
Exports of goods and services	20.8	26.3	23.2	3.7	na	na	na
Imports of goods and services	1.2	9.0	31.0	3.0	na	na	na
Industrial gross output	3.8	14.4	15.3	2.1	7.5	-0.9	na
Agricultural gross output	11.6	4.5	4.0	14.5	11.2	0.4	na
Employment			*(Percentage change)*				
Labour force (end-year)	-2.5	-12.2	-0.6	-0.5	-2.6	na	na
Employment (end-year)	-1.0	-12.5	0.5	-0.1	-0.5	na	na
			(In per cent of labour force)				
Unemployment (annual average) [1]	10.4	10.8	10.1	9.4	8.1	7.4	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	3.1	1.1	4.7	7.0	0.6	2.9	3.5
Consumer prices (end-year)	2.9	2.0	8.6	1.9	-0.2	5.2	3.5
Producer prices (annual average)	-0.4	2.5	5.9	21.7	7.9	5.8	na
Producer prices (end-year)	-3.6	0.9	21.1	25.3	-4.0	na	na
Gross average monthly earnings in economy (annual average)	10.7	12.2	21.7	22.8	29.5	18.9	na
Government sector [2]			*(In per cent of GDP)*				
General government balance	-3.8	-0.4	-1.1	-1.8	-2.6	-2.8	-2.6
General government expenditure	20.9	19.3	18.9	17.1	17.6	16.6	na
General government debt	45.3	46.6	40.9	51.5	39.7	34.2	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	4.3	34.0	10.4	22.3	27.8	32.9	na
Domestic credit (end-year)	-9.8	-8.1	-9.6	41.1	54.4	30.0	na
			(In per cent of GDP)				
Broad money (M2, end-year)	13.4	15.6	14.4	15.0	16.3	18.2	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	15.0	13.5	7.0	3.8	3.5	4.1	na
Money market rate	19.4	12.3	7.5	4.2	3.2	na	na
Deposit rate	14.9	9.6	6.9	4.9	5.8	na	na
Lending rate	26.7	18.8	20.9	18.2	17.3	17.2	na
			(Drams per US dollar)				
Exchange rate (end-year)	561.8	584.9	566.0	486.3	450.2	363.5	na
Exchange rate (annual average)	555.1	573.4	578.8	533.5	457.8	416.0	na
External sector			*(In millions of US dollars)*				
Current account	-199.6	-147.9	-189.4	-161.7	-204.2	-289.6	-242.0
Trade balance	-420.2	-368.8	-434.1	-457.9	-584.7	-770.6	-685.0
Merchandise exports	353.1	513.8	696.1	738.3	981.4	1,030.4	1,250.0
Merchandise imports	773.3	882.5	1,130.2	1,196.3	1,566.1	1,801.0	1,935.0
Foreign direct investment, net	70.0	111.0	121.0	217.0	254.6	290.8	316.0
Gross reserves, excluding gold (end-year)	317.2	415.6	502.0	547.8	669.5	1,071.9	na
External debt stock	906.0	1,026.0	1,788.1	1,868.0	1,860.2	2,052.7	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	3.9	4.5	4.3	4.3	4.1	5.7	na
			(In per cent of exports of goods and services)				
Debt service	9.5	10.1	11.4	7.2	4.4	5.4	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	3.2	3.2	3.2	3.2	3.2	3.2	na
GDP (in billions of drams)	1,175.9	1,362.5	1,624.6	1,907.9	2,244.0	2,665.0	2,992.8
GDP per capita (in US dollars)	659.3	740.3	873.9	1,112.8	1,510.0	1,989.4	na
Share of industry in GDP (in per cent)	20.5	18.9	19.9	19.7	na	na	na
Share of agriculture in GDP (in per cent)	24.9	23.4	21.3	22.5	na	na	na
Current account/GDP (in per cent)	-9.4	-6.2	-6.7	-4.5	-4.2	-4.5	-3.0
External debt - reserves (in US$ million)	588.8	610.4	1,286.1	1,320.2	1,190.7	980.7	na
External debt/GDP (in per cent)	42.8	43.2	63.7	52.2	38.0	32.0	na
External debt/exports of goods and services (in per cent)	167.9	147.1	197.9	189.7	140.6	143.9	na

[1] Registered unemployed only.

[2] Central government account only.

Azerbaijan

Key challenges

- Restructuring, increased investments and private sector participation in power and telecoms would help to improve efficiency in these two sectors and the business environment in general.
- To encourage economic diversification and attract foreign investment in the non-oil sector, it is vital to effectively implement the anti-monopoly and investment laws, together with concrete anti-corruption measures.
- Macroeconomic stability would be enhanced through a longer-term approach from the authorities towards budgetary expenditure, aimed at improving the competitiveness of the non-oil sector while addressing the country's large investment needs.

Country data	
Population (in millions)	8.4
Area ('000 sq km)	86.6
GDP (in billion US$, 2006)	19.9
GDP per capita in 2006 at current international US$ (PPP)	6,949
National currency	Manat

Progress in structural reform

Business environment and competition

The business environment remains difficult. Competition is limited by the existence of monopolies and restricted entry into different areas of the economy. Governance has been especially weak in the state-owned enterprise sector, which remains inefficient and non-transparent, and progress with large-scale privatisation has been slow. The government has, however, recently intensified its efforts to improve the business environment. "One-stop shops" have been established to simplify registration and licensing procedures for businesses, while a new law on investment activity that intends to set a level playing field for domestic and external investors is currently under discussion in the parliament. A new anti-monopoly law is in the process of being passed, having been approved at first reading. There has been some progress in improving anti-corruption legislation as the government has recently submitted to parliament a draft law on the Code of Conduct of Civil Servants to combat corruption of public officials.

In order to stimulate economic diversification, the government is preparing a State Programme on the Development of Entrepreneurship for 2007-12. The purpose of the programme is to improve the regulatory framework, business environment and access to financing, especially for entrepreneurs in the non-oil sector.

Infrastructure

Modernisation of the country's infrastructure has suffered from chronic under-investment and a weak regulatory environment. This has become a top priority for the government, which is focusing on upgrading the principal trade corridors in order to enable exchange and regional cooperation with Azerbaijan's neighbours.

The power sector has suffered from low tariff collection rates, deteriorating infrastructure and high losses. There are a number of projects being prepared that aim to improve electricity generation and transmission, but power generation is still not likely to meet growing demand. The state-owned electricity utility, Azerenerji, continues to be heavily subsidised by the government. Although the government has not yet launched a detailed structural reform programme for the sector, it has committed itself to attracting private capital through various means, including the adoption of a medium-term tariff policy designed with the help of the international community. Energy prices have continued to rise towards international levels. In January 2007 the Tariff Council sharply increased the domestic prices of oil products, electricity (threefold) and natural gas for industrial use (twofold). The price increases, which also included those for water, are intended to reduce government subsidies in the sector and improve energy efficiency.

In the telecoms sector, the plans to separate the regulatory and commercial roles of the Ministry of Telecommunications have been further delayed, although there has been some renewed interest in the sale of Azercell, the main mobile operator that controls 70 per cent of the market and in which the government still owns 37.5 per cent. The state-owned company, Aztelecom, continues to dominate the fixed-line market. Mobile telephone penetration, however, is growing rapidly, reaching 392 mobile phones per 1,000 inhabitants in 2006. Also, the entry in 2006 of the third operator Azerphone, which is mainly foreign-owned, is expected to increase competition.

Social sector

Rapid GDP growth over the past two years has contributed to a significant increase in GDP per capita from US$ 1,051 at the end of 2004 to US$ 2,363 at the end of 2006. According to the government's new household survey and World Bank estimates, poverty levels have also fallen, although the proportion of the population living below the poverty line remained high at about 29.3 per cent in 2005 (down from 39.7 per cent in 2003).

To mitigate the effects of higher utility tariffs on those with low incomes the government implemented in mid-2006 a system of targeted social assistance. The system is based on household surveys carried out twice a year. At the end of 2006 about 65,000 households participated in the programme and over a quarter of a million people received social assistance. The government is expecting to double the number of households participating in the programme by the end of 2007, and is currently assessing the effectiveness of the social assistance so far provided.

Macroeconomic performance

Real GDP rose by a record 34.5 per cent in 2006 after a growth of 26.4 per cent in 2005, reflecting the large increase in oil production and exports. The oil sector accounted for about 54 per cent of GDP in 2006 (up from 44 per cent in 2005) and for more than three-quarters of the industrial sector. Agricultural production rose by only around 1 per cent and the non-oil traded sector grew by only 4 per cent in 2006. Record growth has continued in the first half of 2007 when annual GDP growth was estimated at 35.1 per cent as oil production grew by more than 46 per cent.

The significant increase in domestic demand due to surging oil exports and a large fiscal expansion, together with large unsterilised purchases of foreign exchange by the National Bank of Azerbaijan (NBA) to limit the annual nominal exchange rate appreciation to 5 per cent, have fuelled monetary growth. As a result, the annual rate of inflation rose by 11.4 per cent at the end of 2006. In response, the NBA continued to tighten monetary policy by raising its refinancing rate from 9.5 per cent at the end of 2006 to 13 per cent in June 2007. Nevertheless, given the limited effect of the refinancing rate in the context of the underdeveloped financial sector, annual inflation increased to above 15 per cent in each of the first seven months of 2007.

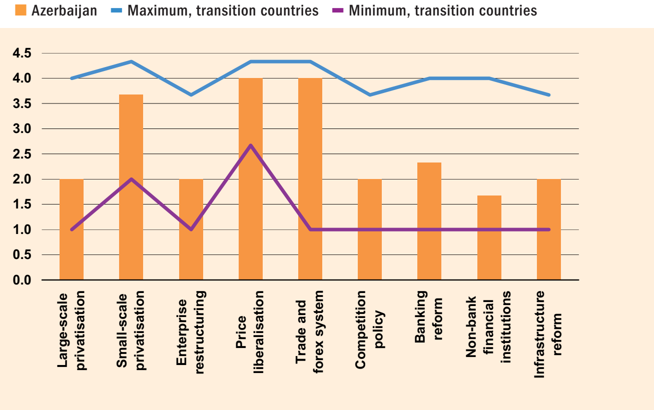
The real exchange rate appreciated by about 18.6 per cent annually during the first half of 2007 (up from 10 per cent in 2006), raising concerns about the possible loss of competitiveness in the non-oil sector. To alleviate the pressure on the exchange rate, the NBA recently liberalised the capital account by allowing entities to make unlimited investments in OECD countries without permission from the NBA.

Government finances continue to be strong, supported by booming oil revenues. As a result, despite an 80 per cent increase in expenditures, mainly on long-term infrastructure investments, the government budget recorded a surplus of 0.1 per cent of GDP in 2006, and it is expected to reach 2.4 per cent in 2007. However, the recent further rapid increase in public expenditure, at 55 per cent year-on-year in the first five months of 2007, has put additional pressure on inflation and the real exchange rate. According to the IMF, a significant reduction in the non-oil deficit is also necessary to ensure long-term fiscal stability.

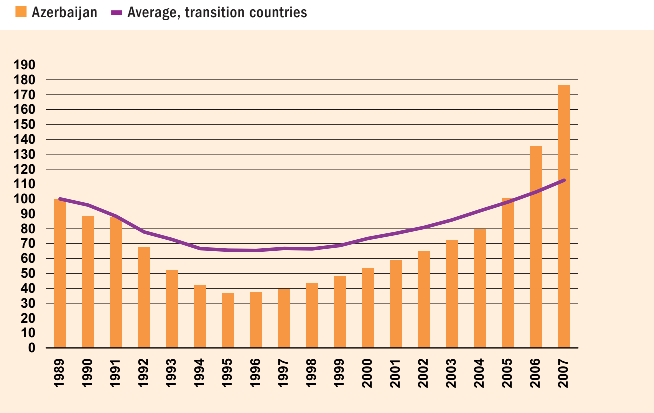
Outlook and risks

With oil and gas output likely to rise further, Azerbaijan will enjoy high economic growth in the short to medium term. However, the economy depends heavily on the energy sector and so remains vulnerable to energy shocks. Economic diversification is therefore essential for longer-term sustainability. The recent hike in public expenditure raises concerns not only about further inflationary and real exchange rate pressures, but also over the economy's general absorption capacity in the short term. Over the medium term, excessive growth in public expenditure threatens the sustainability of public finances given that oil production is expected to decline from 2013. In view of the limited effectiveness of monetary policy instruments on lowering inflation, due to an underdeveloped banking sector, controlling inflation will depend on the government significantly reducing the non-oil primary budget deficit.

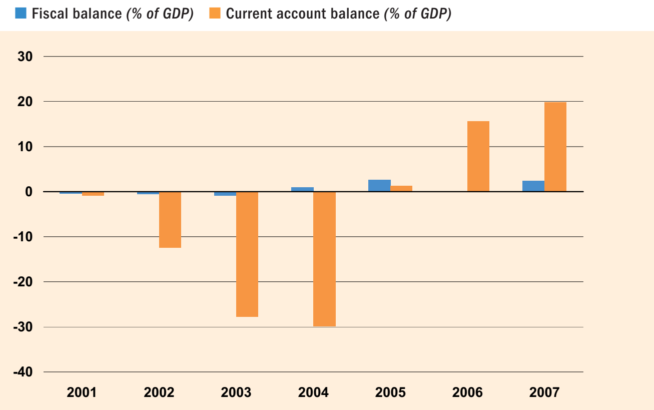
Transition indicators, 2007



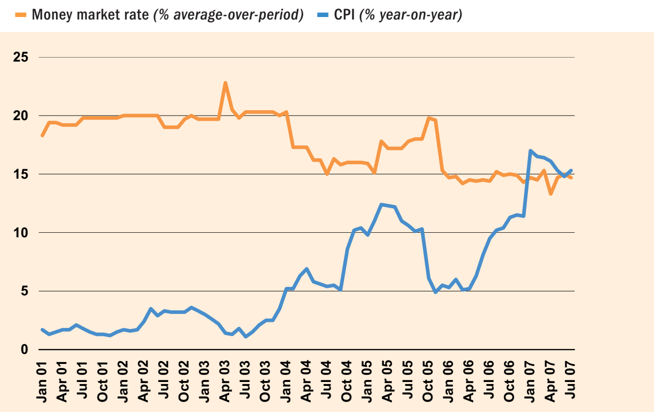
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full** Controls on inward direct investment – **no** Interest rate liberalisation – **full** Exchange rate regime – **floating** Wage regulation – **no** Tradeability of land – **limited de jure**	Competition office – **yes** Quality of insolvency law – **low** Secured transactions law – **malfunctioning** Quality of corporate governance law – **very low**	Independent telecoms regulator – **no** Independent electricity regulator – **no** Separation of railway infrastructure from operations – **no** Independence of the road directorate – **fully** Quality of concession laws – **na** [1]	Capital adequacy ratio – **12 per cent** Deposit insurance system – **no** Quality of securities market laws – **low** Private pension funds – **no**	Share of population living in poverty – **<2.0 per cent** (2002) [2] Government expenditure on health – **0.9 per cent of GDP** (2004) Government expenditure on education – **2.5 per cent of GDP** (2005) Household expenditure on power and water – **3.5 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	2.0	2.4	2.6	3.0	3.2	na	na
Private sector share in GDP (in per cent)	60.0	60.0	60.0	60.0	60.0	60.0	75.0
Private sector share in employment (in per cent)	66.6	68.0	68.5	68.4	68.1	68.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	6.6	11.9	12.1	10.7	7.7	7.5	na
Share of industry in total employment (in per cent)	6.6	6.8	6.7	6.9	7.0	7.1	na
Change in labour productivity in industry (in per cent)	6.4	1.7	5.9	1.3	29.7	31.9	na
Investment/GDP (in per cent)	20.7	34.6	49.6	53.2	56.1	na	na
EBRD index of small-scale privatisation	3.3	3.7	3.7	3.7	3.7	3.7	3.7
EBRD index of large-scale privatisation	2.0	2.0	2.0	2.0	2.0	2.0	2.0
EBRD index of enterprise reform	1.7	1.7	2.0	2.0	2.0	2.0	2.0
Markets and trade							
Share of administered prices in CPI (in per cent)	6.0	6.0	6.0	7.0	na	na	na
Number of goods with administered prices in EBRD-15 basket	3.0	3.0	3.0	3.0	3.0	3.0	na
Share of trade with non-transition countries (in per cent)	79.3	75.0	70.0	67.4	66.9	70.6	na
Share of trade in GDP (in per cent)	61.5	66.2	73.5	84.4	90.6	92.1	na
Tariff revenues (in per cent of imports)	12.5	9.1	6.0	4.9	8.4	9.0	na
EBRD index of price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of forex and trade liberalisation	3.3	3.7	3.7	3.7	4.0	4.0	4.0
EBRD index of competition policy	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Financial sector							
Number of banks (foreign-owned)	53 (5)	46 (4)	46 (4)	44 (5)	44 (5)	44 (5)	na
Asset share of state-owned banks (in per cent)	58.3	63.1	55.3	56.1	55.2	51.0	na
Asset share of foreign-owned banks (in per cent)	4.6	4.1	5.2	5.8	6.6	6.1	na
Non-performing loans (in per cent of total loans)	20.5	19.7	14.6	14.5	14.9	12.0	na
Domestic credit to private sector (in per cent of GDP)	5.0	5.5	6.6	8.9	9.2	12.4	na
Domestic credit to households (in per cent of GDP)	1.0	1.4	2.0	3.0	3.1	4.1	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	0.3	na
Stock market capitalisation (in per cent of GDP)	na	na	na	na	na	na	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	na	na	na	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	na
EBRD index of banking sector reform	2.3	2.3	2.3	2.3	2.3	2.3	2.3
EBRD index of reform of non-bank financial institutions	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	10.6 (8.9)	11.2 (9.6)	11.3 (12.7)	12.3 (17.4)	13.0 (26.7)	14.0 (39.2)	na
Internet users (per 100 inhabitants)	0.3	3.6	4.2	4.9	8.1	9.8	na
Railway labour productivity (1989=100)	25.4	29.4	31.9	32.0	39.9	45.0	na
Residential electricity tariffs (USc kWh)	2.1	2.0	2.0	2.0	2.2	2.2	na
Average collection rate, electricity (in per cent)	30	45	21	27	26	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	2.0	2.2	2.3	2.5	na	na	na
EBRD index of infrastructure reform	1.7	1.7	1.7	2.0	2.0	2.0	2.0
Electric power	2.0	2.3	2.3	2.3	2.3	2.3	2.3
Railways	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Roads	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Telecommunications	1.0	1.0	1.0	1.7	1.7	1.7	1.7
Water and waste water	1.7	1.7	1.7	1.7	1.7	1.7	1.7

[1] Azerbaijan has no specific concession law but generally conforms with internationally accepted principles on concession laws.

[2] The State Statistics Committee reports that 29.3 per cent of the population was in extreme poverty in 2005, down from 39.7 per cent in 2003. Extreme poverty is defined by the national authorities based on the value of the minimum food basket equivalent to old manat 147,430 (US$ 32) per capita a month.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	9.9	10.6	11.2	10.2	26.4	34.5	30.0
Private consumption	9.9	13.1	6.0	6.9	21.7	na	na
Public consumption	4.9	0.5	11.1	4.6	19.7	na	na
Gross fixed capital formation	20.6	64.8	72.6	13.0	14.6	na	na
Exports of goods and services	34.1	14.0	9.2	-9.0	70.9	na	na
Imports of goods and services	33.0	48.4	45.6	-9.5	21.9	na	na
Industrial gross output	5.1	3.6	6.1	5.7	33.5	36.6	na
Agricultural gross output	11.1	6.4	5.6	4.6	7.5	0.9	na
Employment			*(Percentage change)*				
Labour force (end-year)	0.4	0.4	0.6	1.7	1.1	3.1	na
Employment (end-year)	0.3	0.3	0.6	1.7	1.1	3.2	na
			(In per cent of labour force)				
Unemployment (end-year)	1.3	1.4	1.4	1.4	1.4	1.3	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	1.5	2.8	2.2	6.7	9.6	8.3	16.0
Consumer prices (end-year)	1.5	3.3	3.6	10.4	5.5	11.4	14.0
Producer prices (annual average)	1.8	-2.3	16.1	12.9	10.6	17.7	na
Producer prices (end-year)	-5.2	7.2	11.2	21.9	10.8	17.1	na
Gross average monthly earnings in economy (annual average)	17.3	21.3	21.4	26.2	21.9	19.8	na
Government sector			*(In per cent of GDP)*				
General government balance [1]	-0.4	-0.5	-0.8	1.0	2.6	0.1	2.4
General government expenditure	18.7	27.7	28.5	25.9	22.7	28.9	na
General government debt	20.9	20.5	20.0	18.6	13.3	na	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	7.7	15.6	27.9	31.9	15.8	168.3	na
Domestic credit (end-year)	-38.1	85.9	13.2	60.2	52.9	63.6	na
			(In per cent of GDP)				
Broad money (M2, end-year)	6.6	6.7	7.3	8.0	6.3	12.0	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinance rate (6 months)	10.0	7.0	7.0	7.0	9.0	9.5	na
Interbank interest rate (3 months) [2]	19.8	19.7	20.3	16.6	15.3	14.3	na
Deposit rate	8.5	8.7	9.5	9.2	8.5	10.6	na
Lending rate	19.7	17.4	15.5	15.7	17.0	17.7	na
			(Manats per US dollar)				
Exchange rate (end-year) [3]	1.0	1.0	1.0	1.0	0.9	0.9	na
Exchange rate (annual average) [3]	0.9	1.0	1.0	1.0	0.9	0.9	na
External sector			*(In millions of US dollars)*				
Current account	-49.0	-770.0	-2,020.7	-2,588.0	167.0	3,106.0	5,700.0
Trade balance	581.0	482.0	-97.7	162.0	3,299.0	7,745.0	na
Merchandise exports	2,046.0	2,305.0	2,625.0	3,743.0	7,649.0	13,014.0	17,420.0
Merchandise imports	1,465.0	1,823.0	2,722.7	3,581.0	4,350.0	5,269.0	6,057.0
Foreign direct investment, net	299.0	1,048.0	2,353.0	2,351.0	458.0	-926.0	-4,963.0
Gross reserves, excluding gold (end-year) [4]	725.0	721.0	803.0	1,075.0	1,178.0	2,500.0	na
External debt stock	1,154.4	2,602.5	2,744.3	3,488.8	4,345.3	4,877.4	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	4.1	2.8	2.0	2.0	2.0	3.8	na
			(In per cent of exports of goods and services)				
Debt service	4.9	4.4	5.2	3.6	1.3	1.1	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	8.1	8.2	8.3	8.3	8.4	8.4	na
GDP (in billions of manats)	5.3	6.1	7.1	8.5	12.5	17.7	24.4
GDP per capita (in US dollars)	704.6	760.5	880.9	1,050.9	1,576.8	2,363.3	na
Share of industry in GDP (in per cent)	37.6	37.4	37.2	38.3	47.5	57.5	na
Share of agriculture in GDP (in per cent)	14.7	13.8	12.2	10.8	9.0	6.9	na
Current account/GDP (in per cent)	-0.9	-12.3	-27.8	-29.8	1.3	15.6	19.8
External debt - reserves (in US$ million)	429.4	1,881.5	1,941.3	2,413.8	3,167.3	2,377.4	na
External debt/GDP (in per cent)	20.2	41.7	37.7	40.2	32.8	24.6	na
External debt/exports of goods and services (in per cent)	49.4	97.6	89.8	82.4	52.2	35.6	na

1 General government consolidates all levels of government, except for municipalities and state-owned enterprises, and includes the State Oil Fund and other extra-budgetary funds.

2 90-day interbank offer rate in manats, nominal.

3 In January 2006 Azerbaijan introduced a new currency denomination. One new manat is equal to 5,000 old manat. All data are retrospectively converted in new manat.

4 By end-December 2006 there were additional foreign exchange assets of approximately US$ 1.4 billion in the State Oil Fund.

Belarus

Key challenges

- As the price of imported gas gradually rises to European levels the government will need to accelerate enterprise restructuring and step up investment in energy-efficient technologies to improve the competitiveness of domestic industries.
- A comprehensive privatisation programme, supported by an improved business environment, is needed to attract FDI, which would provide long-term external financing and help boost productivity.
- External borrowing may mitigate the energy price hike, but it should be used with caution to prevent a rapid accumulation of external liabilities that would increase the country's vulnerability to adverse external shocks.

Country data

Population (in millions)	9.7
Area ('000 sq km)	207.6
GDP (in billion US$, 2006)	36.9
GDP per capita in 2006 at current international US$ (PPP)	9,037
National currency	Belarussian rouble

Progress in structural reform

Liberalisation and privatisation

On 31 December 2006 the Belarussian state-owned gas transmission company, Beltransgaz, signed a five-year contract with Russia's Gazprom for the supply and transit of gas. The agreement will raise the price of gas imported by Belarus to European levels by 2011. For 2007, the price of Russian gas was set at US$ 100 per 1,000 cubic metres, more than twice what Belarus paid in 2006. Belarus paid only 55 per cent of the new price in the first half of the year and settled the accumulated debt at the beginning of August 2007. For the rest of the year Belarus is expected to pay the full price.

Beltransgaz and Gazprom also set up a joint venture in May 2007. In June Gazprom paid US$ 625 million for an initial 12.5 per cent stake in the new company and by 2010 will have paid a total of US$ 2.5 billion for a 50 per cent stake. Payment will be made in equal instalments from 2007 to 2010.

In January 2007 the terms of oil trade with Russia were amended and brought into line with pre-existing arrangements that Belarus had routinely ignored. Belarus agreed to raise its export taxes on oil and oil products to unify them with those charged by Russia, which reduced the attractiveness of Belarussian refineries for oil processing. Russia also introduced a discounted oil duty on previously duty-free deliveries of Russian crude oil to Belarus.

Shortly after the energy trade arrangements were revised the authorities signalled their intention to proceed with the privatisation of major industrial enterprises in several key industries. There has been interest among international investors, but no significant privatisation had started by September 2007. However, in August, the state sold a 51 per cent stake in the mobile operator Velcom to the Cyprus-based company SB-Telecom, the owner of the remaining shares in the company.

Business environment and competition

There have been few substantive changes in the country's business climate despite the growing need to attract capital to increase energy efficiency and improve industrial competitiveness. The fundamental problems continue to be excessive and arbitrary regulation with little or no consultation with the small private sector and the obligation for enterprises to fulfil various centrally imposed targets, such as for production, exports and wage growth.

The authorities have implemented some measures to promote the development of enterprises in a number of small and medium-sized towns. Since July 2007 tax rates have been lowered and a simplified taxation mechanism has been introduced for enterprises registered in 138 towns. A presidential decree signed in June 2007 calls for a further reduction in the tax burden for 346 enterprises in small urban localities.

Financial sector

Following the abolition of the "golden share" rule in the banking sector in August 2006 (which grants the state the right to participate in the management of privatised enterprises), the Belarussian authorities agreed to sell their significant stakes in three Belarussian mid-sized banks to Russian investors. The first deal was completed in April 2007, when Russia's Vneshtorgbank acquired 50 per cent plus one share in Slavneftebank for US$ 25 million. After a pre-sale capital increase, Slavneftebank became the sixth largest Belarussian bank in terms of capital and assets. A controlling stake in Belvnesheconombank was purchased by the Russian Vnesheconombank in May 2007. Negotiations continue on the acquisition of a majority stake in Mezhtorgbank by Russia's Alfa Bank. However, four out of the five largest banks, which account for about 80 per cent of total bank assets, remain state-owned.

Domestic credit to households increased by 67 per cent in nominal terms in 2006 to reach 6.9 per cent of GDP. Although a significant share of credit is represented by government-supported mortgages, both private and state-owned banks have increased their consumer loans, with relatively new products such as auto loans, overdrafts and market-based mortgages growing rapidly. However, the government continues its policy of directed lending to priority enterprises and sectors. Recently the authorities approved regulations requiring that banks extend loans to agricultural and export-oriented enterprises at preferential rates.

In August 2007, Belarus obtained its first sovereign ratings from two major rating agencies. The long-term sovereign foreign currency ratings were assigned at B+ (Standard & Poor's) and B1 (Moody's). These long-awaited ratings could facilitate access to the international capital markets for the Belarussian government and domestic banks and enterprises.

Macroeconomic performance

Real GDP growth remained robust at 9.9 per cent in 2006. This was supported by high prices for refined oil products and strong demand from Russia. GDP growth slowed to 8.6 per cent in the first half of 2007 (year-on-year), which may have partly reflected the revised terms of oil trade with Russia, as production and exports of refined oil products fell in the first quarter.

The government has continued to stimulate domestic demand via centrally managed wage increases and directed lending, albeit at a slower pace. Inflation remained moderate at 7.2 per cent in the year to June 2007 as energy price increases were only partially passed on to domestic users. Tariffs for electricity and heating for enterprises were raised again in July 2007, but no further increases are planned for households in 2007.

The trade deficit widened significantly to 6.5 per cent of GDP, and the current account returned to a deficit in 2006. External imbalances have risen further as the cost of imports has soared in 2007, although this has been partially compensated by higher prices of goods exported to Russia. The current account deficit is forecast to reach US$ 2.75 billion (around 6 per cent of projected GDP) in 2007. Proceeds from the sale of the initial 12.5 per cent stake in Beltransgaz and other state-owned assets, as well as foreign loans to the banking sector, provided financing for the deficit in the first half of 2007, which helped maintain exchange rate stability. External debt increased by 38 per cent over the first half of 2007, although it remains low at around 21 per cent of projected 2007 GDP.

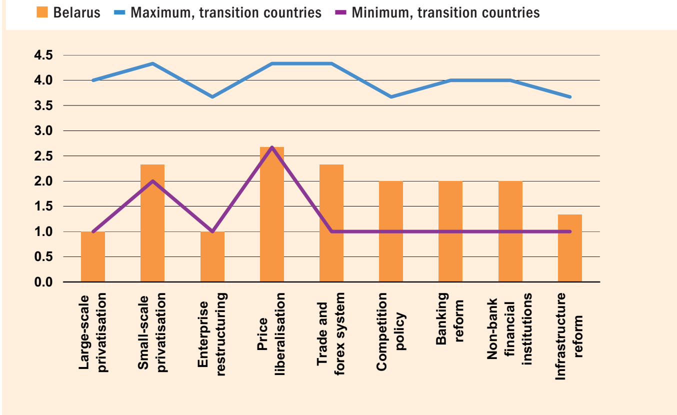
The impact of the new energy trade arrangements on the consolidated budget has been mixed. The proceeds from export duties on refined oil products have increased, but the government has reduced the tax burden and extended subsidies to oil refineries to maintain their profitability. While the headline budget registered a surplus of 4.3 per cent of GDP at the end of June 2007, the financial position of state-owned utilities deteriorated owing to increased energy costs not being completely passed on to domestic users.

Outlook and risks

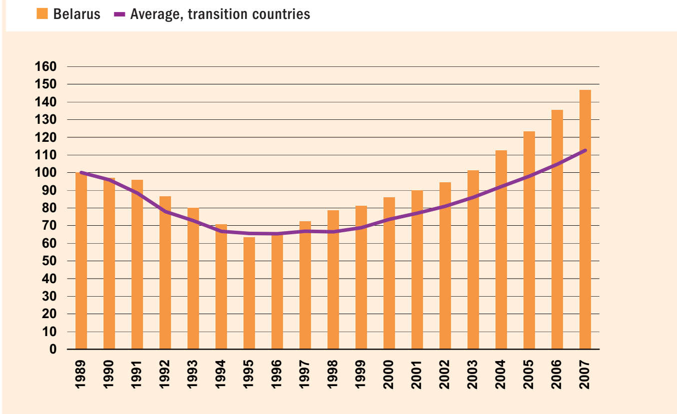
In the short term the main risks are on the external side, as the widening current account deficit needs to be financed while the level of official reserves is very low. The country's low external debt suggests there is scope for further foreign borrowing to finance the external deficit. However, if financing is not secured, then macroeconomic stability could be at risk.

The doubling of imported gas prices and the introduction of export duties on Russian oil have reduced the substantial implicit subsidies that have supported strong economic growth in Belarus in recent years. These subsidies are expected to disappear altogether as the price for imported energy gradually converges with European levels. Adjusting to the energy price rise will ultimately require changing domestic policies, including completely passing on energy price increases to domestic users, cutting back domestic subsidies and deepening enterprise restructuring. If adjustment is delayed, further growth prospects would deteriorate.

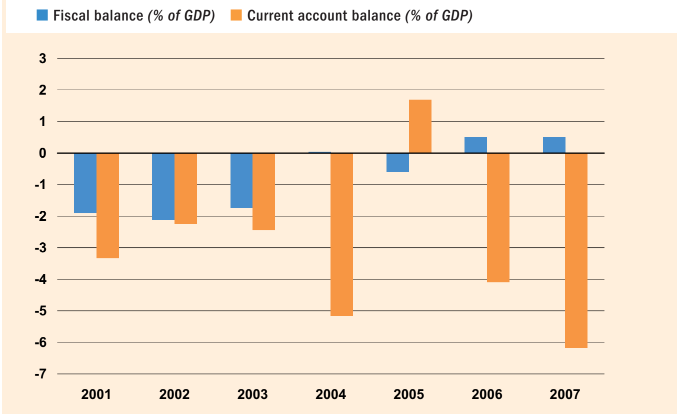
Transition indicators, 2007



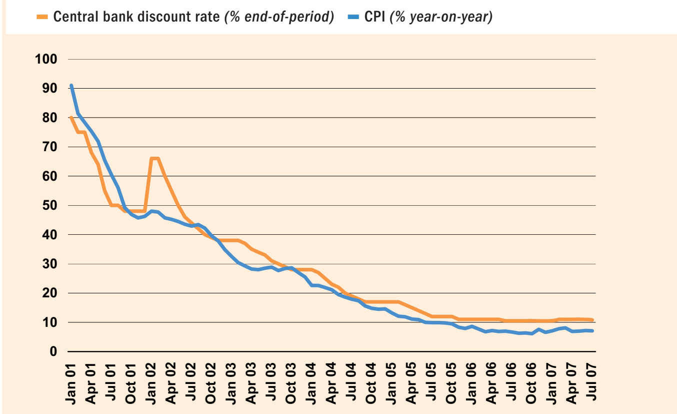
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **limited** Controls on inward direct investment – **yes** Interest rate liberalisation – **limited de facto** Exchange rate regime – **crawling peg** Wage regulation – **yes** Tradeability of land – **limited de jure**	Competition office – **no** Quality of insolvency law – **medium** Secured transactions law – **malfunctioning** Quality of corporate governance law – **very low**	Independent telecoms regulator – **no** Independent electricity regulator – **no** Separation of railway infrastructure from operations – **no** Independence of the road directorate – **no** Quality of concession laws – **very low**	Capital adequacy ratio – **8 per cent** [1] Deposit insurance system – **yes** Quality of securities market laws – **low** Private pension funds – **no**	Share of population living in poverty – **<2.0 per cent** (2002) Government expenditure on health – **6.0 per cent of GDP** (2005) Government expenditure on education – **6.4 per cent of GDP** (2005) Household expenditure on power and water – **4.0 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	1.2	2.8	2.9	3.0	3.1	2.9	na
Private sector share in GDP (in per cent)	20.0	25.0	25.0	25.0	25.0	25.0	25.0
Private sector share in employment (in per cent)	na	na	na	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	19.9	18.9	18.6	18.0	19.4	20.0	na
Share of industry in total employment (in per cent)	23.8	23.7	22.7	22.6	22.3	22.2	na
Change in labour productivity in industry (in per cent)	8.4	5.6	12.6	17.2	10.7	11.9	na
Investment/GDP (in per cent)	23.8	22.2	26.6	30.5	28.5	30.4	na
EBRD index of small-scale privatisation	2.0	2.0	2.3	2.3	2.3	2.3	2.3
EBRD index of large-scale privatisation	1.0	1.0	1.0	1.0	1.0	1.0	1.0
EBRD index of enterprise reform	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Markets and trade							
Share of administered prices in CPI (in per cent)	25.0	24.0	21.0	24.0	27.0	27.0	na
Number of goods with administered prices in EBRD-15 basket	6.0	6.0	4.0	5.0	6.0	6.0	na
Share of trade with non-transition countries (in per cent)	22.9	26.8	27.3	27.0	34.6	35.6	na
Share of trade in GDP (in per cent)	125.3	115.4	120.1	129.9	108.3	113.9	na
Tariff revenues (in per cent of imports) [2]	2.7	3.3	4.1	3.1	4.7	4.1	na
EBRD index of price liberalisation	2.7	2.7	2.7	2.7	2.7	2.7	2.7
EBRD index of forex and trade liberalisation	2.0	2.3	2.3	2.3	2.3	2.3	2.3
EBRD index of competition policy	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Financial sector							
Number of banks (foreign-owned)	29 (9)	28 (12)	30 (17)	32 (19)	30 (18)	30 (18)	na
Asset share of state-owned banks (in per cent)	53.2	61.9	61.6	70.2	75.2	79.0	na
Asset share of foreign-owned banks (in per cent)	7.5	8.1	20.4	20.0	16.2	14.7	na
Non-performing loans (in per cent of total loans)	11.9	8.3	3.7	2.8	1.9	1.2	na
Domestic credit to private sector (in per cent of GDP)	8.2	9.1	11.7	14.0	15.9	20.2	na
Domestic credit to households (in per cent of GDP)	na	na	na	na	na	na	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	na	na
Stock market capitalisation (in per cent of GDP)	na	na	na	na	na	na	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	na	na	na	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	na
EBRD index of banking sector reform	1.0	1.7	1.7	1.7	1.7	1.7	2.0
EBRD index of reform of non-bank financial institutions	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	28.7 (1.4)	29.9 (4.7)	31.1 (11.3)	32.3 (22.8)	33.7 (42.0)	34.7 (61.4)	na
Internet users (per 100 inhabitants)	4.3	9.0	16.3	25.1	34.8	56.5	na
Railway labour productivity (1989=100)	35.1	38.3	40.1	41.5	40.9	42.5	na
Residential electricity tariffs (USc kWh)	1.3	3.2	3.2	3.3	3.5	4.1	na
Average collection rate, electricity (in per cent) [3]	na	98	103	101	100	101	na
GDP per unit of energy use (PPP in US dollars per kgoe)	2.1	2.2	2.2	2.4	na	na	na
EBRD index of infrastructure reform	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Electric power	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Railways	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Roads	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Telecommunications	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Water and waste water	1.0	1.0	1.0	1.0	1.0	1.0	1.0

[1] Ratio is 12 per cent for the first two years of bank's operation.
[2] Refers to taxes on international trade.
[3] Numbers higher than 100 reflect collection of arrears.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	4.7	5.0	7.0	11.4	9.4	9.9	8.5
Private consumption	17.9	11.4	7.4	9.6	15.0	14.6	na
Public consumption	3.1	0.3	0.3	-0.2	0.6	0.2	na
Gross fixed capital formation	-2.3	6.7	20.6	19.9	19.5	26.5	na
Exports	na	na	na	na	na	na	na
Imports	na	na	na	na	na	na	na
Industrial gross output	5.9	4.5	7.1	15.9	10.5	11.3	na
Agricultural gross output	1.8	0.7	6.6	12.6	1.7	6.1	na
Employment			*(Percentage change)*				
Labour force (end-year)	-0.4	-0.4	-0.5	-1.2	0.0	na	7.7
Employment (end-year)	-0.6	-0.8	-1.0	-0.5	0.8	0.3	8.5
			(In per cent of labour force)				
Unemployment (end-year)	2.3	3.0	3.1	1.9	1.5	1.2	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	61.1	42.5	28.4	18.1	10.3	7.0	7.5
Consumer prices (end-year)	46.1	34.8	25.4	14.4	8.0	6.6	8.0
Producer prices (annual average)	71.8	40.4	37.5	24.1	12.1	8.3	na
Producer prices (end-year)	39.1	42.6	28.1	18.8	10.0	9.0	na
Gross average monthly earnings in economy (annual average)	108.8	53.8	32.5	38.6	33.4	25.5	na
Government sector			*(In per cent of GDP)*				
General government balance	-1.9	-2.1	-1.7	0.0	-0.6	0.5	0.5
General government expenditure	46.8	46.6	47.7	46.0	48.0	48.0	na
General government debt	13.2	11.0	10.4	8.9	8.3	8.8	na
Monetary sector			*(Percentage change)*				
Broad money (M3, end-year)	66.1	50.3	56.3	44.1	42.2	39.3	na
Domestic credit (end-year)	72.9	55.6	72.2	30.8	33.5	52.2	na
			(In per cent of GDP)				
Broad money (M3, end-year)	15.2	15.0	16.8	17.7	19.3	22.1	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	48.0	38.0	28.0	17.0	11.0	10.5	na
Deposit rate (1 year) [1]	34.2	26.9	17.4	12.7	9.2	7.7	na
Lending rate (1 year) [2]	47.0	36.9	24.0	16.9	11.4	8.8	na
			(Belarussian roubles per US dollar)				
Official exchange rate (end-year)	1,580.0	1,920.0	2,156.0	2,170.0	2,152.0	2,140.0	na
Official exchange rate (annual average)	1,390.0	1,790.9	2,051.3	2,160.3	2,153.8	2,144.6	na
External sector			*(In millions of US dollars)*				
Current account	-410.6	-326.4	-434.4	-1,193.9	510.1	-1,511.6	-2,750.0
Trade balance	-806.7	-914.3	-1,255.6	-2,183.9	-490.6	-2,398.4	-3,500.0
Merchandise exports	7,334.1	7,964.7	10,072.9	13,942.2	16,108.8	19,838.1	23,000.0
Merchandise imports	8,140.8	8,879.0	11,328.5	16,126.1	16,599.4	22,236.5	26,500.0
Foreign direct investment, net	95.5	453.3	170.3	162.5	302.5	351.0	1,225.0
Gross reserves, excluding gold (end-year)	390.7	417.4	461.5	690.8	1,106.5	1,068.5	na
External debt stock	2,523.2	3,308.3	4,174.9	4,935.4	5,168.4	6,874.7	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	0.5	0.5	0.5	0.5	0.7	0.5	na
			(In per cent of exports of goods and services)				
Debt service	3.4	4.1	4.6	4.0	4.0	na	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	10.0	9.9	9.8	9.8	9.8	9.7	na
GDP (in billions of Belarussian roubles)	17,173.2	26,138.3	36,564.8	49,991.8	65,067.0	79,231.4	96,282.0
GDP per capita (in US dollars)	1,241.6	1,474.4	1,809.9	2,361.4	3,098.3	3,803.3	na
Share of industry in GDP (in per cent)	29.9	29.6	30.8	32.7	33.1	32.3	na
Share of agriculture in GDP (in per cent)	11.9	11.8	10.2	10.3	9.8	9.3	na
Current account/GDP (in per cent)	-3.3	-2.2	-2.4	-5.2	1.7	-4.1	-6.2
External debt - reserves (in US$ million)	2,132.5	2,890.9	3,713.4	4,244.6	4,061.9	5,806.2	na
External debt/GDP (in per cent)	20.4	22.7	23.4	21.3	17.1	18.6	na
External debt/exports of goods and services (in per cent)	29.9	35.6	36.1	31.5	28.4	31.1	na

[1] Data refer to weighted average interest rates on new one-year deposits in commercial banks.

[2] Data refer to weighted average interest rates for one-year loans by commercial banks.

Bosnia and Herzegovina[1]

Key challenges

- Constitutional reform to make the state more efficient and effective is the main challenge facing the country and is essential for ensuring long-term economic viability.
- To invigorate the pace of privatisation, especially in the Federation, urgent changes are needed. These include faster tender procedures and enhanced efforts to prepare companies for sale and attract the interest of investors.
- The volume of total government spending should be reduced significantly to give the private sector the opportunity to grow further, thus helping to ensure the economy's long-term sustainability.

Country data	
Population (in millions)	3.8
Area ('000 sq km)	51.0
GDP (in billion US$, 2006)	11.4
GDP per capita in 2006 at current international US$ (PPP)	8,543
National currency	Convertible mark

Progress in structural reform

Liberalisation and privatisation

Bosnia and Herzegovina's progress towards a Stabilisation and Association Agreement (SAA) with the European Union (EU) has stalled. Although agreement has been reached in principle on most points, the failure by the authorities to agree on several key reforms, notably police reform, is preventing movement towards initialling and signing an SAA. As of late September 2007, the new Central European Free Trade Agreement had not yet been ratified.

Major sales of state assets have taken place in Republika Srpska (RS) over the past year. In addition to the sale of Telekom Srpske, the RS government agreed in February 2007 to sell majority stakes in the Bosanski Brod and Modrica oil refineries, as well as the fuel retailer Petrol, to Russian company Neftegazinkor for €121 million. In the Federation, however, the privatisation process has proceeded extremely slowly for several years. Privatisation receipts in the Federation in 2006 were a mere €5.6 million. The government has opened a tender for the privatisation of 88 per cent of the country's largest aluminium smelter, Aluminij Mostar, which accounted for 15 per cent of the country's total exports in 2006. The process is scheduled to be completed by the end of October 2007. In August, the government announced a tender for expressions of interest in a strategic partnership with the state-owned airline, BH Airlines.

Business environment and competition

The business environment in Bosnia and Herzegovina has improved recently. According to a survey of 460 companies, carried out in April and May 2007 and sponsored by the World Bank, the burden of inspections has been greatly reduced in both Entities relative to a few years ago. However, the process of business registration remains lengthy by regional standards. A single business registration system has been in place since June 2007. The competition authority has become increasingly active over the past year. By July 2007 it had issued 33 decisions, including some high-profile cases in the oil and telecoms sectors.

Infrastructure

Important advances have been made in recent years in the commercialisation of the roads sector. Major construction projects, especially those associated with Corridor Vc, are in preparation. The contracts for the construction and maintenance works are fully open tendered and foreign companies can participate in the process. The financing of road sector maintenance is sound and charges for heavy vehicles have been introduced. In the railway sector, however, the key reforms envisaged when the new Railway Law was adopted in 2005, including the establishment of an independent railway regulatory body, have been delayed until 2008.

In February 2007 the RS energy company Elektroprivreda RS signed a major agreement with the Czech power utility, CEZ, for the upgrading of the existing power plant and development of a new coal-fired power plant in Gacko. The project will be spread over a number of years and is expected to cost around €1.5 billion.

The main development in the telecoms sector over the past year was the sale in early 2007 of 65 per cent of Telekom Srpske in the RS to Telekom Srbija in Serbia for €646 million. The price paid by the winning bidder was considered to be above fair market value by some industry analysts and substantially more than that offered by the second-placed bidder, raising concerns about a political motive behind the deal. However, Telekom Srbija has pledged substantial investment over the coming years to upgrade services in Telekom Srpske. In the Federation, there has been little discernible progress in restructuring or selling the two main operators, BH Telekom and HT Mostar, although the Federation government has hired Deloitte as an investment adviser for the sector.

Financial sector

The country has made strong and visible progress in developing the financial sector. Although there are still a relatively large number of banks – 32 at the end of 2006 – the sector is dominated by private, foreign-owned banks. Total banking assets continue to grow and now exceed €7.5 billion. Competition is quite intense and has led to a decrease in interest rates for borrowers (to about 7-8 per cent for corporates and 9-10 per cent for households as of April 2007), as well as a decline in margins for banks. However, banking supervision is still at the Entity level (although some banks operate in both Entities), despite repeated urging from the international community to unify the two supervisory agencies, either within the central bank or in a separate agency. A number of microfinance institutions and leasing companies are also expanding their activities rapidly.

1 The territorial constitutional entities distinguished in this assessment include the State of Bosnia and Herzegovina (BH), the Federation of Bosnia and Herzegovina (FBH), the Republika Srpska (RS) and the cantons of the Federation. The FBH and the RS are referred to as the "Entities". The District of Brčko enjoys a special status based on an Arbitration Award in accordance with the Dayton Peace Agreement.

Macroeconomic performance

Real GDP growth in 2006 was around 6 per cent, according to the most recent estimates – the highest growth rate since 1999. Strong growth continued into the first half of 2007, with retail sales increasing rapidly. Industrial production rose sharply last year – especially in the RS (up 19 per cent) – and important investments in recent years, such as those in the steel and aluminium sectors, are now bearing fruit. Exports of these goods have benefited from high world prices and overall exports of goods and services rose by 25 per cent in 2006. Preliminary figures for the first half of 2007 show a strong recovery of industrial production in the Federation.

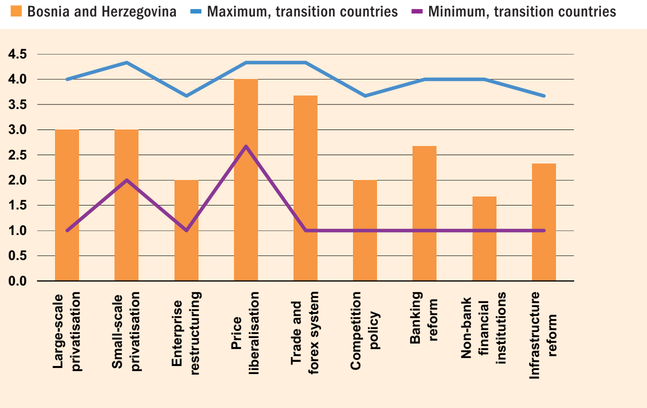
Inflation remains very low (after a transitory upward blip in 2006 reflecting the introduction of VAT) and the currency board continues to function smoothly. Consolidated public spending as a percentage of GDP has been relatively steady in recent years at around 50 per cent, which is among the highest across all transition countries. Revenue collection is also strong (boosted by VAT) and the consolidated government budget has been in surplus for the past two years. However, significant wage and pension increases were promised for 2007 during the election campaign in October 2006. Unless governments at different levels take tough steps to control spending, then a general government deficit may be recorded in 2007.

A strong increase in exports has helped to lower the very high trade and current account deficits in 2006, with the latter estimated at around 11-12 per cent of GDP, although there is a wide margin of error around this figure. There are steady inflows of capital, mainly as a result of a new momentum for privatisation in the RS as well as reinvestments by large companies already in the country, such as Mittal Steel. There have been several further large investments in 2007 to date, and FDI is on course for record levels of well over €1 billion. Foreign reserves have risen steadily and stood close to €3 billion by mid-2007.

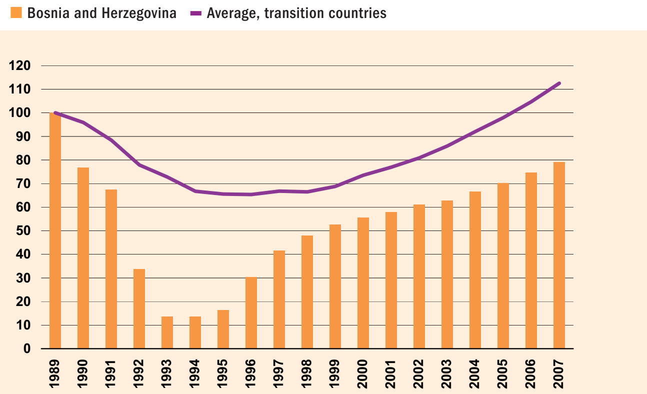
Outlook and risks

On current trends, growth is likely to remain at around 5-6 per cent over the next two years. This growth is being driven by strong private sector activity and entrepreneurship, demonstrating how resilient private enterprises are to the significant obstacles to doing business in the country. The main risks to this relatively favourable scenario lie in the political sphere. Bosnia and Herzegovina is entering perhaps the most sensitive phase of transition since the end of the war in 1995. Continued economic progress is not assured and depends crucially on the authorities introducing and implementing key political and constitutional reforms that are designed to make the state less dysfunctional. At present, there is no consensus in the country on the way forward regarding these matters. There are also important risks on the fiscal side, given that coordination on spending decisions by different levels of government is currently limited and because the borrowing powers of the state and Entity governments were recently expanded. To mitigate this, new laws on government borrowing will impose debt ceilings.

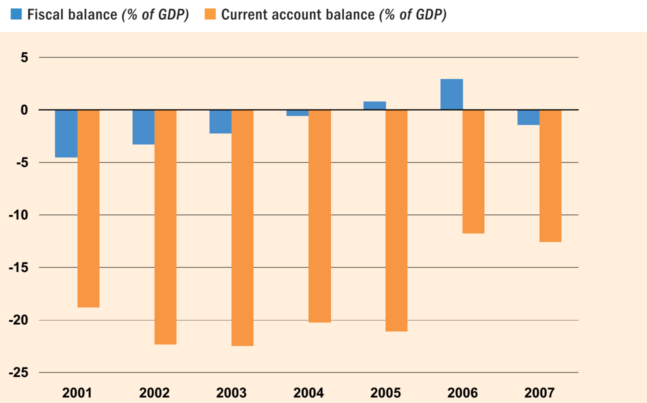
Transition indicators, 2007



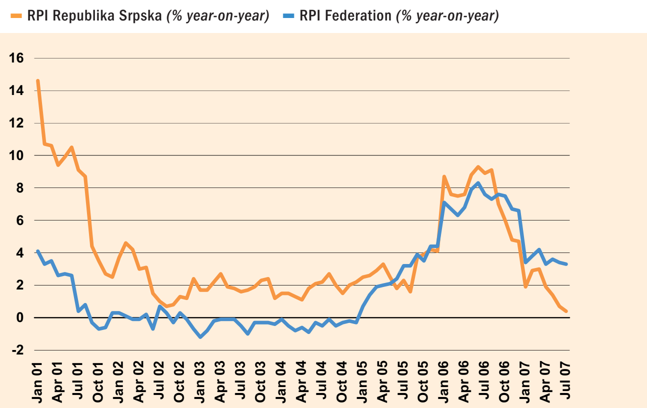
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **yes**[1]

Interest rate liberalisation – **full**

Exchange rate regime – **currency board pegged to euro**

Wage regulation – **no**

Tradeability of land – **limited de jure**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **high**

Secured transactions law – **some defects**

Quality of corporate governance law – **low**

Infrastructure

Independent telecoms regulator – **fully**

Independent electricity regulator – **partially**

Separation of railway infrastructure from operations – **partially**

Independence of the road directorate – **fully**

Quality of concession laws – **medium**

Financial sector

Capital adequacy ratio – **12 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **high**

Private pension funds – **no**

Social reform

Share of population living in poverty – **na**

Government expenditure on health – **10.0 per cent of GDP**

Government expenditure on education – **na**

Household expenditure on power and water – **4.9 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	2.5	2.6	2.6	2.6	na	na	na
Private sector share in GDP (in per cent)	40.0	45.0	50.0	50.0	55.0	55.0	60.0
Private sector share in employment (in per cent)	na	na	na	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	na	na	6.3	5.8	5.8	6.0	na
Share of industry in total employment (in per cent)	na	na	na	na	na	na	na
Change in labour productivity in industry (in per cent)	na	na	na	na	na	na	na
Investment/GDP (in per cent)	18.9	20.4	19.9	20.3	na	na	na
EBRD index of small-scale privatisation	2.7	3.0	3.0	3.0	3.0	3.0	3.0
EBRD index of large-scale privatisation	2.3	2.3	2.3	2.3	2.7	2.7	3.0
EBRD index of enterprise reform	1.7	1.7	2.0	2.0	2.0	2.0	2.0
Markets and trade							
Share of administered prices in CPI (in per cent)	na	na	na	na	na	na	na
Number of goods with administered prices in EBRD-15 basket[2]	5.0	5.0	5.0	5.0	5.0	4.0	na
Share of trade with non-transition countries (in per cent)[3]	52.8	50.8	49.6	na	47.4	45.5	na
Share of trade in GDP (in per cent)	68.1	89.7	91.1	93.8	99.8	96.6	na
Tariff revenues (in per cent of imports)	13.1	7.2	6.4	5.1	na	na	na
EBRD index of price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of forex and trade liberalisation	3.0	3.0	3.7	3.7	3.7	3.7	3.7
EBRD index of competition policy	1.0	1.0	1.0	1.0	1.0	1.7	2.0
Financial sector							
Number of banks (foreign-owned)	49 (20)	40 (21)	37 (19)	33 (17)	33 (20)	32 (22)	na
Asset share of state-owned banks (in per cent)	17.3	6.2	5.3	4.0	3.6	3.2	na
Asset share of foreign-owned banks (in per cent)	65.3	76.7	79.7	80.9	90.9	94.0	na
Non-performing loans (in per cent of total loans)	20.7	11.5	8.4	6.1	5.4	4.1	na
Domestic credit to private sector (in per cent of GDP)	5.8	11.8	15.1	18.4	22.4	25.2	na
Domestic credit to households (in per cent of GDP)	5.2	10.0	12.9	15.2	17.6	19.6	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	na	na
Stock market capitalisation (in per cent of GDP)	na	na	na	na	na	na	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	na	na	na	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	na	na	na
EBRD index of banking sector reform	2.3	2.3	2.3	2.7	2.7	2.7	2.7
EBRD index of reform of non-bank financial institutions	1.0	1.7	1.7	1.7	1.7	1.7	1.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	22.3 (11.7)	23.7 (19.6)	24.5 (28.1)	24.6 (36.4)	24.8 (40.8)	25.3 (48.3)	na
Internet users (per 100 inhabitants)	1.2	2.6	3.9	15.1	20.6	24.3	na
Railway labour productivity (1996=100)	131.2	134.5	136.3	256.0	480.7	481.4	na
Residential electricity tariffs (USc kWh)	5.7	6.0	7.1	6.7	6.9	6.2	na
Average collection rate, electricity (in per cent)	95	86	na	na	96	98	na
GDP per unit of energy use (PPP in US dollars per kgoe)	4.9	5.5	5.3	5.4	na	na	na
EBRD index of infrastructure reform	2.0	2.3	2.3	2.3	2.3	2.3	2.3
Electric power	2.3	3.0	3.0	3.0	3.0	3.0	3.0
Railways	2.3	3.0	3.0	3.0	3.0	3.0	3.0
Roads	2.0	2.0	2.0	2.0	2.3	2.3	2.7
Telecommunications	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Water and waste water	2.0	2.0	2.0	2.0	2.0	2.0	2.0

1 There are restrictions on the production and sale of arms, ammunition, military equipment and public information.

2 Administered prices in either the Federation or Republika Srpska or both Entities.

3 For some years data were unavailable for important trading partners such as Croatia, FYR Macedonia, Montenegro and Serbia. As a result, the share of trade with non-transition countries for these years has been over-estimated.

	2001	2002	2003	2004	2005	2006	2007
						Estimate	*Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	4.3	5.3	3.0	6.0	5.5	6.2	6.0
Total consumption	na	na	na	na	na	na	na
Gross fixed capital formation	na	na	na	na	na	na	na
Industrial gross output	-2.0	11.5	3.8	12.0	9.8	18.0	na
Agricultural gross output	na	na	na	na	na	na	na
Employment			*(Percentage change)*				
Labour force (end-year)	-1.4	-0.7	0.8	1.6	0.5	0.3	na
Employment (end-year)	-3.4	-2.0	-1.0	0.2	2.1	2.1	na
			(In per cent of labour force)				
Unemployment (end-year) [1]	40.2	41.0	42.1	42.9	42.0	41.0	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)							
Federation (KM based)	1.9	-0.2	0.2	-0.3	2.1	7.5	na
Republika Srpska (KM based)	7.0	1.7	1.8	2.2	2.7	7.0	na
Consumer prices (end-year)							
Federation (KM based)	0.3	-0.7	0.3	-0.3	4.4	6.6	na
Republika Srpska (KM based)	2.2	2.4	1.3	2.2	3.7	4.7	na
Gross average monthly earnings in economy (annual average)							
Federation	7.6	9.2	8.3	1.8	4.6	8.0	na
Republika Srpska	14.7	18.7	9.3	11.6	10.0	12.2	na
Government sector			*(In per cent of GDP)*				
General government balance	-4.5	-3.3	-2.2	-0.6	0.8	2.9	-1.4
General government expenditure	53.2	48.0	52.9	50.4	49.4	47.9	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	89.3	8.6	8.4	24.3	18.2	24.7	na
Domestic credit (end-year)	5.2	28.2	19.8	18.0	27.6	20.6	na
			(In per cent of GDP)				
Broad money (M2, end-year)	38.5	39.6	40.7	46.5	51.1	56.8	na
Exchange rates			*(KM per euro)*				
Exchange rate (annual average)	2.0	2.0	2.0	2.0	2.0	2.0	na
External sector			*(In millions of US dollars)*				
Current account	-1,042.5	-1,375.5	-1,750.0	-1,884.0	-2,150.0	-1,338.0	-1,713.0
Trade balance	-2,073.0	-3,327.0	-4,152.0	-4,572.0	-4,990.0	-4,293.0	-4,843.0
Merchandise exports	854.0	1,104.0	1,473.0	2,085.0	2,600.0	3,358.0	4,191.0
Merchandise imports	2,927.0	4,431.0	5,625.0	6,657.0	7,590.0	7,651.0	9,034.0
Foreign direct investment, net	119.0	266.0	381.6	607.5	550.0	420.0	1,500.0
Gross reserves, excluding gold (end-year)	1,221.0	1,295.0	1,765.0	2,389.0	2,720.0	3,160.0	na
External debt stock	2,817.7	3,636.6	4,518.1	5,106.1	5,658.7	6,136.8	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	4.6	3.3	3.5	4.0	4.1	4.7	na
			(In per cent of exports of goods and services)				
Debt service	6.2	8.7	6.8	4.8	4.1	4.1	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million) [2]	3.8	3.8	3.8	3.8	3.8	3.8	na
GDP (in millions of markas)	12,137.0	12,806.0	13,492.0	14,678.0	15,791.0	17,750.0	19,792.0
GDP per capita (in US dollars)	1,461.6	1,623.0	2,049.4	2,453.0	2,687.4	2,999.8	na
Share of industry in GDP (in per cent)	na	na	na	25.0	25.3	25.2	na
Share of agriculture in GDP (in per cent)	na	na	na	10.6	10.9	10.5	na
Current account/GDP (in per cent)	-18.8	-22.3	-22.5	-20.2	-21.1	-11.7	-12.5
External debt - reserves (in US$ million)	1,596.7	2,341.6	2,753.1	2,717.1	2,938.7	2,976.8	na
External debt/GDP (in per cent)	50.7	59.0	58.0	54.8	55.4	53.8	na
External debt/exports of goods and services (in per cent)	216.3	254.6	206.0	170.7	156.3	137.4	na

[1] Registered unemployment. A labour force survey in March 2006, based on ILO definitions, puts the unemployment rate at 31.1 per cent.

[2] Excludes refugees abroad.

Bulgaria

Key challenges

- Perseverance with structural reforms is needed to improve the economy's flexibility. In particular, stepping up the fight against corruption and lowering barriers to market entry would improve the business environment.
- Infrastructure needs to be modernised, particularly in the energy sector where technology needs to be upgraded and efficiency increased, and in the municipal sector where poor absorption capacity of EU funds acts as a constraint on investment.
- The future financing of the large external imbalance will be a challenge, given the current importance of property and construction in FDI inflows. Further fiscal tightening may be necessary to help offset the persistent buoyancy of domestic demand.

Country data	
Population (in millions)	7.7
Area ('000 sq km)	111.0
GDP (in billion US$, 2006)	31.5
GDP per capita in 2006 at current international US$ (PPP)	10,126
National currency	Lev

Progress in structural reform

Liberalisation and privatisation

Progress has been significant – 91 per cent of assets slated for privatisation have been privatised and the process is complete in large parts of the economy. The Privatisation Agency is planning the sale of 41 majority stakes, mainly in energy and industry, and 196 minority stakes in other companies. The Privatisation Agency also plans to sell 70 per cent of Navibulgar, the leader in the maritime shipping market in Bulgaria and the Black Sea region.

Business environment and competition

Conditions for conducting business in Bulgaria have improved since last year, although there is still ample room for improvement in areas such as the functioning of the judiciary and the reduction of barriers to market entry.

In its first monitoring report released in June 2007, the European Commission (EC) identified corruption and organised crime as the two major concerns prior to EU accession. Bulgaria adopted the necessary constitutional amendments removing ambiguity about the independence and accountability of the judiciary, but still needs to adopt and implement the legislation on the establishment of the independent judicial inspectorate. The EC report acknowledges that "substantial progress has been achieved in preventing and fighting corruption at the border and within local government" but that "progress in the fight against high-level corruption cases in Bulgaria is still insufficient".

Procurement law was harmonised with EU standards in 2007, resulting in higher standards for public tenders. As a result of improved auditing of public procurement procedures, Bulgaria's Public International Financial Control Agency recorded an increase in procedural violations in the last year.

The government introduced a 10 per cent flat corporate tax rate in January 2007 and is proposing a 10 per cent flat income tax rate and reduced social security rates from January 2008. Corporate tax revenues in the first half of 2007 have nearly doubled compared with the same period in 2006.

Infrastructure

Consolidation of district heating utilities has progressed. The French company Dalkia International acquired the heating utility Varna in 2007 and is planning to acquire four more district heating companies in Burgas, Vratsa, Pleven and Sliven, which were privatised in 2004 and 2005. It has also expressed an interest in acquiring a minority share in Sofia's utility (one of the three that remain state-owned). The district heating companies of Plovdiv and Rousse are being sold to the Austrian company EVN for €32.1 million and Slovenia's HSE for €85.1 million, respectively. Negotiations between Greek PPC and the government over the sale of the Bobov Dol coal-fired plant were called off in May 2007 as there was no agreement on required environmental upgrades.

Units 3 and 4 of the Kozloduy nuclear power plant were closed in January 2007. Following a public tender, in October 2006 NETC, the power grid operator, awarded a €4 billion contract to Russia's Atomstroyexport to build a new 2,000 MW nuclear power plant at Belene. The first of the plant's two reactors (1,000 MW each) is scheduled to become active in January 2014.

Financial sector

Growth in domestic credit to the private sector slowed from 49 per cent in 2004 to 25 per cent in 2006 as a result of administrative measures introduced in 2005. However, the authorities subsequently phased out the measures that made it expensive for banks to expand their credit portfolios rapidly as the banks had increasingly circumvented them. In the first half of 2007 the growth of domestic credit to the private sector accelerated again to 47.7 per cent. On 1 September 2007 the authorities increased banks' minimum reserve requirements to be maintained with the central bank from 8 per cent to 12 per cent. Despite the recent growth in bank credit and increased competition between banks, domestic credit to the private sector is still considerably below the EU average.

Bulgaria's open capital account allows firms to borrow abroad. Therefore, even with administrative measures to curb the growth of domestic credit, enterprises rarely suffered from reduced access to finance. Moreover, the significant expansion of leasing companies has provided an alternative source of finance, especially for SMEs. The stock exchange has continued to grow rapidly and its market capitalisation increased from 10.4 per cent to 31.2 per cent of GDP between the end of 2004 and the end of 2006.

Macroeconomic performance

The economy grew by 6.1 per cent in 2006 and 6.4 per cent in the first half of 2007 (year-on-year), as buoyant domestic demand stimulated strong output growth. Labour productivity has increased substantially in services and industry as a result of high investment levels in both sectors. Further progress has been made in lowering inflation, partly reflecting the contribution from a well-functioning currency board and sound income and fiscal policies. In June 2007 inflation had fallen to 5.6 per cent from 8.2 per cent 12 months earlier, despite strong growth of domestic credit. However, partly because of the drought's impact on food prices, inflation picked up in August 2007 to 12 per cent.

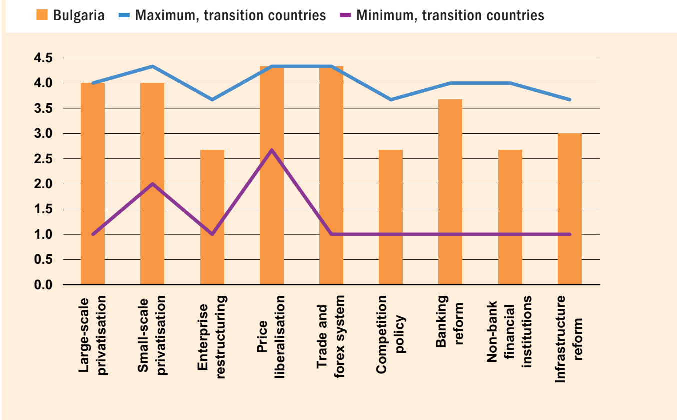
The current account deficit widened from 6.8 per cent of GDP in 2004 to 15.8 per cent of GDP in 2006 and further to 19.6 per cent of GDP in June 2007 on a 12-month rolling basis. In 2006 this mainly reflected declines in accounts other than trade, partly due to one-off events. Financing of the deficit has been supported in the short term by very strong flows of net FDI (which covered 100 per cent of the deficit in 2006 and 81 per cent in the 12 months up to June 2007). These inflows have contributed to the strong increase in foreign exchange reserves which covered 5.2 months of imports of goods and services by the end of 2005.

As monetary policy is not a tool available to policy-makers in the context of the currency board, the authorities have conducted prudent fiscal policies. The fiscal surplus in 2006 was an estimated 3.3 per cent of GDP (ESA95 basis), slightly in excess of the 3 per cent target agreed with the IMF. The government also agreed to a fiscal surplus target of at least 2 per cent of GDP for 2007 (and a similar amount in 2008), although the budget law for 2007 calls for a surplus of only 0.8 per cent of GDP. The budgeted surplus provided for a 10 per cent increase in pensions in July 2007, and a cut in social insurance contributions by 3 percentage points contingent on budget performance during the year. The targeted surpluses include the contribution to the EU common budget, which in 2007 should amount to 1.2 per cent of GDP. By the end of 2006 the fiscal reserve account stood at €3 billion (about 12 per cent of GDP), even after debt buy-backs in 2005-06.

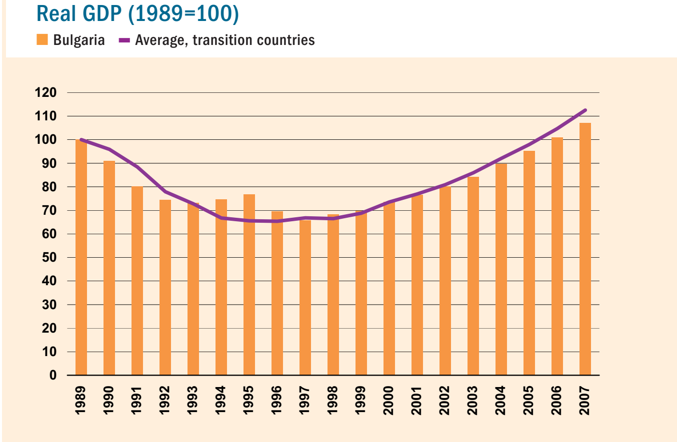
Outlook and risks

Bulgaria's medium-term economic prospects remain favourable, especially following the country's accession to the European Union in January 2007. GDP growth is expected to remain robust, supported by the strong growth of bank credit and EU official capital inflows. The currency board regime is well established and is expected to contribute to tight monetary conditions in the run-up to the eventual adoption of the euro. The main source of vulnerability remains the external position. In particular, there are concerns that more than one-third of the current flows of FDI are investments in property, which may not be sustainable in the long term.

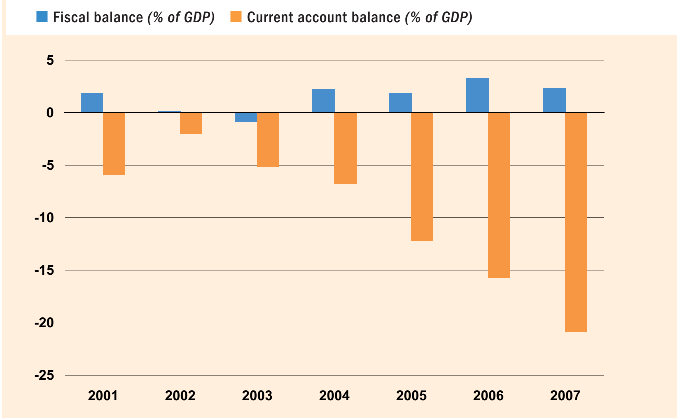
Transition indicators, 2007



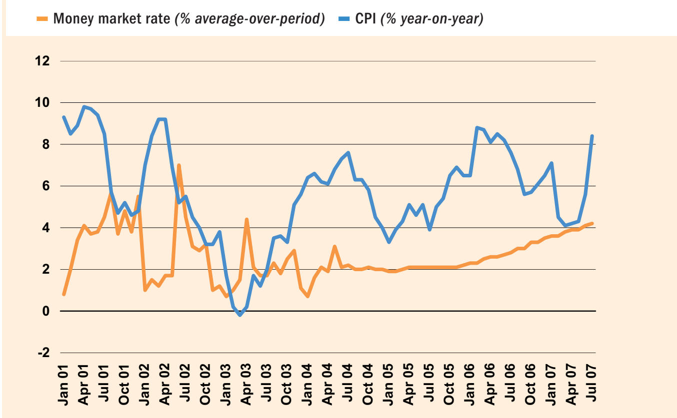
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no**

Interest rate liberalisation – **full**

Exchange rate regime – **currency board**

Wage regulation – **yes**

Tradeability of land – **full within EU**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **medium**

Secured transactions law – **advanced**

Quality of corporate governance law – **medium**

Infrastructure

Independent telecoms regulator – **fully**

Independent electricity regulator – **fully**

Separation of railway infrastructure from operations – **fully**

Independence of the road directorate – **fully**

Quality of concession laws – **high**

Financial sector

Capital adequacy ratio – **12 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **high**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **6.1 per cent** (2003) [1]

Government expenditure on health – **2.7 per cent of GDP** (2006)

Government expenditure on education – **4.2 per cent of GDP** (2005)

Household expenditure on power and water – **11.2 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	12.6	13.8	15.0	18.0	21.4	22.8	na
Private sector share in GDP (in per cent)	70.0	70.0	75.0	75.0	75.0	75.0	75.0
Private sector share in employment (in per cent)	58.9	63.0	65.0	69.0	71.0	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	2.7	2.6	3.0	2.4	2.1	1.5	na
Share of industry in total employment (in per cent)	26.1	24.0	23.5	23.4	24.1	na	na
Change in labour productivity in industry (in per cent)	-0.6	9.7	15.8	17.8	-1.4	na	na
Investment/GDP (in per cent)	20.7	19.8	21.7	23.5	28.0	na	na
EBRD index of small-scale privatisation	3.7	3.7	3.7	3.7	3.7	4.0	4.0
EBRD index of large-scale privatisation	3.7	3.7	3.7	4.0	4.0	4.0	4.0
EBRD index of enterprise reform	2.3	2.3	2.7	2.7	2.7	2.7	2.7
Markets and trade							
Share of administered prices in CPI (in per cent)	20.6	21.3	22.0	24.7	21.3	21.3	na
Number of goods with administered prices in EBRD-15 basket	0.0	0.0	0.0	0.0	0.0	0.0	na
Share of trade with non-transition countries (in per cent)	72.1	76.4	77.1	78.0	73.8	71.8	na
Share of trade in GDP (in per cent)	86.8	79.3	83.8	95.5	106.8	118.3	na
Tariff revenues (in per cent of imports)	8.9	10.3	10.6	9.1	8.0	na	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.3	2.3	2.3	2.3	2.7	2.7	2.7
Financial sector							
Number of banks (foreign-owned)	35 (26)	34 (26)	35 (25)	35 (24)	34 (23)	32 (23)	na
Asset share of state-owned banks (in per cent)	19.9	14.1	2.5	2.3	1.7	1.8	na
Asset share of foreign-owned banks (in per cent)	72.7	75.2	82.7	81.6	74.5	80.1	na
Non-performing loans (in per cent of total loans)	7.9	5.6	4.4	3.7	3.8	3.2	na
Domestic credit to private sector (in per cent of GDP)	14.8	19.4	26.7	35.2	42.9	47.4	na
Domestic credit to households (in per cent of GDP)	2.8	3.7	7.1	10.0	14.4	16.6	na
Of which mortgage lending (in per cent of GDP)	na	na	1.2	2.7	4.8	7.2	na
Stock market capitalisation (in per cent of GDP)	3.7	4.2	7.9	10.4	19.7	31.2	na
Stock trading volume (in per cent of market capitalisation)	12.9	13.9	16.3	22.8	35.2	19.8	na
Eurobond issuance (in per cent of GDP)	2.0	6.6	0.0	1.1	1.4	2.0	na
EBRD index of banking sector reform	3.0	3.3	3.3	3.7	3.7	3.7	3.7
EBRD index of reform of non-bank financial institutions	2.0	2.3	2.3	2.3	2.3	2.7	2.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	36.6 (19.6)	36.6 (33.1)	36.1 (44.9)	35.1 (60.9)	32.1 (80.8)	31.3 (107.6)	na
Internet users (per 100 inhabitants)	7.7	8.0	12.0	15.9	20.6	24.4	na
Railway labour productivity (1989=100)	70.3	65.9	75.2	78.4	73.7	76.3	na
Residential electricity tariffs (USc kWh)	3.8	5.2	5.2	6.0	8.4	8.8	na
Average collection rate, electricity (in per cent)	85	95	92	92	93	93	na
GDP per unit of energy use (PPP in US dollars per kgoe)	2.7	3.0	2.8	3.1	na	na	na
EBRD index of infrastructure reform	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Electric power	3.3	3.3	3.3	3.7	3.7	3.7	3.7
Railways	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Roads	2.3	2.3	2.3	2.3	2.7	2.7	2.7
Telecommunications	3.0	3.0	3.0	3.3	3.3	3.7	3.7
Water and waste water	3.0	3.0	3.0	3.0	3.0	3.0	3.0

[1] The official 12.8 per cent poverty rate, reported in the Bulgaria 2001 Poverty Assessment published by the World Bank, is based on a different poverty line. The latter was fixed at two-thirds of the 1997 average per capita consumption, deflated by 2001 prices.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			(Percentage change in real terms)				
GDP	4.1	4.5	5.0	6.6	6.2	6.1	6.0
Private consumption	4.6	4.0	6.3	5.3	5.5	7.1	na
Public consumption	2.9	6.1	3.1	6.8	4.1	1.7	na
Gross fixed capital formation	23.3	8.5	13.9	13.5	23.3	17.6	na
Exports of goods and services	10.0	8.1	10.7	12.7	8.5	9.0	na
Imports of goods and services	14.8	5.0	16.4	14.5	13.1	15.2	na
Industrial gross output	-4.8	4.0	18.3	21.5	3.2	1.8	na
Agricultural gross output	-0.1	4.2	-1.4	5.6	-5.0	-0.6	na
Employment			(Percentage change)				
Labour force (end-year)	-0.2	-0.5	1.1	1.2	-0.2	3.1	na
Employment (end-year)	-3.9	2.9	4.5	3.4	2.0	4.4	na
			(In per cent of labour force)				
Unemployment (end-year)	19.5	16.8	13.7	12.0	10.1	8.9	na
Prices and wages			(Percentage change)				
Consumer prices (annual average)	7.4	5.9	2.3	6.1	5.0	7.3	8.0
Consumer prices (end-year)	4.8	3.9	5.6	4.0	6.5	6.5	10.0
Producer prices (annual average)	3.6	1.3	4.9	6.0	6.9	6.9	na
Producer prices (end-year)	-1.8	6.3	4.3	5.2	9.6	5.1	na
Gross average monthly earnings in economy (annual average)	6.5	3.4	9.2	9.1	4.3	4.6	na
Government sector			(In per cent of GDP)				
General government balance [1]	1.9	0.1	-0.9	2.2	1.9	3.3	2.3
General government expenditure [1]	38.3	37.1	38.1	36.7	37.5	35.5	na
General government debt [2]	66.2	54.0	45.9	37.9	29.2	22.8	na
Monetary sector			(Percentage change)				
Broad money (M2, end-year)	25.8	11.7	18.8	23.3	24.3	26.9	na
Domestic credit (end-year)	26.0	27.4	33.9	34.2	33.0	15.3	na
			(In per cent of GDP)				
Broad money (M2, end-year)	41.7	42.8	47.5	52.3	59.0	65.2	na
Interest and exchange rates			(In per cent per annum, end-year)				
Base interest rate [3]	4.7	3.3	2.8	2.4	2.1	3.3	na
Interbank interest rate (up to 1 month)	5.5	1.2	1.1	2.0	2.2	3.5	na
Deposit rate (1 month)	2.9	2.8	2.9	3.0	3.0	3.1	na
Lending rate (less than 1 year)	11.1	9.4	8.8	8.8	7.9	8.1	na
			(Leva per US dollar)				
Exchange rate (end-year)	2.2	1.9	1.5	1.4	1.7	1.5	na
Exchange rate (annual average)	2.2	2.1	1.7	1.6	1.6	1.6	na
External sector			(In millions of US dollars)				
Current account	-804.7	-319.0	-1,022.2	-1,671.1	-3,304.6	-4,960.4	-7,523.8
Trade balance	-1,580.5	-1,658.5	-2,575.9	-3,687.9	-5,490.8	-7,028.1	-8,511.4
Merchandise exports	5,112.9	5,354.1	7,081.4	9,931.2	11,776.4	15,101.4	16,349.6
Merchandise imports	6,693.4	7,012.6	9,657.3	13,619.1	17,267.2	22,129.5	24,861.0
Foreign direct investment, net	803.3	876.3	2,070.3	2,879.2	3,938.1	5,331.1	5,389.2
Gross reserves, excluding gold (end-year)	3,591.0	4,407.0	6,291.0	8,776.3	8,519.7	10,941.3	na
External debt stock	10,625.6	11,311.7	13,439.1	17,276.3	18,862.0	25,901.3	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	5.0	6.0	6.2	6.2	4.9	5.0	na
			(In per cent of exports of goods and services)				
Debt service	20.8	17.3	14.9	25.5	42.4	19.0	na
Memorandum items			(Denominations as indicated)				
Population (end-year, million)	7.9	7.8	7.8	7.8	7.7	7.7	na
GDP (in millions of leva)	29,709.2	32,401.6	34,627.5	38,822.6	42,797.4	49,090.6	56,198.9
GDP per capita (in US dollars)	1,723.3	1,988.4	2,561.8	3,175.8	3,522.7	4,088.7	na
Share of industry in GDP (in per cent)	25.2	25.6	20.6	26.0	26.1	na	na
Share of agriculture in GDP (in per cent)	12.1	10.7	10.1	9.4	8.0	na	na
Current account/GDP (in per cent)	-5.9	-2.0	-5.1	-6.8	-12.2	-15.8	-20.8
External debt - reserves (in US$ million)	7,034.6	6,904.7	7,148.1	8,500.1	10,342.3	14,960.0	na
External debt/GDP (in per cent)	78.1	72.5	67.2	70.1	69.4	78.2	na
External debt/exports of goods and services (in per cent)	146.0	149.7	133.8	123.8	116.6	127.4	na

[1] In 2003 and 2004 general government expenditure includes capital transfers for about 0.4 per cent of GDP, which were classified below the line in the Budget Law.

[2] From April 2001 direct debt to the Bulgarian National Bank is excluded from domestic debt to avoid double reporting of IMF credit extended through the Bulgarian National Bank.

[3] Effective interest rate at end-month, based on the average annual yield attained at three-month government securities primary auctions.

Croatia

Key challenges

- Privatisation and restructuring of the remaining state-owned assets is a priority and the government should ensure the regained momentum continues.
- The recommendations of the deregulation programme known as the "regulatory guillotine" should be implemented to reduce state intervention in the economy and improve the business climate.
- Further fiscal consolidation is necessary. In particular, all off-budget operations need to be included in the general government accounts and government spending should be reduced.

Country data	
Population (in millions)	4.4
Area ('000 sq km)	87.7
GDP (in billion US$, 2006)	42.9
GDP per capita in 2006 at current international US$ (PPP)	14,059
National currency	Kuna

Progress in structural reform

Liberalisation and privatisation

The pace of privatisation has picked up recently, although only two privatisations have been finalised since mid-2006. This partly reflects a major corruption scandal that led to the removal of the Croatian Privatisation Fund's (CPF) management in June 2007. The government sold a 17 per cent stake in the oil company INA in November 2006 and recently decided to sell a further 7 per cent to the company's employees. Following repeated tendering procedures, buyers of steel companies Željezara Split and Valjaonica cijevi Sisak, and aluminium producer TLM were finally chosen in April 2007 – just before the deadline for receiving the second tranche of the World Bank Programmatic Adjustment Loan (PAL II), which was conditional on privatising these companies.

As of September 2007 the sale contract for TLM had not yet been signed. The government prepared the shipyards restructuring programme and submitted it to the European Commission in February 2007. It is obliged to privatise the shipyard Uljanik, as well as agricultural company Vupik by the end of 2007 as a precondition for a portion of the World Bank PAL II. The remaining portfolio of the CPF comprises 874 companies, of which the government has controlling shares in 102; these companies are scheduled to be privatised by the end of 2008.

An IPO of at least a 32.5 per cent stake in Croatian telecoms company Hrvatske Telekomunikacije (HT) was completed in October 2007 after delays owing to disputes over the ownership of the underground fibre-optic network. Cooperation with international financial institutions and accession negotiations with the European Union (EU) remain important anchors for structural reform. As of July 2007 negotiations on a total of 13 chapters of the *acquis communautaire*, the body of European law that new members must adopt, had been opened (of which two were provisionally closed in 2006).

Business environment and competition

The third phase of the regulatory guillotine project (known as "Hitrorez"), launched in September 2006 to eliminate a series of unnecessary laws, regulations and decrees, was completed in July 2007. A special unit for Hitrorez recommended scrapping 420 business regulations and simplifying 371 (which together comprise 55 per cent of all business regulations).

State aid increased from 2.3 per cent of GDP in 2005 to 3.4 per cent of GDP in 2006 (1.7 per cent of GDP, if subsidies to fisheries and agriculture are excluded). The largest share of subsidies is still provided to loss-making enterprises in sectors such as railways and shipbuilding.

Infrastructure

Since 1 July 2007, everyone except households can choose their electricity supplier, but competition will only develop when prices reach market levels, as Hrvatska Elektroprivreda's (HEP) price is heavily subsidised. A new tariff-setting methodology for power generation, transmission, distribution and trade is being implemented from July 2007.

HT still controls more than 75 per cent of the fixed-line telecoms market, leading to complaints over inaction of the telecoms regulator for not creating the right conditions for market liberalisation. Six fixed-line operators have entered the market since 2004 and their combined market share increased to 14 per cent.

Croatian Railways was transformed into a holding company with four companies (infrastructure, freight, passenger transport and maintenance) at the end of 2006. Six out of 16 spin-off subsidiaries had been tendered for privatisation by the end of July 2007, but only two had been privatised by the autumn. The railway sector continued to receive large state subsidies (amounting to around 0.4 per cent of GDP in 2006), reflecting the lack of deeper restructuring.

Social sector

The government adopted a social welfare strategy in April 2007 to streamline numerous benefits and target social assistance more effectively through a wider application of means-testing. However, a new population policy adopted in late 2006 partly conflicts with these aims, as it includes measures that do not take means-testing into account (such as free textbooks for all school children).

In the run-up to parliamentary elections in November 2007, the government decided to spend part of the higher-than-expected budget revenues on raising the pensions of post-1998 pensioners by 4 per cent. It also adopted a bonus model, which aims to eliminate the differences between the pensions of the new (post-1998) and old (pre-1998) pensioners. The government also agreed to lower the penalty for early retirement from 20.4 per cent to 9.0 per cent of the pension, and to increase both the minimum and disability pensions.

Slow progress has been made in implementing the initial health care financing reforms adopted in mid-2006, although Kuna 1.7 billion were spent on reducing health sector arrears.

Macroeconomic performance

Real GDP grew by 4.8 per cent year-on-year in 2006 and preliminary figures for the first quarter of 2007 suggest growth has strengthened further in 2007. The main driver of growth was gross fixed capital formation, which recorded real growth of 10.9 per cent, up from 4.8 per cent in 2005. Private investment is concentrated in the services sector and remains relatively low in the processing and manufacturing industries; there has also been little greenfield investment. Public investment remained strong in transport as the extensive motorway network was expanded further.

Net FDI accounted for 7.4 per cent of GDP in 2006 and almost covered the current account deficit of 7.8 per cent of GDP. Record levels of FDI were achieved in the first quarter of 2007, amounting to €1.21 billion. A large share of FDI represents recapitalisations in the banking sector, partly reflecting restrictive monetary policy measures, and only a small portion has been directed towards manufacturing.

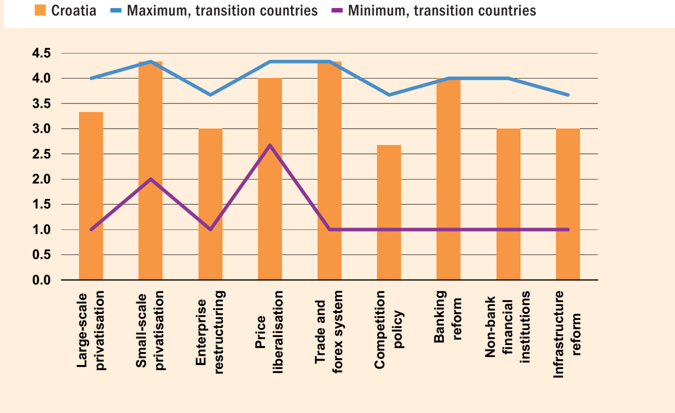
Gross external debt rose to €29 billion at the end of 2006 and continues to grow (€30.2 billion at the end of May 2007), albeit at a slower pace. The business sector accounted for most of its growth. The Croatian National Bank took a number of measures to curb the rise in external indebtedness. These included restricting the growth of credit in 2007 to 12 per cent; however, in July 2007 the permitted credit growth for the rest of the year was reduced to 3 per cent because credit growth in the first half of the year reached 9 per cent.

Fiscal performance improved further in 2006 with the general government budget deficit reduced to 3.0 per cent of GDP. The government is aiming for a deficit of 2.6 per cent of GDP in 2007. General government debt fell to 40.8 per cent of GDP in 2006. However, general government expenditure at 47.7 per cent of GDP in 2006 is among the highest in the region. Average annual consumer price inflation decreased slightly to 3.2 per cent in 2006 and further to 1.9 per cent in the first half of 2007.

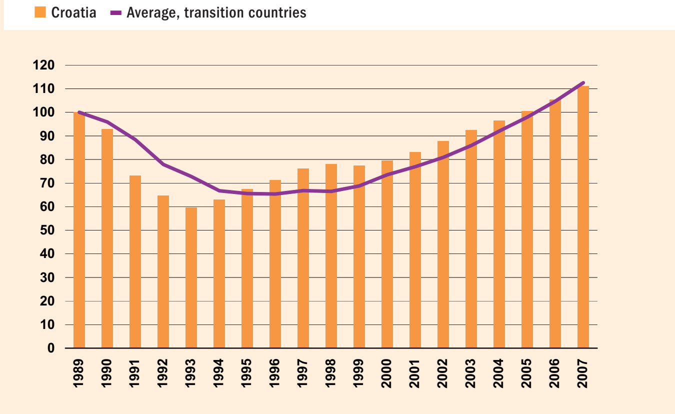
Outlook and risks

The economy is growing strongly. The prospect of EU membership and cooperation with international financial institutions serves as an important anchor for implementing further structural reforms, especially those related to reducing state ownership and intervention. The expected improvements in the investment climate as a result of the regulatory guillotine recommendations should have a positive effect on the sectoral composition of FDI and investment in general, and should therefore increase the economy's potential and result in sustainable higher growth in the longer term. However, domestic credit growth and external indebtedness will need to be monitored carefully and further fiscal consolidation is necessary. The government should reduce its spending and include all off-budget operations in the general government accounts, rather than rely on the continued growth of revenues.

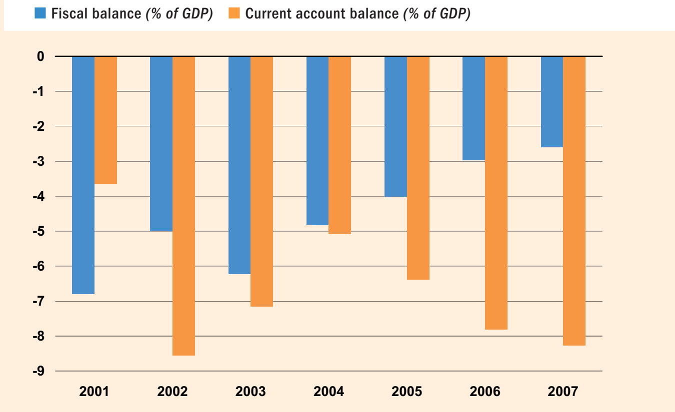
Transition indicators, 2007



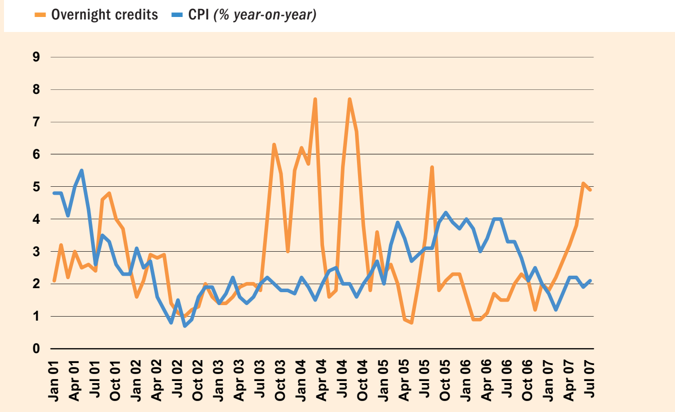
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full**	Competition office – **yes**	Independent telecoms regulator – **fully**	Capital adequacy ratio – **10.0 per cent**	Share of population living in poverty – **4.0 per cent** (2004)
Controls on inward direct investment – **no** [1]	Quality of insolvency law – **high**	Independent electricity regulator – **fully**	Deposit insurance system – **yes**	Government expenditure on health – **6.1 per cent of GDP** (2005)
Interest rate liberalisation – **full**	Secured transactions law – **inefficient**	Separation of railway infrastructure from operations – **fully**	Quality of securities market laws – **very high**	Government expenditure on education – **4.7 per cent of GDP** (2005)
Exchange rate regime – **managed float**	Quality of corporate governance law – **medium**	Independence of the road directorate – **fully**	Private pension funds – **yes**	Household expenditure on power and water – **13.1 per cent**
Wage regulation – **no**		Quality of concession laws – **low**		
Tradeability of land – **full** [2]				

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP) [3]	13.5	14.9	16.6	16.8	17.0	18.1	na
Private sector share in GDP (in per cent)	60.0	60.0	65.0	65.0	65.0	65.0	70.0
Private sector share in employment (in per cent)	60.0	62.0	65.0	66.0	68.0	68.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	16.7	18.8	19.2	19.1	18.5	na	na
Share of industry in total employment (in per cent) [4]	23.4	22.8	21.6	21.7	20.5	21.0	na
Change in labour productivity in industry (in per cent)	9.6	4.2	9.8	2.5	8.8	-1.0	na
Investment/GDP (in per cent)	23.9	29.1	31.1	30.6	31.0	32.8	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	3.0	3.0	3.3	3.3	3.3	3.3	3.3
EBRD index of enterprise reform	2.7	2.7	2.7	3.0	3.0	3.0	3.0
Markets and trade							
Share of administered prices in CPI (in per cent)	0.0	0.0	0.0	0.0	0.0	0.0	na
Number of goods with administered prices in EBRD-15 basket	1.0	1.0	1.0	0.0	0.0	0.0	na
Share of trade with non-transition countries (in per cent)	73.0	72.6	74.2	72.3	69.5	68.2	na
Share of trade in GDP (in per cent)	68.8	67.7	69.1	69.5	70.2	73.7	na
Tariff revenues (in per cent of imports) [5]	4.6	2.9	2.1	1.6	1.5	1.3	1.2
EBRD index of price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.3	2.3	2.3	2.3	2.3	2.3	2.7
Financial sector							
Number of banks (foreign-owned)	43 (24)	46 (23)	41 (19)	37 (15)	34 (13)	33 (15)	na
Asset share of state-owned banks (in per cent)	5.0	4.0	3.4	3.1	3.4	4.2	na
Asset share of foreign-owned banks (in per cent)	89.3	90.2	91.2	86.3	91.2	90.8	na
Non-performing loans (in per cent of total loans)	15.1	11.0	9.7	8.6	7.1	5.9	na
Domestic credit to private sector (in per cent of GDP)	42.1	50.2	52.8	55.8	60.6	68.7	na
Domestic credit to households (in per cent of GDP)	18.2	23.8	27.7	30.4	34.0	38.2	na
Of which mortgage lending (in per cent of GDP)	5.7	6.8	8.5	10.1	12.0	14.7	na
Stock market capitalisation (in per cent of GDP)	16.5	15.6	18.7	28.7	34.8	64.6	na
Stock trading volume (in per cent of market capitalisation)	4.0	3.8	4.8	6.0	6.7	8.8	na
Eurobond issuance (in per cent of GDP)	5.9	11.4	2.9	4.3	0.0	0.9	na
EBRD index of banking sector reform	3.3	3.7	3.7	4.0	4.0	4.0	4.0
EBRD index of reform of non-bank financial institutions	2.3	2.7	2.7	2.7	2.7	3.0	3.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	40.7 (40.1)	41.7 (53.5)	42.8 (58.0)	42.7 (64.2)	41.5 (80.2)	40.2 (98.1)	na
Internet users (per 100 inhabitants)	11.8	18.0	23.2	31.1	32.4	34.6	na
Railway labour productivity (1989=100)	67.3	78.1	90.4	92.7	107.0	125.3	na
Residential electricity tariffs (USc kWh)	6.1	6.5	8.2	9.1	9.4	10.0	na
Average collection rate, electricity (in per cent)	95	94	95	96	98	100	na
GDP per unit of energy use (PPP in US dollars per kgoe)	5.4	5.5	5.6	5.6	na	na	na
EBRD index of infrastructure reform	2.7	2.7	3.0	3.0	3.0	3.0	3.0
Electric power	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Railways	2.3	2.3	2.3	2.7	2.7	2.7	2.7
Roads	2.3	2.3	3.0	3.0	3.0	3.0	3.0
Telecommunications	3.3	3.3	3.3	3.3	3.3	3.7	3.7
Water and waste water	3.3	3.3	3.3	3.3	3.3	3.3	3.3

[1] Registration is required with commercial courts and the National Bank of Croatia.

[2] Land is tradeable but the right to trade land applies to foreigners only on a reciprocity basis and foreigners cannot acquire certain types of land (including agricultural) from the state.

[3] Excludes swaps with frozen currency deposits.

[4] Data based on labour force surveys.

[5] Refers to all taxes on international trade.

	2001	2002	2003	2004	2005	2006	2007
						Estimate	Projection
Output and expenditure			(Percentage change in real terms)				
GDP	4.4	5.6	5.3	4.3	4.3	4.8	5.5
Private consumption	4.5	7.7	4.6	4.8	3.4	3.5	na
Public consumption	-6.2	4.9	1.3	-0.3	0.8	2.2	na
Gross fixed capital formation	7.1	13.9	24.7	5.0	4.8	10.9	na
Exports of goods and services	8.1	1.2	11.4	5.7	4.6	6.9	na
Imports of goods and services	9.8	13.4	12.1	4.6	3.5	7.3	na
Industrial gross output	6.0	5.4	4.1	3.7	5.1	4.5	na
Agricultural gross output	8.5	7.7	-15.9	11.9	-8.7	na	na
Employment [1]			(Percentage change)				
Labour force (end-year)	-6.7	1.4	0.1	-0.2	0.7	0.7	na
Employment (end-year)	-6.0	3.8	0.1	0.5	2.5	2.8	na
			(In per cent of labour force)				
Unemployment (end-year)	16.4	14.5	14.4	13.8	12.3	10.5	na
Prices and wages			(Percentage change)				
Consumer prices (annual average)	3.8	1.7	1.8	2.1	3.3	3.2	2.3
Consumer prices (end-year)	2.4	1.8	1.7	2.7	3.6	2.0	2.6
Producer prices (annual average)	3.6	-0.4	1.9	3.5	3.0	2.9	na
Producer prices (end-year)	-3.1	2.3	1.1	4.8	2.7	1.9	na
Gross average monthly earnings in economy (annual average)	3.9	6.0	4.8	6.4	4.4	6.2	na
Government sector [2]			(In per cent of GDP)				
General government balance	-6.8	-5.0	-6.2	-4.8	-4.0	-3.0	-2.6
General government expenditure	50.7	50.8	51.3	49.7	48.5	47.7	na
General government debt	40.1	40.0	40.9	43.2	43.7	40.8	na
Monetary sector			(Percentage change)				
Broad money (M4, end-year)	45.2	9.5	11.0	8.6	10.5	18.0	na
Domestic credit (end-year)	21.6	28.4	12.3	11.8	19.2	18.9	na
			(In per cent of GDP)				
Broad money (M4, end-year)	64.0	64.1	65.0	65.1	66.8	72.8	na
Interest and exchange rates			(In per cent per annum, end-year)				
Discount rate	5.9	4.5	4.5	4.5	4.5	4.5	na
Money market interest rate (daily)	2.2	1.9	7.0	6.0	4.0	3.5	na
Deposit rate [3]	2.8	1.6	1.7	1.8	1.6	3.0	na
Lending rate [3]	9.5	10.9	11.5	11.4	9.9	9.1	na
			(Kuna per US dollar)				
Exchange rate (end-year)	8.4	7.1	6.1	5.6	6.2	5.6	na
Exchange rate (annual average)	8.3	7.9	6.7	6.0	5.9	5.8	na
External sector			(In millions of US dollars)				
Current account	-717.2	-1,910.6	-2,142.0	-1,903.1	-2,574.9	-3,255.4	-4,011.8
Trade balance	-4,100.8	-5,648.3	-7,908.0	-8,350.4	-9,346.1	-10,511.0	-12,667.0
Merchandise exports	4,759.3	5,003.9	6,308.0	8,209.9	8,955.2	10,606.2	11,981.6
Merchandise imports	8,860.0	10,652.2	14,216.0	16,560.3	18,301.3	21,117.2	24,648.6
Foreign direct investment, net	1,188.3	580.4	1,932.1	732.3	1,551.0	3,170.3	3,844.8
Gross reserves, excluding gold (end-year)	4,704.3	5,885.8	8,191.3	8,759.0	8,801.1	11,488.6	na
External debt stock	12,003.4	15,771.5	24,850.7	31,209.5	30,464.7	38,446.3	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year) [4]	5.3	4.9	5.2	4.8	5.1	5.3	na
			(In per cent of exports of goods and services)				
Debt service [5]	-29.6	-23.8	-20.2	-24.2	-26.9	-36.8	na
Memorandum items			(Denominations as indicated)				
Population (end-year, million)	4.4	4.4	4.4	4.4	4.4	4.4	na
GDP (in billions of kuna)	165.6	181.2	198.4	215.0	231.3	250.6	269.7
GDP per capita (in US dollars)	4,742.5	6,083.6	6,666.3	7,943.3	8,675.4	9,582.0	na
Share of industry in GDP (in per cent)	20.4	19.4	19.5	20.2	20.7	20.5	na
Share of agriculture in GDP (in per cent) [6]	7.5	7.3	6.0	6.5	6.3	6.2	na
Current account/GDP (in per cent) [4]	-3.6	-8.6	-7.1	-5.1	-6.4	-7.8	-8.3
External debt - reserves (in US$ million)	7,299.1	9,885.7	16,659.4	22,450.5	21,663.6	26,957.7	na
External debt/GDP (in per cent) [4]	61.5	61.9	75.8	80.0	82.4	85.3	na
External debt/exports of goods and services (in per cent) [4]	126.0	136.1	151.4	161.0	168.6	172.1	na

[1] Data based on labour force surveys.
[2] Consolidated general government from 2002.
[3] Weighted average over all maturities.
[4] Ratio calculated in euros since 1999.
[5] Ratio calculated in euros since 2001.
[6] Agriculture includes hunting, forestry and fishing.

Czech Republic

Key challenges

- Although transition to a market economy is in its final stages, further reforms of the pension, health care and social security systems are still needed in order to contain rising mandatory expenditures and ensure fiscal sustainability.
- New bankruptcy legislation will take time to become effective while further reforms to the judiciary and the commercial register are required to improve the business environment.
- Economic growth remains strong, but its sustainability depends on further fiscal consolidation and the implementation of reforms to improve the flexibility of the labour market. Education and research and development need more investment to speed up implementation of the Lisbon Agenda.

Country data	
Population (in millions)	10.3
Area ('000 sq km)	78.9
GDP (in billion US$, 2006)	142.4
GDP per capita in 2006 at current international US$ (PPP)	22,719
National currency	Czech koruna (crown)

Progress in structural reform

Liberalisation and privatisation

The privatisation and restructuring of former state-owned enterprises has been largely completed and the enterprise sector is dominated by efficient, internationally competitive companies. High levels of investment have led to a significant transfer of know-how and marked improvements in both productivity and profitability over recent years. However, progress in the privatisation of the remaining state assets has slowed. As a result of the political impasse following the 2006 elections, preparations for the partial privatisation of electricity company CEZ as well as the privatisation of other large entities, including the airline company Ceske Aerolinie (CSA), were put on hold. These are now not expected to be completed before 2008/2009. In the spring of 2007 the government announced tenders for the sale of two smaller companies, Skodaexport and the export insurance company EGAP. These are scheduled to be privatised by the end of the year, with revenues of Kc 1 billion (just under US$ 50 million) expected from their sale.

Business environment and competition

According to the World Bank survey Doing Business 2008, some areas of the business environment in the Czech Republic have deteriorated since 2002. The main areas of concern include starting a business, contract violations, obtaining licences, tax administration and bankruptcy procedures.

Some steps have been taken to improve the situation. A new bill on bankruptcy was passed by parliament in February 2006 and will become effective at the beginning of 2008. However, the new legislation will take some time to produce positive results and remains subject to criticism from businesses.

The commercial register and court system also remain problematic. According to the World Bank, it takes 123 days to register property in the Czech Republic (compared with 32 days in the OECD as a whole and 17 days in the Slovak Republic). Plans are being considered to drastically reduce the number of judges and increase electronic procedures to expedite court cases.

Social sector

The Czech Republic ranks well in international comparisons on a number of objective indicators on social welfare. However, despite the positive overall picture, the country still faces a number of important challenges in the social sphere.

Most importantly, the Czech old age dependency ratio (defined as the ratio of the population aged 65 and above to the population aged 15 to 64) is forecast to rise sharply after 2010, putting severe pressure on the current pay-as-you-go pension system and highlighting the urgent need for pension reform. Public expenditure on health care is also set to increase as a result of both high demand and sharply rising costs. Moreover, flexibility in the labour market is adversely affected by a high tax wedge and generous welfare programmes that continue to weaken the incentives for young low-wage earners to work. As in other countries in central eastern Europe and the Baltic states, structural unemployment remains significant due to continued geographical and skills mismatches. The efficiency of the education system can be further improved in order to address the challenge of supplying appropriately skilled workers for the changing needs of the labour market. As in other EU countries there is also general agreement that more efforts are needed to promote innovation and research and development activities, as indicated in the 2006 Annual Progress Report of the Lisbon Agenda.

To address some of these issues and in preparation for the 2008 budget the new government managed to pass a package of reforms in the autumn of 2007. Aside from important reductions in personal income and corporate taxes, the package introduces fees for a visit to a doctor, a stay in a hospital and prescriptions, all of which were previously covered by compulsory health insurance. The package also cuts benefits to parents, sick pay and other social handouts, and raises sales tax on food and other basic items as well as energy and cigarettes.

Committees have been set up to propose more far-reaching reforms to the health care and pension systems, although their implementation is unlikely before 2009. To reform the pension system, the authorities are considering raising the retirement age from 63 to 65 years and promoting higher private retirement savings. In the health sector, the authorities are considering more private provision of services. For example, in Central Bohemia the regional assembly has approved the sale of 10 small hospitals for Kc 466 million (US$ 22.3 million) to private owners in June 2007.

Macroeconomic performance

Recent years have been marked by particularly strong growth in GDP, driven by high levels of investment, sharp increases in productivity and a rapid expansion in exports. The economy grew by 6.4 per cent in 2006 and over 6.0 per cent in the first half of 2007.

For several years productivity growth has far surpassed wage inflation, mainly because of the high levels of investment and continued slack in the labour market. Robust productivity growth, the strength of the koruna and the stable monetary framework have contributed to low inflation, which has remained comfortably within the central bank's current target of 3 per cent. However, there is a risk that it will start to rise in the short to medium term, mainly due to increases in excise duty.

The Czech Republic originally planned to adopt the euro in 2010 (which implied entry into the ERM II in mid-2007), subject to meeting the Maastricht criteria, successfully consolidating public finances, and achieving a sufficient level of real convergence and adequate progress with structural reforms. However, because of the poor performance of public finances, these targets have slipped. In August 2007 the government approved a new strategy for euro adoption that does not set a target date. Public finance reform is currently at the top of the political agenda.

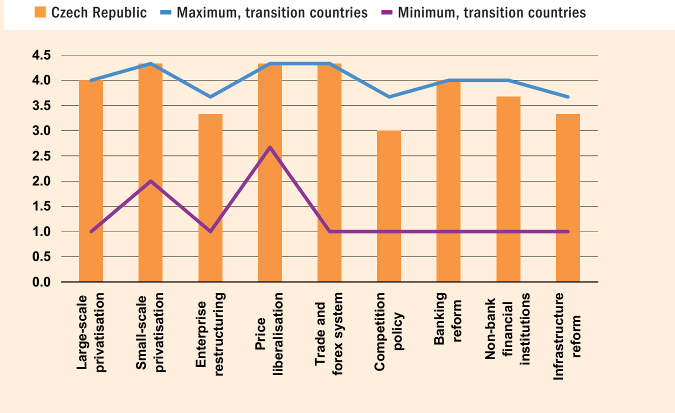
Fiscal policy continues to provide a stimulus to an already strong economy. In 2006 the general government budget deficit was 2.9 per cent of GDP and is projected to increase to 4 per cent of GDP in 2007, according to this year's budget. The more expansionary fiscal stance largely reflects a surge in planned social security spending and a rise in pensions and public sector wages. Although measures have been approved to reform the tax system and reduce social expenditures, the lack of political consensus continues to hamper more far-reaching fiscal consolidation.

Although the koruna has been appreciating in real terms, external competitiveness has remained strong. Sharp gains in productivity and the rapid growth of exports have led to improvements in the trade balance, which has been in surplus for three years running. As a result, the current account deficit was contained to 3.2 per cent of GDP in 2006 and is expected to increase only slightly in 2007. Net FDI inflows remained high in 2006 at US$ 4.7 billion. The Czech Republic continues to rank as the highest recipient of FDI in per capita terms among transition countries (with an FDI stock of US$ 5,061 per capita at the end of 2006).

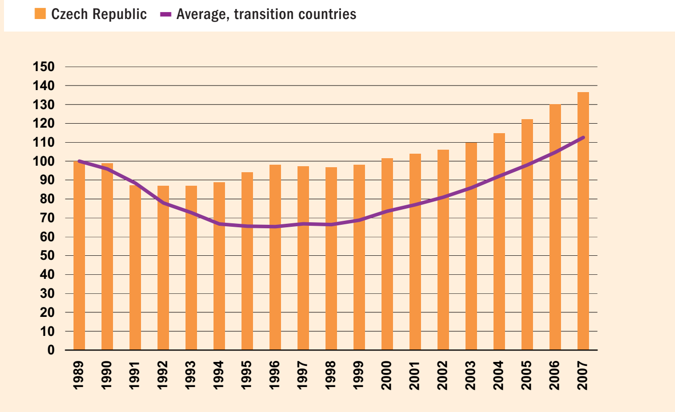
Outlook and risks

Economic growth in 2007 should remain robust at 5.5 per cent. The main medium-term challenges are implementing further urgently needed fiscal reforms in the pension and health sectors and increasing labour market flexibility. Although the consolidated general government deficit has fallen from the levels recorded in 2002-03, budgetary pressures are likely to mount over the medium term. Current reforms to reduce spending are a step in the right direction, but do not go far enough to contain them. The lack of fiscal consolidation will continue to delay entry into ERM II and the euro adoption.

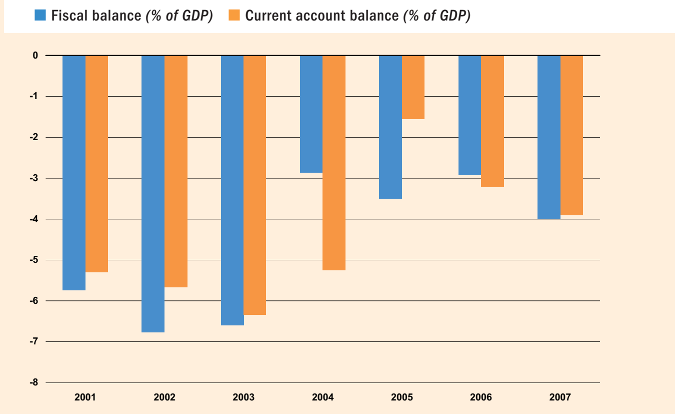
Transition indicators, 2007



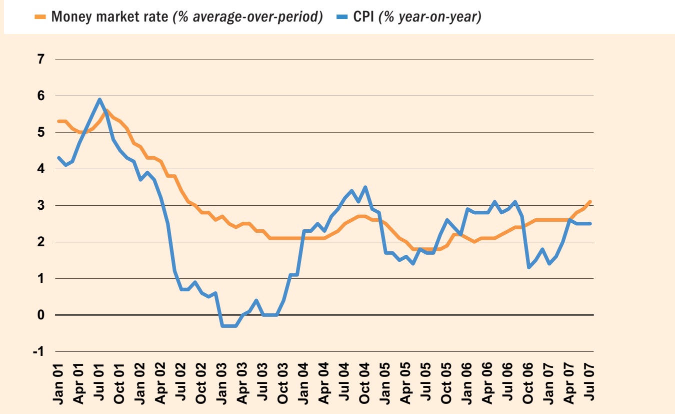
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full**	Competition office – **yes**	Independent telecoms regulator – **fully**	Capital adequacy ratio – **8 per cent**	Share of population living in poverty – **<2.0 per cent** (1996)
Controls on inward direct investment – **yes** [1]	Quality of insolvency law – **medium**	Independent electricity regulator – **fully**	Deposit insurance system – **yes**	Government expenditure on health – **6.5 per cent of GDP** (2004)
Interest rate liberalisation – **full**	Secured transactions law – **inefficient**	Separation of railway infrastructure from operations – **fully**	Quality of securities market laws – **high**	Government expenditure on education – **4.5 per cent of GDP** (2005)
Exchange rate regime – **managed float**	Quality of corporate governance law – **medium**	Independence of the road directorate – **fully**	Private pension funds – **yes**	Household expenditure on power and water – **5.8 per cent**
Wage regulation – **no**		Quality of concession laws – **na** [2]		
Tradeability of land – **full except foreigners**				

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	14.8	20.0	21.0	21.6	25.1	25.3	na
Private sector share in GDP (in per cent)	80.0	80.0	80.0	80.0	80.0	80.0	80.0
Private sector share in employment (in per cent)	70.0	70.0	70.0	70.0	70.0	70.0	na
Budgetary subsidies and current transfers (in per cent of GDP)[3]	8.8	9.6	9.5	8.4	9.4	9.0	na
Share of industry in total employment (in per cent)	40.5	40.1	39.9	39.3	39.5	40.0	na
Change in labour productivity in industry (in per cent)	5.0	1.8	6.7	11.7	4.3	8.3	na
Investment/GDP (in per cent)	29.4	28.4	27.0	27.4	25.7	27.0	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of enterprise reform	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Markets and trade							
Share of administered prices in CPI (in per cent)	12.4	12.4	10.9	10.9	10.9	19.7	na
Number of goods with administered prices in EBRD-15 basket	2.0	2.0	1.0	1.0	1.0	2.0	na
Share of trade with non-transition countries (in per cent)	79.9	80.7	80.6	79.1	77.5	75.8	na
Share of trade in GDP (in per cent)	113.0	105.2	109.4	123.2	122.5	131.5	na
Tariff revenues (in per cent of imports)	0.7	0.7	0.7	0.2	0.2	0.2	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.7	3.0	3.0	3.0	3.0	3.0	3.0
Financial sector							
Number of banks (foreign-owned)	38 (26)	37 (26)	35 (26)	35 (26)	36 (27)	37 (28)	na
Asset share of state-owned banks (in per cent)	3.8	4.6	3.0	2.9	2.5	2.2	na
Asset share of foreign-owned banks (in per cent)	89.1	85.8	86.3	84.9	84.4	84.7	na
Non-performing loans (in per cent of total loans)	14.5	9.4	5.0	4.1	4.0	3.8	na
Domestic credit to private sector (in per cent of GDP)	33.0	29.4	30.7	31.6	35.7	39.9	na
Domestic credit to households (in per cent of GDP)	5.9	7.3	9.1	11.2	13.8	16.5	na
Of which mortgage lending (in per cent of GDP)	2.4	3.0	4.2	5.9	7.7	10.0	na
Stock market capitalisation (in per cent of GDP)	14.1	19.4	17.6	25.1	31.8	31.5	na
Stock trading volume (in per cent of market capitalisation)	34.0	37.0	52.0	79.0	118.6	75.6	na
Eurobond issuance (in per cent of GDP)	0.1	0.3	0.9	2.8	1.1	0.7	na
EBRD index of banking sector reform	3.7	3.7	3.7	3.7	4.0	4.0	4.0
EBRD index of reform of non-bank financial institutions	3.0	3.0	3.0	3.3	3.7	3.7	3.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	37.8 (68.0)	36.0 (84.4)	35.6 (95.2)	33.6 (105.6)	31.5 (115.2)	31.5 (119.0)	na
Internet users (per 100 inhabitants)	14.7	25.5	23.5	25.2	27.0	34.7	na
Railway labour productivity (1989=100)	71.8	68.0	71.0	72.4	81.3	97.3	na
Residential electricity tariffs (USc kWh)	7.3	9.0	8.4	10.3	11.4	12.9	na
Average collection rate, electricity (in per cent)	100	100	100	100	100	100	na
GDP per unit of energy use (PPP in US dollars per kgoe)	3.7	3.8	3.9	4.0	na	na	na
EBRD index of infrastructure reform	3.0	3.0	3.3	3.3	3.3	3.3	3.3
Electric power	3.0	3.0	3.3	3.3	3.3	3.3	3.3
Railways	2.3	2.3	3.0	3.0	3.0	3.0	3.0
Roads	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Telecommunications	4.0	4.0	4.0	4.0	4.3	4.3	4.3
Water and waste water	4.0	4.0	4.0	4.0	4.0	4.0	4.0

1 There are controls in the air transport sector for non-resident investors.

2 The Czech Republic has no specific concession law but largely conforms with internationally accepted principles on concession laws.

3 Subsidies to enterprises and financial institutions, including the Czech Consolidation Agency.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	2.5	1.9	3.6	4.6	6.5	6.4	5.5
Private consumption	2.3	2.2	6.0	2.9	2.4	4.4	na
Public consumption	3.6	6.7	7.1	-3.1	2.3	1.1	na
Gross fixed capital formation	6.6	5.1	0.4	3.9	2.3	7.6	na
Exports of goods and services	11.2	2.1	7.2	20.7	11.8	15.9	na
Imports of goods and services	12.8	5.0	8.0	17.9	5.0	15.2	na
Industrial gross output	6.7	1.9	5.5	9.6	6.7	11.1	na
Agricultural gross output	-1.6	2.5	-5.5	0.0	8.0	-3.7	na
Employment			*(Percentage change)*				
Labour force (end-year)	0.0	1.0	0.4	0.3	1.4	0.5	na
Employment (end-year)	0.1	1.1	-0.6	-0.4	1.7	1.3	na
			(In per cent of labour force)				
Unemployment (end-year)	8.0	7.0	7.5	8.2	7.9	7.1	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	4.7	1.8	0.2	2.8	1.9	2.5	2.7
Consumer prices (end-year)	4.2	0.6	1.1	2.8	2.2	1.7	na
Producer prices (annual average)	2.9	-0.5	-0.3	5.7	3.0	1.6	na
Producer prices (end-year)	0.8	-0.7	0.9	7.7	-0.3	2.6	na
Gross average monthly earnings in economy (annual average)	8.7	7.3	6.6	6.6	5.4	6.2	na
Government sector [1]			*(In per cent of GDP)*				
General government balance	-5.7	-6.8	-6.6	-2.9	-3.5	-2.9	-4.0
General government expenditure	44.5	46.3	47.3	43.8	43.6	42.3	na
General government debt	25.9	28.5	30.1	30.7	30.4	30.6	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	13.0	-11.6	7.2	4.5	10.6	13.7	na
Domestic credit (end-year)	-5.3	-7.1	21.9	0.1	1.7	22.0	na
			(In per cent of GDP)				
Broad money (M2, end-year)	67.9	57.2	58.7	56.0	58.3	61.6	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
2-week repo rate	4.8	2.8	2.0	2.5	2.0	2.5	na
3-month PRIBOR	4.7	2.6	2.1	2.6	2.2	2.6	na
Deposit rate	2.6	1.7	1.3	1.4	1.3	1.3	na
Lending rate	8.7	8.8	8.2	8.0	7.2	6.8	na
			(Korunas per US dollar)				
Exchange rate (end-year)	36.3	30.1	25.7	22.4	24.6	20.9	na
Exchange rate (annual average)	38.0	32.7	28.2	25.7	23.9	22.6	na
External sector			*(In millions of US dollars)*				
Current account	-3,271.8	-4,263.7	-5,785.3	-5,751.3	-1,940.0	-4,585.0	-6,468.0
Trade balance	-3,077.0	-2,239.4	-2,519.1	-529.6	2,522.3	2,979.3	3,367.0
Merchandise exports	33,394.4	38,469.2	48,701.4	67,238.6	77,973.4	95,114.9	107,480.0
Merchandise imports	36,471.4	40,708.6	51,220.5	67,768.2	75,451.1	92,135.6	104,113.0
Foreign direct investment, net	5,474.2	8,281.6	1,813.6	3,940.5	11,630.0	4,666.5	5,200.0
Gross reserves, excluding gold (end-year)	14,340.0	23,550.1	26,759.6	28,252.6	29,318.5	31,165.0	na
External debt stock	22,374.0	26,983.4	34,892.8	45,240.7	46,452.8	58,296.7	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	4.1	6.0	5.5	4.4	4.1	3.6	na
			(In per cent of exports of goods and services)				
Debt service	8.3	6.7	7.6	5.8	7.4	6.0	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	10.2	10.2	10.2	10.2	10.3	10.3	na
GDP (in billions of korunas)	2,352.2	2,464.4	2,577.1	2,817.4	2,994.4	3,220.3	3,468.7
GDP per capita (in US dollars)	6,059.1	7,377.6	8,947.0	10,726.0	12,216.9	13,896.1	na
Share of industry in GDP (in per cent)	37.5	37.5	38.2	40.0	40.1	41.9	na
Share of agriculture in GDP (in per cent)	3.7	3.8	3.4	3.3	3.3	3.0	na
Current account/GDP (in per cent)	-5.3	-5.7	-6.3	-5.2	-1.5	-3.2	-3.9
External debt - reserves (in US$ million)	8,034.0	3,433.3	8,133.2	16,988.1	17,134.3	27,131.7	na
External debt/GDP (in per cent)	36.2	35.8	38.2	41.3	37.1	40.9	na
External debt/current account revenues, excluding transfers (in per cent)	55.3	59.2	61.8	58.8	51.8	53.8	na

[1] Calculated according to Eurostat methodology (ESA95).

Estonia

Key challenges

- Although risks in the banking sector appear to be contained, the continuing rapid credit growth needs to be carefully monitored and cross-border supervision further strengthened to manage risks inherent in the system.
- The authorities should proceed with labour market reforms to counter the effects of unfavourable demographic trends, migration outflows and increasing labour shortages.
- After overheating, the economy is showing tentative signs of slowing down. However, banks will need to constrain credit growth even further and the authorities will have to sustain tight fiscal policies to help contain inflationary pressures and enable the eventual, smooth adoption of the euro.

Country data	
Population (in millions)	1.3
Area ('000 sq km)	45.0
GDP (in billion US$, 2006)	16.4
GDP per capita in 2006 at current international US$ (PPP)	18,324
National currency	Kroon

Progress in structural reform

Business environment and competition

A study conducted by the IMF in July 2007 concluded that Estonia's economic success in recent years can be mainly attributed to a favourable business climate that contributed to rapid growth in labour productivity (which was more than four times that in the EU-15 countries during the mid-1990s) and a very high rate of business entry and exit. Estonia continued to rank 17th in the World Bank's Doing Business 2008 survey (just one point behind Lithuania, the highest ranked country in the region). Estonia now ranks on a par or slightly better than OECD countries in terms of starting a business, dealing with licences, registering property, getting credit and paying taxes. However, the costs and regulatory burden surrounding the hiring and firing of workers continues to be significantly higher than the average in central eastern Europe and the Baltic states (CEB) and the OECD.

Moreover, labour shortages have become increasingly evident, reflected in sharply decreasing levels of unemployment and rapidly rising wages. Labour shortages have arisen not only because the economy has expanded so rapidly, but also because Estonia's population has declined sharply and the workforce has shrunk. As a result, the new government has initiated a review of the 1992 Employment Contracts Act. Plans are being discussed to simplify hiring and firing procedures and change severance and insurance pay. Proposals are also being considered to encourage the immigration of more skilled workers and to streamline applications for work permits.

Infrastructure

Structural reforms in infrastructure are generally advanced. However, in January 2007 the government reversed the controversial 2001 privatisation of Estonian Railways – the freight operator and owner/manager of the rail infrastructure – by buying it back from Baltic Rail Services (BRS), an international consortium owned by three strategic railway investors and a local company. The state agreed to pay Kr 2.35 billion (US$ 188 million) to the consortium for its 66 per cent stake (which had originally cost BRS Kr 1 billion). Relations between the government and BRS had soured following the election in 2003 of a new government opposed to the privatisation and the introduction of a new Railways Act. Differences in interpreting the original privatisation contract and changes to corporate governance in the light of the new Act had resulted in numerous legal actions on both sides.

Financial sector

The banking sector remains strong, with no residual state ownership, 99 per cent of assets in foreign hands, a high level of profitability and a negligible ratio of non-performing loans. While banking sector indicators are generally favourable, credit growth has been very high in recent years. The growth of bank credit to the private sector accelerated to 63 per cent in 2006. Over three-quarters of bank lending was denominated in euros in 2006 and the fastest credit growth has been to the property sector on the back of a property boom. However, there are signs that credit growth slowed in the latter part of 2006 and the beginning of 2007.

With credit expanding so rapidly, the small non-banking sector has started to grow. According to central bank reports, securities market capitalisation was around 35 per cent of GDP in 2006, one of the highest rates among transition countries. The total capital invested in pension and investment funds increased from 3.6 per cent to 13.3 per cent of GDP between 2002 and 2006. In the insurance market, gross premiums (both life and non-life) collected by insurance companies increased from 1.7 per cent to 2.2 per cent of GDP over the same period.

Social sector

According to a recent IMF report the ageing of the population will lead to a sizeable increase in pension and health care costs. Although this is a problem that most other CEB economies share, Estonia is perhaps better placed to deal with it given its low level of public debt. Nevertheless, the problem is likely to be accentuated by government plans to increase public pension benefits.

According to the EBRD/World Bank Life in Transition Survey (LiTS), conducted in 2006, extra spending on pensions was considered a priority among older people and those on lower incomes. However, for respondents in all income and age categories the highest priority for extra government spending was on health care and education. This is consistent with the findings in most other transition countries.

Macroeconomic performance

A combination of strong growth, higher inflation and a growing external deficit meant the economy was overheating in 2005 and 2006, although it has recently been showing signs of slowing down. GDP growth was 11.4 per cent in 2006, but has since decelerated to 10.1 and 7.6 per cent in the first two quarters of 2007, respectively.

The 12-month harmonised index of consumer prices rose by 4.4 per cent by the end of 2006 and has continued to increase since, due mainly to higher food and energy prices. Core inflation has also accelerated, reflecting a sharp rise in rents. Excise tax increases scheduled for 2008 will mean that inflation will remain high over the short term. In addition, the unemployment rate decreased sharply to a low of 6.4 per cent by the end of 2006 from 13.6 per cent in 2000. The growth of real wages has outpaced that of productivity since 2005.

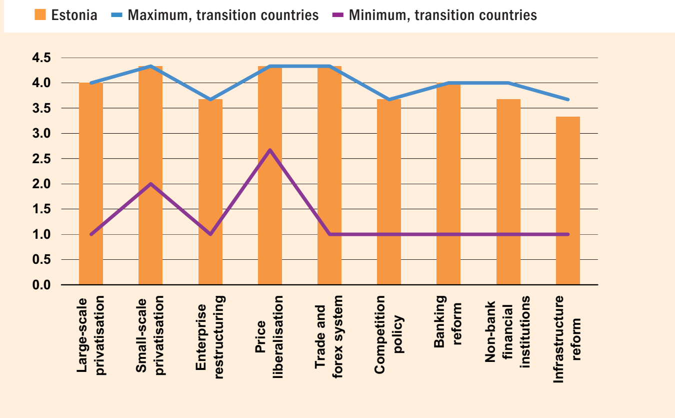
The continued rapid credit growth has fuelled demand for imports and contributed to a significant widening in the current account deficit, which amounted to 15.7 per cent in 2006, up from 10.0 per cent a year earlier. Continued high domestic demand and the temporary disruption in transit trade from Russia in April 2007 are likely to lead to a further deterioration in the current account in 2007. Gross external debt levels have also soared.

After a general government surplus of 3.8 per cent of GDP in 2006, the authorities were targeting a surplus of only 1.9 per cent in 2007, although the outcome is likely to be higher. The 2007 budget includes an increase in expenditure by over 20 per cent with large public sector wage increases. While maintaining the existing tax relief on mortgage interest payments, the government is introducing phased income tax cuts and raising the non-taxable minimum. It also decided to increase public pensions. The planned surplus for the 2008 budget has been fixed at 1.3 per cent of GDP, which is lower than the budget surpluses recently advocated by international financial institutions.

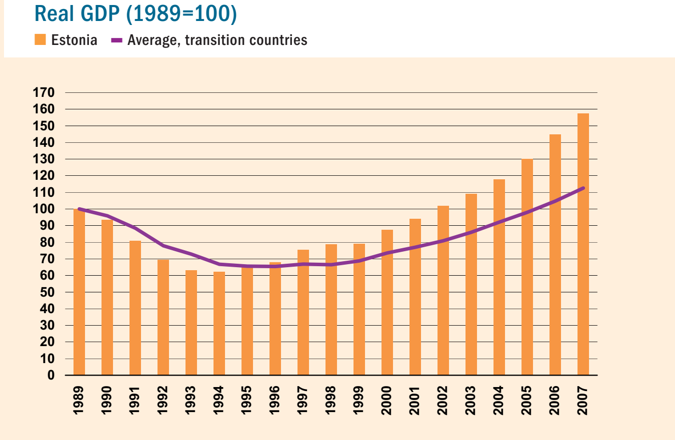
Outlook and risks

The delays in euro adoption, exchange rate pressures in Latvia in February 2007, increased political tensions with Russia and global credit market turbulence have brought the risks of Estonia's current pace of development to the fore. So far, Estonia has been little affected by recent market turmoil thanks to past fiscal prudence, responsive prudential policies and the stability of its currency board arrangement. Nevertheless, the financial sector may still be exposed to risks if Swedish parent banks suffer a more serious credit crunch. While there are increasing signs that demand growth is slowing, that the housing market is cooling and that banks are constraining credit growth, a sustained tightening of the fiscal position and closer scrutiny of credit conditions will be essential to contain macroeconomic vulnerabilities in the future. Labour market flexibility needs to be strengthened to ensure continued competitiveness over the medium term.

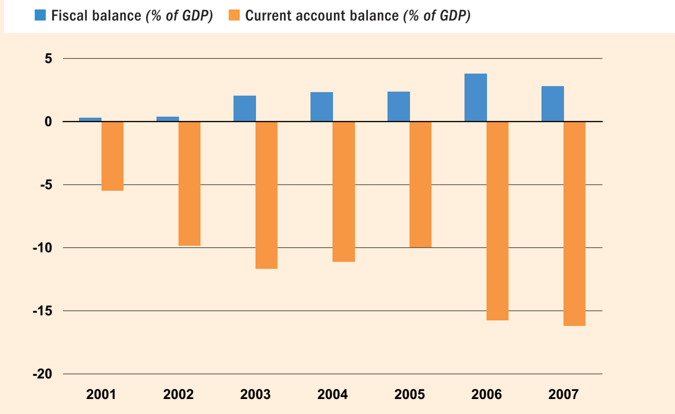
Transition indicators, 2007



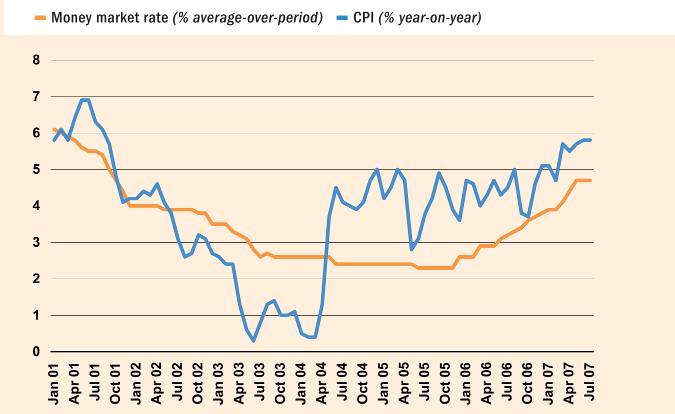
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no**

Interest rate liberalisation – **full**

Exchange rate regime – **currency board in ERM II**

Wage regulation – **no**

Tradeability of land – **full**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **medium**

Secured transactions law – **inefficient**

Quality of corporate governance law – **medium**

Infrastructure

Independent telecoms regulator – **fully**

Independent electricity regulator – **fully**

Separation of railway infrastructure from operations – **fully**

Independence of the road directorate – **partially**

Quality of concession laws – **na** [1]

Financial sector

Capital adequacy ratio – **10 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **very high**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **7.5 per cent** (2003)

Government expenditure on health – **4.0 per cent of GDP** (2004)

Government expenditure on education – **5.7 per cent of GDP** (2005)

Household expenditure on power and water – **6.1 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	6.6	7.0	7.2	7.3	na	na	na
Private sector share in GDP (in per cent)	75.0	80.0	80.0	80.0	80.0	80.0	80.0
Private sector share in employment (in per cent)	70.8	72.9	73.3	73.9	75.0	74.3	na
Budgetary subsidies and current transfers (in per cent of GDP)	0.7	0.9	1.1	1.4	1.5	1.4	na
Share of industry in total employment (in per cent)	26.2	24.7	25.2	27.0	26.0	25.9	na
Change in labour productivity in industry (in per cent)	8.6	13.2	3.0	1.5	15.3	15.0	na
Investment/GDP (in per cent)	28.1	32.4	33.0	36.2	35.2	38.2	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of enterprise reform	3.3	3.3	3.3	3.3	3.7	3.7	3.7
Markets and trade							
Share of administered prices in CPI (in per cent) [2]	28.9	28.5	24.9	26.9	26.7	24.7	na
Number of goods with administered prices in EBRD-15 basket	3.0	3.0	3.0	3.0	2.0	2.0	na
Share of trade with non-transition countries (in per cent)	74.3	71.8	72.0	72.0	72.6	78.3	na
Share of trade in GDP (in per cent)	121.3	111.5	112.3	119.4	124.7	135.6	na
Tariff revenues (in per cent of imports)	0.1	0.0	0.1	0.2	0.3	0.3	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	3.0	3.0	3.0	3.3	3.3	3.7	3.7
Financial sector							
Number of banks (foreign-owned)	7 (4)	7 (4)	7 (4)	9 (6)	13 (10)	14 (12)	na
Asset share of state-owned banks (in per cent)	0.0	0.0	0.0	0.0	0.0	0.0	na
Asset share of foreign-owned banks (in per cent)	97.6	97.5	97.5	98.0	99.4	99.1	na
Non-performing loans (in per cent of total loans)	1.2	0.8	0.5	0.3	0.2	0.2	na
Domestic credit to private sector (in per cent of GDP)	24.3	26.0	31.4	40.9	57.2	78.4	na
Domestic credit to households (in per cent of GDP)	8.4	10.6	14.3	19.7	28.1	38.7	na
Of which mortgage lending (in per cent of GDP)	5.6	7.6	11.2	15.8	23.3	32.1	na
Stock market capitalisation (in per cent of GDP)	24.1	29.9	39.3	48.5	25.3	34.6	na
Stock trading volume (in per cent of market capitalisation)	13.6	14.9	18.3	17.5	51.1	21.2	na
Eurobond issuance (in per cent of GDP)	1.9	8.7	5.8	8.1	2.5	na	na
EBRD index of banking sector reform	3.7	3.7	3.7	4.0	4.0	4.0	4.0
EBRD index of reform of non-bank financial institutions	3.0	3.3	3.3	3.3	3.3	3.7	3.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	35.4 (45.5)	35.1 (65.0)	34.1 (77.7)	33.3 (94.1)	33.3 (108.8)	40.9 (125.2)	na
Internet users (per 100 inhabitants)	30.1	32.8	44.4	50.2	51.9	57.4	na
Railway labour productivity (1989=100)	172.2	223.7	256.5	294.4	359.7	333.7	na
Residential electricity tariffs (USc kWh)	4.4	5.7	6.5	8.1	9.2	10.1	na
Average collection rate, electricity (in per cent)	97	98	99	99	99	99	na
GDP per unit of energy use (PPP in US dollars per kgoe)	3.3	3.7	3.4	3.5	na	na	na
EBRD index of infrastructure reform	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Electric power	3.7	3.0	3.0	3.0	3.0	3.3	3.3
Railways	4.0	4.3	4.3	4.3	4.3	4.3	4.0
Roads	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Telecommunications	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Water and waste water	4.0	4.0	4.0	4.0	4.0	4.0	4.0

1 Estonia has no specific concession law but generally conforms with internationally accepted principles on concession laws.

2 The high share is explained by the inclusion of gasoline (on which there are excise taxes) in the calculations of the Statistical Office.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			(Percentage change in real terms)				
GDP	7.7	8.0	7.1	8.1	10.5	11.4	8.5
Private consumption	7.4	11.2	6.9	6.9	8.2	15.7	na
Public consumption	2.6	1.9	0.3	2.2	1.1	2.8	na
Gross fixed capital formation	9.7	24.1	7.0	13.5	12.7	19.7	na
Exports of goods and services	2.0	1.7	7.6	17.1	21.5	10.0	na
Imports of goods and services	3.5	6.0	10.6	15.2	15.9	14.7	na
Industrial gross output	8.7	8.1	7.0	8.9	13.2	12.2	na
Agricultural gross output	-5.2	8.3	0.8	-7.2	2.3	0.2	na
Employment			(Percentage change)				
Labour force (annual average)	-0.2	-1.2	1.2	-0.2	0.1	-3.7	na
Employment (annual average)	0.9	1.4	1.5	0.2	2.0	-2.1	na
			(In per cent of labour force)				
Unemployment (annual average)	12.6	10.3	10.0	9.6	7.9	6.4	na
Prices and wages			(Percentage change)				
Consumer prices (annual average)	5.8	3.6	1.3	3.0	4.1	4.4	6.0
Consumer prices (end-year)	4.2	2.6	1.2	5.0	3.6	5.1	6.8
Producer prices (annual average)	4.4	0.4	0.2	2.9	2.1	4.5	na
Producer prices (end-year)	1.7	1.4	0.3	3.9	2.2	5.9	na
Gross average monthly earnings in economy (annual average)	12.3	11.5	9.4	8.4	10.8	16.5	na
Government sector			(In per cent of GDP)				
General government balance	0.3	0.4	2.0	2.3	2.3	3.8	2.8
General government expenditure	35.1	35.6	35.3	34.2	33.2	33.2	na
General government debt	4.7	5.8	6.0	5.5	4.8	4.1	na
Monetary sector			(Percentage change)				
Broad money (M2, end-year)	23.7	11.1	10.9	15.8	42.0	28.2	na
Domestic credit (end-year)	24.4	27.6	28.7	29.2	32.1	41.9	na
			(In per cent of GDP)				
Broad money (M2, end-year)	37.7	37.3	37.8	39.7	47.7	51.8	na
Interest and exchange rates			(In per cent per annum, end-year)				
Deposit rate (over 12 months)	4.5	3.7	2.4	2.1	2.3	3.6	na
Lending rate (over 12 months)	10.1	6.6	5.1	6.2	9.2	7.7	na
			(Kroons per US dollar)				
Exchange rate (end-year)	17.6	14.9	12.4	11.5	12.5	11.9	na
Exchange rate (annual average)	17.5	16.6	13.9	12.6	12.4	12.5	na
External sector			(In millions of US dollars)				
Current account	-338.6	-716.3	-1,116.0	-1,292.8	-1,392.3	-2,581.2	-3,280.0
Trade balance	-788.4	-1,088.6	-1,553.4	-1,966.1	-1,903.8	-2,958.3	-3,800.0
Merchandise exports	3,359.3	3,530.2	4,607.2	5,970.8	7,770.9	9,654.3	11,600.0
Merchandise imports	4,147.7	4,618.8	6,160.6	7,936.9	9,674.7	12,612.6	15,400.0
Foreign direct investment, net	342.7	152.5	762.7	703.0	2,252.2	568.5	600.0
Gross reserves, excluding gold (end-year)	820.2	1,000.4	1,373.4	1,792.5	1,945.1	2,855.9	na
External debt stock [1]	3,278.7	4,703.8	7,064.7	10,016.8	11,315.0	16,805.1	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	1.9	2.1	2.2	2.2	2.0	2.3	na
			(In per cent of exports of goods and services)				
Debt service	11.7	15.1	15.9	12.4	12.9	14.4	na
Memorandum items			(Denominations as indicated)				
Population (end-year, million)	1.4	1.4	1.4	1.4	1.3	1.3	na
GDP (in billions of kroons)	108.2	121.4	132.9	146.7	173.1	204.6	235.3
GDP per capita (in US dollars)	4,528.4	5,368.7	7,071.6	8,619.4	10,386.0	12,209.1	na
Share of industry in gross value added (in per cent)	25.3	25.3	25.5	25.0	25.1	25.5	na
Share of agriculture in gross value added (in per cent)	4.2	3.7	3.3	3.4	3.3	2.8	na
Current account/GDP (in per cent)	-5.5	-9.8	-11.6	-11.1	-10.0	-15.7	-16.2
External debt - reserves (in US$ million)	2,458.5	3,703.4	5,691.3	8,224.3	9,369.9	13,949.2	na
External debt/GDP (in per cent)	53.0	64.4	73.7	86.0	80.9	102.3	na
External debt/exports of goods and services (in per cent)	65.5	89.7	103.3	113.9	103.3	127.8	na

[1] Data from the Bank of Estonia. Includes non-resident currency and deposits, liabilities to affiliated enterprises and liabilities to direct investors.

FYR Macedonia

Key challenges

- The country's infrastructure urgently needs further modernisation. Upgrading the transport and power networks to facilitate trade and ensure reliable power supplies would help greatly to achieve this, as would policies to encourage private sector involvement.
- The success of initiatives to attract additional foreign investment will depend on progress made in improving the business environment, especially regarding judicial reform and the protection of property rights.
- Measures to attract more FDI and facilitate exports are key to overcoming the persistently high unemployment rate and improving living standards.

Country data	
Population (in millions)	2.0
Area ('000 sq km)	26.0
GDP (in billion US$, 2006)	6.2
GDP per capita in 2006 at current international US$ (PPP)	7,757
National currency	Denar

Progress in structural reform

Business environment and competition

In early 2007 the government launched a campaign to present the country as a "new business heaven" to attract further investment from abroad. The "one-stop shop" established in 2006 for the registration of businesses has reduced the time needed to establish a business to only three days, and in May 2007 the government announced that this would now take no longer than a day. The new property cadastre will greatly improve the registration process of property transactions. The system is expected to be fully operational by the end of 2008, and will make it possible to register property within one day.

The tax reform that came into force in January 2007 reduced personal income tax and corporate tax to 12 per cent with a further reduction to 10 per cent planned from January 2008. Other recent initiatives introduced by the government include an exemption for companies from paying taxes on reinvested profits and a 10-year tax exemption on corporate tax for foreign investors in free economic zones. In April 2007, the government started to introduce a one-stop-shop service for foreign trade deals at customs offices, intended to simplify the procedures that are necessary to complete foreign trade deals. The full introduction of the new system is expected for 2008.

The legislative framework for the independent competition office established in 2005 has been gradually improving and its enforcement records continued to increase in 2006. However, judicial reform remains a serious challenge. Although discussions have continued among the leading political parties, little substantive progress has been made since last year.

Judicial reform is a key requirement for NATO membership and for advancing in EU negotiations. In September 2007, NATO officials highlighted the need to progress this reform agenda, including completing the Judiciary Council and adopting laws reforming public prosecution.

Infrastructure

Ensuring reliable power supplies remains a major concern. In 2007 power production is expected to cover only two-thirds of total consumption so dependence on electricity imports is still high. The privatisation of the oil-fired power plant Negotino is expected to lead to an increase in domestic supply during the next few years. An international consortium led by Canada's Hatch Group will buy the plant for €62 million and it has offered to build a 500 MW coal-fired power plant at the site. In July 2007, the government announced that it will seek a strategic partner for up to 25 per cent of ELEM, the electricity generator, abandoning earlier plans for the company's full privatisation.

In telecoms, a third mobile operator owned by Austrian company Mobilkom started operations in September 2007 while the tender for a fourth will be called by the end of 2007. These developments are expected to lead to significantly reduced prices, as well as an increase in mobile phone penetration, which stood at 70 per cent in December 2006. Although in January 2007 On.Net became the first alternative fixed-line operator, complete liberalisation of the telecoms sector as a whole remains to be achieved.

In July 2007 the government commissioned a study for the development of the country's two civilian airports in Skopje and Ohrid through a concession agreement. The state of air transport facilities is still a problem given that the government wishes to substantially increase the number of tourists visiting the country. Also in July 2007 a tender for the construction of 10 hotels was opened. The state of the road network is also a bottleneck for the growth of trade and several donor-funded projects are under way to upgrade the road network.

Financial sector

In May 2007 the parliament adopted a new banking law that aims to strengthen the stability of the banking system by raising the minimum capital requirement for establishing a bank from €3.5 million to €5 million. In addition, foreign banks will be allowed to open branches, although they have to fulfil a number of additional requirements, effectively allowing only the top banks to enter the country. The new regulations are expected to contribute to better supervision standards and stronger corporate governance in the banking system. The growth of private credit accelerated from 20 to 30 per cent between 2005 and 2006, contributing to a sharp rise in bank profitability. However, the level of domestic credit remains relatively low, accounting for around 32 per cent of annualised GDP in June 2007.

Macroeconomic performance

Real GDP rose by 3.2 per cent in 2006 compared with 4.1 per cent in 2005. Exports and household consumption were the main driving forces, while investment flows were weak. However, there are signs of an upturn in 2007 with GDP rising by 7 per cent (year-on-year) during the first quarter. Stronger growth reflected higher output from all the main sectors, with trade, industry, transport and telecoms all expanding rapidly. However, it was also partly the result of a revision of the weights in the calculation of the industrial production index. So far, stronger growth has had little impact on the unemployment rate, which remains above one-third of the labour force.

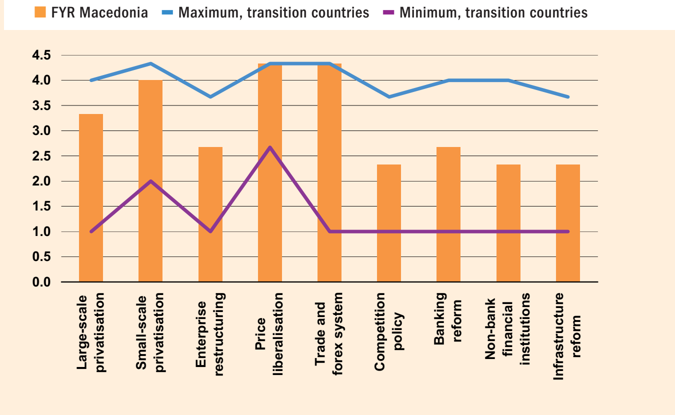
Monetary policy remains prudent, contributing to low inflation and the maintenance of the exchange rate peg to the euro. The government has continued with restrained spending policies, although the general government budget recorded a deficit of 0.4 per cent of GDP in 2006, after a slight surplus in 2005, mainly because of a significant increase in state benefits. For 2007 the deficit is expected to increase to 1 per cent of GDP. The tax reform that came into force in January 2007 has been implemented successfully, with tax revenues up 17 per cent in the first eight months of 2007 compared with their level a year earlier. Although revenues from personal income tax fell by 4 per cent over this period, this was more than offset by strong growth of profit tax revenues (up by 25 per cent) and by VAT (up by 23 per cent) and excise tax revenues (up by 13 per cent). An increase in the tax collection rate as well as the process of fiscal decentralisation to the municipalities, which started in mid-2007, is expected to further boost government revenues and increase efficiency of spending.

The current account deficit fell from 1.4 per cent in 2005 to 0.4 per cent in 2006, driven mainly by a narrowing of the trade deficit (as exports to the European Union and the Western Balkans increased substantially) and higher remittances. The positive trend for exports was sustained during the first half of 2007 with strong export growth, well in excess of that of imports, contributing to a small surplus on the current account in the first quarter. The combination of FDI and portfolio investment reached a record €350 million in 2006 mainly due to privatisation in the energy sector.

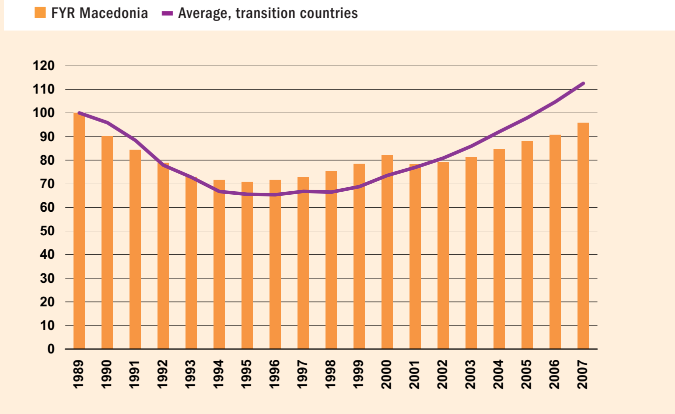
Outlook and risks

Over the past decade the economy has tended to be very stable but has lacked dynamism so that growth has been consistently below, and unemployment above, the regional averages. On current trends, available indicators show that the prospects for higher growth this year are positive. However, the medium- and long-term outlooks depend on a sustained commitment to reform and significant amounts of greenfield investment. At present, the deficiencies of the infrastructure sector, especially in transport and energy, are major hindrances, although measures to improve the situation are being implemented. The success of initiatives to attract private investment also depends on progress in continuing reforms of the judiciary and ensuring property rights. However, meeting these challenges would be helped if further tangible progress were made towards EU membership.

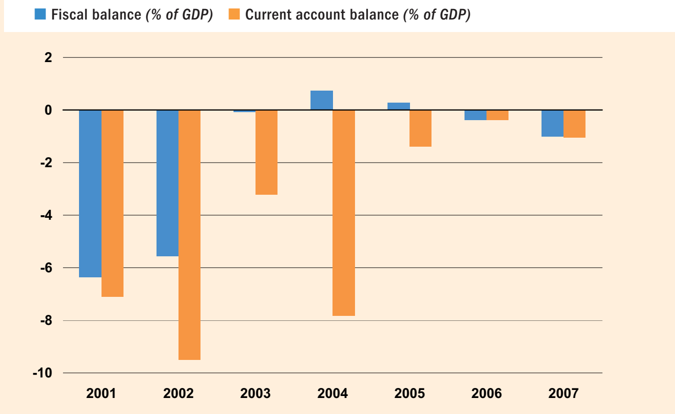
Transition indicators, 2007



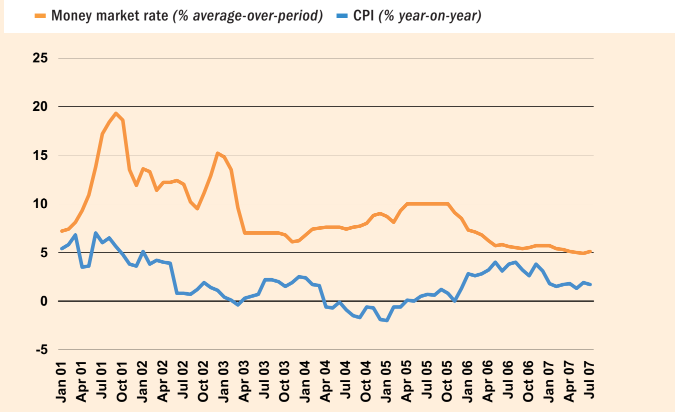
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **yes**

Interest rate liberalisation – **full**

Exchange rate regime – **de facto fixed to euro**

Wage regulation – **no**

Tradeability of land – **limited de jure**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **medium**

Secured transactions law – **some defects**

Quality of corporate governance law – **high**

Infrastructure

Independent telecoms regulator – **fully**

Independent electricity regulator – **partially**

Separation of railway infrastructure from operations – **no**

Independence of the road directorate – **partially**

Quality of concession laws – **medium**

Financial sector

Capital adequacy ratio – **8 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **high**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **<2.0 per cent** (2003)

Government expenditure on health – **5.7 per cent of GDP** (2004)

Government expenditure on education – **3.4 per cent of GDP** (2005)

Household expenditure on power and water – **12.6 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	12.6	13.3	13.6	13.8	14.0	20.7	na
Private sector share in GDP (in per cent)	60.0	60.0	60.0	65.0	65.0	65.0	65.0
Private sector share in employment (in per cent)	50.0	50.0	50.0	55.0	55.0	60.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	7.5	10.5	8.5	8.5	8.1	8.2	na
Share of industry in total employment (in per cent)	26.5	24.8	23.8	23.2	19.9	19.4	na
Change in labour productivity in industry (in per cent)	-10.6	13.5	12.4	4.7	15.5	7.4	na
Investment/GDP (in per cent)	14.8	16.6	16.7	18.8	20.0	na	na
EBRD index of small-scale privatisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of large-scale privatisation	3.0	3.0	3.0	3.3	3.3	3.3	3.3
EBRD index of enterprise reform	2.3	2.3	2.3	2.3	2.3	2.7	2.7
Markets and trade							
Share of administered prices in CPI (in per cent)	8.3	10.9	13.4	1.5	1.2	1.2	na
Number of goods with administered prices in EBRD-15 basket	1.0	1.0	1.0	0.0	0.0	0.0	na
Share of trade with non-transition countries (in per cent)[1]	57.6	56.6	68.7	54.1	58.0	na	na
Share of trade in GDP (in per cent)	82.6	80.3	77.2	84.0	87.6	97.6	na
Tariff revenues (in per cent of imports)	5.3	5.1	5.1	4.2	3.5	3.0	na
EBRD index of price liberalisation	4.0	4.0	4.0	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.0	4.0	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.0	2.0	2.0	2.0	2.0	2.0	2.3
Financial sector							
Number of banks (foreign-owned)	21 (8)	20 (7)	21 (8)	21 (8)	20 (8)	19 (8)	na
Asset share of state-owned banks (in per cent)	1.3	2.0	1.8	1.9	1.6	1.6	na
Asset share of foreign-owned banks (in per cent)	51.1	44.0	47.0	47.3	51.3	53.2	na
Non-performing loans (in per cent of total loans)	44.4	35.7	34.9	27.5	22.2	15.1	na
Domestic credit to private sector (in per cent of GDP)	17.6	17.7	19.9	23.2	25.9	31.0	na
Domestic credit to households (in per cent of GDP)	1.7	2.4	3.7	5.6	7.5	9.6	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	na	na
Stock market capitalisation (in per cent of GDP)	0.4	4.3	7.7	7.7	11.1	16.8	na
Stock trading volume (in per cent of market capitalisation)	6.6	4.3	8.1	8.6	18.3	23.0	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	3.1	na	na
EBRD index of banking sector reform	2.7	2.7	2.7	2.7	2.7	2.7	2.7
EBRD index of reform of non-bank financial institutions	1.7	1.7	1.7	2.0	2.0	2.3	2.3
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	26.7 (11.1)	27.7 (18.1)	25.9 (38.3)	26.5 (48.5)	26.2 (62.0)	24.1 (69.6)	na
Internet users (per 100 inhabitants)	3.5	5.0	6.2	7.8	7.9	13.2	na
Railway labour productivity (1989=100)	78.9	59.2	67.2	76.2	112.9	132.0	na
Residential electricity tariffs (USc kWh)	na	4.1	5.1	5.5	5.5	4.8	na
Average collection rate, electricity (in per cent)	80	75	76	82	88	79	na
GDP per unit of energy use (PPP in US dollars per kgoe)	na	4.5	4.5	4.6	na	na	na
EBRD index of infrastructure reform	2.0	2.0	2.0	2.3	2.3	2.3	2.3
Electric power	2.3	2.3	2.3	2.3	2.7	3.0	3.0
Railways	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Roads	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Telecommunications	2.3	2.3	2.7	3.0	3.0	3.0	3.3
Water and waste water	2.0	2.0	2.0	2.0	2.0	2.3	2.3

[1] For some years data were unavailable for some important trading partners, such as Bosnia and Herzegovina, Croatia, Montenegro and Serbia. As a result, the share of trade with non-transition countries for these years has been over-estimated.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	-4.5	0.9	2.8	4.1	4.1	3.2	5.5
Industrial gross output	-4.6	-0.8	5.1	-2.1	6.9	5.0	na
Agricultural gross output	-10.8	-2.0	4.8	4.9	3.0	4.0	na
Employment			*(Percentage change)*				
Labour force (end-year)	6.3	-4.4	4.4	-3.3	6.9	0.2	na
Employment (end-year)	9.0	-6.3	-2.9	3.0	8.0	0.3	na
			(In per cent of labour force)				
Unemployment (end-year)	30.9	31.9	36.7	37.2	37.3	36.0	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	5.5	1.8	1.2	-0.4	0.5	3.2	2.5
Consumer prices (end-year)	3.7	1.1	2.6	-1.9	1.2	2.9	2.0
Producer prices (annual average)	2.0	-0.9	-0.3	0.9	3.2	4.5	na
Producer prices (end-year)	-2.5	1.1	-0.2	1.3	2.9	3.2	na
Gross average monthly earnings in economy (annual average)	3.6	6.9	4.8	3.5	3.8	6.3	na
Government sector			*(In per cent of GDP)*				
General government balance	-6.3	-5.6	-0.1	0.7	0.3	-0.4	-1.0
General government expenditure	40.3	40.5	38.5	35.8	36.8	34.1	na
General government debt	51.6	49.6	45.7	44.3	47.6	43.3	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	66.3	-8.0	18.4	16.1	18.4	24.5	na
Domestic credit (end-year)	-11.5	28.8	14.1	20.0	16.7	14.3	na
			(In per cent of GDP)				
Broad money (M2, end-year)	29.8	26.3	30.2	33.3	36.8	42.9	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Basic rate of the National Bank	10.7	10.7	7.0	6.5	6.5	6.5	na
Interbank interest rate	11.9	14.4	5.8	7.9	8.5	5.7	na
Deposit rate	10.0	9.2	6.7	6.5	5.2	4.7	na
Lending rate	19.2	17.7	14.5	12.0	12.1	11.3	na
			(Denars per US dollar)				
Exchange rate (end-year)	69.2	58.6	49.9	49.4	48.9	46.5	na
Exchange rate (annual average)	68.1	64.7	54.3	50.0	48.5	48.7	na
External sector			*(In millions of US dollars)*				
Current account	-243.6	-357.8	-149.1	-414.8	-81.5	-23.7	-75.0
Trade balance	-526.4	-804.3	-847.9	-1,112.1	-1,057.5	-1,285.2	-1,330.0
Merchandise exports	1,155.4	1,112.2	1,362.7	1,672.4	2,039.6	2,396.3	2,900.0
Merchandise imports	1,681.8	1,916.5	2,210.6	2,784.5	3,097.1	3,681.5	4,230.0
Foreign direct investment, net	440.7	77.7	96.0	155.9	97.1	350.3	170.0
Gross reserves, excluding gold (end-year)	760.0	730.0	903.4	975.3	1,324.7	1,865.8	na
External debt stock	1,494.4	1,640.6	1,840.0	2,079.0	2,274.0	2,411.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	4.8	4.1	4.3	3.8	4.6	5.5	na
			(In per cent of exports of goods and services)				
Debt service	14.7	17.2	14.8	16.3	12.9	21.7	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	2.0	2.0	2.0	2.0	2.0	2.0	na
GDP (in billions of denars)	233.8	244.0	251.5	265.3	284.2	303.3	328.0
GDP per capita (in US dollars)	1,716.9	1,885.4	2,315.7	2,652.6	2,932.5	3,113.1	na
Share of industry in GDP (in per cent)	17.5	17.2	17.6	16.5	17.0	17.3	na
Share of agriculture in GDP (in per cent)	9.8	9.5	9.7	9.8	9.7	9.7	na
Current account/GDP (in per cent)	-7.1	-9.5	-3.2	-7.8	-1.4	-0.4	-1.0
External debt - reserves (in US$ million)	734.4	910.6	936.6	1,103.7	949.3	545.2	na
External debt/GDP (in per cent)	43.5	43.5	39.7	39.2	38.8	38.7	na
External debt/exports of goods and services (in per cent)	106.9	120.0	109.4	102.8	94.0	86.2	na

Georgia

Key challenges

- While the rapid pace of reforms continues, it is essential to strengthen capacity in the public and private sector to ensure the reforms are effectively implemented. This is particularly important for reforms to the legal and regulatory framework.
- Effective implementation of ambitious health care reforms depends on the quality of management by the private sector and the establishment of a sound financing system for the sector.
- Large foreign investments and the strength of domestic demand have put upward pressure on the exchange rate and inflation. Given the national bank's constraints to target both these areas, a tighter fiscal policy is vital.

Country data

Population (in millions)	4.5
Area ('000 sq km)	70.0
GDP (in billion US$, 2006)	7.8
GDP per capita in 2006 at current international US$ (PPP)	3,755
National currency	Lari

Progress in structural reform

Liberalisation and privatisation

Large-scale privatisation is almost complete. During 2006 lari 656 million was raised through privatisation, or about 4.7 per cent of GDP. Among the large enterprises privatised in 2006 were the fixed-line operator Georgian United Telecommunications Company and the gas distribution company for Tbilisi, TbilGaz. As with the Batumi sea port, whose management operations were transferred under a concession to the Danish Greanoak Group in mid-2006, management of Poti port has been offered to a private sector operator on a concession basis. In August 2007, the state-owned railway company was transferred to the British company Parkfield Investment for a 99-year management contract. The remaining assets for sale mainly comprise property owned by the central government.

The legal framework for doing business has been further improved. A new bankruptcy law took effect from August 2007, under which the maximum time taken for bankruptcy proceedings to be completed has been shortened to five months from two to three years. Further changes in corporate governance legislation, which took effect from May 2007, address investor protection, particularly the interests of minority shareholders.

Infrastructure

Significant progress has been made in power sector reform. The sale of two major regional power distributors – the United Distribution Company and JSC Adjara Energy Company – and six power stations to the Czech company ENERGO-PRO was completed in February 2007. Tariffs were increased significantly in 2006 and 2007, while electricity and gas subsidies were introduced to protect those living below the poverty line. After the tariff increase in June 2006, electricity prices reached internationally comparable levels and despite this, collection rates in the electricity sector rose to 90 per cent in 2006 (from 70 per cent in 2005). Gas tariffs were also increased in May 2007 to a weighted average of US$ 167.5 per 1,000 cubic metres from US$ 110.

The legal framework in the energy sector has also improved, allowing the distribution companies and some large industrial consumers to have direct sales contracts with new generation companies. These direct contracts replace the former wholesale market.

Financial sector

Domestic credit to the private sector grew by more than 50 per cent in real terms during 2006 and in the first half of 2007. Mortgage lending is up, accompanied by improvements to the property registration system. The National Bank of Georgia (NBG) has continued to consolidate the banking sector with an increase in the minimum capital requirements to lari 12 million (around US$ 7.2 million) from July 2007. The rapid credit growth, however, has led to an increase in credit risk. In response the NBG has prepared a draft of the "Risk Management Manual for Commercial Banks", which is expected be in place in 2008.

The non-bank financial sector remains small despite recent growth. Gross insurance premiums accounted for less than 0.5 per cent of GDP by the end of 2006. Bank-owned insurance companies account for more than three-quarters of the market share, increasing the vulnerability of the financial sector given the lack of consolidated supervision. Amendments to the Civil Code to support the legal framework for leasing are being discussed.

A collateral registry for movable property that is in the process of being set up will support further growth in lending as well as leasing activities. The law on credit information bureaux is being discussed in the parliament. Work has started on establishing a unified financial services authority that will supervise all areas of the financial sector.

Social sector

The current focus of government reform is the social sector. Last year the government introduced a targeted social assistance programme based on biannual household surveys. As of mid-2007 about 50 per cent of those living in poverty were covered by the programme, contributing to a reduction in the poverty level. The government has also started implementing an ambitious health care reform that involves privatising the health care system and establishing an efficient financing system for the sector. Most state-owned hospitals have been sold to a combination of property developers and companies with experience in the health sector. One hundred new hospitals, to be operated by the private sector, will be built over three years. A financing system that includes mandatory health insurance for state-sector employees and government health insurance for the poor, which would cover 35 per cent of the population, is expected to be in place by April 2008.

Macroeconomic performance

Real GDP rose by 9.4 per cent in 2006 with strong output growth in industry, construction and financial services. Growth strengthened further in the first quarter of 2007: real GDP rose by 11.4 per cent with the largest growth seen in mining, financial services, trade and construction. FDI flows were also a major source of growth in 2006 with inflows of some US$ 1.1 billion, double those recorded in 2005, and directed mainly towards privatisations, large infrastructure projects and tourism. Total foreign investments for 2007 are estimated at about US$ 2.1 billion (about 25 per cent of GDP), of which some US$ 1.5 billion is likely to be FDI.

Improved tax collection as well as growing privatisation revenues helped to raise budget revenues during 2006 and led the government to increase spending significantly, resulting in a fiscal deficit of 3 per cent of GDP. Revenues increased at an annual rate of 33 per cent in the first half of 2007 due to further improvements in tax policy and tax administration, while expenditures grew by about 30 per cent. As a result, the government increased the envisaged expenditure in the revised budget in mid-2007, and has projected a fiscal deficit of 1.3 per cent of GDP in 2007.

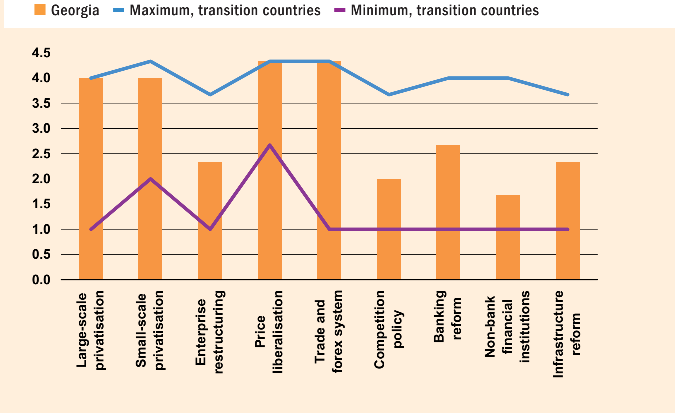
Large foreign investments, stronger domestic demand and increased fiscal spending have put upward pressure on inflation and the currency, which in turn could further damage Georgian exports. Annual inflation reached 11 per cent in February although it decreased to 7.3 per cent in June, helped by a seasonal decrease in food prices. To help lower inflation, the NBG allowed the lari to appreciate in nominal terms against the US dollar during 2006 and started to issue certificates of deposits to reduce the money supply from September 2006.

Higher demand for imports, higher energy prices and the impact of the Russian ban on imports of Georgian mineral water, wine and other agricultural products contributed to a significant widening of the current account deficit in 2006, amounting to about 14 per cent of GDP. These trends, as well as the effect of higher natural gas prices since January 2007, are expected to lead to a further rise in the deficit, especially after the sharp deterioration of the trade deficit in the first half of 2007.

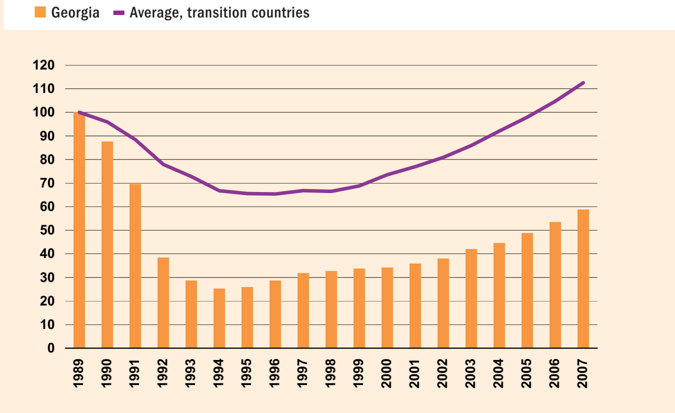
Outlook and risks

GDP growth is expected to remain high at about 7-8 per cent a year in the short term, driven mainly by industrial output, credit growth and construction, and supported by large FDI flows. FDI flows will help to finance the external deficit but expansion of the export base, especially in manufacturing, remains a major challenge. FDI flows need to be encouraged in the export sector. In the face of large expected foreign inflows, and given the inability of the NBG to control inflation and the exchange rate simultaneously, fiscal tightening is essential to reduce inflationary pressures. However, the necessary fiscal adjustments would be difficult to achieve given the likely growth in expenditures to implement reforms in the health sectors.

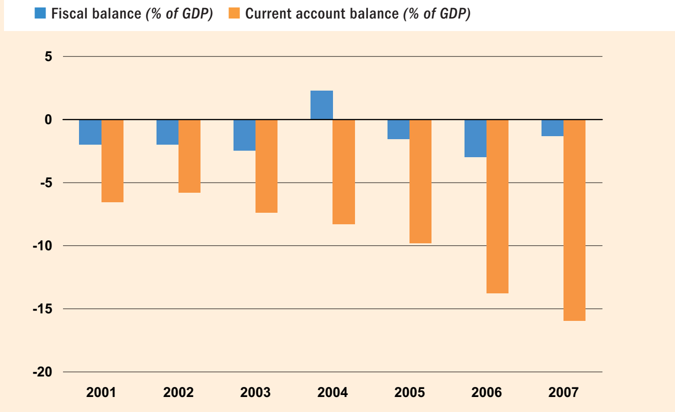
Transition indicators, 2007



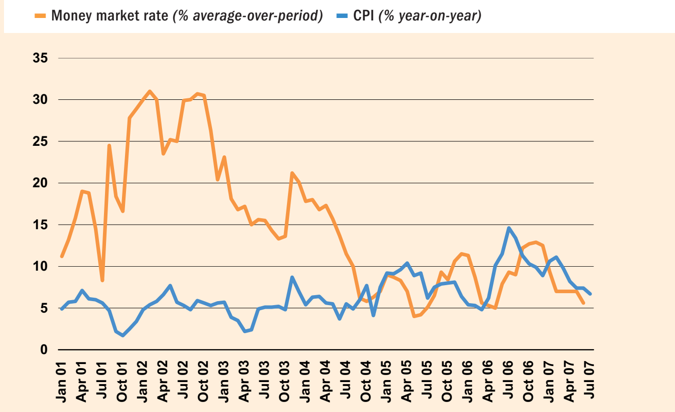
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no**

Interest rate liberalisation – **full**

Exchange rate regime – **floating**

Wage regulation – **no**

Tradeability of land – **unlimited**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **low**

Secured transactions law – **some defects**

Quality of corporate governance law – **low** [1]

Infrastructure

Independent telecoms regulator – **fully**

Independent electricity regulator – **partially**

Separation of railway infrastructure from operations – **no**

Independence of the road directorate – **partially**

Quality of concession laws – **very low**

Financial sector

Capital adequacy ratio – **12 per cent**

Deposit insurance system – **no**

Quality of securities market laws – **medium**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **25.3 per cent** (2003)

Government expenditure on health – **1.2 per cent of GDP** (2006)

Government expenditure on education – **1.5 per cent of GDP** (2006)

Household expenditure on power and water – **11.0 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	23.1	23.3	23.6	24.5	28.1	32.9	na
Private sector share in GDP (in per cent)	60.0	65.0	65.0	65.0	65.0	70.0	80.0
Private sector share in employment (in per cent)	78.7	76.8	77.3	77.9	77.7	79.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	2.1	1.8	1.6	2.4	7.5	9.3	na
Share of industry in total employment (in per cent)	6.4	6.3	5.9	6.5	6.8	6.0	na
Change in labour productivity in industry (in per cent)	11.3	17.5	11.1	9.0	8.3	31.9	na
Investment/GDP (in per cent)	21.9	22.0	24.4	26.6	26.3	25.6	na
EBRD index of small-scale privatisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of large-scale privatisation	3.3	3.3	3.3	3.3	3.7	3.7	4.0
EBRD index of enterprise reform	2.0	2.0	2.0	2.0	2.3	2.3	2.3
Markets and trade							
Share of administered prices in CPI (in per cent)	5.3	5.4	5.5	5.4	5.4	5.4	na
Number of goods with administered prices in EBRD-15 basket	0.0	0.0	0.0	0.0	0.0	0.0	na
Share of trade with non-transition countries (in per cent)	68.4	64.5	64.0	55.4	50.3	61.5	na
Share of trade in GDP (in per cent)	44.5	45.5	51.6	62.7	64.9	68.9	na
Tariff revenues (in per cent of imports)	7.3	7.1	6.8	8.0	8.4	7.2	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Financial sector							
Number of banks (foreign-owned)	29 (7)	27 (5)	24 (6)	21 (7)	19 (10)	17 (10)	na
Asset share of state-owned banks (in per cent)	0.0	0.0	0.0	0.0	0.0	0.0	na
Asset share of foreign-owned banks (in per cent) [2]	15.3	12.2	34.9	58.1	75.9	86.9	na
Non-performing loans (in per cent of total loans)	11.3	7.9	7.5	6.2	3.8	2.5	na
Domestic credit to private sector (in per cent of GDP)	7.5	8.1	8.7	9.7	14.8	19.7	na
Domestic credit to households (in per cent of GDP)	2.8	3.0	3.0	2.8	4.1	5.6	na
Of which mortgage lending (in per cent of GDP)	0.3	0.5	0.5	1.0	1.1	1.4	na
Stock market capitalisation (in per cent of GDP)	2.9	2.9	5.3	3.8	5.5	8.3	na
Stock trading volume (in per cent of market capitalisation)	11.3	4.1	0.5	11.6	13.6	18.9	na
Eurobond issuance (in per cent of GDP)	3.7	0.0	0.0	0.0	0.0	0.0	na
EBRD index of banking sector reform	2.3	2.3	2.3	2.7	2.7	2.7	2.7
EBRD index of reform of non-bank financial institutions	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	12.2 (6.5)	13.9 (10.9)	14.6 (15.6)	15.1 (18.6)	15.1 (26.3)	12.5 (38.4)	na
Internet users (per 100 inhabitants)	1.0	1.6	2.6	3.9	6.1	7.5	na
Railway labour productivity (1989=100)	65.2	71.9	72.6	68.6	93.4	118.4	na
Residential electricity tariffs (USc kWh)	5.0	5.2	4.5	4.7	5.2	na	na
Average collection rate, electricity (in per cent)	32	90	72	na	71	90	na
GDP per unit of energy use (PPP in US dollars per kgoe)	4.2	4.6	4.1	4.1	na	na	na
EBRD index of infrastructure reform	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Electric power	3.3	3.3	3.0	3.0	3.0	3.0	3.3
Railways	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Roads	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Telecommunications	2.3	2.3	2.3	2.3	2.3	2.7	2.7
Water and waste water	2.0	2.0	2.0	2.0	2.0	2.0	2.0

[1] Assessment as of end-2004. A new law has since been approved by the parliament.

[2] Data on bank ownership are based on legal registration of ownership and not the beneficial ownership.

	2001	2002	2003	2004	2005	2006 *Estimate*	2007 *Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	4.7	5.5	11.1	5.9	9.6	9.4	10.0
Private consumption	na	na	na	na	na	na	na
Public consumption	na	na	na	na	na	na	na
Gross fixed capital formation	na	na	na	na	na	na	na
Exports of goods and services	na	na	na	na	na	na	na
Imports of goods and services	na	na	na	na	na	na	na
Industrial gross output	-4.5	7.8	14.0	12.2	13.0	16.2	na
Agricultural gross output	8.2	-1.4	10.3	-7.9	12.0	-9.6	na
Employment [1]			*(Percentage change)*				
Labour force (end-year)	-2.2	-5.0	8.1	-4.4	0.7	2.5	na
Employment (end-year)	-2.1	-6.8	9.6	-6.3	-0.8	0.2	na
			(In per cent of labour force)				
Unemployment (end-year)	10.3	11.9	10.7	12.5	13.8	13.6	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	4.6	5.7	4.9	5.7	8.4	9.2	8.5
Consumer prices (end-year)	3.4	5.6	7.0	7.5	6.4	8.8	9.0
Producer prices (annual average)	3.6	6.0	2.3	3.8	7.2	9.6	na
Producer prices (end-year)	8.9	1.5	5.4	0.7	8.2	10.9	na
Gross average monthly earnings in economy (annual average)	30.8	20.5	10.4	24.5	30.2	30.0	na
Government sector [2]			*(In per cent of GDP)*				
General government balance	-1.9	-2.0	-2.5	2.3	-1.5	-3.0	-1.3
General government expenditure	18.2	17.8	18.7	19.4	24.9	29.2	na
General government debt	68.3	67.4	61.5	47.0	36.6	28.9	na
Monetary sector			*(Percentage change)*				
Broad money (M3, end-year)	18.5	17.1	22.7	42.6	26.4	39.3	na
Domestic credit (end-year)	2.3	9.5	14.7	7.4	39.8	34.5	na
			(In per cent of GDP)				
Broad money (M3, end-year)	11.1	11.6	12.4	15.2	16.4	19.3	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Money market rate	17.5	27.7	16.9	11.9	7.7	9.5	na
Treasury bill rate (3-month maturity) [3]	29.9	43.4	44.3	19.2	na	na	na
Deposit rate (3-month) [4]	7.8	9.8	9.3	7.2	7.6	11.4	na
Lending rate (3-month)	27.0	31.8	32.3	31.2	21.6	18.8	na
			(Laris per US dollar)				
Exchange rate (end-year)	2.1	2.1	2.1	1.8	1.8	1.7	na
Exchange rate (annual average)	2.1	2.2	2.1	1.9	1.8	1.8	na
External sector			*(In millions of US dollars)*				
Current account	-210.0	-196.0	-294.0	-430.0	-628.0	-1,069.0	-1,542.0
Trade balance	-486.0	-439.0	-598.0	-719.0	-1,214.0	-2,019.0	-2,748.0
Merchandise exports	473.0	553.0	730.0	1,272.0	1,472.0	1,667.0	1,788.0
Merchandise imports	959.0	992.0	1,328.0	1,991.0	2,686.0	3,686.0	4,536.0
Foreign direct investment, net	80.0	122.0	335.0	420.0	529.0	1,115.0	1,542.0
Gross reserves, excluding gold (end-year)	161.1	197.7	190.9	383.0	473.9	881.0	na
External debt stock	1,712.0	1,858.0	1,954.0	2,039.0	2,137.0	2,000.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	1.4	1.6	1.3	1.8	1.8	2.5	na
			(In per cent of current account revenues, excluding transfers)				
Debt service	19.3	7.4	10.0	10.2	5.6	5.6	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	4.6	4.6	4.6	4.5	4.5	4.5	na
GDP (in millions of laris)	6,674.0	7,456.0	8,565.0	9,969.8	11,621.0	13,783.0	16,527.0
GDP per capita (in US dollars)	697.0	741.0	877.0	1,155.9	1,419.5	1,721.3	na
Share of industry in GDP (in per cent)	16.6	17.6	17.7	16.1	15.7	14.9	na
Share of agriculture in GDP (in per cent)	20.7	19.3	19.3	16.4	14.8	11.3	na
Current account/GDP (in per cent)	-6.5	-5.8	-7.4	-8.3	-9.8	-13.8	-15.9
External debt - reserves (in US$ million)	1,550.9	1,660.3	1,763.1	1,656.0	1,663.1	1,119.0	na
External debt/GDP (in per cent)	53.2	54.7	49.0	39.2	33.3	25.7	na
External debt/exports of goods and services (in per cent)	175.6	167.2	151.7	111.4	106.9	77.8	na

1 Figures consistent with ILO methodology.

2 General government includes the state, municipalities and extra-budgetary funds.

3 Data relate to the average auction rates during the year.

4 Data refer to average rates for local currency from international financial statistics.

Hungary

Key challenges

- More private sector involvement in municipal infrastructure is needed to increase investment and improve management, as well as to reduce pressure on public finances.
- To ensure the country's long-term competitiveness it is essential to increase labour participation through private sector growth, to improve education and to cut public expenditures to allow a lowering of the tax burden.
- To maintain investor confidence it is crucial to restore the balance in government finances by limiting public spending while ensuring that reforms of the health care, pension and social protection systems are properly implemented.

Country data	
Population (in millions)	10.1
Area ('000 sq km)	93.0
GDP (in billion US$, 2006)	112.0
GDP per capita in 2006 at current international US$ (PPP)	19,569
National currency	Forint

Progress in structural reform

Business environment and competition

Progress in fiscal reform over the last year was driven by the need to reduce the size of the deficit in government finances. Public sector salaries were frozen for two years and gas subsidies were reduced in the summer of 2006, followed by direct tax increases in the autumn. These included hikes in employee social contributions, value-added tax and business taxation. However, these measures increased enterprise costs, and had negative effects on business profitability and corporate investments. Even before these tax rises, Hungary had the third highest labour taxes in the OECD and the overall result has damaged Hungary's appeal as a destination for FDI.

Despite the progress made with initial reforms, there remains significant room to exploit economies of scale in the provision of public services. Although political constraints appear to preclude consolidation among the large number of small municipalities, the joint provision of services should grow, encouraged by changes in government financing rules. This regionalisation of service delivery is essential for cutting spending, implementing regional investment programmes co-financed from EU funds and providing more efficient public services.

Infrastructure

Reform in the railways, which has lagged behind other sectors, started to catch up in 2007, although private participation is still limited to a small share in freight. Operations and policy-making functions have been separated and core railway functions have been divided into individual business units within MAV, the national railway company. MAV Start, the passenger operator, began operations as a separate company on 1 July 2007. The privatisation of MAV Cargo has been launched and it is expected to be completed in 2007. Access to the track is legally available but not fully working in practice.

The private sector is becoming increasingly involved in other transport sectors. MALEV, the national airline, was sold in spring 2007 to AirBridge, which must now restructure the company and bring much-needed investment. Regional airports are slowly being developed for charter and low cost flights as well as air cargo, with selective government support and limited private involvement. In the first half of 2007 the government launched a tender for a new stretch of the M6 motorway to be constructed and managed under a 30-year public-private partnership (PPP).

Competition in the energy sector is still limited. The re-integration of electricity grid operator MAVIR into the incumbent power company MVM in 2005 further strengthened MVM's market power. MVM now controls about 80 per cent of electricity production and sales. In addition, long-term power purchase agreements set up by MVM continue to stifle the electricity retail market. As a result, competition in the electricity supply market is unlikely to increase, despite the opening of the retail market to households in June 2007.

Social sector

In the autumn of 2006 the government began carrying out its health care reforms. The most controversial were hospital capacity restructuring and the introduction of co-payments by patients for seeing a doctor or staying in hospital. These measures are aimed at increasing public awareness of the huge cost of running Hungary's health care system. Other important measures included reducing subsidies for pharmaceutical products, liberalising the retail distribution of pharmaceuticals and taking administrative steps to cut the number of hospital beds. The government has introduced measures to monitor actual payment of health care contributions and check the validity of health care insurance before providing medical services. It also initiated a debate on the introduction of competing health insurance providers. In parallel, some local authorities have moved towards PPPs for the provision of basic health services, including hospital management contracts.

In education the government has implemented over the past year a number of measures aimed at improving quality and cost effectiveness. These included tuition fees for higher education, an increase in the number of teaching hours per teacher, incentives to merge local schools and enhanced standards for accreditations in higher education institutions. The government has also introduced reforms to tighten the eligibility criteria for early retirement schemes. At present the vast majority of workers retire before the statutory retirement age, contributing to low labour participation and high pension costs.

Macroeconomic performance

Real GDP growth in 2006 was an estimated 3.9 per cent. It declined further in 2007, reaching only 1.2 per cent in the second quarter of the year. Consumer spending slowed in 2006 and fell in 2007 due to higher taxes, tight monetary policy and hikes in utility bills introduced during the summer of 2006. The economic slowdown was also driven by weak corporate investment, particularly in the sectors serving the domestic market, in the face of the government's stabilisation measures. On the positive side, industrial production was boosted by rising demand in the eurozone and, as a result, net exports remained the main driver of economic growth. Growth of around 2.5 per cent is likely to continue through 2007 as the full effect of the fiscal tightening measures over the last year is expected to constrain the growth of domestic demand.

The general government deficit in 2005 reached 7.8 per cent of GDP and deteriorated further in 2006 to an estimated 9.2 per cent of GDP. Further worsening of public finances was prevented by the introduction of stringent fiscal austerity measures and tax increases during 2006, as well as by higher tax revenues driven by improvements in tax administration. These have cut the 2006 fiscal deficit by an estimated 2 per cent of GDP and helped lower the gap in public finances in 2007, with the deficit currently on track to fall below 7 per cent.

Tax increases and administrative price hikes did, however, lead to a transitory increase in inflation to 9 per cent in March 2007. Although the rate of inflation fell back to 8.4 per cent in July, it is expected to stay high throughout most of 2007. Inflationary pressures led the National Bank of Hungary to increase the reference rate to 8 per cent in October 2006, up from 6.25 per cent in June 2006, although the rate was subsequently cut to 7.75 per cent in June 2007.

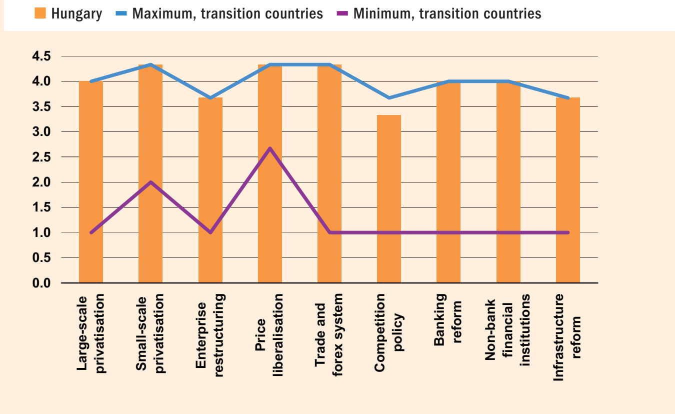
The current account deficit declined to 5.8 per cent of GDP in 2006 due to strong exports and lower imports, the latter driven by weaker domestic demand. Net FDI declined to US$ 3 billion in 2006 following record US$ 5.4 billion inflows in 2005.

Outlook and risks

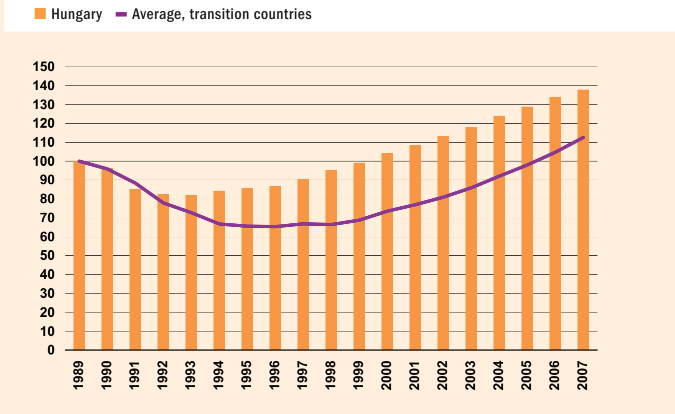
The economic outlook will continue to be affected by the need to lower the fiscal deficit and the impact of the government's reforms. The negative effects of the revenue-enhancing measures on inflation and domestic consumption are likely to be transitory and should largely disappear over the next two years. Long-term growth will depend on the strength of structural reforms, especially those aimed at reducing public expenditure and increasing efficiency of the public sector. Given the current size of the fiscal deficit and the tax burden, the government will have to continue reducing public spending for a number of years to ensure stable public finances and reduce uncertainty about future taxes.

If reforms were weakened or abandoned, then long-term growth prospects and Hungary's international competitiveness could suffer greatly. Furthermore, a significant fiscal slippage would most likely affect the confidence of foreign investors and have implications for the date of the adoption of the euro, now expected between 2012 and 2014.

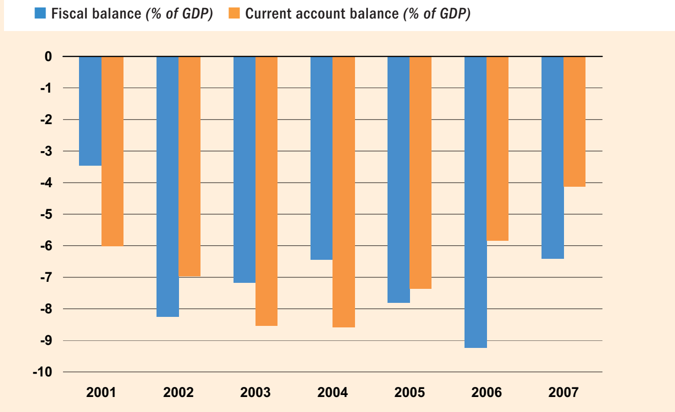
Transition indicators, 2007



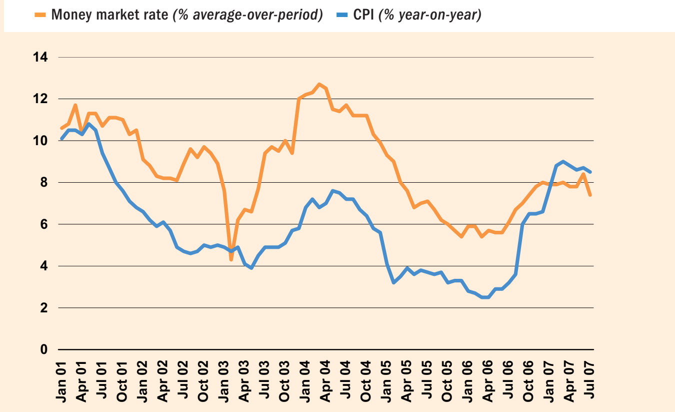
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no**

Interest rate liberalisation – **full**

Exchange rate regime – **fixed with band to euro**

Wage regulation – **no**

Tradeability of land – **full except foreigners**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **medium**

Secured transactions law – **advanced**

Quality of corporate governance law – **high**

Infrastructure

Independent telecoms regulator – **fully**

Independent electricity regulator – **fully**

Separation of railway infrastructure from operations – **fully**

Independence of the road directorate – **fully**

Quality of concession laws – **low**

Financial sector

Capital adequacy ratio – **8 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **low**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **<2.0 per cent** (2002)

Government expenditure on health – **5.4 per cent of GDP** (2004)

Government expenditure on education – **5.9 per cent of GDP** (2005)

Household expenditure on power and water – **10.9 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	30.6	30.7	31.5	33.5	34.2	35.3	na
Private sector share in GDP (in per cent)	80.0	80.0	80.0	80.0	80.0	80.0	80.0
Private sector share in employment (in per cent)	79.6	79.3	79.1	79.1	79.3	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	2.3	2.5	2.4	3.7	2.3	na	na
Share of industry in total employment (in per cent)	34.1	34.1	33.3	33.0	32.6	31.9	na
Change in labour productivity in industry (in per cent)	-1.3	1.9	7.0	5.4	5.7	10.2	na
Investment/GDP (in per cent)	22.9	22.9	21.9	22.4	22.7	21.9	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of enterprise reform	3.3	3.3	3.3	3.3	3.7	3.7	3.7
Markets and trade							
Share of administered prices in CPI (in per cent)	16.7	16.4	15.9	16.0	15.4	14.8	na
Number of goods with administered prices in EBRD-15 basket	2.0	2.0	2.0	2.0	2.0	1.0	na
Share of trade with non-transition countries (in per cent)	84.4	84.5	84.0	83.1	78.5	75.2	na
Share of trade in GDP (in per cent)	120.7	107.1	106.5	114.1	116.1	131.5	na
Tariff revenues (in per cent of imports)	1.3	1.4	1.3	0.3	0.1	na	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	3.0	3.0	3.0	3.3	3.3	3.3	3.3
Financial sector							
Number of banks (foreign-owned)	41 (32)	38 (28)	38 (29)	38 (27)	38 (27)	40 (28)	na
Asset share of state-owned banks (in per cent)	9.1	10.7	7.4	6.6	7.0	7.4	na
Asset share of foreign-owned banks (in per cent)	66.5	85.0	83.5	63.0	82.6	82.9	na
Non-performing loans (in per cent of total loans)	3.0	4.9	3.8	3.7	3.1	3.0	na
Domestic credit to private sector (in per cent of GDP)	30.9	33.6	41.0	44.7	49.8	54.6	na
Domestic credit to households (in per cent of GDP)	4.7	7.4	10.9	12.8	15.6	18.5	na
Of which mortgage lending (in per cent of GDP)	1.7	4.1	8.0	9.5	11.5	13.9	na
Stock market capitalisation (in per cent of GDP)	18.7	17.1	18.3	25.0	31.6	34.1	na
Stock trading volume (in per cent of market capitalisation)	90.7	44.4	46.5	57.6	78.0	87.5	na
Eurobond issuance (in per cent of GDP)	2.4	0.0	0.5	4.2	6.1	6.0	na
EBRD index of banking sector reform	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of reform of non-bank financial institutions	3.7	3.7	3.7	3.7	4.0	4.0	4.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	36.8 (48.8)	36.2 (67.9)	35.6 (78.5)	35.3 (86.4)	33.2 (92.3)	33.3 (99.0)	na
Internet users (per 100 inhabitants)	14.6	15.8	23.7	26.7	29.7	34.8	na
Railway labour productivity (1989=100)	123.3	130.3	133.9	145.1	160.8	177.5	na
Residential electricity tariffs (USc kWh)	7.0	8.7	11.4	13.5	14.7	na	na
Average collection rate, electricity (in per cent)	na	90	99	99	na	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	5.3	5.6	5.6	5.9	na	na	na
EBRD index of infrastructure reform	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Electric power	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Railways	3.3	3.3	3.3	3.3	3.3	3.3	3.7
Roads	3.3	3.3	3.3	3.3	3.7	3.7	3.7
Telecommunications	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Water and waste water	4.0	4.0	4.0	4.0	4.0	4.0	4.0

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	4.1	4.4	4.2	4.8	4.1	3.9	2.5
Private consumption	5.7	9.8	7.8	3.2	3.8	1.2	na
Public consumption	1.6	5.5	5.3	0.0	0.2	-5.5	na
Gross fixed capital formation	5.1	10.1	2.1	7.7	5.6	-1.8	na
Exports of goods and services	8.1	3.9	6.2	15.7	11.6	18.0	na
Imports of goods and services	5.3	6.8	9.3	14.1	6.8	12.6	na
Industrial gross output	0.4	1.8	5.9	3.9	4.3	8.6	na
Agricultural gross output	16.5	-9.8	-0.7	54.4	-2.4	-6.1	na
Employment			*(Percentage change)*				
Labour force (annual average)	-0.4	0.2	1.4	0.1	1.3	1.1	na
Employment (annual average) [1]	0.3	0.1	1.3	-0.6	0.0	0.7	na
			(In per cent of labour force)				
Unemployment (end-year)	5.7	5.8	5.9	6.3	7.3	7.5	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	9.2	5.3	4.7	6.8	3.6	3.9	7.8
Consumer prices (end-year)	6.8	4.8	5.7	5.5	3.3	6.6	6.0
Producer prices (annual average)	5.2	-1.8	2.4	3.5	4.3	6.5	na
Producer prices (end-year)	-0.4	-1.3	6.2	1.6	4.5	4.5	na
Gross average monthly earnings in economy (annual average)	18.2	18.3	12.0	6.0	8.8	8.1	na
Government sector			*(In per cent of GDP)*				
General government balance [2]	-3.5	-8.2	-7.2	-6.4	-7.8	-9.2	-6.4
General government expenditure	47.4	51.2	49.1	48.9	50.0	53.0	na
General government debt	50.7	54.0	58.0	59.4	61.7	66.0	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	16.8	13.8	13.6	9.9	13.0	11.9	na
Domestic credit (end-year)	4.7	15.3	19.8	11.9	23.4	15.9	na
			(In per cent of GDP)				
Broad money (M2, end-year)	43.4	43.9	45.3	45.5	48.4	50.6	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinance rate	9.8	8.5	12.5	9.5	6.0	8.0	na
Interbank interest rate (up to 30-day maturity)	10.0	8.9	12.2	9.7	6.1	8.1	na
Deposit rate weighted average (fixed for less than 1 year)	9.4	7.4	8.7	9.1	5.2	7.4	na
Lending rate weighted average (maturing within 1 year)	12.0	9.7	11.2	11.0	7.4	9.2	na
			(Forints per US dollar)				
Exchange rate (end-year)	279.0	225.2	207.9	180.3	213.6	191.6	na
Exchange rate (annual average)	286.5	257.9	224.3	202.7	199.6	210.4	na
External sector			*(In millions of US dollars)*				
Current account	-3,201.1	-4,643.2	-7,205.2	-8,767.4	-8,128.1	-6,527.6	-4,897.0
Trade balance	-2,233.7	-2,075.6	-3,271.2	-3,081.5	-1,960.9	-524.1	724.0
Merchandise exports	31,054.4	34,684.1	43,324.6	56,720.3	63,071.4	73,374.4	76,956.0
Merchandise imports	33,288.1	36,759.7	46,595.8	59,801.8	65,032.3	73,898.5	76,232.0
Foreign direct investment, net	3,573.0	2,721.8	478.8	3,541.9	5,412.1	3,054.5	3,000.0
Gross reserves, excluding gold (end-year)	10,738.2	10,359.0	12,748.7	15,920.0	18,552.3	21,528.4	na
External debt stock	33,951.4	36,883.2	53,767.5	70,871.9	86,400.8	105,384.7	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	3.3	2.9	2.7	2.7	2.9	3.0	na
			(In per cent of exports of goods and services)				
Debt service [3]	14.5	13.7	14.2	15.1	16.0	13.2	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	10.2	10.1	10.1	10.1	10.1	10.1	na
GDP (in billions of forints)	15,274.9	17,203.7	18,935.7	20,712.3	22,026.8	23,561.5	26,029.8
GDP per capita (in US dollars)	5,238.0	6,577.6	8,344.3	10,116.8	10,948.9	11,127.8	na
Share of industry in GDP (in per cent)	26.6	26.1	26.7	26.5	26.6	23.0	na
Share of agriculture in GDP (in per cent)	5.0	4.4	4.2	6.1	5.8	5.4	na
Current account/GDP (in per cent)	-6.0	-7.0	-8.5	-8.6	-7.4	-5.8	-4.1
External debt - reserves (in US$ million)	23,213.2	26,524.1	41,018.7	54,951.8	67,848.5	83,856.3	na
External debt/GDP (in per cent)	63.7	55.3	63.7	69.4	78.3	94.1	na
External debt/exports of goods and services (in per cent)	89.1	87.7	103.1	104.8	114.3	121.4	na

1 Data from labour force surveys.

2 From 1999, data are based on Eurostat methodology (ESA95), excluding part of the cost of pension reform.

3 Excluding inter-company loans.

Kazakhstan

Key challenges

- Transport and energy infrastructure needs upgrading to improve efficiency and capacity. To achieve this, the government needs to change procurement and tariff regulations to allow regulated monopolies to enter into long-term contracts.
- Government-led initiatives to diversify the economy should be transparent and non-discriminatory so as not to impede competition or stifle private entrepreneurship.
- The financial sector needs to become more transparent and robust by reducing banks' dependence on foreign funding and preventing over-exposure to the construction sector.

Country data

Population (in millions)	15.4
Area ('000 sq km)	2,728.0
GDP (in billion US$, 2006)	80.4
GDP per capita in 2006 at current international US$ (PPP)	8,800
National currency	Tenge

Progress in structural reform

Business environment and competition

The government announced in April 2007 that all energy and mineral resources contracts will be audited for licence violations, especially as regards local content requirements. Despite government assurances that no contracts would be changed unilaterally, some investors have come under pressure to amend contracts as a result of tax and custom audits. In July 2007, as a reaction to mounting delays and cost overruns at the Kashagan oil field in the Caspian Sea, the government started to put strong pressure on Italian energy company Eni to make certain changes to the Kashagan contract. International investment in the Kazakh hydrocarbon sector is still much-needed in order to ease transport bottlenecks in export routes.

The government has repeatedly stated its ambition to lead Kazakhstan into the group of 50 most competitive economies by 2015. The government plans an industrial policy that foresees the creation of 30 "corporate leaders" that would benefit from preferential tax treatment and special economic zones. However, it remains unclear under which criteria these corporate leaders will be selected and how long state support will last.

Infrastructure

The power generation and distribution industries have suffered from under-investment, which contributes to power shortages, especially in southern Kazakhstan. This is a particular concern in the winter. Kazakhstan's national electricity grid, which is operated by power company KEGOC, is being upgraded (completion by the end of 2007) and a new KEGOC north-south power transmission line is scheduled to become operational by 2009. However, this is unlikely to fully resolve the power deficit problems. The implementation of a comprehensive energy efficiency programme – covering improvements in power generation, energy transmission and distribution networks as well as energy savings by industrial corporations – is widely expected to enhance the competitiveness of Kazakh enterprises and to help alleviate regional supply imbalances.

In public transport, the fleets of buses and trams remain in poor condition. Current laws do not allow regulated infrastructure services to enter into contracts longer than one year so contracts need to be renewed annually. Private operators in the railway sector, for instance, have to win a tender for renewal each year, making it commercially risky to purchase expensive rolling stock and equipment, further contributing to under-investment.

While increased financing has been made available for the (re)construction of roads and road maintenance, and tolls in general have been increased to cover maintenance costs, user charges for heavy goods vehicles remain very low and do not reflect the damage these vehicles do to the road network.

Financial sector

In March 2007 Kazakhstan launched a new transparent money market index, KazPrime. The index will help develop a more liquid market and provide a peg for floating-rate loans and bonds, mortgage lending and the pricing of interest-rate derivatives. The Kazakh financial system also integrated further with global markets. Kazakh banks bought stakes in financial institutions in neighbouring countries and in July 2007 Alliance bank placed 20 per cent of its shares on the London Stock Exchange in the form of global depository receipts. The Italian UniCredit Group started the process of acquiring ATF Bank in 2007, the first big purchase by a major Western bank in Central Asia.

Currently almost half of all bank liabilities originate abroad. The inflow of foreign funding has led to a rapid expansion in credit to the private sector – by 80 per cent in 2006 – fuelling a property and construction boom. Lending to the property sector accounted for more than 32 per cent of bank lending at the end of 2006, increasing banks' exposure to potential adverse price shocks.

To reduce banks' dependence on foreign funding, the authorities announced additional measures in August 2007. These included more mandatory reserve requirements on foreign borrowing and fewer requirements on domestic funding. However, in light of the turmoil on the global financial markets since early August 2007, and Kazakh banks' reduced access to international funding, the central bank decided to shelve the measures to curtail foreign funding until January 2008. But the financial regulator did tighten capital adequacy regulations by raising the risk weights on mortgage lending. This regulatory tightening, combined with the reduced availability of foreign funding to Kazakh banks as a result of the global liquidity crisis, led to a deceleration of bank lending during the second half of 2007.

Macroeconomic performance

Economic growth remains robust, with real GDP growing by 10.6 per cent in 2006 and 10.2 per cent (year-on-year) in the first half of 2007. Labour productivity has grown substantially in recent years, although the rate of growth has slowed. GDP growth is not only driven by the hydrocarbon sector, but increasingly also by non-oil sectors such as financial services and property development. The latter has grown to meet the demand for high-quality apartments, but there are signs that speculation has pushed up property prices. Since June 2007, apartment prices in some parts of Almaty have been corrected downwards.

Inflation, driven by strong domestic demand, is expected to persist at the relatively high level of 8.5 per cent in 2007. In January 2007 the government increased public sector wages by 30 per cent, adding to upward price pressures. Given the large-scale foreign borrowing by banks In 2006, increases in the refinancing rate during that year had little effect on slowing inflation.

The general government budget for 2007 is forecast to show a surplus of 4.3 per cent of GDP, after a surplus of 7.5 per cent in 2006. Expenditure has continued to grow at a fast pace, financed by buoyant tax revenues reflecting the surge in oil income and improvements in tax collection, which boosted non-oil revenues.

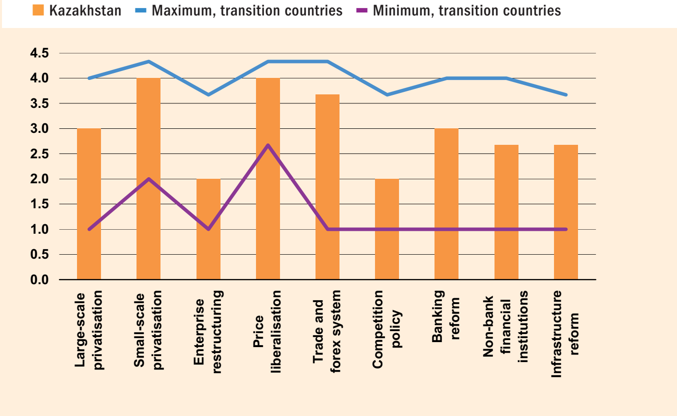
The current account recorded a deficit of 2.2 per cent of GDP in 2006 and is forecast at 3.3 per cent in 2007. A large trade surplus, reflecting high oil and gas prices, will be more than offset by a further increase in income payments associated with FDI in the hydrocarbon sector and an increase in imports of services, also linked to the oil and gas sector. Net FDI inflows in 2006 rose sharply to 8.2 per cent of GDP, partly reflecting cost overruns at the Kashagan oil field.

In July 2007, the international reserves, combined with assets of the National Fund of the Republic of Kazakhstan, amounted to US$ 42 billion. Despite the growth in net external reserves, in July the central bank international reserves covered less than 60 per cent of the stock of external debt of commercial banks, which amounted to about US$ 39 billion (40 per cent of GDP).

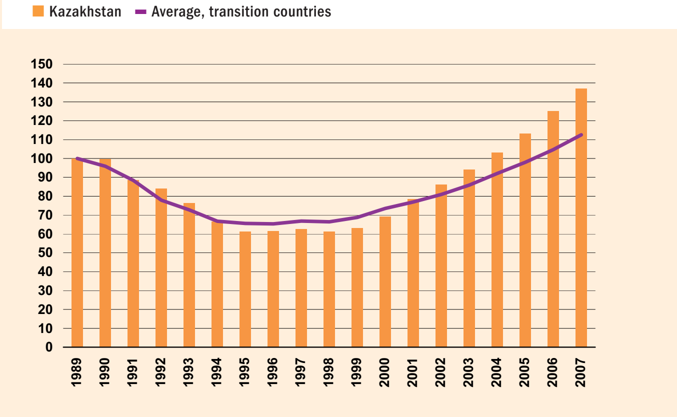
Outlook and risks

Economic growth continues to be underpinned by high oil prices and the share of oil in GDP is likely to increase further with the start of oil production in the Kashagan oil field, now expected for 2010. The international financial turmoil that erupted in the summer of 2007 and the resulting less benign external financing conditions for many banks are slowing down bank lending. Risks are therefore mainly related to possible further price corrections in the property market and to the high proportion of foreign currency lending in combination with increased exchange rate volatility since June 2007. A potential substantial depreciation of the tenge could lead to repayment problems for some bank borrowers that earn income in tenge but must repay loans denominated in foreign currency.

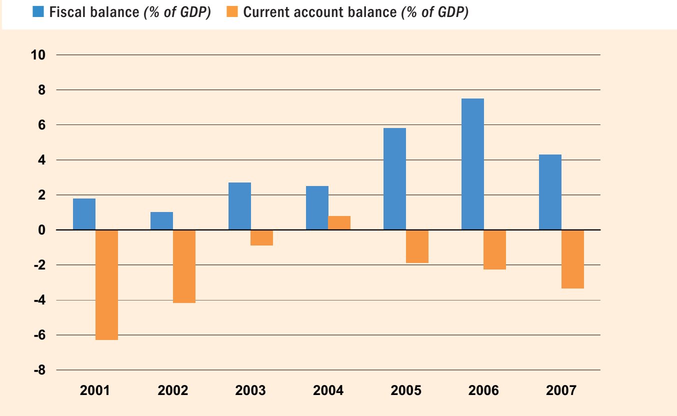
Transition indicators, 2007



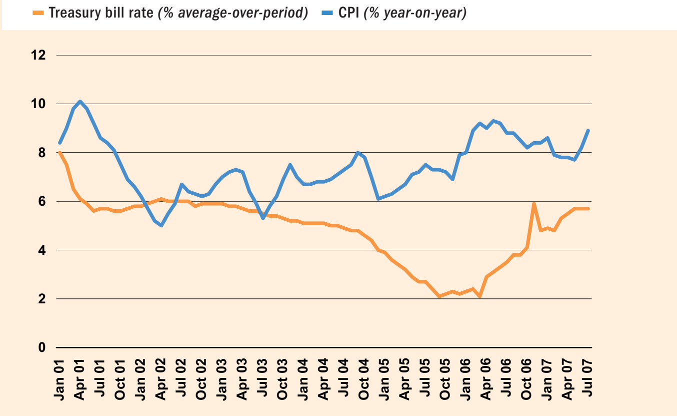
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **yes**

Interest rate liberalisation – **full**

Exchange rate regime – **managed float**

Wage regulation – **no**

Tradeability of land – **full except foreigners** [1]

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **medium**

Secured transactions law – **some defects**

Quality of corporate governance law – **high**

Infrastructure

Independent telecoms regulator – **partially**

Independent electricity regulator – **partially**

Separation of railway infrastructure from operations – **partially**

Independence of the road directorate – **no**

Quality of concession laws – **na** [2]

Financial sector

Capital adequacy ratio – **12 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **high**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **16.0 per cent** (2003)

Government expenditure on health – **2.3 per cent of GDP** (2005)

Government expenditure on education – **2.3 per cent of GDP** (2004)

Household expenditure on power and water – **3.7 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	27.1	27.6	28.9	29.0	29.2	29.5	na
Private sector share in GDP (in per cent)	60.0	65.0	65.0	65.0	65.0	65.0	70.0
Private sector share in employment (in per cent)	74.9	75.0	75.4	75.3	75.5	77.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	0.1	0.1	0.1	0.1	na	na	na
Share of industry in total employment (in per cent)	12.4	12.3	12.2	12.1	12.3	na	na
Change in labour productivity in industry (in per cent)	17.2	11.4	5.1	8.6	2.2	0.0	na
Investment/GDP (in per cent)	26.9	27.3	25.7	26.3	31.0	33.0	na
EBRD index of small-scale privatisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of large-scale privatisation	3.0	3.0	3.0	3.0	3.0	3.0	3.0
EBRD index of enterprise reform	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Markets and trade							
Share of administered prices in CPI (in per cent)	0.0	0.0	0.0	0.0	0.0	0.0	na
Number of goods with administered prices in EBRD-15 basket	0.0	0.0	0.0	0.0	0.0	0.0	na
Share of trade with non-transition countries (in per cent)	57.3	61.8	65.5	65.3	64.6	64.6	na
Share of trade in GDP (in per cent)	76.2	73.3	73.9	79.8	81.0	78.2	na
Tariff revenues (in per cent of imports) [3]	2.1	3.1	3.0	2.7	2.6	3.6	na
EBRD index of price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of forex and trade liberalisation	3.3	3.3	3.3	3.7	3.7	3.7	3.7
EBRD index of competition policy	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Financial sector							
Number of banks (foreign-owned)	44 (15)	38 (17)	36 (16)	35 (15)	34 (14)	33 (14)	na
Asset share of state-owned banks (in per cent)	3.5	5.2	5.1	3.7	3.1	2.0	na
Asset share of foreign-owned banks (in per cent) [4]	17.3	34.3	56.9	5.5	7.3	na	na
Non-performing loans (in per cent of total loans)	2.1	2.0	2.1	2.9	2.2	1.6	na
Domestic credit to private sector (in per cent of GDP)	16.0	18.6	21.9	26.5	35.7	48.1	na
Domestic credit to households (in per cent of GDP) [5]	0.9	1.6	2.6	5.2	9.0	15.8	na
Of which mortgage lending (in per cent of GDP) [6]	na	0.2	0.6	1.7	3.0	4.1	na
Stock market capitalisation (in per cent of GDP)	5.6	5.5	7.7	8.7	18.6	54.7	na
Stock trading volume (in per cent of market capitalisation)	25.1	26.5	22.0	30.3	14.9	14.5	na
Eurobond issuance (in per cent of GDP)	1.1	1.3	1.7	8.1	4.9	9.7	na
EBRD index of banking sector reform	2.7	2.7	3.0	3.0	3.0	3.0	3.0
EBRD index of reform of non-bank financial institutions	2.3	2.3	2.3	2.3	2.3	2.7	2.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	13.0 (3.9)	14.0 (6.9)	15.0 (9.0)	16.9 (16.5)	16.9 (36.4)	19.8 (52.9)	na
Internet users (per 100 inhabitants)	1.0	1.7	2.0	2.7	4.1	8.4	na
Railway labour productivity (1989=100)	46.3	51.0	58.5	62.6	101.7	119.2	na
Residential electricity tariffs (USc kWh)	2.7	3.0	3.1	3.0	3.1	na	na
Average collection rate, electricity (in per cent)	na	92	na	na	na	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	1.8	1.9	1.9	1.9	na	na	na
EBRD index of infrastructure reform	2.3	2.3	2.3	2.3	2.3	2.7	2.7
Electric power	3.0	3.0	3.0	3.3	3.3	3.3	3.3
Railways	2.7	2.7	2.7	2.7	3.0	3.0	3.0
Roads	2.0	2.0	2.0	2.0	2.0	2.0	2.3
Telecommunications	2.3	2.3	2.3	2.7	2.7	3.0	3.0
Water and waste water	1.7	1.7	1.7	2.0	2.0	2.0	2.0

1 Ownership of agricultural land is limited to residents of Kazakhstan.

2 A new concession law came into force on 19 July 2006. It has not yet been evaluated within the EBRD Concession Assessment Project.

3 Refers to taxes on international trade.

4 Significant drop in 2004 was due to changes in legal registration of ownerhsip of one of the largest banks in Kazakhstan.

5 National Bank of Kazakhstan, Statistical Bulletin.

6 Data sources are Agency of the Republic of Kazakhstan for Regulation and Supervision of Financial Market and Financial Organisation and Kazakhstan Mortgage Company, and includes loans from non-bank financial institutions.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			(Percentage change in real terms)				
GDP	13.5	9.8	9.3	9.6	9.7	10.6	9.5
Private consumption	7.8	2.7	11.8	13.9	11.4	15.3	na
Public consumption	19.2	-7.5	8.9	10.6	11.8	18.0	na
Gross fixed capital formation	25.3	10.0	8.0	22.5	11.9	24.0	na
Exports of goods and services	-1.8	16.6	7.5	10.9	1.4	5.3	na
Imports of goods and services	0.3	3.1	-7.6	14.8	13.3	13.8	na
Industrial gross output	13.8	10.5	9.1	10.4	4.8	7.0	na
Agricultural gross output	17.3	3.4	1.6	1.0	6.7	7.0	na
Employment [1]			(Percentage change)				
Labour force (end-year)	5.2	-1.1	3.5	2.2	0.8	1.5	na
Employment (end-year)	8.0	0.2	4.1	2.6	1.1	1.4	na
			(In per cent of labour force)				
Unemployment (end-year)	10.4	9.3	8.8	8.4	8.1	7.8	na
Prices and wages			(Percentage change)				
Consumer prices (annual average)	8.4	5.9	6.4	6.9	7.6	8.6	8.5
Consumer prices (end-year)	6.4	6.6	6.8	6.7	7.5	8.6	8.5
Producer prices (annual average)	0.3	0.3	9.3	16.7	23.7	18.4	na
Producer prices (end-year)	-14.1	11.9	5.9	23.8	20.3	14.6	na
Gross average monthly earnings in economy (annual average)	20.4	17.5	13.8	22.5	20.3	20.4	na
Government sector [2]			(In per cent of GDP)				
General government balance [3]	1.8	1.0	2.7	2.5	5.8	7.5	4.3
General government expenditure [4]	23.0	21.0	22.6	22.1	22.3	20.4	na
General government debt	18.0	15.6	13.5	10.1	7.1	6.1	na
Monetary sector			(Percentage change)				
Broad money (M2, end-year)	40.2	30.1	34.2	68.2	26.3	78.1	na
Domestic credit (end-year)	18.0	30.2	38.1	81.1	52.3	76.5	na
			(In per cent of GDP)				
Broad money (M2, end-year)	17.1	19.2	21.1	27.8	27.2	36.3	na
Interest and exchange rates			(In per cent per annum, end-year)				
Refinancing rate	9.0	7.5	7.0	7.0	8.0	9.0	na
Treasury bill rate (3-month maturity) [5]	5.3	5.2	5.9	3.3	3.3	3.3	na
Deposit rate [6]	12.8	11.0	10.9	9.3	9.1	9.8	na
Lending rate [7]	15.3	14.1	14.9	13.7	13.0	12.2	na
			(Tenges per US dollar)				
Exchange rate (end-year)	150.2	155.6	144.2	130.0	134.0	127.0	na
Exchange rate (annual average)	146.7	153.3	149.6	136.0	132.9	126.1	na
External sector			(In millions of US dollars)				
Current account	-1,389.5	-1,024.3	-272.6	335.0	-1,066.0	-1,797.0	-3,247.0
Trade balance [8]	983.4	1,987.1	3,679.0	6,785.4	10,321.8	14,642.0	13,015.0
Merchandise exports	8,927.8	10,026.9	13,232.6	20,603.1	28,300.6	38,762.0	41,112.0
Merchandise imports	7,944.4	8,039.8	9,553.6	13,817.7	17,978.8	24,120.0	28,097.0
Foreign direct investment, net	2,860.6	2,163.8	2,213.4	5,436.0	2,123.0	6,556.0	5,103.0
Gross reserves, excluding gold (end-year)	1,997.2	2,555.3	4,962.0	9,277.0	7,070.0	19,113.0	na
External debt stock [9]	15,157.4	18,251.0	22,920.6	32,946.0	43,539.0	73,455.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year) [10]	2.3	2.6	4.5	5.9	3.3	6.8	na
			(In per cent of exports of goods and services)				
Debt service	37.6	35.4	35.2	36.2	37.0	32.2	na
Memorandum items			(Denominations as indicated)				
Population (end-year, million)	14.9	14.9	15.0	15.1	15.2	15.4	na
GDP (in billions of tenges)	3,250.6	3,776.3	4,612.0	5,870.1	7,591.0	10,139.0	11,850.0
GDP per capita (in US dollars)	1,491.7	1,657.2	2,062.3	2,862.5	3,758.3	5,221.5	na
Share of industry in GDP (in per cent)	25.2	25.3	25.3	25.4	24.2	23.4	na
Share of agriculture in GDP (in per cent)	10.1	9.5	8.8	8.1	7.9	7.6	na
Current account/GDP (in per cent)	-6.3	-4.2	-0.9	0.8	-1.9	-2.2	-3.3
External debt - reserves (in US$ million)	13,160.2	15,695.7	17,958.6	23,669.0	36,469.0	54,342.0	na
External debt/GDP (in per cent)	68.4	74.1	74.3	75.8	76.0	91.3	na
External debt/exports of goods and services (in per cent)	148.8	157.8	153.4	145.8	142.5	153.5	na

[1] Data based on labour force surveys.
[2] General government includes the state, municipalities and extra-budgetary funds and is on a cash basis.
[3] Government balance includes quasi-fiscal operations and transfers to the National Fund. Balance excludes privatisation revenues.
[4] Expenditures include extra-budgetary funds.
[5] Average effective yield of short-term National Bank of Kazakhstan notes.
[6] Deposit rate refers to the weighted average of interest rates on time deposits of individuals, in tenge.
[7] Lending rate refers to weighted average of interest rates on credits extended to legal entities, excluding banks in tenge.
[8] Exports at declared customs prices. They are not corrected for under-invoicing of oil and gas exports.
[9] Includes inter-company debt by branches of non-resident foreign enterprises and short-term debt.
[10] Excludes National Fund.

Kyrgyz Republic

Key challenges

- Lack of clarity for investment in the mining sector could undermine prospective FDI. While the recent settlement of a dispute with a key foreign investor has subdued tensions, it is essential to adopt transparent licensing procedures for the future.
- Reforms in the power sector, especially those related to tariffs, should be accelerated to enable the privatisation of the power generation and distribution companies to proceed.
- As economic ties with neighbouring countries strengthen, economic diversification is increasingly important to reduce the vulnerability to external factors. To this end, macroeconomic stability should be maintained and the business environment improved further.

Country data

Population (in millions)	5.1
Area ('000 sq km)	200.0
GDP (in billion US$, 2006)	2.8
GDP per capita in 2006 at current international US$ (PPP)	2,051
National currency	Som

Progress in structural reform

Business environment and competition

A number of recent events have raised concerns among foreign investors in mining. In March 2007, parliament began readings of a law that challenges the legal validity of the privatisation agreements for the Kumtor gold mine, the largest in the country. The draft law proposes a retroactive tax on past activities and provides for the transfer of all gold deposits to a state-owned company – a de facto nationalisation. Then in the first quarter of 2007 the government passed a decree awarding higher wages to employees working at high altitude, which will affect workers at Kumtor.

Centerra, an operator of the Kumtor mine, challenged the decree, arguing that it contravened the investment agreement and subsequently initiated a court case. In July, a working group comprising government members, parliament and civil society groups held discussions with Centerra to try and resolve the dispute. The authorities have meanwhile decided to review the legality of all licences in the mining sector.

By the end of August 2007 the government agreed to enlarge Centerra's concession area for exploration and apply a simplified tax regime to its operations. In exchange, Cameco, the largest shareholder in Centerra, agreed to transfer some of its shares to the Kyrgyz government. The agreement still required parliamentary approval by the end of October.

In June 2007 the government adopted a new law that introduced the framework for all checks of commercial entities to be carried out by authorised bodies. It is intended to limit discretionary inspections, and thus reduce the scope for corruption.

Infrastructure

In mid-2007 parliament cleared the way for the privatisation of the electricity generation and distribution companies, including the Kambarata hydro power plants. The sector is characterised by high technical and financial losses owing to under-investment, tariff levels that are below operating costs, theft and corruption. It is hoped that by attracting private investors performance will improve. However, private investment will only be realised if tariffs are increased to cover operating costs and investment. In 2006, the average residential tariff was 1.3 US cents per kWh, significantly below the short-term cost recovery level of 2.66 US cents per kWh. On the positive side, the quasi-fiscal deficit in the power sector (defined as the cost of production minus cash revenues) declined to 5.4 per cent of GDP in 2006 from 7.5 per cent in 2005.

If completed, the Kambarata hydro power plants will generate 6 billion kWh per year, equalling about half the country's production of 13 billion kWh per year, and could allow it to more than double exports from 2.4 billion kWh per year to 6 billion kWh. FDI will be essential to meet much of the costs, currently estimated at US$ 2.5 billion (equivalent to about 80 per cent of GDP). Russia, Kazakhstan, China and Iran have expressed interest in the project but it is not clear if there is a market for electricity above 8-9 US cents per kWh, the estimated cost-recovery level.

Financial sector

The banking sector continued to grow strongly – customer credits grew by 45 per cent in real terms in 2006. Political instability in the autumn of 2006 temporarily slowed lending, but customer credits by commercial banks at the end of June 2007 were up by 93 per cent in real terms year-on-year. Growth in lending has been driven by subsidiaries of Kazakh banks. At the end of 2006, there were five Kazakh bank subsidiaries operating in the Kyrgyz Republic, accounting for around 43 per cent of total lending.

The parliament continues to challenge the independence and limit the supervisory capacity of the regulator, the National Bank of the Kyrgyz Republic (NBKR). In the first quarter of 2007 parliament limited the budgetary independence of the NBKR and passed a law restricting the NBKR's right to increase minimum capital requirements. Banks continue to successfully challenge NBKR decisions through the court system and there are concerns over the effectiveness of anti-money laundering legislation.

Social sector

The government adopted its country development strategy for the period 2007-10 in June 2007. It emphasises the importance of economic growth in reducing poverty. From 2000 to 2005 the economy grew by 3.7 per cent per annum and this had a positive effect as the poverty ratio declined from 63 per cent to 43 per cent of the population. The strategy aims to reduce the poverty ratio to 30 per cent by 2010.

Macroeconomic performance

The economy rebounded in 2006 with real GDP growth of 2.7 per cent, partly reflecting increased investment in property and higher consumption, supported by growth of remittances and a sharp increase in bank lending. Real GDP growth strengthened to 9.2 per cent in the first half of 2007, although these figures reflect the recent move of many enterprises from the informal to the formal economy.

Inflation picked up in mid-2007 due to higher international commodity prices. An accommodating monetary policy stance by the NBKR, underlined by its undertaking of large unsterilised interventions in the foreign exchange market, has also contributed to increased price pressures.

The general government fiscal deficit narrowed to 2.1 per cent of GDP in 2006. Tax revenues increased as VAT and custom revenues performed strongly, reflecting increased formalisation of the economy and a surge in imports, more than offsetting the impact of tax cuts introduced in 2006. The 2007 budget projects a fiscal deficit of 2.2 per cent of GDP, which allows for higher spending on pensions and wages of civil servants. Fiscal control may be weakened as the government proceeds with fiscal decentralisation. A recent decision by the parliament to lower the retirement age will exert pressure on pension expenditures in the near future.

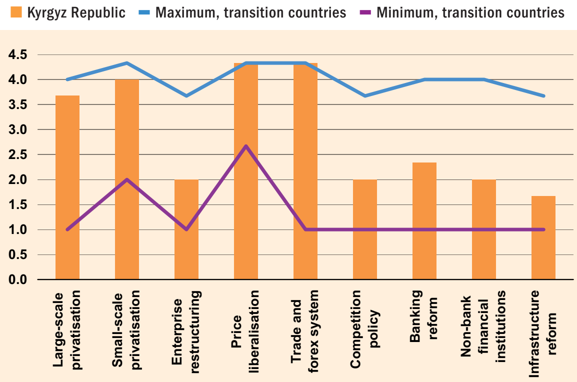
The current account deficit widened sharply to 13.7 per cent of GDP in 2006. This partly reflected one-off factors relating to the Kumtor gold mine. In recent years workers' remittances have been an increasingly important source for narrowing the current account deficit.

The authorities' decision in February 2007 not to seek debt relief under the Highly Indebted Poor Countries initiative means that total public external debt outstanding as a percentage of GDP, which was 73.2 per cent at the end of 2006, will remain high in the medium term. Debt service on the other hand, will be manageable (US$ 65-80 million per annum) as the country will continue to benefit from Paris Club debt reschedulings (in 2002 and 2005).

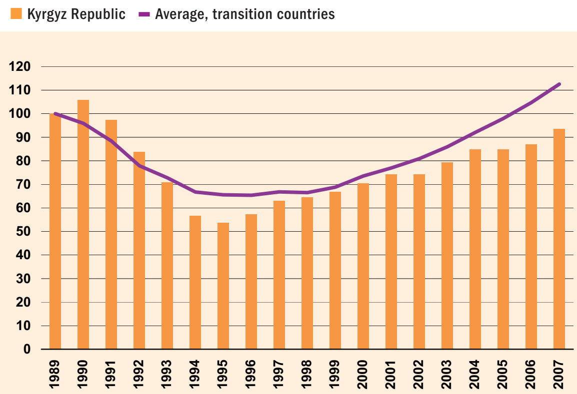
Outlook and risks

Despite recent political turbulence, growth is expected to remain robust in 2007 with real GDP projected to grow by 7.5 per cent in 2007. The Kyrgyz economy is vulnerable to an economic downturn in Russia and Kazakhstan, as recent growth is primarily driven by a surge in credit by Kazakh banks and remittances from migrant workers in Russia and Kazakhstan. In the short term, a recent rise in inflation is a challenge to macroeconomic stability and requires a tightening of monetary and fiscal policies.

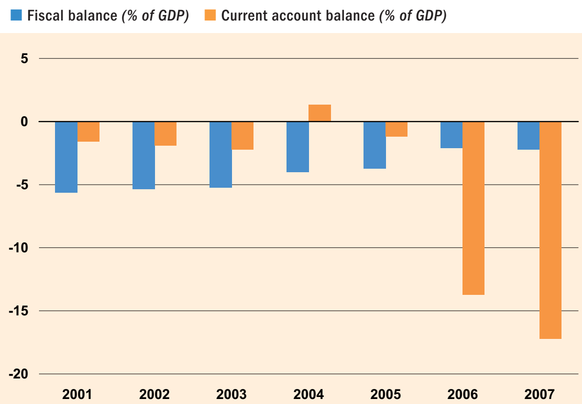
Transition indicators, 2007



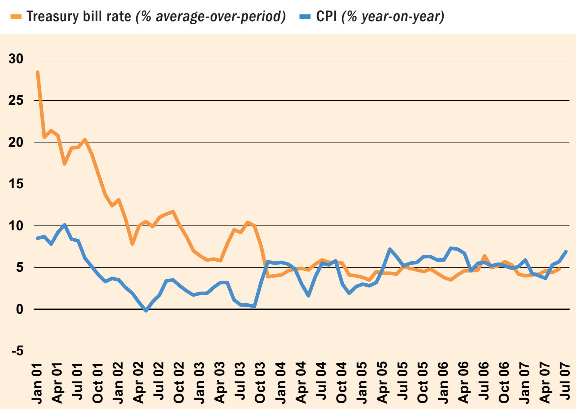
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no**[1]

Interest rate liberalisation – **full**

Exchange rate regime – **managed float**

Wage regulation – **no**

Tradeability of land – **full except foreigners**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **medium**

Secured transactions law – **some defects**

Quality of corporate governance law – **medium**

Infrastructure

Independent telecoms regulator – **partially**

Independent electricity regulator – **partially**

Separation of railway infrastructure from operations – **no**

Independence of the road directorate – **no**

Quality of concession laws – **low**

Financial sector

Capital adequacy ratio – **12 per cent**

Deposit insurance system – **no**

Quality of securities market laws – **medium**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **21.4 per cent** (2003)[2]

Government expenditure on health – **2.3 per cent of GDP** (2004)

Government expenditure on education – **4.4 per cent of GDP** (2005)

Household expenditure on power and water – **4.4 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	2.7	2.9	3.2	7.2	7.4	7.7	na
Private sector share in GDP (in per cent)	60.0	65.0	65.0	75.0	75.0	75.0	75.0
Private sector share in employment (in per cent)	79.1	79.7	80.3	80.9	81.2	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	3.0	3.4	3.2	3.1	3.4	3.7	na
Share of industry in total employment (in per cent)	7.9	7.8	7.7	8.1	na	na	na
Change in labour productivity in industry (in per cent)	5.8	-10.2	15.9	-3.1	na	na	na
Investment/GDP (in per cent)	17.8	17.6	11.8	14.5	16.4	17.4	na
EBRD index of small-scale privatisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of large-scale privatisation	3.0	3.0	3.0	3.7	3.7	3.7	3.7
EBRD index of enterprise reform	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Markets and trade							
Share of administered prices in CPI (in per cent)	na	na	na	12.0	12.9	12.5	na
Number of goods with administered prices in EBRD-15 basket	1.0	1.0	1.0	1.0	2.0	2.0	na
Share of trade with non-transition countries (in per cent)	52.5	53.8	50.3	53.9	60.9	69.1	na
Share of trade in GDP (in per cent)	60.8	66.6	68.4	74.0	72.9	92.4	na
Tariff revenues (in per cent of imports)	1.4	1.6	1.3	1.2	3.7	2.9	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Financial sector							
Number of banks (foreign-owned)	20 (5)	20 (6)	21 (7)	19 (9)	19 (10)	na	na
Asset share of state-owned banks (in per cent)	16.6	9.7	7.2	4.1	4.8	na	na
Asset share of foreign-owned banks (in per cent)	32.7	50.4	61.2	70.1	73.6	na	na
Non-performing loans (in per cent of total loans)	13.8	17.6	11.2	6.1	7.7	na	na
Domestic credit to private sector (in per cent of GDP)	3.8	4.2	4.8	7.1	8.0	10.5	na
Domestic credit to households (in per cent of GDP)	0.4	0.3	0.5	0.9	1.2	na	na
Of which mortgage lending (in per cent of GDP)	0.0	0.0	0.1	0.3	0.5	na	na
Stock market capitalisation (in per cent of GDP)	0.3	0.5	1.6	1.5	1.7	3.1	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	na	na	na	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	na	na	na
EBRD index of banking sector reform	2.0	2.0	2.3	2.3	2.3	2.3	2.3
EBRD index of reform of non-bank financial institutions	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	7.9 (0.6)	7.9 (1.1)	7.9 (2.8)	8.2 (5.2)	8.3 (10.3)	8.4 (na)	na
Internet users (per 100 inhabitants)	3.0	3.0	4.0	5.2	5.3	5.6	na
Railway labour productivity (1989=100)	14.3	16.2	22.0	27.4	25.4	28.7	na
Residential electricity tariffs (USc kWh)	0.7	1.0	1.0	1.0	1.2	1.3	na
Average collection rate, electricity (in per cent)	na	48	48	76	86	74	na
GDP per unit of energy use (PPP in US dollars per kgoe)	3.6	3.2	3.2	3.3	na	na	na
EBRD index of infrastructure reform	1.3	1.7	1.7	1.7	1.7	1.7	1.7
Electric power	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Railways	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Roads	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Telecommunications	2.3	2.3	2.7	3.0	3.0	3.0	3.0
Water and waste water	1.0	1.7	1.7	1.7	1.7	1.7	1.7

[1] All investments must be registered with the Ministry of Justice and statistical agencies.

[2] Based on the nationally defined poverty line, the percentage of the population living in poverty was 43 per cent in 2005.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	5.3	0.0	7.0	7.0	-0.2	2.7	7.5
Private consumption	1.6	4.2	22.1	7.5	7.5	20.0	na
Public consumption	0.0	-0.2	-2.0	2.5	-5.1	1.3	na
Gross fixed capital formation	-3.2	-7.4	-6.4	7.4	10.3	11.8	na
Exports of goods and services	-3.2	8.1	5.3	12.8	-11.0	-0.3	na
Imports of goods and services	-13.8	13.1	16.0	16.3	6.5	38.7	na
Industrial gross output	5.4	-10.9	17.0	3.7	-12.1	-10.2	na
Agricultural gross output	7.3	3.1	3.2	4.1	-4.2	1.5	na
Employment			*(Percentage change)*				
Labour force (end-year) [1]	1.4	-8.8	1.7	2.5	-3.4	na	na
Employment (end-year)	1.1	1.1	1.7	2.3	2.8	na	na
			(In per cent of labour force)				
Unemployment (end-year)	7.8	8.8	9.2	9.3	9.6	na	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	6.9	2.0	3.1	4.1	4.3	5.6	7.0
Consumer prices (end-year)	3.7	2.3	5.6	2.8	4.9	5.1	8.5
Producer prices (annual average)	12.0	4.8	4.6	9.0	2.6	15.3	na
Producer prices (end-year)	11.2	7.5	13.5	4.3	6.0	10.4	na
Gross average monthly earnings in economy (annual average)	18.6	15.8	13.7	16.9	16.6	17.1	na
Government sector [2]			*(In per cent of GDP)*				
General government balance	-5.6	-5.3	-5.2	-4.0	-3.7	-2.1	-2.2
General government expenditure	26.0	28.1	27.4	27.4	28.4	28.7	na
General government debt	107.3	107.3	104.9	93.8	85.1	76.3	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	11.3	33.9	33.4	32.1	10.0	51.5	na
Domestic credit (end-year)	-8.1	21.6	11.3	-18.8	19.6	39.7	na
			(In per cent of GDP)				
Broad money (M2, end-year)	11.1	14.6	17.5	20.6	21.2	28.6	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Official rate	10.7	4.4	4.0	4.0	4.1	3.2	na
Money market rate [3]	19.1	7.0	4.0	4.0	4.3	4.2	na
Deposit rate [4]	12.5	5.9	5.0	6.7	5.8	5.6	na
Lending rate [4]	37.3	24.8	21.7	29.3	26.6	23.2	na
			(Soms per US dollar)				
Exchange rate (end-year)	47.7	46.1	44.2	41.6	41.3	38.1	na
Exchange rate (annual average)	48.3	46.9	43.7	42.6	41.0	40.2	na
External sector			*(In millions of US dollars)*				
Current account	-24.1	-30.4	-42.5	29.0	-29.3	-385.8	-585.9
Trade balance	30.5	-73.3	-132.8	-170.6	-418.7	-981.5	-1,434.9
Merchandise exports	480.3	498.1	590.3	733.2	686.8	810.8	1,074.3
Merchandise imports	449.8	571.4	723.1	903.8	1,105.5	1,792.3	2,509.2
Foreign direct investment, net	-1.1	4.7	45.5	131.5	42.6	182.0	50.0
Gross reserves, excluding gold (end-year)	230.0	288.8	364.6	548.7	569.7	764.4	na
External debt stock	1,677.7	1,784.6	1,978.3	2,103.5	2,020.0	2,061.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	4.8	4.8	5.0	5.8	4.9	4.3	na
			(In per cent of exports of goods and services)				
Debt service [5]	30.8	21.0	22.5	18.9	14.9	6.0	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	4.9	5.0	5.0	5.1	5.1	5.1	na
GDP (in millions of soms)	73,883.3	75,366.7	83,871.6	94,350.7	100,899.2	113,175.6	130,800.0
GDP per capita (in US dollars)	309.3	322.1	381.4	434.5	479.6	549.0	na
Share of industry in GDP (in per cent)	26.8	21.3	20.2	21.7	20.0	17.6	na
Share of agriculture in GDP (in per cent)	34.5	34.4	33.6	29.9	28.5	28.9	na
Current account/GDP (in per cent)	-1.6	-1.9	-2.2	1.3	-1.2	-13.7	-17.2
External debt - reserves (in US$ million)	1,447.7	1,495.8	1,613.7	1,554.8	1,450.3	1,296.7	na
External debt/GDP (in per cent)	109.6	111.1	103.0	95.1	82.1	73.2	na
External debt/exports of goods and services (in per cent)	299.3	278.6	267.4	221.3	213.0	192.4	na

[1] Based on labour force data from World Bank World Development Indicators.

[2] General government includes the state, municipalities and extra-budgetary funds. It also includes expenditure under the foreign-financed public investment programme and net lending.

[3] Weighted average rate on interbank loans in soms with 1-90 day maturities, from IMF International Financial Statistics.

[4] Weighted average over all maturities from IMF International Financial Statistics.

[5] Debt service scheduled and excludes US$ 111 million debt rescheduling granted by the Paris Club of official creditors for 2002-04.

Latvia

Key challenges

- To maintain steady growth the economy needs to diversify and increase competitiveness in the production of higher value-added goods.
- The decline in unemployment and above-productivity wage increases in major industries has put additional pressure on overall competitiveness. Given these pressures in the labour market policy measures are needed to improve skill levels in the labour force.
- Overheating remains a major challenge and the growing current account imbalances may not be sustainable. Inflationary pressures continue to make euro adoption less likely in the short run, increasing the pressure on the financial and monetary authorities to react further.

Country data

Population (in millions)	2.3
Area ('000 sq km)	64.5
GDP (in billion US$, 2006)	20.1
GDP per capita in 2006 at current international US$ (PPP)	15,824
National currency	Lat

Progress in structural reform

Business environment and competition

Rapid wage growth has dampened Latvia's overall competitiveness. Although the business environment remains one of the best in the region and labour costs in absolute levels still remain among the lowest in the European Union (EU), several obstacles remain. Political corruption is still a concern, particularly after recent investigations of high level government officials for tax fraud, money laundering and abuse of power.

An annual survey of entrepreneurs and businessmen undertaken by Parex Bank showed that there is increasing concern about rising inflation, lat devaluation rumours and rising labour and utility costs. Measures to reduce property tax for businesses from 1.5 per cent to 1 per cent of the property's value (as determined by the land cadastre) by 2008 might not be far reaching enough to counter these cost developments.

Infrastructure

Reorganisation of the Latvian railways has been completed and registered in the commercial register. The state-owned company LDz is now a holding company and will be the railway infrastructure manager, ensuring the equal provision of basic and supplementary services to all carriers. It will also ensure the management of the subsidiary companies, four of which already existed and another three – LDz Infrastruktura, LDz Cargo and LDz Ritosa Sastava Serviss – that were recently established and began operations in July 2007. As a result of the reorganisation Latvia has fulfilled the requirements of the EU directives on liberalising the railway sector.

After little progress in privatising the remaining infrastructure companies the government has taken active steps to sell off its 51 per cent stake in Lattelecom. In June 2007 the government endorsed a management buy-out offer for Lattelecom amounting to approximately Ls 290 million (US$ 550 million). If the buy-out were to fail, the government is also considering auctioning off its stake in the company.

Financial sector

Much of Latvia's economic growth is financed by external borrowing, mostly via loans to Latvian subsidiaries from their overseas (mainly Scandinavian) parent banks. Most of these loans (almost 40 per cent) have then been extended as euro-denominated mortgage loans to households. As a result, house prices have increased sharply, reaching comparatively high levels. Overall, a combination of low interest rates and a highly competitive banking sector contributed to an annual growth of domestic credit of 56 per cent in 2006, equivalent to some 85 per cent of GDP by the end of 2006. Both growth and the absolute level of domestic credit are the highest among central and eastern Europe and Baltic countries.

The government has been concerned about the rapid growth of credit and the property market. To restrict growth in these two areas the government has introduced a tax on speculative property by 2010, tightened regulations on bank lending and committed to balance the budget as early as 2007 by limiting growth of expenditure. But neither these measures nor the suggestions made by some of the leading banks earlier this year that a more conservative approach would be taken towards lending have been reflected in the credit figures for early 2007. Mortgage loans rose by 23 per cent in the first half of 2007, representing a staggering 73 per cent increase over their level a year earlier. The largest contribution to the loan increase came from loans in euros but the overall annual growth rate of loans remained broadly unchanged at 55.3 per cent after the first half in 2007. Overall domestic credit accounted for 78.9 per cent of GDP at the end of 2006, an increase from 60 per cent in 2005.

Both financial institutions and the authorities have significantly decreased the risk of money laundering by implementing stricter anti-money laundering rules and better enforcement procedures, which has led to a sharp decline in Russian rouble foreign exchange trading.

Social sector

Overall unemployment has been falling over the past five years, but remains very high in certain regions, especially in eastern rural Latvia (up to 22.9 per cent in Latgale) and is largely structural in nature. Long-term unemployment is particularly concentrated among low-skilled workers. The combination of unemployment with the lowest level of monthly pensions among the Baltic states could lead to an increase in poverty in the rural regions in the medium term.

Macroeconomic performance

Economic growth remained strong in 2006 and the first half of 2007 with GDP growing by 11.9 and 11.1 per cent, respectively. This has been accompanied by higher inflation, which reached a new high of 10.1 per cent in August 2007, the highest in the EU. The central bank has increased its refinancing rate twice this year in order to stem inflation and curb the overheating economy. To date, however, it has had limited success as households and companies are able to borrow more cheaply in euros, as long as the exchange rate peg holds.

The labour market is also showing signs of overheating. Unemployment fell to 6.1 per cent at the end of 2006, and the numbers of those employed have now reached their highest level since the start of transition. Wage growth, particularly in the public sector, remains very strong and above-productivity levels with an overall average increase of 23.5 per cent in 2006. The tightening labour market is partly due to a continuing increase in emigration, mainly to the United Kingdom and Ireland. Several analysts forecast significant labour shortages by 2010.

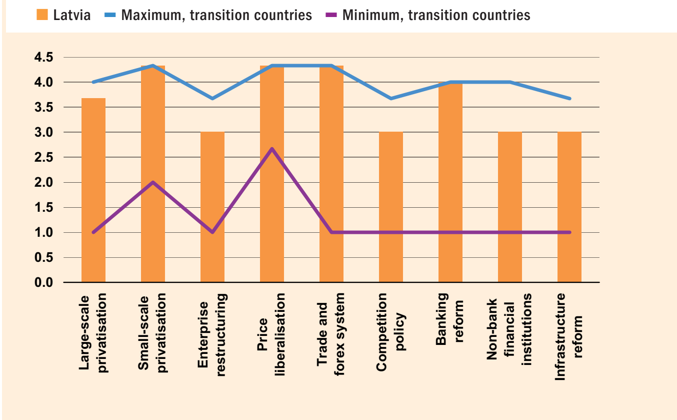
The current account deficit averaged 21.3 per cent of GDP overall in 2006, mainly as a result of a deteriorating trade balance. Initial data for 2007 reveal a significant widening of the trade deficit in the first quarter of the year. Latvia retains a dual structured export pattern with comparatively higher-value-added goods exported predominantly to the Commonwealth of Independent States, whereas exports to the EU consist mainly of lower-value-added production. This results in low levels of innovation and sluggish productivity growth. In the meantime imports have increased faster than exports, reflecting solid domestic demand that has been fuelled by the strong growth in credit.

The government is tackling the growing macroeconomic imbalances. Apart from targeting a balanced budget in 2007 the government's anti-inflation plans include a property tax (targeted at property owned for less than five years) from 2010, several measures to dampen credit expansion and a proposal to restrict public sector wage growth. The consolidated general government budget surplus was 0.4 per cent of GDP in 2006. This was below the target of 1.5 per cent, mainly because of lower than planned expenditures on investment. To balance the budget the government has tightened fiscal policy and postponed indefinitely earlier plans to cut the rate of personal income tax from 25 to 15 per cent, while it can also rely on the continued strong growth in revenues. The government is now working on a new macroeconomic stabilisation plan with further fiscal tightening planned for 2008.

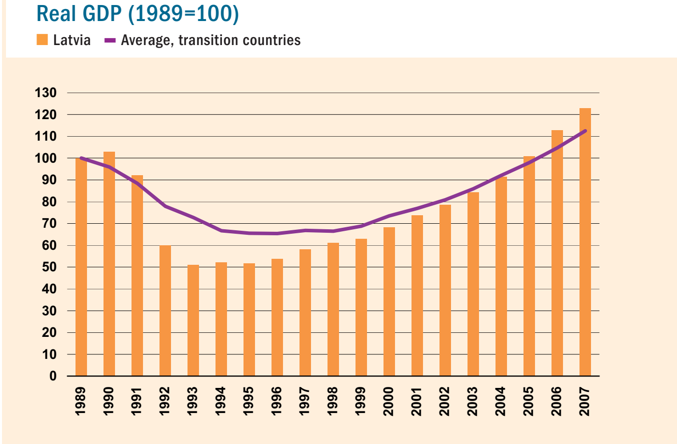
Outlook and risks

Overall growth will remain strong, as domestic demand is expected to continue to grow on the back of significant real wage growth. However, the Latvian economy continues to show all the main signs of overheating, with rapid credit growth, high inflation and an increasing current account deficit. The recent minor speculative attack on the currency, as well as the high proportion of loans that are in euros, shows that Latvia remains vulnerable to a financial crisis, especially if membership of the European monetary union is delayed.

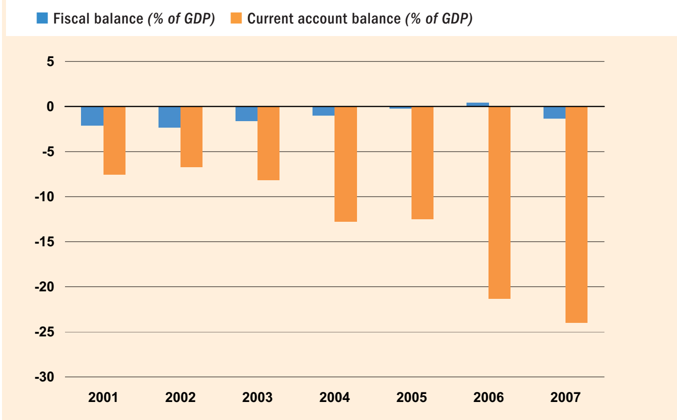
Transition indicators, 2007



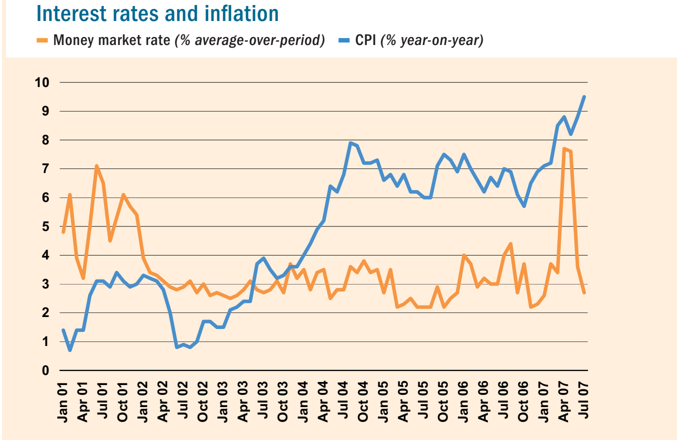
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no**[1]

Interest rate liberalisation – **full**

Exchange rate regime – **fixed peg in ERM II**

Wage regulation – **no**

Tradeability of land – **full except foreigners**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **low**

Secured transactions law – **advanced**

Quality of corporate governance law – **high**

Infrastructure

Independent telecoms regulator – **fully**

Independent electricity regulator – **fully**

Separation of railway infrastructure from operations – **fully**

Independence of the road directorate – **partially**

Quality of concession laws – **low**

Financial sector

Capital adequacy ratio – **8 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **high**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **4.7 per cent** (2003)

Government expenditure on health – **3.4 per cent of GDP** (2005)

Government expenditure on education – **5.6 per cent of GDP** (2005)

Household expenditure on power and water – **3.8 per cent**[2]

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	4.3	4.9	5.1	5.2	5.3	na	na
Private sector share in GDP (in per cent)	65.0	70.0	70.0	70.0	70.0	70.0	70.0
Private sector share in employment (in per cent)	73.0	75.0	76.0	76.0	76.0	76.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	4.8	5.4	5.3	5.0	4.5	na	na
Share of industry in total employment (in per cent)	18.3	19.5	19.7	18.8	17.3	18.0	na
Change in labour productivity in industry (in per cent)	19.2	-0.8	5.3	12.3	15.6	-1.2	na
Investment/GDP (in per cent)	26.6	26.7	28.8	33.2	34.4	38.0	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	3.0	3.3	3.7	3.7	3.7	3.7	3.7
EBRD index of enterprise reform	2.7	2.7	3.0	3.0	3.0	3.0	3.0
Markets and trade							
Share of administered prices in CPI (in per cent)	22.0	20.7	16.3	16.0	14.3	14.0	na
Number of goods with administered prices in EBRD-15 basket	2.0	2.0	2.0	2.0	2.0	2.0	na
Share of trade with non-transition countries (in per cent)	68.6	67.7	65.5	59.6	54.5	53.6	na
Share of trade in GDP (in per cent)	70.0	70.5	74.6	81.5	85.7	84.8	na
Tariff revenues (in per cent of imports)	0.7	0.6	0.6	0.3	0.3	na	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.3	2.3	2.7	2.7	3.0	3.0	3.0
Financial sector							
Number of banks (foreign-owned)	23 (10)	23 (9)	23 (10)	23 (9)	23 (10)	24 (12)	na
Asset share of state-owned banks (in per cent)	3.2	4.0	4.1	4.0	4.3	4.4	na
Asset share of foreign-owned banks (in per cent)	65.2	42.8	53.0	48.6	57.9	62.9	na
Non-performing loans (in per cent of total loans)	2.8	2.0	1.4	1.1	0.7	0.5	na
Domestic credit to private sector (in per cent of GDP)	21.1	26.2	34.2	44.2	59.0	77.9	na
Domestic credit to households (in per cent of GDP)	4.6	7.3	11.6	17.6	26.8	38.0	na
Of which mortgage lending (in per cent of GDP)	2.4	4.1	7.6	12.4	19.5	28.9	na
Stock market capitalisation (in per cent of GDP)	8.4	7.3	9.5	11.5	16.5	12.8	na
Stock trading volume (in per cent of market capitalisation)	26.3	24.0	15.7	8.1	4.6	4.2	na
Eurobond issuance (in per cent of GDP)	4.2	0.0	0.0	0.0	0.8	1.3	na
EBRD index of banking sector reform	3.3	3.7	3.7	3.7	3.7	3.7	4.0
EBRD index of reform of non-bank financial institutions	2.3	3.0	3.0	3.0	3.0	3.0	3.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	30.7 (27.9)	30.1 (39.4)	28.2 (52.6)	28.5 (67.2)	31.7 (81.1)	28.6 (95.1)	na
Internet users (per 100 inhabitants)	7.2	13.3	24.2	35.4	44.7	46.7	na
Railway labour productivity (1989=100)	90.5	99.0	118.2	109.4	118.6	106.7	na
Residential electricity tariffs (USc kWh)	6.3	6.5	7.1	8.2	8.1	8.4	na
Average collection rate, electricity (in per cent)	99	100	100	na	na	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	4.6	5.1	5.3	5.6	na	na	na
EBRD index of infrastructure reform	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Electric power	3.0	3.0	3.0	3.3	3.3	3.3	3.3
Railways	3.3	3.3	3.3	3.3	3.3	3.7	3.7
Roads	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Telecommunications	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Water and waste water	3.3	3.3	3.3	3.3	3.3	3.3	3.3

[1] There are controls on raffles and gambling for certain nationals.

[2] Estimate based on the poorest 20 per cent of households (lowest income quintile).

	2001	2002	2003	2004	2005	2006 *Estimate*	2007 *Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	8.0	6.5	7.2	8.5	10.2	11.9	9.0
Private consumption	7.3	7.4	8.2	9.5	11.5	19.8	na
Public consumption	2.8	2.2	1.9	2.1	2.7	4.0	na
Gross fixed capital formation	11.4	13.0	12.3	23.8	23.6	18.3	na
Exports of goods and services	7.5	5.4	5.2	9.4	20.3	5.3	na
Imports of goods and services	14.3	4.7	13.1	16.6	14.8	17.5	na
Industrial gross output	8.7	8.8	8.0	8.3	8.4	8.2	na
Agricultural gross output	6.3	4.4	-2.4	3.3	9.4	-0.3	na
Employment			*(Percentage change)*				
Labour force (end-year)	0.7	1.7	0.2	0.9	-0.1	2.8	na
Employment (end-year)	2.2	3.0	1.8	1.1	1.8	5.0	na
			(In per cent of labour force)				
Unemployment (end-year)	13.1	12.4	10.6	10.4	8.7	6.1	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	2.6	2.5	1.9	2.9	6.2	6.5	5.8
Consumer prices (end-year)	3.0	1.5	3.6	7.3	7.0	6.8	7.6
Producer prices (annual average)	1.7	1.0	3.2	8.6	7.8	10.3	na
Producer prices (end-year)	1.8	0.8	4.1	11.3	7.0	13.2	na
Gross average monthly earnings in economy (annual average)	3.8	7.8	8.4	9.3	17.5	18.9	na
Government sector			*(In per cent of GDP)*				
General government balance	-2.1	-2.3	-1.6	-1.0	-0.2	0.4	-1.3
General government expenditure [1]	34.6	35.3	34.6	34.7	35.5	37.0	na
General government debt	15.0	13.5	14.4	14.5	12.0	10.0	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	20.8	21.0	21.1	27.0	36.1	39.7	na
Domestic credit (end-year)	36.2	39.8	39.2	40.2	63.2	56.1	na
			(In per cent of GDP)				
Broad money (M2, end-year)	29.5	32.4	35.3	38.6	43.1	48.4	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	3.5	3.0	3.0	4.0	4.0	5.0	na
Interbank market rate [2]	5.4	2.7	3.2	3.5	2.7	2.3	na
Deposit rate (short-term, under 1 year)	5.3	3.2	3.0	3.3	2.8	3.6	na
Lending rate (short-term, under 1 year)	10.8	7.5	5.4	7.5	5.9	7.3	na
			(Lats per US dollar)				
Exchange rate (end-year)	0.6	0.6	0.5	0.5	0.6	0.5	na
Exchange rate (annual average)	0.6	0.6	0.6	0.5	0.6	0.6	na
External sector			*(In millions of US dollars)*				
Current account	-626.3	-624.6	-910.9	-1,757.8	-2,002.5	-4,280.4	-5,985.0
Trade balance	-1,335.4	-1,479.0	-2,004.2	-2,780.8	-3,019.2	-4,941.2	-6,400.0
Merchandise exports	2,242.8	2,545.0	3,170.0	4,221.0	5,360.0	6,050.8	7,600.0
Merchandise imports	3,578.2	4,024.0	5,174.2	7,001.8	8,379.2	10,992.0	14,000.0
Foreign direct investment, net	114.3	250.2	256.0	595.9	603.0	1,486.9	1,100.0
Gross reserves, excluding gold (end-year)	1,148.7	1,241.4	1,432.0	1,912.0	2,231.9	4,353.3	na
External debt stock [3]	5,571.2	7,043.1	9,400.0	13,399.6	15,183.1	23,704.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	3.2	3.1	2.8	2.8	2.7	4.0	na
			(In per cent of exports of goods and services)				
Debt service	20.5	15.8	19.8	19.2	17.0	19.4	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	2.4	2.3	2.3	2.3	2.3	2.3	na
GDP (in millions of lats)	5,219.9	5,758.3	6,392.8	7,434.5	9,059.1	11,264.7	12,990.7
GDP per capita (in US dollars)	3,518.9	3,971.1	4,799.0	5,935.1	6,953.0	8,760.5	na
Share of industry in GDP (in per cent)	20.8	20.5	20.0	19.9	19.1	18.9	na
Share of agriculture in GDP (in per cent)	4.7	4.5	4.3	5.3	6.3	na	na
Current account/GDP (in per cent)	-7.5	-6.7	-8.1	-12.8	-12.5	-21.1	-24.0
External debt - reserves (in US$ million)	4,422.5	5,801.7	7,968.0	11,487.6	12,951.2	19,350.8	na
External debt/GDP (in per cent)	67.0	75.6	84.0	97.4	94.7	117.9	na
External debt/exports of goods and services (in per cent)	162.3	185.5	200.1	223.3	201.7	271.8	na

[1] General government expenditure includes net lending.

[2] Weighted average interest rates in the interbank market.

[3] Includes non-resident currency and deposits, liabilities to affiliated enterprises and liabilities to direct investors.

Lithuania

Key challenges

- Although the business environment in Lithuania is among the best in the transition region, more needs to be done to fight corruption in public administration, strengthen media independence and improve the quality of the judiciary.
- Faced with a rapidly tightening labour market, the government should implement reforms to improve education and skills training to meet market demand and reinforce Lithuania's competitiveness.
- With a limited range of instruments available to dampen domestic demand, the government needs to pursue a prudent fiscal policy to rein in growth and avoid overheating.

Country data

Population (in millions)	3.4
Area ('000 sq km)	65.3
GDP (in billion US$, 2006)	29.8
GDP per capita in 2006 at current international US$ (PPP)	16,206
National currency	Litas

Progress in structural reform

Liberalisation and privatisation

Privatisation in Lithuania moved a step closer to completion with the sale of the government's stake in the AB Mazeikiu Nafta oil refinery at the end of 2006. The Lithuanian government announced in March 2006 that it would exercise its pre-emptive rights over the 53.7 per cent majority stake in the refinery owned by Yukos International and sell it, along with its own 30.7 per cent stake, to a selected investor. Following a protracted international legal dispute, in May 2006 the Polish oil company PKN Orlen secured agreement to buy Yukos International's stake. This was followed in June 2006 by an agreement between PKN Orlen and the Lithuanian government on the sale of the government's 30.7 per cent stake. The purchase was approved by the European Commission in November 2006 and finalised in December 2006, following which PKN Orlen completed the purchase of an additional 5.1 per cent stake from minority shareholders, increasing its holding to 89.3 per cent.

Although this sale has greatly advanced privatisation in Lithuania, in accordance with the government's economic strategy for 2006 to 2008, further privatisation of state-owned economic entities such as the postal service and railways, and possibly strategic infrastructure such as airports, is to be postponed until at least 2009. Nevertheless, more than 75 per cent of economic activity in Lithuania is now in the private sector.

Business environment and competition

The business environment in Lithuania is among the best in the region. This is reflected in Lithuania's strong scores on the World Bank's Governance Indicators for both "government effectiveness" and "regulatory quality". However, some significant challenges remain. According to Transparency International's 2007 Corruption Perceptions Index and other sources, there has been a lack of effective and concerted government action to address corruption. This is mostly because the administration's capacity for reform has been weakened by unstable coalition or minority governments over the past few years.

The media – the public's watchdog against administrative corruption – is subject to significant financial and political influences. Much-needed reform to Lithuania's judicial system was also hampered over the past year by a series of judicial scandals and low levels of public trust in the court system. Moreover, recently enacted civil and criminal law reforms have proven less effective than anticipated, with no appreciable improvements in the time required to conduct trials.

Addressing these shortcomings will become increasingly important as the advantage of relatively low wages that the economy has enjoyed is gradually eroded and the economy is forced into more direct competition for foreign investment with more advanced economies in the European Union (EU).

Social sector

The EBRD/World Bank Life in Transition Survey, which included 1,000 households in Lithuania, questioned individuals about their priorities for state social spending, among other issues. Most Lithuanians emphasised the need for increased investment in education and health care, while the elderly were particularly keen on higher pensions. The survey also found that most Lithuanians were satisfied with their lives while the overwhelming majority believed that life would be even better for their children's generation.

This relatively high level of satisfaction may be driven, at least partly, by the rapid drop in unemployment from 11.4 per cent in 2004 to 5.6 per cent by the end of 2006. This sharp fall is attributable in part to Lithuania's accession to the EU in 2004, which provided opportunities for mostly young Lithuanians to seek employment opportunities elsewhere in the EU. It is also due to the strength of domestic demand for labour, especially for skilled and highly educated workers.

While the demand for labour is strong, emigration has meant that the labour market has experienced an acute shortage of graduates and other skilled workers. These pressures have contributed to strong growth in wage inflation across the skill spectrum over the past year. Although it has long been a priority reform area for the government, little substantive progress has been made over the past year in addressing the problems related to the reform of tertiary education and vocational training that is necessary to satisfy labour market demands.

Macroeconomic performance

Real GDP growth in Lithuania remained strong at 7.5 per cent in 2006, accelerating to 8.2 per cent in the first half of 2007. Growth is fuelled by strong domestic demand as well as dynamic investment and increasing exports, and has contributed to rising inflation, heightened in 2006 by increases in the cost of Russian gas imports and rising prices for food and municipal services.

In 2006 CPI inflation reached 3.7 per cent, up from 2.7 per cent in 2005. This resulted in Lithuania missing the Maastricht inflation criterion when it was last assessed in May 2006. Wages continued to grow rapidly, at nearly 20 per cent during 2006, and are now well beyond productivity growth. If this inflationary trend continues it will exert severe pressure on the competitiveness of the economy. However, the government remains committed to achieving the Maastricht criteria and in March 2007 announced a strategy to reduce inflation based on a prudent budgetary policy.

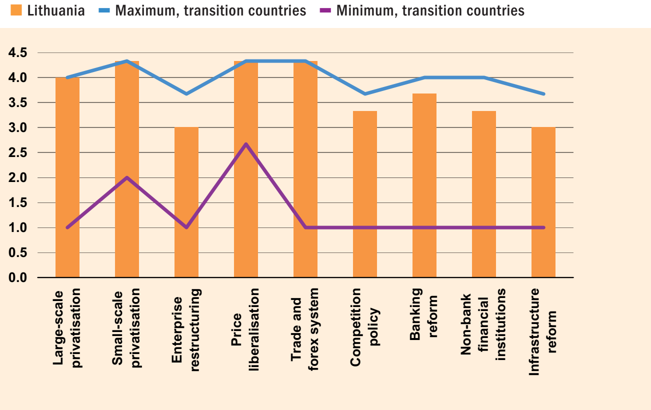
In the first half of 2007 the central government budget recorded a small surplus. However, despite rapid GDP growth, the fiscal balance is expected to show a deficit of about 0.5 per cent of full-year GDP at the end of 2007, implying a moderate loosening of fiscal policy. Public debt remains low, below 20 per cent of GDP. These figures are well within the limits imposed by the Stability and Growth Pact and so imply little pressure on the authorities for further fiscal tightening. However, as the authorities cannot use monetary instruments to contain buoyant domestic demand, fiscal tightening is the only tool available to reduce pressure on inflation and the external account.

Despite strong growth in exports, Lithuania's current account deficit has widened rapidly as the growth of imports has outstripped that of exports. The current account deficit reached 13.2 per cent of GDP in the first quarter of 2007, up from 10.9 per cent recorded in full-year 2006, although this was due in part to a fall in exports from the Mazeikiu Nafta oil refinery following the 2006 discontinuation of Russian pipeline oil supplies. FDI more than doubled in 2006 to US$ 1.59 billion (5.2 per cent of GDP), covering almost half of the current account deficit, although much of this increase was attributable to the sale of the Mazeikiu Nafta refinery.

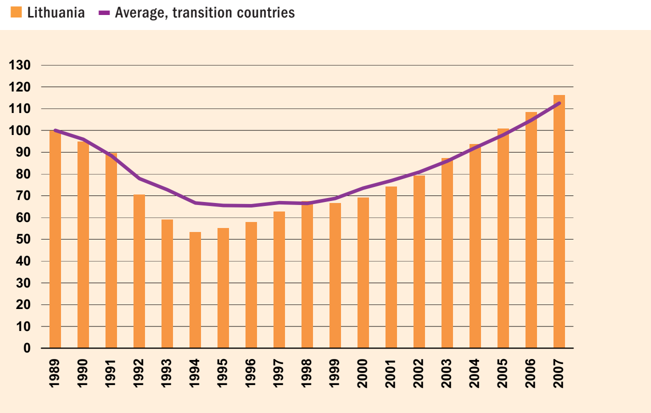
Outlook and risks

The economic outlook remains good, with GDP growth in 2007 and 2008 expected to remain very robust. However, this strong growth also carries significant risks. The first is the widening current account deficit. The second risk is associated with wage-related overheating. The third, related, risk is of a possible weakening in the current market perception that the Lithuanian authorities are committed to eventual accession to the eurozone. While this latter risk is unlikely at the moment, the authorities must continue to reinforce the perception of their desire to accede to the euro by strengthening efforts to achieve the Maastricht criteria within a reasonable time frame. In this regard, dampening domestic demand and reining in growth to slow inflation and prevent overheating will require even greater commitment to fiscal austerity.

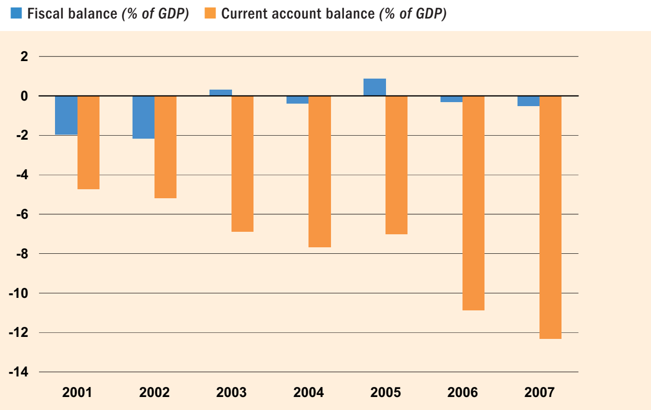
Transition indicators, 2007



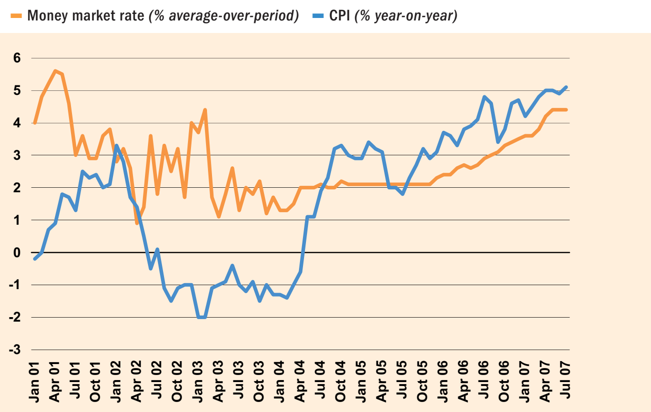
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full** Controls on inward direct investment – **no**[1] Interest rate liberalisation – **full** Exchange rate regime – **currency board in ERM II** Wage regulation – **no** Tradeability of land – **full except foreigners**[2]	Competition office – **yes** Quality of insolvency law – **low** Secured transactions law – **advanced** Quality of corporate governance law – **high**	Independent telecoms regulator – **fully** Independent electricity regulator – **fully** Separation of railway infrastructure from operations – **partially** Independence of the road directorate – **partially** Quality of concession laws – **very high**	Capital adequacy ratio – **8 per cent** Deposit insurance system – **yes** Quality of securities market laws – **high** Private pension funds – **yes**	Share of population living in poverty – **7.8 per cent** (2003) Government expenditure on health – **4.9 per cent of GDP** (2004) Government expenditure on education – **5.2 per cent of GDP** (2005) Household expenditure on power and water – **3.8 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	10.6	11.1	12.7	13.3	13.7	na	na
Private sector share in GDP (in per cent)	70.0	75.0	75.0	75.0	75.0	75.0	75.0
Private sector share in employment (in per cent)	na	na	na	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	0.2	0.2	0.3	0.7	0.8	0.8	na
Share of industry in total employment (in per cent)	20.8	20.9	20.7	20.1	20.1	19.7	na
Change in labour productivity in industry (in per cent)[3]	19.9	0.2	14.1	13.0	5.1	10.4	na
Investment/GDP (in per cent)	20.6	22.0	22.9	24.2	25.0	28.0	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	3.3	3.7	3.7	3.7	4.0	4.0	4.0
EBRD index of enterprise reform	2.7	3.0	3.0	3.0	3.0	3.0	3.0
Markets and trade							
Share of administered prices in CPI (in per cent)	22.1	23.4	19.6	17.1	15.4	14.1	na
Number of goods with administered prices in EBRD-15 basket	1.0	1.0	1.0	1.0	1.0	1.0	na
Share of trade with non-transition countries (in per cent)	59.9	61.5	63.6	58.2	54.2	52.1	na
Share of trade in GDP (in per cent)	89.7	94.8	91.7	93.5	101.6	108.7	na
Tariff revenues (in per cent of imports)[4]	0.6	0.5	0.5	0.5	0.4	na	na
EBRD index of price liberalisation	4.0	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	3.0	3.0	3.0	3.0	3.3	3.3	3.3
Financial sector							
Number of banks (foreign-owned)	13 (6)	14 (7)	13 (7)	12 (6)	12 (6)	11 (6)	na
Asset share of state-owned banks (in per cent)	12.2	0.0	0.0	0.0	0.0	0.0	na
Asset share of foreign-owned banks (in per cent)	78.2	96.1	95.6	90.8	91.7	91.8	na
Non-performing loans (in per cent of total loans)	7.4	5.8	2.6	2.4	0.7	1.0	na
Domestic credit to private sector (in per cent of GDP)	11.4	13.9	20.2	25.7	34.9	47.7	na
Domestic credit to households (in per cent of GDP)	1.5	2.4	4.2	7.1	12.0	17.9	na
Of which mortgage lending (in per cent of GDP)	na	1.9	3.4	5.5	9.0	12.6	na
Stock market capitalisation (in per cent of GDP)	9.9	9.3	16.9	26.2	31.8	32.6	na
Stock trading volume (in per cent of market capitalisation)	14.8	15.1	17.5	8.2	10.1	23.3	na
Eurobond issuance (in per cent of GDP)	1.8	0.7	0.1	5.0	3.0	4.2	na
EBRD index of banking sector reform[5]	3.0	3.0	3.3	3.3	3.7	3.7	3.7
EBRD index of reform of non-bank financial institutions	3.0	3.0	3.0	3.0	3.0	3.0	3.3
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	33.0 (29.2)	26.9 (47.4)	23.9 (62.8)	23.8 (88.5)	23.4 (127.1)	23.2 (138.1)	na
Internet users (per 100 inhabitants)	7.2	14.4	20.1	22.3	25.8	31.7	na
Railway labour productivity (1989=100)	39.1	54.4	67.8	71.0	77.1	83.0	na
Residential electricity tariffs (USc kWh)	6.3	7.9	9.4	9.7	10.2	10.6	na
Average collection rate, electricity (in per cent)	91	90	91	97	99	99	na
GDP per unit of energy use (PPP in US dollars per kgoe)	4.1	4.2	4.3	4.6	na	na	na
EBRD index of infrastructure reform	2.7	2.7	2.7	2.7	2.7	3.0	3.0
Electric power	3.0	3.0	3.0	3.3	3.3	3.3	3.3
Railways	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Roads	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Telecommunications	3.3	3.3	3.3	3.3	3.3	3.7	3.7
Water and waste water	3.3	3.3	3.3	3.3	3.3	3.3	3.3

1 There are controls for national security, defence and lotteries.
2 There is full tradeability of non-agricultural land. Ownership of agricultural land, however, is constitutionally prohibited for foreigners and partially restricted for Lithuanian legal persons.
3 Data are based on the population census.
4 Refers to all taxes on foreign trade.
5 Series has been revised.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			(Percentage change in real terms)				
GDP	7.2	6.9	10.3	7.3	7.6	7.5	7.2
Private consumption	3.7	5.8	11.1	9.7	10.4	12.6	na
Public consumption	0.7	1.4	3.8	7.5	5.6	6.6	na
Gross fixed capital formation	13.5	8.7	11.4	12.3	11.2	12.7	na
Exports of goods and services	21.2	19.5	6.9	4.2	14.3	14.0	na
Imports of goods and services	17.6	17.7	10.3	14.8	15.9	16.0	na
Industrial gross output	15.9	4.6	15.8	9.6	7.8	10.4	na
Agricultural gross output	-5.0	7.9	7.7	-0.8	1.3	-7.2	na
Employment [1]			(Percentage change)				
Labour force (end-year)	-2.1	-0.3	0.7	-1.3	-0.9	-1.2	na
Employment (end-year)	-3.3	4.0	2.3	-0.1	2.6	1.7	na
			(In per cent of labour force)				
Unemployment (end-year)	17.4	13.8	12.4	11.4	8.3	5.6	na
Prices and wages			(Percentage change)				
Consumer prices (annual average)	1.5	0.3	-1.2	1.2	2.7	3.7	4.4
Consumer prices (end-year)	2.1	-1.0	-1.3	2.9	3.0	4.5	4.1
Producer prices (annual average)	-3.0	-2.8	-0.5	6.0	11.5	7.4	na
Producer prices (end-year)	-7.8	1.9	-0.2	6.8	13.5	2.8	na
Gross average monthly earnings in economy (annual average)	1.2	3.2	5.8	7.2	11.0	17.6	na
Government sector			(In per cent of GDP)				
General government balance	-2.0	-2.2	0.3	-0.4	0.9	-0.3	-0.5
General government expenditure [2]	31.0	31.4	30.9	32.3	32.5	32.9	na
General government debt	22.9	22.3	21.2	19.5	18.7	18.2	na
Monetary sector			(Percentage change)				
Broad money (M2, end-year)	21.4	16.9	18.2	24.1	32.9	23.8	na
Domestic credit (end-year)	25.6	22.7	37.8	32.0	56.1	34.9	na
			(In per cent of GDP)				
Broad money (M2, end-year)	26.1	28.6	30.9	34.9	40.7	43.7	na
Interest and exchange rates			(In per cent per annum, end-year)				
Interbank interest rate	5.5	10.0	4.3	3.0	3.3	4.5	na
Treasury bill rate (3-month maturity)	5.7	3.7	2.5	2.1	2.4	3.0	na
Deposit rate [3]	0.8	0.3	0.2	0.2	0.3	0.3	na
Lending rate [4]	8.1	6.1	5.1	5.6	5.6	5.5	na
			(Litai per US dollar)				
Exchange rate (end-year)	4.0	3.3	2.7	2.5	2.8	2.6	na
Exchange rate (annual average)	4.0	3.7	3.1	2.8	2.7	2.7	na
External sector			(In millions of US dollars)				
Current account	-573.7	-733.9	-1,278.5	-1,724.4	-1,829.5	-3,244.1	-4,410.0
Trade balance	-1,108.0	-1,336.8	-1,704.3	-2,382.3	-2,916.3	-4,168.9	-5,010.0
Merchandise exports	4,888.9	6,030.7	7,658.2	9,305.3	11,775.8	14,123.6	15,420.0
Merchandise imports	5,996.9	7,367.6	9,362.5	11,687.6	14,692.0	18,292.5	20,430.0
Foreign direct investment, net	438.7	714.5	142.0	510.4	689.0	1,585.0	1,000.0
Gross reserves, excluding gold (end-year)	1,669.2	2,412.8	3,449.7	3,594.0	3,815.5	5,772.6	na
External debt stock [5]	5,268.0	6,198.8	8,337.8	10,471.6	12,560.0	18,918.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	3.0	3.5	3.9	3.2	2.7	3.3	na
			(In per cent of exports of goods and services)				
Debt service	15.3	14.8	16.6	14.9	16.6	16.6	na
Memorandum items			(Denominations as indicated)				
Population (end-year, million)	3.5	3.5	3.5	3.4	3.4	3.4	na
GDP (in millions of litai)	48,562.9	51,948.4	56,771.9	62,440.2	71,083.9	81,973.6	91,742.2
GDP per capita (in US dollars)	3,478.4	4,067.9	5,360.0	6,518.1	7,602.8	8,770.8	na
Share of industry in GDP (in per cent)	27.3	26.4	28.3	29.4	30.2	na	na
Share of agriculture in GDP (in per cent)	6.3	6.3	5.8	5.3	5.2	4.8	na
Current account/GDP (in per cent)	-4.7	-5.2	-6.9	-7.7	-7.0	-10.9	-12.3
External debt - reserves (in US$ million)	3,598.8	3,786.0	4,888.1	6,877.6	8,744.5	13,145.4	na
External debt/GDP (in per cent)	43.4	43.8	44.9	46.6	48.2	63.4	na
External debt/exports of goods and services (in per cent)	87.1	82.5	87.4	89.1	84.4	106.6	na

1 Data based on the population census.
2 General government expenditure includes net lending.
3 Average interest rate on demand deposits in litai.
4 Average interest rate on loans in litai.
5 Includes non-resident currency and deposits and loans to foreign subsidiaries.

Moldova

Key challenges

- Strengthening the independence and authority of sectoral regulators would improve the business environment, encourage more entry and competition in the market and aid economic diversification.
- Deeper restructuring in the economy, particularly improving quality control in agriculture, diversifying wine export markets and restructuring the energy sector, would better exploit the country's comparative advantage.
- A prudent mix of fiscal and monetary policies, together with diversification of export opportunities, are required to protect against the macroeconomic vulnerabilities that are generated by excessive reliance on too few markets.

Country data	
Population (in millions)	3.4
Area ('000 sq km)	33.8
GDP (in billion US$, 2006)	3.4
GDP per capita in 2006 at current international US$ (PPP)	2,817
National currency	Leu

Progress in structural reform

Liberalisation and privatisation

The free trade agreement between Moldova and Romania, one of its key trading partners, was terminated after Romania acceded to the European Union (EU) in January 2007. At the same time, Romania started applying the EU Generalised System of Preferences Plus regime to exports from Moldova, under which most non-agricultural products have free access to the EU market under stringent rules of origin and quality certification. In practice this has meant that some Moldovan agricultural exports to Romania face additional barriers, but non-agricultural exports to the EU continue to expand. Moldova is expected to be granted access to the Autonomous Trade Preferences (ATP) regime of the EU, which would include easier access to EU markets for agricultural products and wine. However, improving the standards of products would allow Moldova to better exploit the benefits of the ATP regime.

Business environment and competition

Under the Law on Economic Liberalisation, which came into effect in April 2007, reinvested profits are exempt from corporate tax. The Law also introduces a tax and capital amnesty. Moldovan residents can register their undeclared capital for a nominal 5 per cent tax until the end of 2008. Under the tax amnesty some Lei 3.1 billion (US$ 250 million) worth of taxes and penalties due had already been written off by August 2007. However, there are concerns that the amnesty could affect tax discipline.

As corporate tax rates in Moldova are already low, improvements in the business environment – fair competition and less regulatory and bureaucratic interference – are needed in order to foster investment.

The competition authority was established in February 2007 when the head of the National Agency for the Protection of Competition (NAPC) was appointed by parliament. NAPC started operating two months later. The first decision, which was to designate Moldtelecom a dominant operator, was published in August 2007 and several investigations are under way.

Infrastructure

In late 2006 Gazprom, Moldovagaz and the Moldovan authorities signed a five-year agreement on Russian gas deliveries to Moldova, including a formula that would gradually bring prices in line with European levels. The price at which Moldova imports electricity from Ukraine has been increased from US$ 27 to US$ 30 per MWh with an agreement for further price increases of US$ 0.1 per kWh per month for the rest of 2007. These agreements are expected to provide more predictability over energy costs.

The electricity and gas regulator, ANRE, subsequently raised industry and household electricity and gas tariffs broadly in proportion to the changes in import tariffs. Part of the tariff increase for households is currently covered by central or local government operating subsidies, which provide support for socially vulnerable households. However, they also distort price signals and act as a disincentive to energy efficiency and efficient consumption. ANRE's regulatory review of tariff methodology for electricity during 2007 has highlighted the potential and need for further improvements in transparency and accountability. Parliament approved the postponement of energy sector liberalisation from 2007 until 2015. The Chisinau municipal council approved a long-delayed increase of tariffs for water and district heating, bringing them closer to cost recovery levels.

Financial sector

There have been significant changes to bank ownership over the past year. In January 2007 Société Générale of France acquired Mobiasbanca, one of the top five banks in Moldova, while Erste Bank of Austria now owns and operates Banca Comerciala Romana Chisinau since acquiring the Romanian parent bank in 2006. An independent evaluator for Banca de Economii was appointed in late 2006, a necessary step in the privatisation process. The entry of strategic investors has provided momentum for further consolidation in banking.

The legal framework for banking supervision was revised and improved. The National Bank of Moldova intervened and effectively coordinated the response to the crisis in the wine industry. Despite modest turbulence in 2006, the banking sector proved to be resilient; credit growth continued at a fast pace, particularly consumer credit.

Regulation in the non-bank financial sector remains weak. The regulatory authorities still lack the authority to suspend licences for market participants. Legal amendments to address this weakness and unify the regulation of non-bank financial entities are expected to take effect in 2008. In June 2007 parliament approved a bill on the previously unregulated savings and loans associations, which also provides for the establishment of a unified non-banking regulator.

Macroeconomic performance

Economic growth slowed to only 4 per cent in real terms during 2006. The import ban on Moldovan wine and agricultural products imposed by Russia coupled with the doubling of imported gas prices were the main causes of the economic slowdown. Preliminary estimates indicate a recovery of GDP growth to 7.3 per cent in the first quarter of 2007, with private consumption remaining the main driver. However, a severe drought in 2007 is expected to affect output from the agricultural and food processing industries.

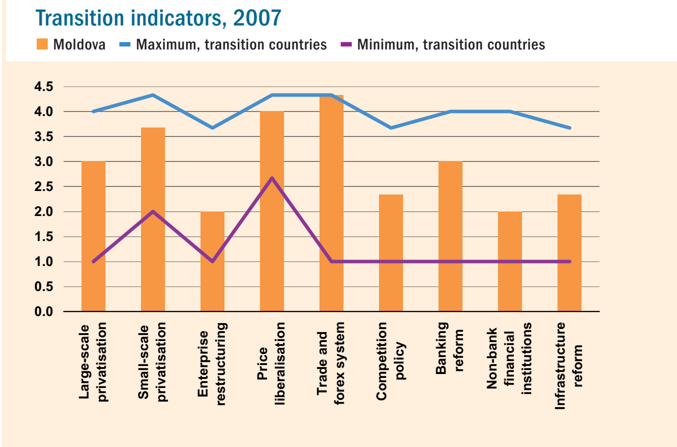
Legislation governing the central bank and monetary policy was amended to make price stability a more central policy objective. However, fast growth of the money supply, the sharp increase in energy prices and substantial inflows of remittances from workers abroad led to a surge in year-end inflation to 14 per cent in 2006. Monetary policy was tightened in early 2007 and had an immediate effect as the rate of inflation fell to 10 per cent by June 2007. Fiscal policy was prudent in 2006, with a modest deficit of 0.3 per cent of GDP. The target for the fiscal deficit in both 2007 and 2008 is 0.5 per cent of GDP.

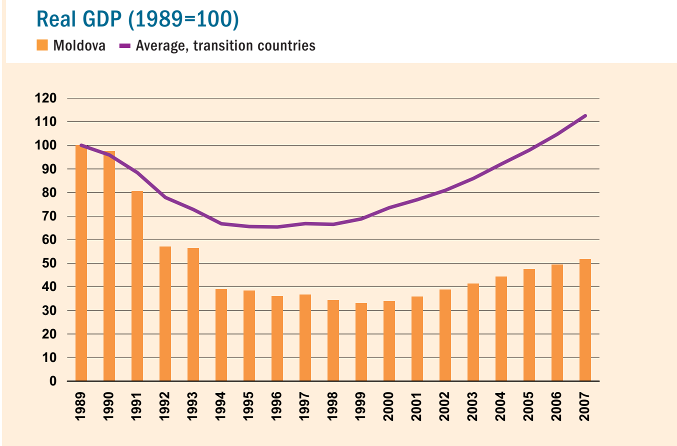
The external imbalances in the economy grew substantially in 2006. The trade deficit reached almost 50 per cent of GDP as exports declined by 3.6 per cent and imports surged by 17.5 per cent. Consequently the current account deficit rose to almost 12 per cent of GDP in 2006. The trade deficit continued to grow in nominal terms in the first half of 2007 and the current account deficit is expected to remain high. Remittances continue to provide a major source of support for the current account. Nevertheless, the Moldovan leu appreciated in the second half of 2006 and first half of 2007, reflecting substantial (recorded and unrecorded) inflows of remittances as well as FDI and external financing.

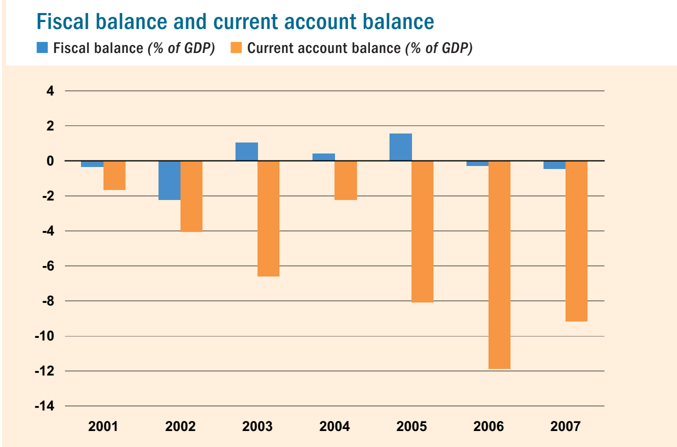
FDI provided some US$ 225 million of financing in 2006, the highest level ever achieved in Moldova. Following a restructuring agreement for the Paris Club debt in May 2006 the external public debt service eased significantly. Furthermore, in spite of negative external factors the central bank's foreign exchange reserves increased to US$ 775 million in 2006, almost three months of imports, and continued to increase in 2007.

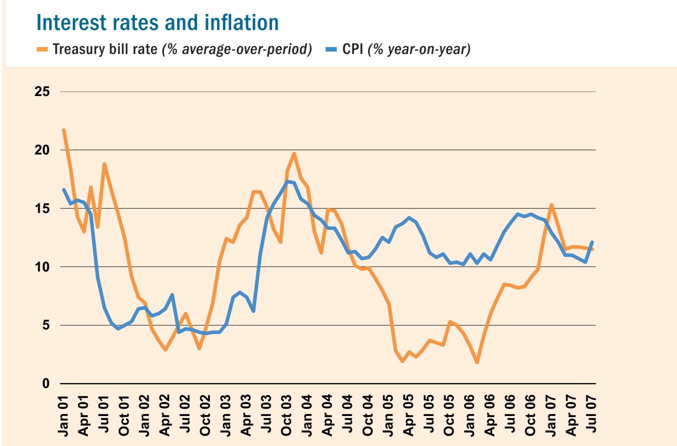
Outlook and risks

More expensive gas imports and the ban on wine and agricultural exports to Russia negatively affected the Moldovan economy, highlighting its heavy reliance on remittances and agriculture. Generous commitments to increase public sector wages, a tax break for reinvested profits as well as the need to partially absorb the energy price rises through subsidies will pose additional macroeconomic challenges. Economic growth in the short term will be further hindered by a poor harvest in 2007 due to a severe drought, delays in the resumption of wine and agricultural exports to Russia and difficulties with diversifying export markets. Long-term growth prospects depend on substantial productivity gains and further expansion of export-oriented production capacity. This in turn requires effective implementation of reforms and improvements in the business environment to promote domestic and foreign investment and the transfer of know-how.









Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no**

Interest rate liberalisation – **full**

Exchange rate regime – **managed float**

Wage regulation – **yes**

Tradeability of land – **full except foreigners**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **high**

Secured transactions law – **some defects**

Quality of corporate governance law – **high**

Infrastructure

Independent telecoms regulator – **partially**

Independent electricity regulator – **partially**

Separation of railway infrastructure from operations – **no**

Independence of the road directorate – **no**

Quality of concession laws – **medium**

Financial sector

Capital adequacy ratio – **12 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **low**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **29.1 per cent** (2005)

Government expenditure on health – **4.8 per cent of GDP** (2006)

Government expenditure on education – **8.2 per cent of GDP** (2006)

Household expenditure on power and water – **9.6 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	12.9	13.5	13.9	14.2	14.7	15.6	na
Private sector share in GDP (in per cent)	50.0	55.0	55.0	55.0	60.0	65.0	65.0
Private sector share in employment (in per cent)	na	na	60.0	60.0	60.0	60.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	na	na	na	na	na	na	na
Share of industry in total employment (in per cent)	11.0	11.4	12.1	12.4	12.0	12.8	na
Change in labour productivity in industry (in per cent)	14.3	6.8	20.4	9.9	10.7	-9.6	na
Investment/GDP (in per cent)	23.3	21.7	23.2	25.3	30.8	34.3	na
EBRD index of small-scale privatisation [1]	3.7	3.7	3.7	3.7	3.7	3.7	3.7
EBRD index of large-scale privatisation	3.0	3.0	3.0	3.0	3.0	3.0	3.0
EBRD index of enterprise reform	2.0	2.0	1.7	1.7	2.0	2.0	2.0
Markets and trade							
Share of administered prices in CPI (in per cent)	na	na	na	na	na	na	na
Number of goods with administered prices in EBRD-15 basket	8.0	7.0	7.0	7.0	4.0	9.0	na
Share of trade with non-transition countries (in per cent)	42.9	43.4	37.0	37.3	37.7	36.3	na
Share of trade in GDP (in per cent)	97.7	102.1	112.8	105.6	113.8	110.2	na
Tariff revenues (in per cent of imports)	2.1	2.4	2.4	2.3	2.4	2.4	na
EBRD index of price liberalisation	3.7	3.7	3.7	3.7	4.0	4.0	4.0
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.0	2.0	2.0	2.0	2.0	2.0	2.3
Financial sector							
Number of banks (foreign-owned)	19 (10)	16 (10)	16 (9)	16 (9)	16 (7)	15 (6)	na
Asset share of state-owned banks (in per cent)	10.2	13.4	15.5	17.6	19.3	15.3	na
Asset share of foreign-owned banks (in per cent)	34.9	36.7	35.2	33.6	19.6	22.9	na
Non-performing loans (in per cent of total loans)	10.4	7.6	6.4	6.9	5.3	4.4	na
Domestic credit to private sector (in per cent of GDP)	14.8	17.2	20.3	21.2	23.6	27.9	na
Domestic credit to households (in per cent of GDP)	0.5	0.5	0.6	0.9	2.1	2.9	na
Of which mortgage lending (in per cent of GDP)	0.7	0.9	1.0	1.1	1.5	2.6	na
Stock market capitalisation (in per cent of GDP)	24.0	24.3	24.4	22.3	na	na	na
Stock trading volume (in per cent of market capitalisation)	5.8	5.2	7.7	9.7	5.9	na	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	na
EBRD index of banking sector reform	2.3	2.3	2.3	2.7	2.7	2.7	3.0
EBRD index of reform of non-bank financial institutions	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	15.0 (5.3)	16.9 (8.0)	18.7 (11.3)	20.3 (18.5)	22.1 (25.9)	24.3 (32.4)	na
Internet users (per 100 inhabitants)	1.4	3.5	6.8	9.5	13.1	17.4	na
Railway labour productivity (1989=100)	23.3	28.2	29.5	31.0	31.4	40.0	na
Residential electricity tariffs (USc kWh)	5.2	5.0	5.1	6.1	6.0	5.7	na
Average collection rate, electricity (in per cent)	86	99	100	96	98	96	na
GDP per unit of energy use (PPP in US dollars per kgoe)	1.9	2.1	1.9	2.0	na	na	na
EBRD index of infrastructure reform	2.3	2.3	2.0	2.0	2.3	2.3	2.3
Electric power	3.3	3.3	3.0	3.0	3.0	3.0	3.0
Railways	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Roads	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Telecommunications	2.3	2.3	2.3	2.3	2.7	3.0	3.0
Water and waste water	2.0	2.0	2.0	2.0	2.0	2.0	2.0

[1] The series has been revised.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	6.1	7.8	6.6	7.3	7.1	4.0	5.0
Private consumption	6.1	5.9	18.5	6.2	10.1	7.0	na
Public consumption	-5.8	31.4	3.2	-16.2	6.3	5.3	na
Gross fixed capital formation	5.2	1.1	13.5	10.5	11.0	15.1	na
Exports of goods and services	15.7	18.9	19.2	11.0	17.7	2.8	na
Imports of goods and services	11.1	15.8	28.7	3.6	18.1	10.3	na
Industrial gross output	13.7	10.8	15.6	8.2	7.0	-6.9	na
Agricultural gross output	6.4	3.4	-13.6	20.8	0.8	-4.6	na
Employment			*(Percentage change)*				
Labour force (end-year)	-2.3	-0.1	-8.8	-3.3	-2.2	-2.5	na
Employment (end-year)	-1.0	0.4	-9.9	-3.4	-0.6	-3.5	na
			(In per cent of labour force)				
Unemployment (end-year) [1]	7.3	6.8	7.9	8.0	6.4	7.4	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	9.6	5.2	11.6	12.5	12.0	12.8	11.4
Consumer prices (end-year)	6.3	4.4	15.7	12.5	10.2	14.0	11.3
Producer prices (annual average)	12.3	4.7	7.8	5.6	5.3	12.2	na
Producer prices (end-year)	5.7	6.7	9.2	4.9	7.0	13.1	na
Gross average monthly earnings in economy (annual average)	33.3	27.2	28.8	23.8	19.5	28.7	na
Government sector			*(In per cent of GDP)*				
General government balance [2]	-0.3	-2.2	1.0	0.4	1.5	-0.3	-0.5
General government expenditure [2]	29.4	31.5	33.1	35.1	37.0	40.8	na
General government debt [3]	78.4	73.1	58.9	46.0	34.7	34.7	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	37.8	30.4	24.4	44.7	36.7	12.2	na
Domestic credit (end-year)	29.6	25.2	24.3	25.8	15.8	27.5	na
			(In per cent of GDP)				
Broad money (M2, end-year)	18.2	20.0	20.4	25.4	29.5	28.3	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	13.0	9.5	14.0	14.5	12.5	14.5	na
Interbank interest rate (up to 30-days maturity)	10.8	5.2	13.0	13.3	6.3	9.5	na
Deposit rate (1 year)	20.6	14.4	12.7	15.2	13.0	11.9	na
Lending rate (1 year)	28.5	23.1	19.2	21.0	18.9	18.2	na
			(Lei per US dollar)				
Exchange rate (end-year)	13.1	13.8	13.2	12.5	12.8	12.9	na
Exchange rate (annual average)	12.9	13.6	13.9	12.3	12.6	13.1	na
External sector			*(In millions of US dollars)*				
Current account	-24.6	-67.2	-130.4	-57.6	-241.4	-399.0	-382.0
Trade balance	-312.8	-378.2	-623.4	-754.2	-1,191.5	-1,590.9	-1,937.0
Merchandise exports	567.3	659.8	805.2	994.1	1,104.6	1,053.5	1,263.0
Merchandise imports	880.1	1,038.0	1,428.5	1,748.2	2,296.1	2,644.4	3,200.0
Foreign direct investment, net	101.8	132.0	71.0	145.7	198.9	223.0	300.0
Gross reserves, excluding gold (end-year)	228.5	268.9	302.3	470.3	597.4	775.3	na
External debt stock	1,675.1	1,814.9	1,924.5	1,897.8	2,080.5	2,482.1	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	2.5	2.5	2.1	2.7	2.6	3.0	na
			(In per cent of exports of goods and services)				
Debt service	13.4	13.8	12.2	10.2	5.8	6.4	11.0
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million) [4]	3.6	3.6	3.6	3.4	3.4	3.4	na
GDP (in millions of lei)	19,052.0	22,556.0	27,618.9	32,032.0	37,651.9	44,068.8	51,547.3
GDP per capita (in US dollars)	407.5	458.2	547.5	767.3	882.6	988.4	na
Share of industry in GDP (in per cent)	21.8	20.2	20.5	20.5	17.0	na	na
Share of agriculture in GDP (in per cent)	22.4	21.0	18.3	17.5	14.2	na	na
Current account/GDP (in per cent)	-1.7	-4.0	-6.6	-2.2	-8.1	-11.9	-9.2
External debt - reserves (in US$ million)	1,446.5	1,546.0	1,622.3	1,427.5	1,483.0	1,706.8	na
External debt/GDP (in per cent)	113.1	109.2	97.2	73.0	69.6	74.0	na
External debt/exports of goods and services (in per cent)	226.9	207.1	181.7	142.6	138.1	161.6	na

[1] According to ILO methodology.

[2] General government includes the state, local government, social security and health care funds.

[3] Includes public and publicly guaranteed debt.

[4] Excluding Transnistria.

Mongolia

Key challenges

- A sound and stable institutional framework is needed to attract more foreign investment to help develop the mining sector.
- There is considerable scope to further broaden the financial sector by introducing new products such as mortgage loans, health and other types of insurance.
- While tackling poverty remains a key challenge for the government, budgetary policy – including the fiscal management of mining revenues – must remain prudent and sustainable.

Country data

Population (in millions)	2.7
Area ('000 sq km)	1,567.0
GDP (in billion US$, 2006)	3.1
GDP per capita in 2006 at current international US$ (PPP)	2,273
National currency	Togrog

Progress in structural reform

Liberalisation and privatisation

The number of enterprises subject to privatisation has diminished in recent years. However, during 2006 the government privatised 14 large state-owned enterprises (SOEs), which raised a total of Togrog 32 billion (US$ 27 million), according to Mongolia's State Property Committee. Among these were the last state-owned bank to be privatised – the Savings Bank – which was sold to a consortium of Chinggis Khaan Bank, Russia's Bratsky Narodny Bank and Mongol Daatgal Insurance for US$ 20.1 million, and the country's largest cashmere producer, Gobi Cashmere, which was sold to a consortium of Japan's Toshisoke Investment Bank and HS Security for US$ 13.9 million. About 70 SOEs still remain but most of these are either financially unviable or the government intends to keep them under state control. Only four enterprises are scheduled for privatisation in 2007.

Business environment and competition

The investment agreement between the government and Canadian and UK-based mining companies Ivanhoe Mines and Rio Tinto to develop the Oyu Tolgoi copper and gold fields was concluded in principle in April 2007. However, it seems that parliamentary approval may take longer than envisaged. In September 2007 both companies expressed concerns over the delay in ratification, and indicated that first production from Oyu Tolgoi should be pushed back from 2009 to 2010. In any case, the agreement should pave the way for other large-scale mining projects in the country (providing the authorities ensure that the conditions under the agreement are fair) and attract other foreign investors. If successful, these developments in the mining sector will significantly enhance the economy's medium-term growth prospects.

The competition authority, established in early 2005, has strengthened its capacity and started functioning as an independent regulator. While it has identified 29 businesses as natural monopolies over the past 12 months, it has also intervened in 30 cases following allegations over the violation of dominant market positions and/or unfair business practices. These cases included an allegation about simultaneous increases of petrol prices by oil-importing companies and an investigation into alleged misleading advertisements by a mobile operator on mobile phone prices.

Financial sector

There have been further positive developments in the banking sector, including an increase in the minimum capital requirement to Togrog 8 billion (US$ 6.6 million) in March 2006 while the average capital adequacy ratio rose to 16 per cent in mid-2007. With strong economic growth, private sector credit has increased significantly, raising the ratio of private sector credit to GDP to 34 per cent.

The ratio of non-performing loans fell further to 4.3 per cent in May, down from an average of 5.7 per cent in 2006. Moreover, the spreads between deposit and lending rates have narrowed from 10 per cent two years ago to 5 per cent in early 2007. After the privatisation of the Savings Bank, all 16 banks are now in private hands. Ten of these, along with the Bank of Mongolia, have established the Mortgage Cooperation Company to securitise mortgage assets and increase liquidity. In January 2007 the Trade and Development Bank issued a eurobond for US$ 150 million, the first Mongolian entity to issue bonds on the international capital markets.

There have been fewer improvements in the non-bank financial sector. However, the Financial Regulatory Commission, which was established in 2005, has strengthened its functions. In each of its areas of responsibility a number of regulations and minimum requirements have been tightened, leading to a significant decline in the number of non-bank financial institutions.

Social sector

Mongolian living standards have improved in recent years, reflecting more favourable economic conditions. Per capita GDP increased from US$ 430 in 2000 to nearly US$ 1,200 in 2006. The child mortality rate has declined from 32.8 per 1,000 infants in 2000 to 19.1 in 2006, while life expectancy has risen to 67. The World Bank's Mongolia Poverty Assessment 2006 showed that alleviation of poverty in Mongolia has continued in recent years. The incidence of poverty declined from 36 per cent in 2002 to 32 per cent in 2006. However, disparities between urban and rural areas remain a problem – the incidence of poverty in rural areas was 38 per cent compared with 28 per cent in urban areas. Overall, according to the results of the EBRD/World Bank Life in Transition Survey, conducted in September 2006, Mongolian people remain dissatisfied with their current living standards, although there is widespread optimism about the future.

Macroeconomic performance

The economy continues to expand rapidly. Real GDP grew by 8.6 per cent during 2006, up from 7.3 per cent in 2005. The economy benefited from higher copper and gold prices and strong FDI. Disposable income has increased, partly because of a sharp rise in social benefits starting from 2007. This has contributed to a boom in the construction and service sectors.

Inflation has been reduced to single digits, partly thanks to favourable weather conditions (hence good agricultural production levels) and large tax cuts from January 2007. The central bank is switching gradually to using new monetary policy instruments and intends to further improve monetary policy through more transparency and better governance. The Mongolian currency appreciated against both the US dollar and Chinese renminbi during 2006 and 2007, which is due to a larger current account surplus and growing international reserves (to 4.6 months of imports).

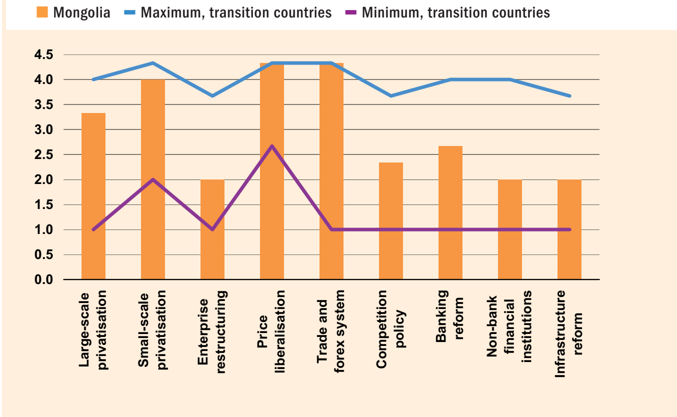
Public finances benefited from robust growth as well as the introduction of the windfall tax in 2006. Fiscal revenue grew by over 60 per cent during 2006 and by almost 37 per cent in the first half of 2007. The growth in revenues was despite a package of large tax cuts that took effect in January 2007. It reflects the likelihood that more businesses in the informal sector now pay corporate tax than before as tax rates became affordable. However, spending also rose in 2006 and 2007 with increases in social spending (including child allowances), public investment and public sector wages. The net result of these trends was a fiscal surplus of 8.1 per cent of GDP in 2006 and the budget remained in surplus during the first quarter of 2007.

Strong exports helped improve the balance of payments position during 2006. The current account surplus rose to US$ 176 million in 2006 (5.6 per cent of GDP) from US$ 29 million in 2005. The improvement was largely due to growing exports of copper and gold. Moreover, the services account, which is normally in deficit, contributed a small surplus because tourism benefited from celebrations for the 800th anniversary of the Mongolian empire. The value of exports rose by almost 37 per cent during the first half of 2007, but as imports grew more rapidly a small trade deficit was recorded.

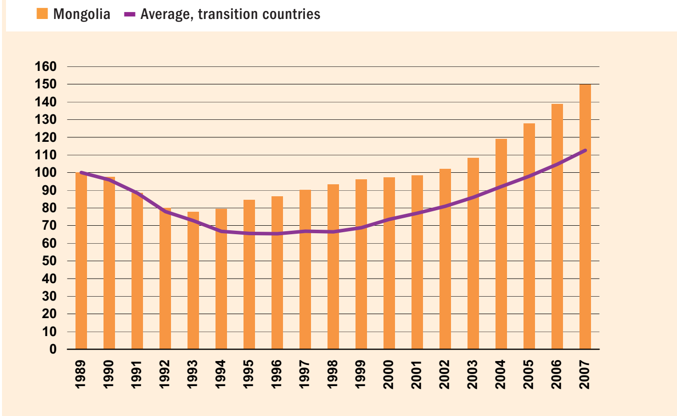
Outlook and risks

Despite solid economic growth in recent years poverty remains widespread and the economy is still vulnerable to variations in weather conditions and fluctuations in global commodity prices (especially for oil, metals and textiles). Continued growth depends largely on the progress in structural reforms and integration into the global economy. If these factors remain relatively stable, economic growth is expected to stay strong at 7 per cent per year over the medium term. When large-scale mining projects are completed and production is on-stream, double-digit growth could be achieved for a number of years.

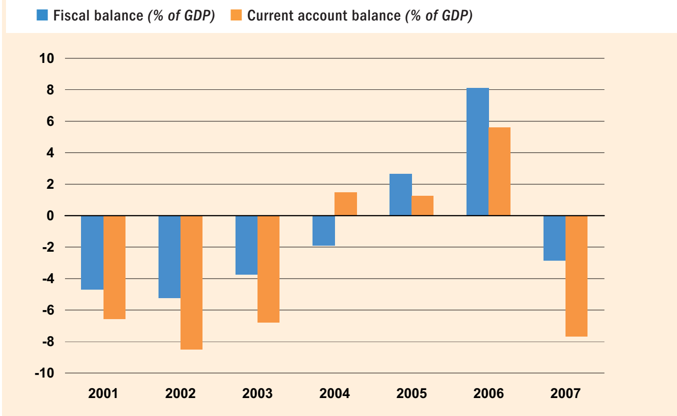
Transition indicators, 2007



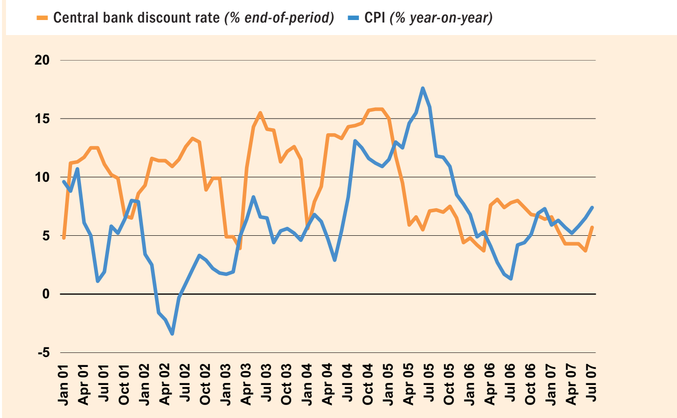
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no**

Interest rate liberalisation – **full**

Exchange rate regime – **managed float**

Wage regulation – **no**

Tradeability of land – **limited de facto**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **low**

Secured transactions law – **malfunctioning**

Quality of corporate governance law – **high**

Infrastructure

Independent telecoms regulator – **fully**

Independent electricity regulator – **partially**

Separation of railway infrastructure from operations – **no**

Independence of the road directorate – **no**

Quality of concession laws – **na**

Financial sector

Capital adequacy ratio – **17 per cent** (2006)

Deposit insurance system – **no**

Quality of securities market laws – **na**

Private pension funds – **no**

Social reform

Share of population living in poverty – **44.6 per cent** (2002)

Government expenditure on health – **3.0 per cent of GDP** (2006)

Government expenditure on education – **5.8 per cent of GDP** (2006)

Household expenditure on power and water – **9.4 per cent** [1]

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	7.2	7.5	8.2	8.9	9.1	9.5	na
Private sector share in GDP (in per cent)	60.0	65.0	70.0	70.0	70.0	70.0	75.0
Private sector share in employment (in per cent)	na	na	na	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	7.4	7.8	7.6	7.5	7.0	7.2	na
Share of industry in total employment (in per cent)	13.7	14.3	15.6	16.1	16.7	na	na
Change in labour productivity in industry (in per cent)	1.2	-7.5	-11.2	8.4	3.8	na	na
Investment/GDP (in per cent)	37.9	34.7	40.5	36.5	35.5	35.9	na
EBRD index of small-scale privatisation	3.7	3.7	4.0	4.0	4.0	4.0	4.0
EBRD index of large-scale privatisation	2.0	2.3	2.7	3.0	3.0	3.0	3.3
EBRD index of enterprise reform	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Markets and trade							
Share of administered prices in CPI (in per cent)	0.0	0.0	0.0	0.0	0.0	0.0	na
Number of goods with administered prices in EBRD-15 basket	0.0	0.0	0.0	0.0	0.0	0.0	na
Share of trade with non-transition countries (in per cent)	72.0	73.7	75.1	76.4	75.8	79.0	na
Share of trade in GDP (in per cent)	104.0	100.3	100.1	104.2	99.4	97.2	na
Tariff revenues (in per cent of imports)	3.5	2.9	3.5	3.7	3.9	4.0	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	1.7	1.7	1.7	1.7	2.0	2.0	2.3
Financial sector							
Number of banks (foreign-owned)	15 (0)	16 (2)	17 (4)	17 (4)	17 (4)	na	na
Asset share of state-owned banks (in per cent)	na	na	na	na	na	na	na
Asset share of foreign-owned banks (in per cent)	na	na	na	na	na	na	na
Non-performing loans (in per cent of total loans)	6.7	5.0	4.7	6.0	na	na	na
Domestic credit to private sector (in per cent of GDP)	11.0	16.6	26.6	28.4	30.6	33.6	na
Domestic credit to households (in per cent of GDP)	na	na	na	na	na	na	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	na	na
Stock market capitalisation (in per cent of GDP)	3.2	2.5	3.0	1.4	2.0	3.5	na
Stock trading volume (in per cent of market capitalisation)	4.3	3.5	2.2	2.3	6.1	13.8	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	na
EBRD index of banking sector reform	2.0	2.0	2.3	2.3	2.3	2.3	2.7
EBRD index of reform of non-bank financial institutions	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	5.2 (8.1)	5.3 (8.9)	5.6 (13.0)	5.6 (16.3)	5.9 (21.1)	5.9 (na)	na
Internet users (per 100 inhabitants)	1.7	2.1	5.8	7.6	10.1	10.1	na
Railway labour productivity (1989=100)	128.9	148.1	159.8	189.2	202.6	198.3	na
Residential electricity tariffs (USc kWh)	4.1	4.2	4.1	4.1	5.0	na	na
Average collection rate, electricity (in per cent)	na	na	na	na	na	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	na	na	na	na	na	na	na
EBRD index of infrastructure reform	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Electric power	1.7	2.3	2.3	2.3	2.7	2.7	2.7
Railways	2.0	2.0	2.0	2.3	2.3	2.3	2.3
Roads	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Telecommunications	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Water and waste water	2.0	2.0	2.0	2.0	2.0	2.0	2.0

[1] Estimate is for the poor households in Ulaanbaatar, based on UNDP's survey "Impact of Utility Charges on Poor Households".

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			(Percentage change in real terms)				
GDP	1.0	4.0	5.9	10.1	7.3	8.6	8.0
Industrial gross output	0.6	1.5	3.0	15.0	9.6	9.7	na
Agricultural gross output	1.0	5.0	3.7	17.7	7.7	9.1	na
Employment			(Percentage change)				
Labour force (end-year) [1]	2.9	3.3	6.4	2.7	1.5	2.0	na
Employment (end-year)	2.9	4.6	6.4	2.6	1.9	2.0	na
			(In per cent of labour force)				
Unemployment (end-year) [2]	4.6	3.4	3.5	3.6	3.3	3.3	na
Prices and wages			(Percentage change)				
Consumer prices (annual average)	8.0	0.3	5.1	8.3	12.7	5.1	5.3
Consumer prices (end-year)	8.0	1.7	4.7	11.0	9.5	6.0	5.0
Producer prices (annual average)	na	na	na	na	na	na	na
Producer prices (end-year)	na	na	na	na	na	na	na
Gross average monthly earnings in economy (annual average)	4.7	9.4	22.0	30.4	9.8	30.6	na
Government sector			(In per cent of GDP)				
General government balance [3]	-4.7	-5.2	-3.7	-1.9	2.6	8.1	-2.8
General government expenditure [3]	38.2	39.0	37.1	35.0	27.5	28.5	na
General government debt [4]	78.4	88.2	106.7	89.3	68.1	52.7	na
Monetary sector			(Percentage change)				
Broad money (M2, end-year)	27.9	42.0	49.6	20.5	37.2	30.8	na
Domestic credit (end-year)	6.1	25.2	160.8	19.9	35.9	-7.4	na
			(In per cent of GDP)				
Broad money (M2, end-year)	25.8	33.3	42.4	39.3	41.8	40.9	na
Interest and exchange rates			(In per cent per annum, end-year)				
Central bank bills rate	8.6	9.9	11.5	15.8	4.4	6.4	na
Deposit rate [5]	14.3	13.2	14.0	14.2	13.0	13.0	na
Lending rate [5]	30.2	28.4	26.3	25.4	23.6	21.4	na
			(Togrog per US dollar)				
Exchange rate (end-year)	1,101.3	1,122.2	1,168.3	1,211.8	1,221.0	1,165.0	na
Exchange rate (annual average)	1,097.6	1,108.5	1,142.7	1,185.2	1,205.2	1,179.7	na
External sector			(In millions of US dollars)				
Current account	-76.8	-108.0	-98.6	26.6	29.2	176.0	-283.0
Trade balance	-169.9	-228.8	-199.3	-149.1	-155.0	29.0	-319.0
Merchandise exports	523.2	524.0	627.3	872.0	1,069.0	1,545.0	1,963.0
Merchandise imports	693.1	752.8	826.6	1,021.1	1,224.0	1,516.0	2,282.0
Foreign direct investment, net	43.0	77.8	131.5	129.0	258.0	290.0	994.0
Gross reserves, excluding gold (end-year)	207.0	271.0	178.0	208.0	333.0	718.0	na
External debt stock	853.7	978.1	1,287.0	1,361.0	1,308.0	1,350.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	3.0	3.4	2.0	1.8	2.5	4.6	na
			(In per cent of exports of goods and services)				
Debt service	5.3	4.5	34.0	7.4	2.9	2.2	2.2
Memorandum items			(Denominations as indicated)				
Population (end-year, million)	2.5	2.6	2.6	2.6	2.6	2.7	na
GDP (in billions of togrog)	1,283.0	1,411.0	1,660.0	2,154.0	2,779.0	3,715.0	4,431.0
GDP per capita (in US dollars)	463.3	499.0	562.7	695.2	871.2	1,177.0	na
Share of industry in GDP (in per cent)	22.0	22.5	25.3	29.9	30.2	na	na
Share of agriculture in GDP (in per cent)	24.9	20.7	20.1	20.9	21.7	na	na
Current account/GDP (in per cent)	-6.6	-8.5	-6.8	1.5	1.3	5.6	-7.7
External debt - reserves (in US$ million)	646.7	707.1	1,109.0	1,153.0	975.0	632.0	na
External debt/GDP (in per cent)	73.0	76.8	88.6	74.9	56.7	42.9	na
External debt/exports of goods and services (in per cent)	134.1	138.0	154.1	112.6	88.1	66.5	na

[1] Economically active population registered at the employment registration office.

[2] Officially registered. According to the 2003 population census, the real unemployment rate was 17 per cent.

[3] General government revenue and expenditure include grants and net lending.

[4] Direct and assumed debt of the central government and loans guaranteed by the government.

[5] Weighted average over all maturities.

Montenegro

Key challenges

- Considerable liberalisation has already taken place but the government needs to continue fighting corruption and ease licensing restrictions. This will promote genuine competition and entrepreneurship and reduce barriers to doing legitimate business.
- Much of the country's infrastructure needs modernising and expanding. This should be supported by reforms such as labour shedding, reduced subsidies and more private sector involvement.
- The current high GDP growth rates, promoted by the surge in foreign investment, are not yet broad-based and the government needs to carefully manage the present fiscal surpluses to ensure long-term sustainability.

Country data

Population (in millions)	0.7
Area ('000 sq km)	13.8
GDP (in billion US$, 2006)	2.3
GDP per capita in 2006 at current international US$ (PPP)	na
National currency	Euro

Progress in structural reform

Liberalisation and privatisation

As a new state, Montenegro has made significant progress on integration into the European Union (EU) and other international structures. A Stabilisation and Association Agreement (SAA) with the EU was initialled on 16 March 2007 and, as at August 2007, is expected to be signed in October. Montenegro is also part of the enlarged and amended Central European Free Trade Agreement, which entered into force in July 2007. The trade regime is open, and negotiations on World Trade Organization (WTO) membership have advanced. The third meeting of the WTO working party took place in February 2007 and membership is expected in 2008.

Privatisation is well advanced. Over the past year one of the biggest sales was that of Nikšić steel mill, which had been effectively renationalised by the government in 2006. Four companies made bids for the 67 per cent stake on offer and the company was taken over in January 2007 by Resource Capital and Management, which pledged a substantial investment programme over the next few years. However, a number of large companies are yet to be sold. In July 2007, the government approved a privatisation programme for the rest of the year, but large state-owned enterprises in the energy, airport, post and wine-producing sectors were not included.

Business environment and competition

Montenegro's business environment is quite liberal, with more than 32,000 registered businesses (as of 1 February 2007) – a high number given the country's population, which reflects the relative ease of registration. The corporate tax rate, at 9 per cent, remains the lowest in the region and a flat personal income tax (set initially at 15 per cent) was introduced in the first quarter of 2007. However, the World Bank's Doing Business survey highlights Montenegro's relatively poor ranking on issues such as dealing with licences or enforcing contracts. In August 2007 the government established an autonomous competition authority, but members of this body will continue to be appointed by the relevant government ministry. Although some progress has been made, more effort is needed to ensure that competition law is implemented more effectively.

Infrastructure

Privatisation of the telecoms sector is complete and the government recently awarded a new mobile phone licence to a subsidiary of Telekom Srbija, which began providing services in July 2007. However, reforms in other infrastructure sectors, where the state remains dominant, have a long way to go. Privatisation of the power sector is at an early stage, with preparations under way to implement a pre-privatisation agreement associated with the unbundling of the state-owned power company, Elektroprivreda Crne Gore. A proposed tender for the sale of the thermal power plant in Pljevlja was cancelled in June 2007 because of disagreement within the ruling coalition. Montenegro has considerable, but relatively undeveloped, hydroelectric potential, and two hydro power plants are under reconstruction. Electricity prices for households were raised in July 2007 by 9.3 per cent as part of the ongoing tariff reform process.

Road and railway sector reforms have progressed slowly. Consultants have been chosen by international tender for the construction of two motorways but work is not expected to begin before 2010. There are two separate railway infrastructure and operating companies, and a rail regulator has been established. Both railway companies suffer from considerable overstaffing but the main short-term priority is to upgrade the tracks and improve safety.

Financial sector

Performance and supervision of the banking sector have improved significantly in recent years. At the end of 2006, 11 banks were operating in Montenegro (with one in liquidation and another in bankruptcy). All the banks have now been transferred to private hands and by the end of 2006 less than 5 per cent of bank capital belonged to state-owned companies. Credit and deposits have grown rapidly over the past 18 months, although from a fairly low base. In the year to May 2007 total credit rose by 163 per cent and bank deposits by 155 per cent.

In the non-bank financial sector there has been significant growth in turnover and capitalisation over the past year on the country's two stock markets – NEX Montenegro and Montenegroberza – although activity cooled in mid-2007. The exchanges had a combined market capitalisation of more than €8 billion by the end of April 2007 (equivalent to about 400 per cent of GDP), but the overall contribution of equity markets to economic development remains small. The leasing market has also expanded rapidly, with new financing of over €61 million in 2006.

Macroeconomic performance

The economy is enjoying its best period of growth and stability for many years. Real GDP rose by 6.5 per cent in 2006, driven by higher exports and the continued growth in tourism revenues, with the latter now accounting for about 15 per cent of GDP. The growth in exports mainly reflects high aluminium prices, which helped KAP, the country's main exporter, to return to profitability last year. There is currently a strong consumption boom, much of it associated with the surge in FDI (see below). These trends are continuing in 2007 and the economy is likely to grow by 6-7 per cent this year.

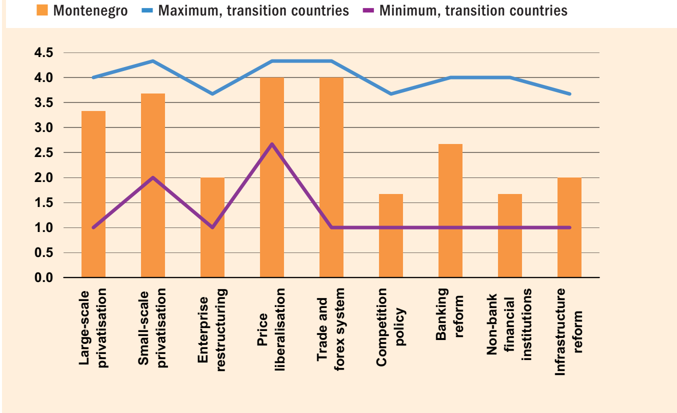
Inflation has been below 3 per cent in recent years, anchored by the country's unilateral adoption in 2000 of the deutschmark (and subsequently the euro in 2002) as sole legal tender. A consolidated budget surplus of around 3-4 per cent of GDP was recorded in 2006. This was mainly the result of strong revenue growth on the back of the buoyant economy, and increased efforts to register companies and bring them into the formal economy, supported by the government's prudent approach to spending. A further surplus is expected this year. However, the medium-term fiscal position depends partly on the extent of the government's obligations to pay restitution claims for property confiscated under the socialist regime, which some estimates place at over 50 per cent of GDP. In July 2007 the parliament approved a government proposal to limit the total liability to no more than 10 per cent of GDP (currently about €180 million) and to limit the payments in any one year to 0.5 per cent of GDP (around €9 million). However, this may be subject to challenges.

There has been a dramatic increase in FDI inflows in recent years. FDI exceeded €500 million in 2006 and is expected to increase further in 2007, to perhaps between €600 and €700 million. More than half of FDI in these years has been for greenfield investments, much of it associated with tourism. These investments have fuelled a construction boom that has in turn led to a surge in imports. The current account deficit jumped to nearly 30 per cent of GDP in 2006, but the overall balance of payments is in surplus.

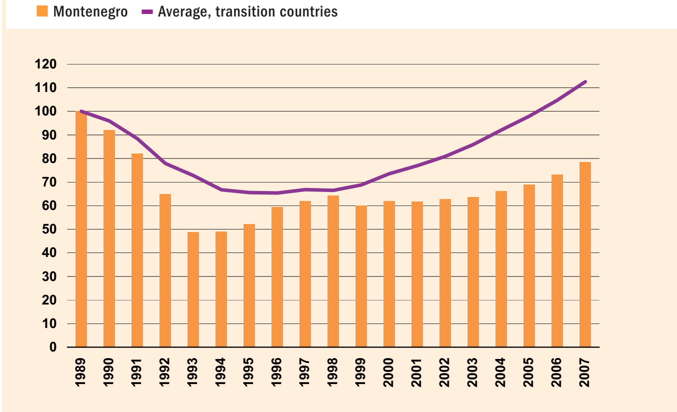
Outlook and risks

While the headline figures on growth, inflation and the fiscal accounts are impressive, the economic base is rather narrow and the economy remains vulnerable over the short to medium term. The economy depends heavily on the performance of two sectors – metals (aluminium and steel) and tourism. The metals sector is subject to swings in commodity prices on world markets, while tourism is vulnerable to possible regional spillovers from conflict, or the perception of potential conflict in Kosovo. There are also some concerns that the growth of tourism is not matched by corresponding progress in the quality of infrastructure and services, as evidenced by frequent water and electricity shortages. A further risk is the possibility that the government will face large domestic liabilities if the Constitutional Court upholds restitution claims.

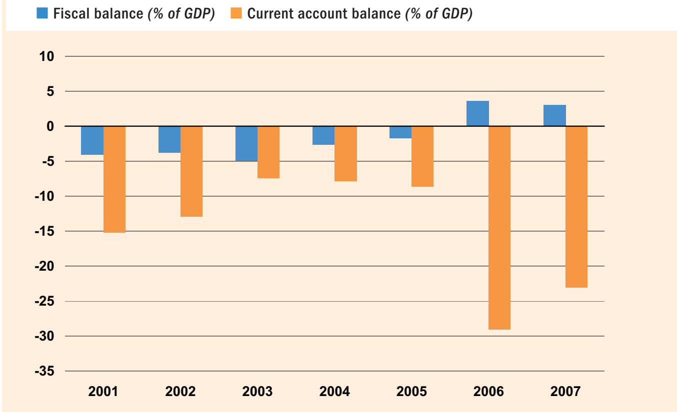
Transition indicators, 2007



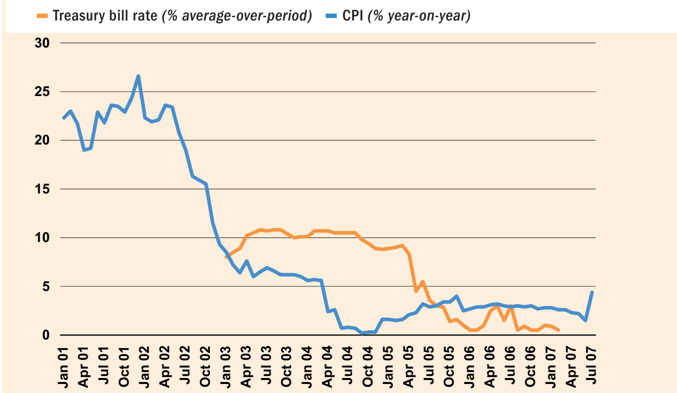
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Short-term treasury bill rate data were not available for 2001–03.

Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full** Controls on inward direct investment – **no** Interest rate liberalisation – **full** Exchange rate regime – **unilateral euroisation** Wage regulation – **no** Tradeability of land – **limited de jure**	Competition office – **yes** Quality of insolvency law – **high** Secured transactions law – **some defects** Quality of corporate governance law – **na**	Independent telecoms regulator – **fully** Independent electricity regulator – **partially** Separation of railway infrastructure from operations – **fully** Independence of the road directorate – **partially** Quality of concession laws – **medium**	Capital adequacy ratio – **8 per cent** Deposit insurance system – **yes** Quality of securities market laws – **medium** Private pension funds – **no**	Share of population living in poverty – **na** Government expenditure on health – **6.4 per cent of GDP** (2006) Government expenditure on education – **5.4 per cent of GDP** (2004) Household expenditure on power and water – **na**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	na	na	na	na	na	na	na
Private sector share in GDP (in per cent)	50.0	55.0	55.0	55.0	65.0	65.0	65.0
Private sector share in employment (in per cent)	na	na	na	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	na	na	na	na	na	na	na
Share of industry in total employment (in per cent)	na	na	na	na	na	na	na
Change in labour productivity in industry (in per cent)	na	na	na	na	na	na	na
Investment/GDP (in per cent)	na	na	na	na	na	na	na
EBRD index of small-scale privatisation [1]	2.0	3.0	3.3	3.3	3.7	3.7	3.7
EBRD index of large-scale privatisation	1.7	2.7	2.7	2.7	3.3	3.3	3.3
EBRD index of enterprise reform	1.0	1.7	1.7	2.0	2.0	2.0	2.0
Markets and trade							
Share of administered prices in CPI (in per cent)	na	na	na	na	na	na	na
Number of goods with administered prices in EBRD-15 basket	na	na	na	na	na	na	na
Share of trade with non-transition countries (in per cent)	na	na	na	na	na	na	na
Share of trade in GDP (in per cent)	77.0	82.5	64.7	86.1	83.7	106.3	na
Tariff revenues (in per cent of imports)	na	na	na	na	na	na	na
EBRD index of price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of forex and trade liberalisation [1]	2.7	3.0	3.0	3.0	3.7	3.7	4.0
EBRD index of competition policy	1.0	1.0	1.0	1.0	1.0	1.0	1.7
Financial sector							
Number of banks (foreign-owned)	na	10 (3)	10 (3)	10 (3)	10 (7)	10 (8)	na
Asset share of state-owned banks (in per cent)	na	23.8	19.2	16.4	5.1	0.0	na
Asset share of foreign-owned banks (in per cent)	na	16.9	23.5	31.0	87.7	91.9	na
Non-performing loans (in per cent of total loans)	na	16.5	8.3	8.7	6.7	3.4	na
Domestic credit to private sector (in per cent of GDP)	na	8.3	12.2	15.9	19.8	43.3	na
Domestic credit to households (in per cent of GDP)	na	1.7	3.6	4.8	6.4	17.3	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	na	na
Stock market capitalisation (in per cent of GDP)	na	na	na	na	na	na	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	na	na	na	na
Eurobond issuance (in per cent of GDP)	na	na	na	na	na	na	na
EBRD index of banking sector reform	1.7	2.0	2.0	2.3	2.3	2.7	2.7
EBRD index of reform of non-bank financial institutions	1.0	1.7	1.7	1.7	1.7	1.7	1.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	na	na	na	na	na	3.4 (7.8)	na
Internet users (per 100 inhabitants)	na	na	na	na	na	2.5	na
Railway labour productivity (1989=100)	na	na	na	na	na	na	na
Residential electricity tariffs (USc kWh)	na	na	na	6.0	5.9	na	na
Average collection rate, electricity (in per cent)	na	na	na	na	na	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	na	na	na	na	na	na	na
EBRD index of infrastructure reform	1.3	1.3	1.7	1.7	2.0	2.0	2.0
Electric power	1.0	1.0	1.7	2.0	2.3	2.3	2.3
Railways	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Roads	1.7	1.7	1.7	2.0	2.0	2.0	2.0
Telecommunications	2.3	2.3	2.3	2.7	3.0	3.0	3.3
Water and waste water	2.0	2.0	2.0	2.0	2.0	2.0	2.0

[1] The series has been revised.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	-0.2	1.7	1.5	3.7	4.1	6.5	7.0
Industrial gross output	-2.0	0.7	2.2	13.8	-1.9	1.1	na
Agricultural gross output	na	na	na	na	na	na	na
Employment			*(Percentage change)*				
Labour force (end-year)	-1.3	-0.5	-2.7	-3.3	-4.8	0.0	na
Employment (end-year)	0.0	-0.7	2.1	0.0	0.7	10.4	na
			(In per cent of labour force)				
Unemployment (end-year)	36.5	36.7	33.5	31.3	27.3	19.7	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	22.6	18.2	6.7	2.2	2.6	3.0	3.0
Consumer prices (end-year)	26.6	9.3	6.0	1.6	2.5	2.8	3.0
Producer prices (annual average)	14.5	4.6	2.9	5.8	2.1	na	na
Gross average monthly earnings in economy (annual average)	16.8	30.5	17.8	12.2	7.6	15.3	na
Government sector			*(In per cent of GDP)*				
General government balance	-4.0	-3.8	-4.9	-2.6	-1.7	3.6	3.0
General government expenditure	39.9	37.3	45.6	43.3	42.0	41.9	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	na	na	na	16.3	49.6	87.4	na
Domestic credit (end-year)	na	na	na	42.4	10.6	135.9	na
			(In per cent of GDP)				
Broad money (M2, end-year)	na	na	33.1	34.9	48.8	83.5	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Discount rate	na	na	na	na	na	na	na
Money market rate	na	na	na	na	na	na	na
Deposit rate	na	5.2	4.9	4.8	5.0	5.4	na
Lending rate (long-term)	na	na	na	na	12.1	9.9	na
			(Euros per US dollar)				
Exchange rate (official, end-year)	1.1	1.0	0.8	0.7	0.8	0.8	na
Exchange rate (official, annual average)	1.1	1.1	0.9	0.8	0.8	0.8	na
External sector			*(In millions of US dollars)*				
Current account	-169.0	-158.0	-116.3	-149.0	-179.6	-657.0	-608.3
Trade balance	-436.0	-402.0	-405.3	-517.9	-640.0	-1,197.1	-1,290.7
Merchandise exports	211.0	305.0	305.9	561.4	548.9	602.9	709.3
Merchandise imports	647.0	707.0	711.2	1,079.3	1,188.9	1,800.0	2,000.0
Foreign direct investment, net	10.0	84.0	44.0	63.3	474.3	650.0	750.0
Gross reserves, excluding gold (end-year)	na	na	56.4	74.5	218.8	251.2	na
External debt stock	na	700.0	na	na	822.1	866.7	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	na	na	0.8	0.7	1.9	1.5	na
			(In per cent of exports of goods and services)				
Debt service	na	4.2	4.8	3.4	2.9	3.0	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	0.7	0.7	0.7	0.7	0.7	0.7	na
GDP (in millions of euros)	1,245.0	1,302.0	1,392.0	1,535.0	1,642.0	1,800.0	1,970.0
GDP per capita (in US dollars)	1,688.1	1,857.5	2,381.0	2,888.7	3,146.8	3,425.6	na
Share of industry in GDP (in per cent)	na	na	na	na	na	na	na
Share of agriculture in GDP (in per cent)	na	na	na	na	na	na	na
Current account/GDP (in per cent)	-15.2	-12.9	-7.4	-7.8	-8.6	-29.1	-23.0
External debt - reserves (in US$ million)	na	na	na	na	603.3	615.5	na
External debt/GDP (in per cent)	na	57.1	na	na	39.6	38.3	na
External debt/exports of goods and services (in per cent)	na	148.6	na	na	86.7	80.2	na

Poland

Key challenges

- Privatisation and public-private partnerships need to be accelerated to reduce state interference in the economy and to increase the efficiency and competitiveness of enterprises.
- The independent and professional structure of financial regulation should remain free from state interference to support the development of the rapidly growing financial sector.
- The authorities should take advantage of the current favourable macroeconomic conditions and reform public finances – especially through better management of spending and curtailing some social benefits – to ensure their sustainability over the economic cycle.

Country data	
Population (in millions)	38.1
Area (‘000 sq km)	313.9
GDP (in billion US$, 2006)	340.9
GDP per capita in 2006 at current international US$ (PPP)	15,436
National currency	Zloty

Progress in structural reform

Liberalisation and privatisation

Privatisation came to a near standstill in 2006 following the parliamentary elections in autumn 2005. Gross privatisation revenues in 2006 were around Zl 620 million (US$ 200 million), the lowest since the early 1990s, equivalent to 11 per cent of the planned amount. In the first half of 2007 privatisation revenues reached Zl 1 billion, about a third of the targeted amount. The largest privatisation-related transactions over the past year included dilution of the government’s ownership in the press distribution company Ruch through a capital increase on the Warsaw Stock Exchange (WSE), and the sale of the government’s 85 per cent stake in the combined heat and power plant in Bydgoszcz in early 2007.

Despite more than a decade of privatisation, the government still owns around 1,300 enterprises, holding large stakes in oil, gas, power, coal, chemicals, ship building and transport. It also controls the country’s biggest lender, PKO Bank Polski, and insurance group PZU. The government also recently prepared a lengthy list of “strategic” enterprises in which it intends to retain control in the medium term.

Infrastructure

Most infrastructure assets remain under state control. However, some municipalities in need of cash to co-invest in EU projects have expressed interest in involving private companies in some areas. For example, in December 2006 the city of Krakow agreed the construction of a large underground car park through a build-operate-transfer contract with private investors.

The private provision of rail services has grown, with the share of private transport providers in the rail freight market reaching some 20 per cent in the first half of 2007. In June 2007 the first tender was awarded to a private train company to provide passenger railway transportation. The company is expected to start services in the Kujawsko-Pomorski region later this year. However, private participation in major investment projects suffered a set-back when in February 2007 the government decided to cancel the A1 motorway concession held by the Gdansk Transport Company. Construction of motorways remains slow, creating bottlenecks in the country’s infrastructure system.

Reforms in the energy sector were impeded in May 2007 when the government consolidated some of the state-owned coal mines, electricity generation, distribution and supply companies into four vertically integrated energy groups. The move was explained by the need to create financially strong, domestically controlled enterprises capable of implementing large-scale investment programmes. Nevertheless, it reversed sector unbundling and there are concerns it could threaten competition in energy supply in the now fully liberalised market.

Financial sector

The WSE remains a leader in the IPO market in central eastern Europe and the Baltic states. Around 40 new companies were listed on the WSE in the first seven months of the year, raising more than Zl 13.7 billion in new share capital. In addition, by providing an exit opportunity for private equity investors, the WSE helped attract further funds to this sector, as exemplified by the €658 million raised by private equity managers Enterprise Investors in autumn 2006.

In the insurance sector, the dispute between the government and the Dutch registered company, Eureko, over the transfer of the remaining state shares of insurance entity PZU has yet to be resolved. PZU still controls around 50 per cent of the insurance market despite growing competition from private providers.

The asset management industry has grown rapidly, with assets of mutual funds exceeding Zl 140 billion in July 2007, driven by low interest rates and high returns on the WSE. The portfolios of pension funds continue to be dominated by government bonds and shares of large companies listed on the WSE, accounting for 58 and 36 per cent respectively of the Zl 137 billion held by the 14 funds in July this year. The growth of bank credit remained strong, especially residential mortgages.

The new centralised financial sector regulator, the Financial Supervisory Committee (FSC), has gradually taken over the responsibility for supervising institutions in the capital markets, including insurance companies and pension funds, but the central bank is expected to retain responsibility for banking regulation in the medium term. The delay in transferring banking supervision to the FSC has been justified by the need to maintain strong prudential regulation. Nevertheless, it raised some questions about the government’s willingness to allocate all key responsibilities for financial regulation to a single, independent body.

Macroeconomic performance

Real GDP growth accelerated to 6.1 per cent in 2006, and to 7.4 per cent and 6.7 per cent in the first and second quarters of 2007, respectively, driven by strong domestic demand. Investment rose by 14.1 per cent in 2006 and a remarkable 29.6 per cent year-on-year in the first quarter of 2007, supported by inflows of EU funds and FDI, which reached €15.2 billion in 2006. Consumption also strengthened on the back of higher employment, rising wages and remittances from Polish workers abroad. Domestic demand was driven by strong credit expansion while exports benefited from continued growth in the eurozone. On the supply side, growth in construction was particularly strong at 40 per cent year-on-year in the first quarter of 2007 although it slowed to 17.7 per cent in the second quarter.

Inflation has been on an upward trend in 2007, reflecting strong growth and wage increases, although it dropped unexpectedly to 1.5 per cent in August 2007. Nevertheless, to contain inflationary pressures, the Monetary Policy Council of the central bank increased the policy rate in three moves this year to 4.75 per cent in August 2007.

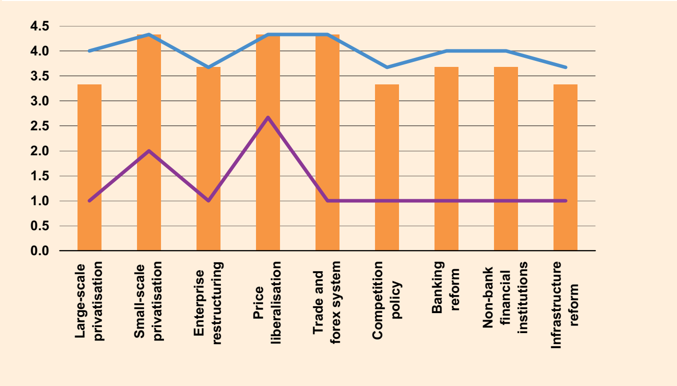
The general government deficit (including the full costs of pension reforms) fell to an estimated 3.9 per cent of GDP in 2006, the lowest outturn since 2000, and is expected to decline further in 2007 owing to buoyant tax revenues. Disability pension contributions were cut by three percentage points on 1 July 2007 and will be further reduced by four percentage points in 2008. There has been little progress in implementing reforms to reduce public expenditure. Public debt stabilised at around 48 per cent of GDP in 2006.

The external position remains balanced, supported by the flexible exchange rate arrangements. During 2006 imports grew slightly faster than exports, resulting in a widening trade deficit, which increased from 0.9 to 2.1 per cent of GDP between 2005 and 2006. Coupled with a deteriorating income balance caused by the increased outflows in investment income, this led to a higher current account deficit, which nevertheless remained moderate at 3.3 per cent of GDP in 2006.

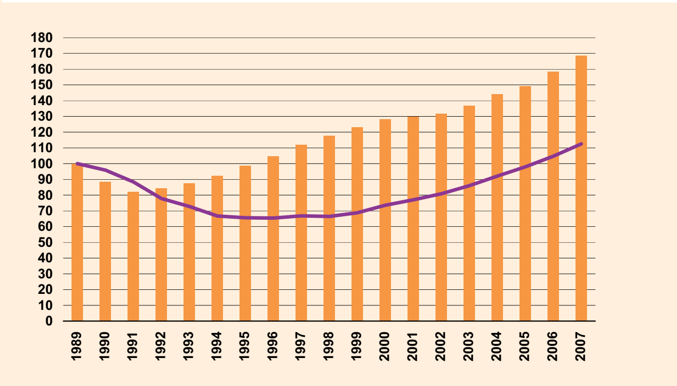
Outlook and risks

Growth has gained momentum and is expected to remain strong in the short term. Increasing demand for labour may result in greater wage and inflationary pressures. The political situation continues to be a key source of uncertainty in the near term. The lack of consistent fiscal reforms represents a risk to the medium-term outlook. Although a recent upturn in revenues has led to improved budget outcomes, the underlying structural weaknesses in public finances remain and will become more apparent should growth slow down. In this context, the approved cuts in contribution rates for social security – a welcome step in reducing the tax burden and improving labour market performance – need to be complemented with measures leading to better targeted and more flexible public spending. This would ensure fiscal sustainability and stronger incentives to increase labour participation in the medium term. Euro adoption will remain an objective, albeit a long-term one.

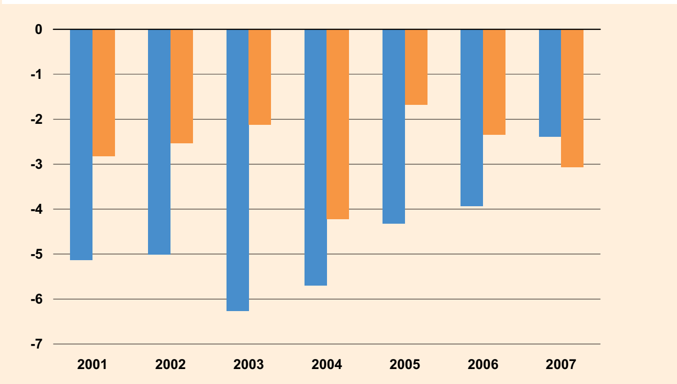
Transition indicators, 2007



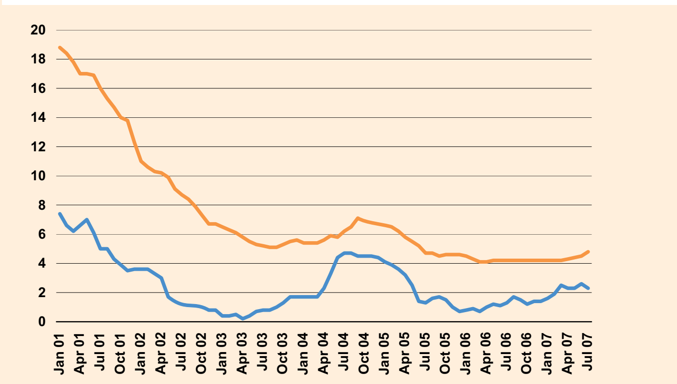
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full** Controls on inward direct investment – **no** Interest rate liberalisation – **full** Exchange rate regime – **floating** Wage regulation – **no** Tradeability of land – **full except foreigners**	Competition office – **yes** Quality of insolvency law – **medium** Secured transactions law – **inefficient** Quality of corporate governance law – **high**	Independent telecoms regulator – **fully** Independent electricity regulator – **fully** Separation of railway infrastructure from operations – **fully** Independence of the road directorate – **partially** Quality of concession laws – **na**[1]	Capital adequacy ratio – **8 per cent** Deposit insurance system – **yes** Quality of securities market laws – **high** Private pension funds – **yes**	Share of population living in poverty – **<2.0 per cent** (2002) Government expenditure on health – **4.2 per cent of GDP** (2004) Government expenditure on education – **5.6 per cent of GDP** (2005) Household expenditure on power and water – **9.6 per cent**[2]

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	11.6	11.9	12.4	13.5	13.9	14.0	na
Private sector share in GDP (in per cent)	75.0	75.0	75.0	75.0	75.0	75.0	75.0
Private sector share in employment (in per cent)	67.9	66.8	68.5	70.6	70.7	73.2	na
Budgetary subsidies and current transfers (in per cent of GDP)	0.4	0.4	0.3	0.6	0.6	0.8	na
Share of industry in total employment (in per cent)	29.7	28.3	28.6	28.9	29.1	31.1	na
Change in labour productivity in industry (in per cent)	5.6	7.0	7.5	7.1	0.2	1.5	na
Investment/GDP (in per cent)	20.8	18.6	18.7	20.1	19.3	20.6	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	3.3	3.3	3.3	3.3	3.3	3.3	3.3
EBRD index of enterprise reform	3.3	3.3	3.3	3.3	3.7	3.7	3.7
Markets and trade							
Share of administered prices in CPI (in per cent)	1.2	1.0	1.0	1.0	1.2	1.0	na
Number of goods with administered prices in EBRD-15 basket	1.0	1.0	1.0	1.0	1.0	1.0	na
Share of trade with non-transition countries (in per cent)	80.9	81.3	81.7	79.9	78.1	78.0	na
Share of trade in GDP (in per cent)	47.8	50.8	58.9	66.9	64.3	70.3	na
Tariff revenues (in per cent of imports)	2.4	1.7	1.7	0.9	0.4	na	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	3.0	3.0	3.0	3.0	3.3	3.3	3.3
Financial sector							
Number of banks (foreign-owned)	69 (46)	59 (45)	58 (46)	57 (44)	61 (50)	64 (53)	na
Asset share of state-owned banks (in per cent)	24.4	26.6	25.8	21.7	21.5	21.1	na
Asset share of foreign-owned banks (in per cent)	72.2	70.7	71.5	71.3	74.3	74.3	na
Non-performing loans (in per cent of total loans)	20.5	24.7	25.1	17.6	12.9	8.3	na
Domestic credit to private sector (in per cent of GDP)	28.0	28.2	29.2	27.5	29.2	33.4	na
Domestic credit to households (in per cent of GDP)	na	9.4	10.3	10.6	12.4	15.6	na
Of which mortgage lending (in per cent of GDP)	na	2.4	3.4	3.8	5.0	7.2	na
Stock market capitalisation (in per cent of GDP)[3]	13.2	13.6	16.5	23.0	31.1	41.0	na
Stock trading volume (in per cent of market capitalisation)	26.1	28.7	26.6	33.1	36.3	46.2	na
Eurobond issuance (in per cent of GDP)	1.4	11.2	0.7	1.7	4.0	1.4	na
EBRD index of banking sector reform	3.3	3.3	3.3	3.3	3.7	3.7	3.7
EBRD index of reform of non-bank financial institutions	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	29.5 (25.9)	30.7 (36.0)	31.9 (45.1)	32.6 (59.9)	30.6 (75.7)	29.8 (95.5)	na
Internet users (per 100 inhabitants)	9.8	23.0	23.2	23.4	26.0	28.6	na
Railway labour productivity (1989=100)	86.7	99.9	101.3	103.3	98.8	102.4	na
Residential electricity tariffs (USc kWh)	6.5	7.0	7.7	8.5	9.9	10.8	na
Average collection rate, electricity (in per cent)	na	90	na	na	na	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	4.4	4.6	4.6	5.1	na	na	na
EBRD index of infrastructure reform	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Electric power	3.0	3.3	3.3	3.3	3.3	3.3	3.3
Railways	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Roads	3.3	3.3	3.0	3.0	3.0	3.0	3.0
Telecommunications	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Water and waste water	3.3	3.3	3.3	3.3	3.3	3.3	3.3

[1] Poland has no specific concession law but partly conforms with internationally accepted principles on concession law.

[2] Estimate based on the poorest 20 per cent of households (lowest income quintile).

[3] Excluding listings by foreign companies.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	1.2	1.4	3.9	5.3	3.6	6.1	6.5
Private consumption	2.3	3.4	1.9	4.3	2.0	5.1	na
Public consumption	2.7	1.4	4.9	3.1	5.2	3.9	na
Gross fixed capital formation	-9.7	-7.2	-0.1	6.4	6.5	16.5	na
Exports of goods and services	3.1	4.8	14.2	14.0	8.0	14.5	na
Imports of goods and services	-5.3	2.7	9.3	15.2	4.7	15.8	na
Industrial gross output	-0.8	-0.5	7.8	10.5	3.5	9.2	na
Agricultural gross output	6.6	1.0	2.7	6.8	-1.0	6.7	na
Employment			*(Percentage change)*				
Labour force (end-year)	-0.6	-1.1	-3.4	0.2	1.0	-4.4	na
Employment (end-year)	-3.5	-2.4	-0.7	2.0	2.7	0.9	na
			(In per cent of labour force)				
Unemployment (end-year) [1]	18.9	20.0	19.6	18.2	16.9	12.3	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	5.5	1.9	0.8	3.5	2.1	1.0	2.4
Consumer prices (end-year)	3.6	0.8	1.7	4.4	0.7	1.4	2.8
Producer prices (annual average)	1.7	1.2	2.7	7.1	0.7	2.2	na
Producer prices (end-year)	-0.3	2.3	3.7	5.4	0.2	2.4	na
Gross average monthly earnings in economy (annual average)	7.2	3.5	3.2	4.0	4.0	4.1	na
Government sector [2]			*(In per cent of GDP)*				
General government balance	-5.1	-5.0	-6.3	-5.7	-4.3	-3.9	-2.4
General government expenditure	43.7	44.2	44.6	42.5	43.3	43.3	na
General government debt	37.6	42.2	47.1	45.7	47.1	47.8	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	9.7	-1.6	5.7	7.5	12.6	15.9	na
Domestic credit (end-year) [3]	11.7	2.3	7.6	2.1	8.6	21.2	na
			(In per cent of GDP)				
Broad money (M2, end-year)	42.3	40.1	40.7	39.9	42.2	45.5	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Rate on 28-day open market operations [4]	11.5	6.8	5.3	6.5	4.5	4.0	na
3-months WIBOR	12.3	6.7	5.6	6.7	4.6	4.2	na
Deposit rate [5]	8.0	4.2	2.9	3.7	3.4	3.1	na
Lending rate [5]	16.8	11.6	9.6	10.3	7.6	7.2	na
			(Zlotys per US dollar)				
Exchange rate (end-year)	4.0	3.9	3.8	3.0	3.3	2.9	na
Exchange rate (annual average)	4.1	4.1	3.9	3.7	3.2	3.1	na
External sector			*(In millions of US dollars)*				
Current account	-5,376.0	-5,009.0	-4,599.0	-10,693.0	-4,775.0	-11,084.0	-12,500.0
Trade balance	-7,661.0	-7,249.0	-5,725.0	-5,622.0	-2,766.0	-7,004.0	-9,000.0
Merchandise exports	41,663.0	46,742.0	61,007.0	81,862.0	96,395.0	117,468.0	129,000.0
Merchandise imports	49,324.0	53,991.0	66,732.0	87,484.0	99,161.0	124,472.0	138,000.0
Foreign direct investment, net	5,804.0	3,901.0	4,284.0	12,259.0	7,013.0	10,037.0	10,000.0
Gross reserves, excluding gold (end-year)	25,649.2	28,660.4	32,787.4	35,334.5	40,874.1	46,381.2	na
External debt stock	71,970.5	84,875.0	106,961.0	129,422.0	132,685.0	168,115.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	5.3	5.4	5.1	4.2	4.3	4.0	na
			(In per cent of exports of goods and services)				
Debt service	13.0	11.7	8.9	8.3	9.2	na	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	38.6	38.2	38.2	38.2	38.2	38.1	na
GDP (in billions of zlotys)	779.6	808.6	843.2	924.5	983.3	1,057.9	1,136.8
GDP per capita (in US dollars)	4,930.6	5,185.4	5,676.8	6,625.2	7,968.0	8,939.9	na
Share of industry in GDP (in per cent)	29.5	28.7	29.6	30.8	30.7	31.6	na
Share of agriculture in GDP (in per cent)	3.2	2.7	2.6	2.5	2.5	2.5	na
Current account/GDP (in per cent)	-2.8	-2.5	-2.1	-4.2	-1.6	-3.3	-4.3
External debt - reserves (in US$ million)	46,321.3	56,214.6	74,173.6	94,087.5	91,810.9	121,733.8	na
External debt/GDP (in per cent)	37.8	42.8	49.3	51.2	43.6	49.3	na
External debt/exports of goods and services (in per cent)	140.0	149.5	148.2	135.8	117.8	121.9	na

1 According to Eurostat.
2 Calculated according to Eurostat methodology (ESA95).
3 Includes domestic credit to non-financial sector and general government.
4 In 2003 and 2004 the rate refers to 14-day open market operations; from January 2005 it refers to 7-day open market operations.
5 Weighted average, as reported by the National Bank of Poland. Calculation of the new rates has been conceptually adjusted to harmonised ECB requirements. The data since 2004 are adjusted to the new methodology.

Romania

Key challenges

- International competition and skilled labour shortages are squeezing traditional industries while demand shifts to higher quality products and services. Better governance and enforcement of regulations is needed to support necessary corporate restructuring.
- Integration into European production networks is hampered by infrastructure bottlenecks. The necessary modernisation of the road network can only be achieved by rapidly improving the framework for private sector investment and employing EU structural funds more effectively.
- Macroeconomic imbalances associated with domestic demand pressures and rapid growth in credit call for far more prudent fiscal and income policies to mitigate vulnerabilities.

Country data

Population (in millions)	21.7
Area ('000 sq km)	238.0
GDP (in billion US$, 2006)	122.1
GDP per capita in 2006 at current international US$ (PPP)	10,001
National currency	Romanian leu

Progress in structural reform

Business environment and competition

Competition from the single market has highlighted the urgent need to restructure many local companies. It is also contributing to structural changes in the economy. Those industries that have until now relied on cheap labour are moving out of Romania and being replaced by companies producing higher value added products and services and relying on skilled labour. The main constraints on this trend are labour migration and lack of capital and know-how.

The European Commission (EC) identified judicial reform and corruption as two areas of concern prior to EU accession. The first post-accession EC monitoring report in June 2007 concluded that progress had been made in these areas but that efforts needed to be stepped up. Romania has made progress in reforming the judiciary, as shown by the establishment of coherent jurisprudence, but reforms to staffing and organisation are lagging. Romania has intensified its fight against corruption by setting up a National Integrity Agency, expected to begin operations by October 2007, and by continuing with processing high level corruption cases. However, the EC report notes that, overall, "progress in the judicial treatment of high-level corruption is still insufficient". The decriminalisation of bank fraud in 2007 and the number of replacements and resignations of key officials at the Ministry of Justice have cast a shadow over the progress that has been made.

Infrastructure

The government has started implementing its ambitious programme of building more than 1,300 km of highways and express roads by 2013. However, all past attempts to use public-private partnership (PPP) structures have failed and poor utilisation of the available structural funds for this programme is limiting the speed at which it can be implemented. EU funding will be used to complete only one major project in the short term – the Pan-European Corridor IV. This relatively slow pace of reform may constrain economic growth.

Privatisation in the energy sector is progressing, with five of the eight power distribution companies in private hands. Plans to privatise generation and the remaining three distribution companies also exist but have not yet been finalised. Since 2001, some 75 per cent of the gas market has been opened to competition, with eligible industrial consumers able to choose their supplier. Domestic gas prices have not yet been brought into line with international prices.

Evidence from the EBRD/World Bank Life in Transition Survey suggests that access to public services other than electricity is strongly linked to income levels – only 68 per cent of the population has access to a water supply, 52 per cent has access to sewerage and 70 per cent has access to solid waste management. The environmental upgrades required to meet EU standards are estimated at €30 billion during 2004-15, a large proportion of which are to be funded by municipalities.

Financial sector

Privatisation in the banking sector is nearing completion. However, the privatisation of Casa di Economii si Consemnatiuni (CEC) bank has been postponed after the government rejected the sole bid submitted by the National Bank of Greece (NBG) because the offer price was too low.

Finance available to enterprises is mostly debt finance (bank loans and, to a very small degree, corporate bonds). The Bucharest Stock Exchange (BSE) has grown rapidly with a market capitalisation of €32 billion, with another €8.7 billion capitalisation of the over-the-counter market by the end of July 2007. Yet the number of bonds traded and IPOs executed in the last two years remains small, and the BSE is still not a major source of finance for industrial investment.

Social sector

Pension reforms, which include the introduction of a three pillar model, have progressed. The second pillar will be introduced in January 2008. Since July 2007 the Commission for Supervision of the Private Pension System awarded licences to 17 companies operating as private pension funds that invest mandatory pension contributions from employees younger than 35.

Macroeconomic performance

Economic growth remained strong in the run-up to, and after, EU accession, with growth rates of 7.7 per cent in 2006 and 6 per cent in the first quarter of 2007 (year-on-year). The rate of inflation fell to 3.8 per cent in June 2007 from 4.9 per cent at the end of 2006 (and from 8.6 per cent at the end of 2005) but picked up to 5 per cent in August 2007 due to higher food prices. However, administrative price adjustments have not yet been completed.

Growth has largely been driven by strong domestic demand from several sources. Lax incomes policy, as evidenced by an 18 per cent increase in the minimum wage and three rounds of public sector wage increases of up to an average of 20 per cent approved for 2007, stimulated domestic demand. In parallel, a similar stimulus came from domestic credit growth of 52 per cent in 2006. This was in spite of administrative measures that had been introduced to curb credit expansion, and which were subsequently phased out because of their distortive effect and replaced with tighter supervision and higher interest rates.

A further stimulus came from an expansionary fiscal policy. In 2006 the government initially targeted a budget deficit of 0.5 per cent of GDP, but the outcome was actually a deficit of 1.9 per cent, owing to a substantial spending increase in the last two months of the year (the budget ran a surplus of over 2 per cent of GDP in the first 10 months of 2006). The general government deficit target for 2007 is 2.8 per cent of GDP.

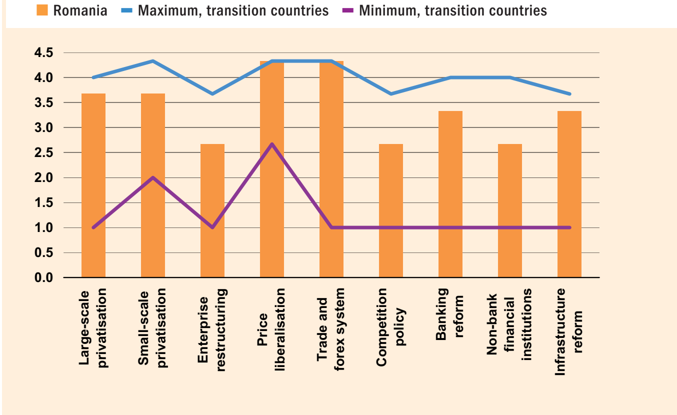
These demand pressures have contributed to a rapid increase in the trade deficit, with imports growing almost twice as fast as exports. This in turn has added to a widening of the current account deficit to €10 billion (11.3 per cent of GDP) at the end of 2006. The trend has continued during 2007 with the deficit reaching €13.6 billion or 12.2 per cent of GDP in June 2007 (on a 12-month rolling basis).

Much of the external deficit has been financed by FDI flows (external deficit coverage by FDI was in excess of 91 per cent in 2006). However, future FDI flows are hard to predict given that €2.2 billion out of total FDI flows of €9.1 billion in 2006 were linked to privatisation revenues, which may not be as important soon because privatisation has virtually come to an end. FDI coverage of the external deficit in the first half of 2007 amounted to 38 per cent.

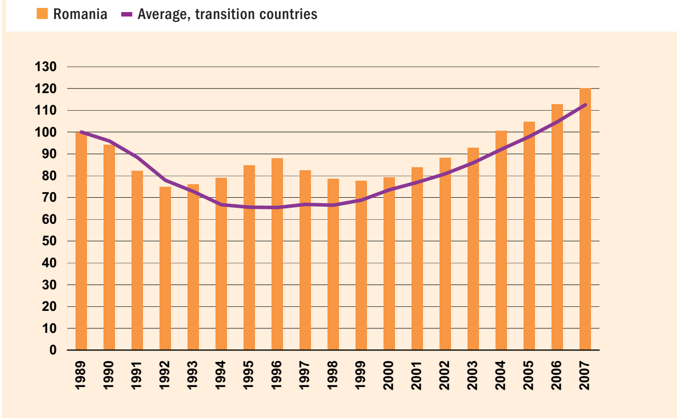
Outlook and risks

Although short-term risks are low, lax fiscal and income policies increase the vulnerabilities of an economy going through significant structural changes. Policy-makers need to plan for the longer term in order to lay the foundations for future growth. Potentially, increased investment stimulated by EU accession in January 2007 and the completion of privatisation and enterprise restructuring can help to maintain strong economic growth. However, failure to develop physical infrastructure – in particular transport infrastructure – could act as a brake on this growth.

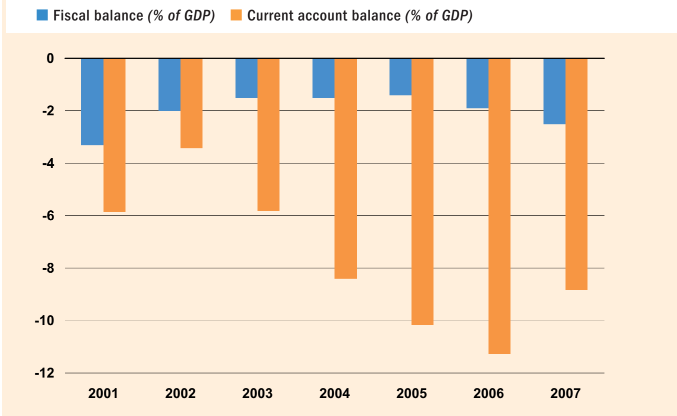
Transition indicators, 2007



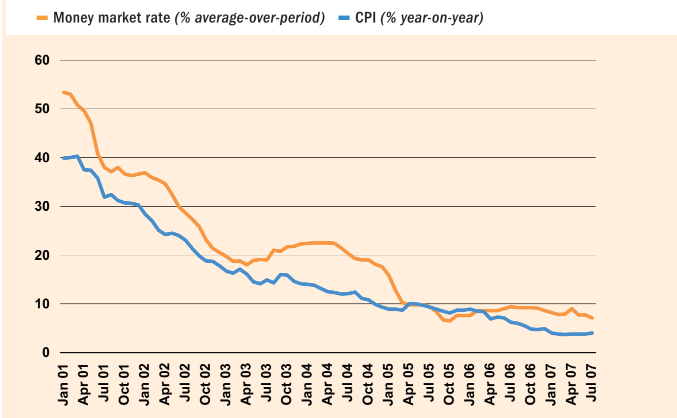
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no**

Interest rate liberalisation – **full**

Exchange rate regime – **managed float**

Wage regulation – **yes**

Tradeability of land – **full within EU**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **high**

Secured transactions law – **advanced**

Quality of corporate governance law – **low**

Infrastructure

Independent telecoms regulator – **fully**

Independent electricity regulator – **fully**

Separation of railway infrastructure from operations – **fully**

Independence of the road directorate – **fully**

Quality of concession laws – **medium**

Financial sector

Capital adequacy ratio – **12 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **medium**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **12.9 per cent** (2003)

Government expenditure on health – **3.4 per cent of GDP** (2004)

Government expenditure on education – **3.6 per cent of GDP** (2005)

Household expenditure on power and water – **3.7 per cent** [1]

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	8.3	8.7	8.9	9.2	9.5	na	na
Private sector share in GDP (in per cent)	65.0	65.0	65.0	70.0	70.0	70.0	70.0
Private sector share in employment (in per cent)	49.1	52.5	56.5	58.0	64.9	66.3	na
Budgetary subsidies and current transfers (in per cent of GDP)	14.4	14.0	13.5	14.6	14.1	14.6	na
Share of industry in total employment (in per cent)	18.9	20.4	25.2	26.0	24.8	35.0	na
Change in labour productivity in industry (in per cent)	7.6	11.6	-16.4	3.0	7.0	na	na
Investment/GDP (in per cent)	22.6	21.7	21.8	23.8	22.7	na	na
EBRD index of small-scale privatisation	3.7	3.7	3.7	3.7	3.7	3.7	3.7
EBRD index of large-scale privatisation	3.3	3.3	3.3	3.7	3.7	3.7	3.7
EBRD index of enterprise reform	2.0	2.0	2.0	2.0	2.3	2.7	2.7
Markets and trade							
Share of administered prices in CPI (in per cent)	17.6	20.3	21.5	22.4	21.9	20.6	na
Number of goods with administered prices in EBRD-15 basket	0.0	0.0	0.0	0.0	0.0	0.0	na
Share of trade with non-transition countries (in per cent)	83.2	84.0	83.9	80.5	78.1	77.0	na
Share of trade in GDP (in per cent)	64.1	66.2	66.7	71.0	66.9	65.3	na
Tariff revenues (in per cent of imports)	2.2	1.7	1.8	1.5	na	na	na
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.3	2.3	2.3	2.3	2.3	2.7	2.7
Financial sector							
Number of banks (foreign-owned)	33 (24)	31 (24)	30 (21)	32 (23)	33 (24)	31 (26)	na
Asset share of state-owned banks (in per cent)	45.4	43.6	40.6	7.5	6.5	5.9	na
Asset share of foreign-owned banks (in per cent)	51.4	52.9	54.8	58.5	59.2	87.9	na
Non-performing loans (in per cent of total loans)	3.5	2.3	1.5	1.7	1.7	1.8	na
Domestic credit to private sector (in per cent of GDP)	8.7	10.1	13.7	15.7	20.0	26.3	na
Domestic credit to households (in per cent of GDP)	na	na	3.8	4.8	7.2	11.2	na
Of which mortgage lending (in per cent of GDP)	na	na	0.3	0.5	0.6	0.9	na
Stock market capitalisation (in per cent of GDP)	5.8	10.1	9.2	13.9	22.2	24.6	na
Stock trading volume (in per cent of market capitalisation)	15.7	23.0	8.8	11.6	21.0	16.1	na
Eurobond issuance (in per cent of GDP)	2.2	3.3	0.9	0.0	1.2	na	na
EBRD index of banking sector reform	2.7	2.7	2.7	3.0	3.0	3.0	3.3
EBRD index of reform of non-bank financial institutions	2.0	2.0	2.3	2.3	2.3	2.3	2.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	18.4 (17.2)	19.3 (23.5)	20.0 (32.5)	20.3 (47.1)	20.2 (61.8)	19.4 (80.5)	na
Internet users (per 100 inhabitants)	4.5	10.1	18.5	20.8	22.1	32.4	na
Railway labour productivity (1989=100)	48.7	51.0	53.7	60.0	55.1	63.2	na
Residential electricity tariffs (USc kWh)	5.7	7.0	8.1	8.6	11.3	10.4	na
Average collection rate, electricity (in per cent)	62	96	98	100	99	100	na
GDP per unit of energy use (PPP in US dollars per kgoe)	3.8	4.0	4.0	4.5	na	na	na
EBRD index of infrastructure reform	3.0	3.0	3.0	3.3	3.3	3.3	3.3
Electric power	3.0	3.0	3.0	3.3	3.3	3.3	3.7
Railways	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Roads	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Telecommunications	3.0	3.0	3.0	3.0	3.0	3.3	3.3
Water and waste water	3.0	3.0	3.0	3.3	3.3	3.3	3.3

[1] Estimate based on the poorest 20 per cent of households (lowest income quintile).

	2001	2002	2003	2004	2005	2006	2007
						Estimate	*Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP [1]	5.7	5.1	5.2	8.5	4.1	7.7	6.5
Private consumption	6.9	5.3	8.5	14.5	9.7	14.1	na
Public consumption	3.6	3.0	7.5	-3.2	8.7	2.4	na
Gross fixed capital formation	10.1	8.2	8.6	11.1	12.6	16.1	na
Exports of goods and services	12.1	17.5	8.4	13.9	8.1	10.6	na
Imports of goods and services	18.4	12.0	16.0	22.1	16.6	23.0	na
Industrial gross output, unadjusted series	8.3	4.3	3.1	5.3	2.1	3.9	na
Agricultural gross output	22.1	-3.0	7.6	16.8	-13.9	na	na
Employment			*(Percentage change)*				
Labour force (end-year)	-1.2	-12.0	-1.6	0.4	-1.1	na	na
Employment (end-year)	-0.6	-13.7	-0.1	-0.7	-0.1	na	na
			(In per cent of labour force)				
Unemployment (end-year) [2]	6.6	8.4	7.0	6.3	5.9	5.2	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	34.5	22.5	15.3	11.9	9.5	6.6	7.0
Consumer prices (end-year)	30.3	17.8	14.1	9.3	8.6	4.9	6.5
Producer prices (annual average)	40.3	24.5	19.6	18.6	12.3	11.4	na
Producer prices (end-year)	32.6	20.1	20.0	16.3	10.4	11.6	na
Gross average monthly earnings in economy (annual average)	48.9	27.3	23.6	22.5	17.0	18.9	na
Government sector			*(In per cent of GDP)*				
General government balance [3]	-3.3	-2.0	-1.5	-1.5	-1.4	-1.9	-2.5
General government expenditure	33.3	32.3	30.9	31.1	31.0	32.3	na
General government debt [3]	23.2	23.8	21.5	18.8	15.8	12.4	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	46.2	38.1	23.3	37.1	36.5	28.1	na
Domestic credit (end-year)	34.9	38.7	49.0	33.0	43.7	53.0	na
			(In per cent of GDP)				
Broad money (M2, end-year)	23.2	24.7	23.3	25.6	29.9	32.3	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Discount rate	35.0	29.0	20.4	18.0	7.5	8.8	na
1-week BUBOR	36.6	20.5	22.3	17.6	7.6	8.6	na
Deposit rate (average)	26.2	18.4	10.8	11.3	6.2	4.8	na
Lending rate (average)	45.7	36.7	26.2	25.8	19.2	13.9	na
			(Lei per US dollar)				
Exchange rate (end-year) [4]	3.2	3.4	3.3	2.9	3.1	2.6	na
Exchange rate (annual average) [4]	2.9	3.3	3.3	3.3	2.9	2.8	na
External sector			*(In millions of US dollars)*				
Current account	-2,349.0	-1,573.0	-3,454.5	-6,333.3	-10,054.2	-13,754.4	-15,019.2
Trade balance	-2,969.0	-2,613.0	-4,464.9	-6,611.5	-9,873.3	-14,770.1	-14,726.4
Merchandise exports	11,385.0	13,869.0	17,627.0	23,518.4	28,148.9	32,469.4	28,118.4
Merchandise imports	14,354.0	16,482.0	22,091.9	30,129.8	38,022.2	47,239.5	42,844.8
Foreign direct investment, net	1,154.0	1,080.0	2,156.2	6,368.0	6,587.3	11,430.2	5,131.2
Gross reserves, excluding gold (end-year)	3,960.0	6,144.5	8,049.9	14,805.6	20,994.5	28,061.1	na
External debt stock	13,048.0	16,886.0	22,498.0	29,876.0	36,201.0	41,815.7	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	2.9	3.9	3.9	5.2	5.8	6.2	na
			(In per cent of exports of goods and services)				
Debt service [5]	21.1	18.9	16.3	18.6	18.2	19.5	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	22.4	21.8	21.7	21.7	21.7	21.7	na
GDP (in billions of lei) [4]	116.8	151.5	197.6	246.5	288.0	342.4	390.2
GDP per capita (in US dollars)	1,793.1	2,102.5	2,738.0	3,484.5	4,548.7	5,616.8	na
Share of industry in GDP (in per cent)	28.2	28.4	25.0	24.7	24.1	na	na
Share of agriculture in GDP (in per cent)	13.3	11.3	11.6	12.8	8.5	na	na
Current account/GDP (in per cent)	-5.8	-3.4	-5.8	-8.4	-10.2	-11.3	-8.8
External debt - reserves (in US$ million)	9,088.0	10,741.5	14,448.1	15,070.4	15,206.5	13,754.6	na
External debt/GDP (in per cent)	32.5	36.8	37.8	39.6	36.6	34.3	na
External debt/exports of goods and services (in per cent)	97.9	104.2	109.0	110.1	109.3	106.1	na

1 From 2001 growth rates are calculated by the National Statistical Institute using a new methodology that complies with European standards of national accounting.

2 Officially registered unemployed. According to ILO methodology, the rate of unemployment in Romania is lower than the official one.

3 Calculated according to Eurostat methodology (ESA95).

4 The old Romanian lei was redenominated in July 2005. All data have been converted to new lei (RON).

5 Debt service payments on private and public external debt.

Russia

Key challenges

- Investment outside the extractive sectors is picking up. However, to promote further diversification outside natural resources and develop knowledge-intensive industries, it is necessary to level the playing field, allowing scope for private initiative.
- More transparent tender procedures for public sector contracts, along with increased government capacity to negotiate and implement agreements with private investors, would help to stimulate private investment in infrastructure.
- The authorities need to adhere to medium-term spending targets and rely on market mechanisms to fulfil industrial policy initiatives to contain fiscal expansion and prevent inordinate price pressures.

Country data

Population (in millions)	142.2
Area ('000 sq km)	17,075.0
GDP (in billion US$, 2006)	977.5
GDP per capita in 2006 at current international US$ (PPP)	11,988
National currency	Rouble

Progress in structural reform

Liberalisation and privatisation

Further progress has been made towards World Trade Organization (WTO) accession over the past 12 months. Russia concluded the bilateral market access agreement with the United States in October 2006 and committed to enact legislation to bring its intellectual property rights regime into line with international norms. The trade regime for automotive investors has improved – custom tariffs on imports of car components fell to between 0 and 3 per cent.

However, Russia is still engaged in a number of trade disputes with several countries such as Georgia, Moldova, the Baltic states and Poland, mostly concerning trading standards and certifications in agricultural products. Energy trade arrangements, notably with Belarus and Georgia, were significantly revised. To encourage the development of domestic processing industries, the government increased export duties on timber exports in July 2007, with further rises planned by January 2009.

Business environment and competition

In July 2007 a law limiting foreign investments in strategic sectors such as mining, the aircraft industry and nuclear power went to parliament for approval. The rules for foreign investor involvement in the oil and gas sector are not part of this legislation and will be covered under amendments to the subsoil law, which are pending. The state has further consolidated its control of significant oil and gas reserves through state-owned companies Gazprom and Rosneft, as well as consolidating its stakes in politically significant areas such as shipping, airlines and the media. State-owned enterprises in natural resources are, however, still entering into partnerships with foreign investors – for example on exploration of the Shtokman gas field in the Barents Sea – albeit under different terms (with foreign investors now principally providing technology and know-how as sub-contractors without an equity stake). Outside the strategic and energy sectors, foreign investment has been increasing but impediments such as corruption and bureaucracy remain high.

Infrastructure

At the end of December 2006 the government approved a plan to liberalise gas and electricity prices, with full price liberalisation envisaged by 2011. There has been progress in restructuring the power company UES, including privatisation of some of its power generating subsidiaries (OGKs). In November 2006 UES launched a public offering of shares in OGK-5, selling a 14 per cent stake for US$ 459 million, followed by the sale of a 25 per cent stake for US$ 1.5 billion to Enel in June 2007. Meanwhile Norilsk Nickel increased its stake in OGK-3 in several stages to 73 per cent by July 2007. In addition, UES and Gazprom agreed a long-term gas off-take agreement in March 2007 and in summer 2007 the two agreed to a share swap of power assets, shifting controlling stakes in OGK-2 and OGK-6 from UES to Gazprom.

In April 2007 the government approved new legislation on toll roads as well as a strategy for private sector involvement in transport infrastructure. In March 2007 the Tender Evaluation Committee announced the pre-qualification of four consortia to participate in the tender for the concession agreement on the Western High-Speed Diameter toll road in St. Petersburg.

Railway reforms passed several milestones in the last year. A series of joint-stock companies were set up, cross-subsidisation among the railway services was eliminated, passenger services were separated, private sector participation in freight transport was increased and ancillary activities were privatised.

Financial sector

The financial sector continues to expand rapidly. Credit to the private sector rose by nearly 5 percentage points in GDP terms in 2006, with particularly strong growth in the regions and in new products such as mortgages. The banking sector has been strengthened partly owing to wider coverage by the deposit insurance system and partly due to the use of certain forms of subordinated debt. In the first half of 2007 the two largest Russian state-owned banks, Sberbank and Vneshtorgbank, also raised approximately US$ 8 billion each through IPOs. There have been a number of foreign acquisitions, and Société Générale of France has moved towards exercising its option to acquire 30 per cent of Rosbank, the 10th largest bank in Russia, potentially increasing its stake to a majority.

Macroeconomic performance

GDP grew by 6.7 per cent in 2006 and accelerated to an estimated 7.8 per cent in the first half of 2007. Domestic demand was the main driver. Investment grew at nearly 20 per cent in real terms in the first quarter of this year, providing an opportunity to relieve the many capacity constraints in Russian industry and infrastructure and to diversify the economy. Industrial production rose by 8.4 per cent in the first quarter of 2007 compared with output growth of only about 2.4 per cent for the extractive sector.

Growth continues to be underpinned by favourable commodity prices and the associated increases in real disposable income. Annual growth in bank credit to the private sector above 50 per cent acted as a further stimulus.

The strength of domestic demand has also led to an exceptionally steep rise in imports. They increased by 21 per cent in real terms in 2006 whereas exports were up by only 7 per cent, in line with weak volume growth in the hydrocarbons sector. This has meant that the recent substantial trade surpluses (about 14 per cent of GDP in 2006) are now rapidly diminishing.

Stronger capital inflows have provided an additional stimulus to growth in the year to July. Net private capital flows to Russia in the first half of 2007 (US$ 67 billion) were well in excess of last year's total, reflecting the strength in FDI inflows, receipts from foreign IPOs and borrowing by state-owned enterprises.

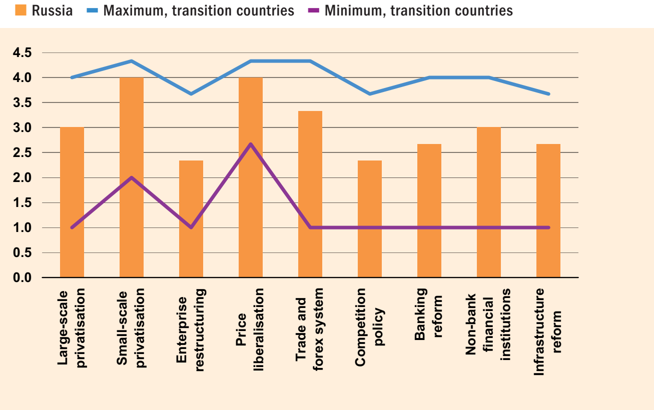
As the central bank continues to permit only minimal flexibility in the rouble exchange rate, liquidity inflows translate into rapid expansion of the domestic broad money supply. By mid-2007 inflation had exceeded the authorities' end-year target. Inflationary pressures are set to intensify given the considerably looser federal budget stance and spending is set to accelerate towards the end of 2007. Nevertheless, by adopting binding spending targets for the medium-term federal budget as well as clarifying the roles of its reserve and national welfare funds, the government has improved fiscal policy management.

Outlook and risks

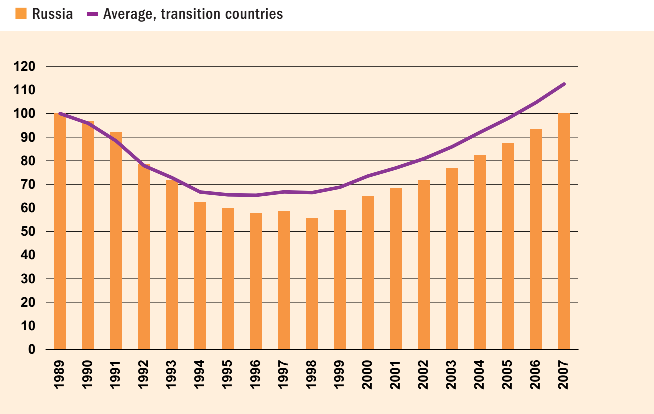
In the short term, despite its recent revival, investment remains well below the level in other emerging markets growing at similar rates, or what Russia's ageing capital stock would require. Infrastructure could still act as a brake on growth. Any resort to administrative measures to contain price pressures would risk creating further distortions in the economy and affect weaker banks. Volatility in international credit markets led to capital outflows and sharp increases in domestic money market interest rates but the banking system has been substantially strengthened recently and should withstand such strains well.

Over the medium term, the rapidly diminishing current account surpluses will underline the need to maintain a favourable environment for foreign investors. Growth rates of domestic money supply are set to slow, pushing up domestic real interest rates. This development will accelerate once the central bank gives priority to stabilising prices rather than the exchange rate, as it has announced, providing a considerably more challenging environment for the financial sector and corporate borrowers.

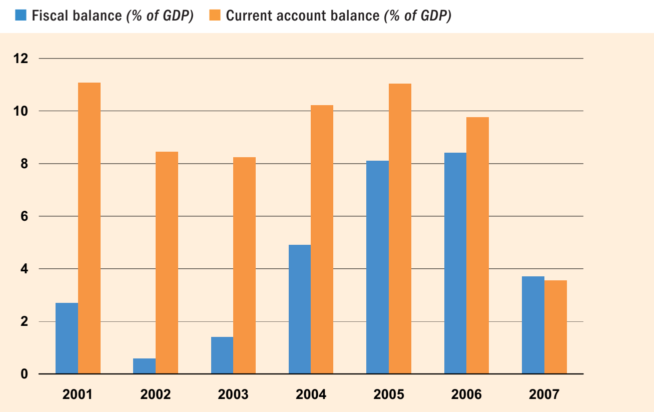
Transition indicators, 2007



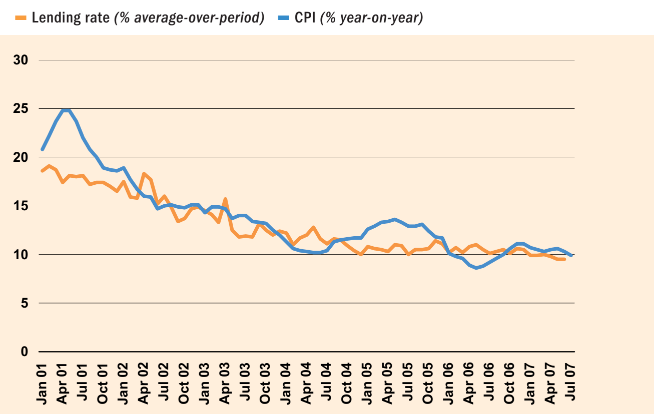
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full** Controls on inward direct investment – **yes** [1] Interest rate liberalisation – **full** Exchange rate regime – **managed float** Wage regulation – **no** Tradeability of land – **limited de facto**	Competition office – **yes** Quality of insolvency law – **medium** Secured transactions law – **malfunctioning** Quality of corporate governance law – **high**	Independent telecoms regulator – **no** Independent electricity regulator – **partially** Separation of railway infrastructure from operations – **partially** Independence of the road directorate – **partially** Quality of concession laws – **medium**	Capital adequacy ratio – **10-11 per cent** Deposit insurance system – **yes** Quality of securities market laws – **medium** Private pension funds – **yes**	Share of population living in poverty – **15.8 per cent** (2005) Government expenditure on health – **3.7 per cent of GDP** (2004) Government expenditure on education – **3.7 per cent of GDP** (2005) Household expenditure on power and water – **6.6 per cent** [2]

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	4.3	4.7	5.6	6.2	6.3	6.5	na
Private sector share in GDP (in per cent)	70.0	70.0	70.0	70.0	65.0	65.0	65.0
Private sector share in employment (in per cent)	na	na	na	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	na	na	na	na	na	na	na
Share of industry in total employment (in per cent)	22.7	22.2	21.8	21.4	21.7	21.2	na
Change in labour productivity in industry (in per cent)	3.8	4.8	8.4	8.9	6.2	5.8	na
Investment/GDP (in per cent)	21.9	20.0	20.8	20.9	20.1	20.3	na
EBRD index of small-scale privatisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of large-scale privatisation	3.3	3.3	3.3	3.3	3.0	3.0	3.0
EBRD index of enterprise reform	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Markets and trade							
Share of administered prices in CPI (in per cent)	13.0	13.0	13.0	13.0	13.0	13.0	na
Number of goods with administered prices in EBRD-15 basket	2.0	2.0	2.0	2.0	2.0	1.0	na
Share of trade with non-transition countries (in per cent)	63.8	70.3	69.5	67.5	73.2	75.3	na
Share of trade in GDP (in per cent)	50.8	48.8	49.1	48.2	56.6	47.9	na
Tariff revenues (in per cent of imports) [3]	21.1	16.9	19.4	25.1	21.9	na	na
EBRD index of price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of forex and trade liberalisation	2.7	3.0	3.3	3.3	3.3	3.3	3.3
EBRD index of competition policy	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Financial sector							
Number of banks (foreign-owned)	1,319 (35)	1,329 (37)	1,329 (41)	1,299 (42)	1,253 (52)	1,189 (65)	na
Asset share of state-owned banks (in per cent)	na	na	na	na	na	na	na
Asset share of foreign-owned banks (in per cent)	8.8	8.1	7.4	7.6	8.3	12.1	na
Non-performing loans (in per cent of total loans)	7.5	6.4	5.6	3.6	2.8	2.4	na
Domestic credit to private sector (in per cent of GDP)	16.5	17.7	21.0	24.5	25.7	31.0	na
Domestic credit to households (in per cent of GDP)	0.8	1.0	1.9	3.2	4.9	7.1	na
Of which mortgage lending (in per cent of GDP)	na	na	na	0.1	0.2	0.9	na
Stock market capitalisation (in per cent of GDP)	26.0	36.7	51.1	44.6	71.9	104.4	na
Stock trading volume (in per cent of market capitalisation)	39.1	30.1	46.0	53.0	39.0	64.6	na
Eurobond issuance (in per cent of GDP)	0.4	1.0	1.2	2.8	2.3	2.2	na
EBRD index of banking sector reform	1.7	2.0	2.0	2.0	2.3	2.7	2.7
EBRD index of reform of non-bank financial institutions	1.7	2.3	2.7	2.7	2.7	3.0	3.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	22.8 (5.3)	24.4 (12.1)	25.0 (25.0)	26.8 (51.2)	27.9 (83.6)	27.9 (na)	na
Internet users (per 100 inhabitants)	3.0	4.1	8.3	12.9	15.2	18.0	na
Railway labour productivity (1989=100)	85.0	90.1	101.6	108.1	115.7	125.6	na
Residential electricity tariffs (USc kWh)	na	na	2.7	3.2	3.9	na	na
Average collection rate, electricity (in per cent) [4]	na	102	na	na	na	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	1.8	1.9	1.9	2.0	na	na	na
EBRD index of infrastructure reform	2.3	2.3	2.3	2.7	2.7	2.7	2.7
Electric power	2.0	2.3	3.0	3.0	3.0	3.0	3.0
Railways	2.3	2.3	2.3	2.7	2.7	2.7	3.0
Roads	2.0	2.3	2.3	2.3	2.3	2.3	2.3
Telecommunications	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Water and waste water	2.3	2.3	2.3	2.3	2.3	2.3	2.3

[1] FDI in non-financial companies requires an authorisation from the Central Bank of Russia.

[2] Estimate based on the poorest 20 per cent of households (lowest income quintile).

[3] Refers to all taxes on international trade.

[4] Numbers greater than 100 per cent reflect collection of several years' worth of payments.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			(Percentage change in real terms)				
GDP	5.1	4.7	7.3	7.1	6.4	6.7	7.2
Private consumption	9.5	8.5	7.5	12.1	12.7	11.2	na
Public consumption	-0.8	2.6	2.2	2.1	2.2	4.2	na
Gross fixed capital formation	10.2	2.8	12.8	12.6	8.3	13.9	na
Exports of goods and services	4.2	10.3	12.5	11.8	6.4	7.2	na
Imports of goods and services	18.7	14.6	17.7	23.3	17.0	21.7	na
Industrial gross output	4.9	3.7	7.0	7.3	4.0	3.9	na
Agricultural gross output	7.5	1.5	5.5	3.0	1.5	1.7	na
Employment			(Percentage change)				
Labour force (end-year)	-2.0	1.2	0.8	1.5	0.7	0.0	na
Employment (end-year)	-0.3	2.4	0.1	2.0	1.2	0.2	na
			(In per cent of labour force)				
Unemployment (end-year)	8.7	8.8	8.6	8.3	7.6	7.2	na
Prices and wages			(Percentage change)				
Consumer prices (annual average)	21.6	15.7	13.7	10.9	12.7	9.7	8.5
Consumer prices (end-year)	18.6	15.0	12.0	11.7	10.9	9.0	9.0
Producer prices (annual average)	19.2	14.0	16.6	22.0	18.2	12.6	na
Producer prices (end-year)	10.7	17.1	12.5	28.8	13.4	10.4	na
Gross average monthly earnings in economy (annual average)	47.3	36.7	24.4	22.3	26.9	25.4	na
Government sector [1]			(In per cent of GDP)				
General government balance	2.7	0.6	1.4	4.9	8.1	8.4	3.7
General government expenditure	34.6	37.1	35.7	33.6	31.6	31.3	na
General government debt	48.2	41.4	32.4	25.9	16.5	9.0	na
Monetary sector			(Percentage change)				
Broad money (M2, end-year)	39.7	32.4	50.5	35.8	38.5	48.8	na
Domestic credit (end-year)	27.0	26.5	26.5	18.7	2.7	28.4	na
			(In per cent of GDP)				
Broad money (M2, end-year)	18.0	19.7	24.3	26.0	27.9	33.8	na
Interest and exchange rates			(In per cent per annum, end-year)				
Central Bank refinance rate (uncompounded)	25.0	21.0	16.0	13.0	12.8	11.7	na
Treasury bill rate (all maturities)	14.7	15.0	4.5	4.5	3.9	4.5	na
Deposit rate	5.2	4.3	4.4	3.8	3.6	4.1	na
Lending rate	16.5	15.0	12.4	10.0	11.1	10.5	na
			(Roubles per US dollar)				
Exchange rate (end-year)	30.1	31.8	29.5	27.9	28.8	26.3	na
Exchange rate (annual average)	29.2	31.3	30.7	28.8	28.3	27.2	na
External sector			(In millions of US dollars)				
Current account	33,934.0	29,116.0	35,410.0	59,514.0	84,443.0	96,106.0	74,070.0
Trade balance	48,120.0	46,335.0	60,493.0	85,825.0	118,364.0	139,234.0	119,467.0
Merchandise exports	101,884.0	107,301.0	135,929.0	183,207.0	243,798.0	303,926.0	338,800.0
Merchandise imports	53,764.0	60,966.0	75,436.0	97,382.0	125,434.0	164,692.0	219,233.0
Foreign direct investment, net	216.0	-72.0	-1,769.0	1,662.0	119.0	7,387.0	20,000.0
International reserves, excluding gold (end-year)	32,542.4	44,053.6	73,175.0	120,809.0	175,900.0	295,568.0	na
External debt stock	151,122.0	169,900.0	199,400.0	225,000.0	257,200.0	309,700.0	na
			(In months of imports of goods and services)				
International reserves, excluding gold (end-year)	5.3	6.3	8.6	11.1	10.4	16.9	na
			(In per cent of exports of goods and services)				
Debt service	15.2	16.8	20.1	22.2	26.0	25.1	na
Memorandum items			(Denominations as indicated)				
Population (end-year, million)	145.6	145.0	144.2	143.5	142.8	142.2	na
GDP (in billions of roubles)	8,943.6	10,817.5	13,201.1	16,778.8	21,665.0	26,621.0	30,464.0
GDP per capita (in US dollars)	2,123.4	2,379.8	2,982.8	4,058.0	5,360.5	6,874.0	na
Share of industry in GDP (in per cent)	36.5	34.8	34.9	36.0	na	na	na
Share of agriculture in GDP (in per cent)	6.8	5.7	5.4	5.0	na	na	na
Current account/GDP (in per cent)	11.1	8.4	8.2	10.2	11.0	9.8	6.2
External debt - reserves (in US$ million)	118,579.6	125,846.4	126,225.0	104,191.0	81,300.0	14,132.0	na
External debt/GDP (in per cent)	49.3	49.2	46.4	38.6	33.6	31.7	na
External debt/exports of goods and services (in per cent)	133.4	140.5	131.2	110.6	87.7	92.5	na

[1] General consolidated government includes the federal, regional and local budgets and extra-budgetary funds, and excludes transfers.

Serbia

Key challenges

- Further trade and economic integration is crucial for Serbia's economic prospects, highlighting the importance of advancing WTO and EU negotiations and implementing the new regional free trade agreement.
- After recent delays, the privatisation of large state- and socially-owned companies needs to be accelerated to attract new investment and promote restructuring.
- The government needs to keep spending under control and reduce subsidies to loss-making companies. This will help sustain the macroeconomic benefits that improved fiscal discipline and lower inflation have delivered in recent years.

Country data

Population (in millions)	9.9 (including Kosovo)
Area ('000 sq km)	102.0
GDP (in billion US$, 2006)	28.8
GDP per capita in 2006 at current international US$ (PPP)	6,771
National currency	Dinar

Progress in structural reform

Liberalisation and privatisation

Negotiations with the European Union (EU) on a Stabilisation and Association Agreement (SAA) resumed in June 2007, following the election of a new government and progress in detaining war crimes suspects. The final round of technical negotiations on the SAA was completed in September 2007. Serbia is also part of the expanded Central European Free Trade Agreement that came into force in July 2007 and was ratified by the Serbian parliament in September. However, in August 2007 the government imposed a three-month ban on wheat, corn, soy and sunflower oil exports, citing concerns about rising prices of basic goods following the severe drought in the country.

The privatisation programme has slowed in the past year, and the deadline to complete it has now been extended to the end of 2008. Between 2002 and 2007 a total of 1,737 firms were privatised for €1.88 billion. However, more than 1,000 companies are still to be privatised through public auction and another 77 through tender.

The government faces the problem of dealing with a number of large, state-owned companies, some of which are supported by subsidies. Earlier in 2007 a flagship privatisation – the RTB Bor mining complex – was cancelled after the buyer, Cuprom of Romania, failed to meet its commitments. Bor has now been re-tendered, with sale completion targeted for the end of this year. In July 2007 the government launched the process of selling the national airline, JAT, and in September it chose a consortium led by Rothschild, a leading consultant in the aviation industry, to advise on the process. Privatisation of the oil conglomerate NIS may begin in late 2007 with the offer of a minority stake, but several other large enterprises will not be offered for sale this year.

Business environment and competition

The business environment has improved markedly in recent years, but serious obstacles remain. A number of companies are monopolies and the competition commission, established in December 2005, has yet to make a major impact, mainly because of its limited resources (although staff numbers have increased greatly in the past year and a number of cases have opened). State subsidies to inefficient socially-owned companies are still significant, and although well over 1,000 bankruptcy cases are under way, by August 2007, only 209 companies had been placed into bankruptcy under the new law. In addition, the current employment law continues to attract strong criticism from investors because of its generous protection of workers' rights, to the possible detriment of overall labour market efficiency.

Infrastructure

Much of the government's infrastructure spending plans are contained in the National Investment Plan, a flagship initiative of the previous government that has been carried over by its successor. The government has stated that many of the main public infrastructure enterprises will not be sold during the present parliament.

Over the past year railway infrastructure and operations have been separated, contributing to significant staff reductions and the divestiture of a number of non-core activities. In the energy sector collection rates have improved steadily, but a planned increase in average tariffs to 5 cents per kWh, following a 15 per cent increase in May, has been postponed. In roads, the first major concession project was signed in March 2007 with the FCC-Alpine consortium for €800 million of investment to build and maintain new highways. In telecoms, the government awarded a third mobile licence in late 2006 to Mobilkom of Austria. However, no discernible progress has been made in liberalising the effective monopoly of Telekom Srbija in fixed-line services.

Financial sector

The number of banks remains relatively large – 37 at the end of 2006 – while the volume of credit continues to grow, despite the central bank's strict monetary policies. Lending to households rose by more than 50 per cent in 2006 with particularly strong growth in loans for household construction, where credits more than doubled. Lending to enterprises was relatively subdued, but still grew at about 15 per cent in 2006.

Non-bank financial institutions continue to develop, albeit rather slowly. Pension reform is at an early stage and the insurance sector remains in majority state hands (in terms of assets). In November 2006 a number of companies submitted bids for a majority stake in DDOR Novi Sad, Serbia's second largest insurance company. However, the outcome has been delayed until the end of 2007. Meanwhile, the largest insurance company, Dunav Osiguranje, will undergo restructuring before any sale is launched.

Macroeconomic performance

The economy continues to grow strongly, even in the absence of significant reforms over the past year. After real GDP growth in 2006 of 5.7 per cent, growth is estimated at almost 9 per cent in the first quarter of 2007 compared with the same period last year. Growth has been driven by construction and services, up by 35 and 30 per cent respectively over the past year.

Serious macroeconomic challenges lie ahead for the authorities. The proposed deficit is 0.6 per cent of GDP, although independent analysts estimate that the outcome may be higher, owing to strong wage growth in the public sector and a commitment to implementing spending promises made during the election campaign. The central bank has maintained its tight monetary policies. It imposed new constraints on bank lending and raised the key policy rate in August 2007 to 9.75 per cent, reflecting its commitment to maintaining inflation within a band of 4-8 per cent this year. On current trends, however, there is a strong possibility that inflation will exceed 8 per cent by the end of the year.

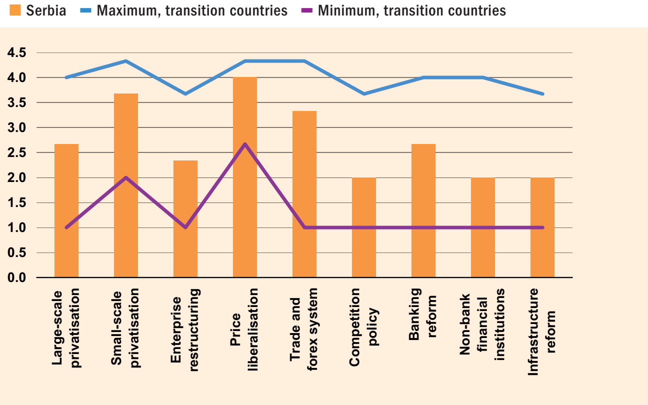
Foreign reserves continue to rise to new record levels and FDI was over €600 million in the first quarter of 2007. Strong foreign reserve inflows are helping to maintain exchange rate stability, with the nominal rate remaining close to 80 dinars to one euro. The current account deficit has risen to about 17 per cent of GDP, although continued strong inflows of FDI and other capital, especially portfolio investment, are helping to maintain a healthy level of foreign reserves. The level of short-term debt, although small, is rising rapidly and overall debt servicing requirements are on an upward trend for the next two to three years.

Outlook and risks

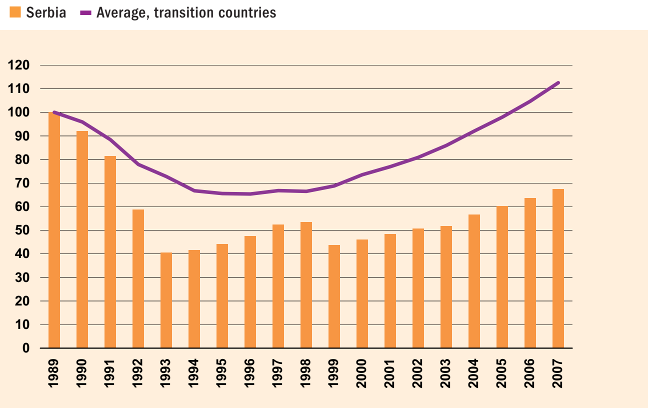
The economy has the potential to achieve high growth over the coming years but it also faces some serious risks. Serbia's size, location and improved prospects of regional and EU integration mean that it is of great interest to investors. However, further improvements to the business climate and an accelerated approach to privatisation and restructuring are required to realise this potential.

A key challenge for the authorities is to maintain the disciplined approach to fiscal policy achieved in recent years. Wages in the public sector were raised substantially last year in advance of the January 2007 elections, fuelling a consumer, import-led boom, and they have continued to rise in 2007. Current levels of wage growth and the current account deficit appear unsustainable over the medium term, but there is no evidence of a clear strategy to address this. Political discourse in the country is dominated by the issue of Kosovo's status, which has the potential to cause negative repercussions both in Serbia and in the region more generally.

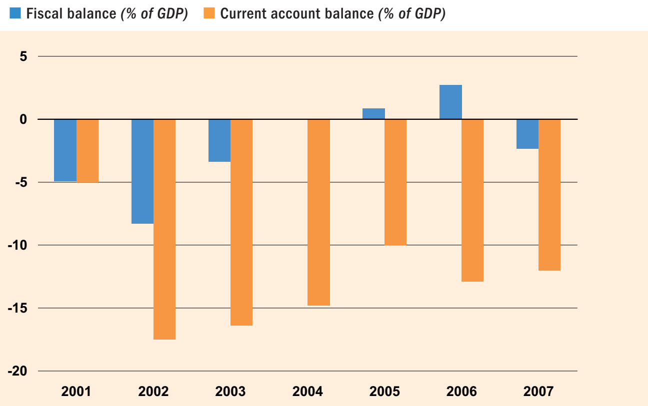
Transition indicators, 2007



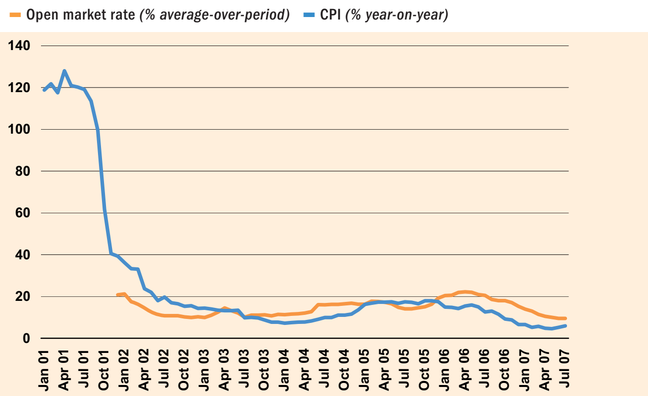
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Open market rate data were not available for 2001.

Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full**	Competition office – **yes**	Independent telecoms regulator – **fully**	Capital adequacy ratio – **8 per cent**	Share of population living in poverty – **na**
Controls on inward direct investment – **no**	Quality of insolvency law – **high**	Independent electricity regulator – **partially**	Deposit insurance system – **yes**	Government expenditure on health – **7.3 per cent of GDP** (2004)
Interest rate liberalisation – **full**	Secured transactions law – **some defects**	Separation of railway infrastructure from operations – **no**	Quality of securities market laws – **medium**	Government expenditure on education – **na**
Exchange rate regime – **managed float**	Quality of corporate governance law – **medium**	Independence of the road directorate – **no**	Private pension funds – **no**	Household expenditure on power and water – **9.3 per cent**
Wage regulation – **no**		Quality of concession laws – **medium**		
Tradeability of land – **limited de jure**				

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	0.0	2.4	7.0	7.6	na	na	na
Private sector share in GDP (in per cent)	40.0	40.0	45.0	50.0	55.0	55.0	55.0
Private sector share in employment (in per cent)	na	na	na	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	3.4	4.8	3.8	3.3	2.6	na	na
Share of industry in total employment (in per cent)	40.4	37.8	36.2	na	na	na	na
Change in labour productivity in industry (in per cent)	2.0	10.4	3.1	na	na	na	na
Investment/GDP (in per cent)	na	na	na	na	na	na	na
EBRD index of small-scale privatisation	3.0	3.0	3.0	3.3	3.3	3.7	3.7
EBRD index of large-scale privatisation	1.0	2.0	2.3	2.3	2.7	2.7	2.7
EBRD index of enterprise reform	1.0	2.0	2.0	2.0	2.3	2.3	2.3
Markets and trade							
Share of administered prices in CPI (in per cent)	11.0	11.0	11.2	11.2	9.2	9.9	na
Number of goods with administered prices in EBRD-15 basket	2.0	2.0	3.0	3.0	2.0	3.0	na
Share of trade with non-transition countries (in per cent)	na	na	na	na	na	na	na
Share of trade in GDP (in per cent)	64.5	57.7	55.2	63.1	61.3	66.8	na
Tariff revenues (in per cent of imports)	4.9	6.8	6.8	6.1	na	na	na
EBRD index of price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of forex and trade liberalisation	2.7	3.0	3.0	3.0	3.3	3.3	3.3
EBRD index of competition policy	1.0	1.0	1.0	1.0	1.0	1.7	2.0
Financial sector							
Number of banks (foreign-owned)	54 (8)	50 (12)	47 (16)	43 (11)	40 (17)	37 (22)	na
Asset share of state-owned banks (in per cent)	68.0	35.6	34.1	23.4	23.9	14.9	na
Asset share of foreign-owned banks (in per cent)	13.2	27.0	38.4	37.7	66.0	78.7	na
Non-performing loans (in per cent of total loans)	na	na	na	na	na	na	na
Domestic credit to private sector (in per cent of GDP)	13.6	16.9	15.7	20.0	21.6	18.9	na
Domestic credit to households (in per cent of GDP)	na	na	2.6	4.9	7.6	na	na
Of which mortgage lending (in per cent of GDP)	na	na	0.4	0.7	1.4	na	na
Stock market capitalisation (in per cent of GDP)	na	4.7	7.1	14.5	24.0	35.4	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	na	na	na	na
Eurobond issuance (in per cent of GDP)	na	na	na	na	na	na	na
EBRD index of banking sector reform	1.0	2.3	2.3	2.3	2.7	2.7	2.7
EBRD index of reform of non-bank financial institutions	1.0	1.7	2.0	2.0	2.0	2.0	2.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	22.9 (na)	30.7 (na)	32.1 (na)	32.9 (na)	32.9 (na)	25.9 (63.3)	na
Internet users (per 100 inhabitants)	na	na	na	na	na	13.3	na
Railway labour productivity (1989=100)	na	na	na	na	na	na	na
Residential electricity tariffs (USc kWh)	1.9	3.5	4.7	5.3	5.1	5.8	na
Average collection rate, electricity (in per cent)	92	88	90	94	94	95	na
GDP per unit of energy use (PPP in US dollars per kgoe)	na	na	na	na	na	na	na
EBRD index of infrastructure reform	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Electric power	2.0	2.0	2.3	2.3	2.3	2.3	2.3
Railways	2.0	2.3	2.3	2.3	2.3	2.3	2.3
Roads	2.0	2.3	2.3	2.3	2.3	2.7	2.7
Telecommunications	2.0	2.0	2.0	2.0	2.0	2.3	2.3
Water and waste water	2.0	2.0	2.0	2.0	2.0	1.7	1.7

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	5.1	4.5	2.4	9.3	6.3	5.7	6.0
Industrial gross output	0.0	1.7	-2.7	7.5	0.0	4.7	na
Agricultural gross output	23.2	3.0	-6.0	19.4	-5.2	-0.3	na
Employment			*(Percentage change)*				
Labour force (end-year)	1.8	1.4	2.6	0.3	2.2	-1.1	na
Employment (end-year)	0.2	-1.7	-1.3	0.5	0.9	-2.3	na
			(In per cent of labour force)				
Unemployment (end-year)	26.8	29.0	31.7	31.6	32.4	33.2	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	91.1	21.2	11.3	9.5	17.2	12.5	7.0
Consumer prices (end-year)	39.0	14.2	7.6	13.4	17.5	6.6	7.5
Producer prices (annual average)	na	na	na	na	na	na	na
Gross average monthly earnings in economy (annual average)	129.6	51.7	25.3	23.7	24.1	24.4	na
Government sector			*(In per cent of GDP)*				
General government balance	-4.9	-8.3	-3.4	0.0	0.9	2.7	-2.3
General government expenditure	43.8	51.8	46.7	45.3	43.1	42.1	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	107.0	62.9	12.6	17.1	31.4	47.3	na
Domestic credit (end-year)	19.8	-32.7	23.4	52.6	40.7	3.8	na
			(In per cent of GDP)				
Broad money (M2, end-year)	9.6	12.1	11.4	11.2	11.8	14.7	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Discount rate	16.4	9.5	9.0	8.5	8.5	8.5	na
Money market rate	55.3	32.2	27.1	16.3	19.2	15.3	na
Deposit rate	6.4	3.8	2.1	2.0	1.5	1.9	na
Lending rate (long-term)	34.5	19.7	15.5	15.5	16.8	16.6	na
			(Dinars per US dollar)				
Exchange rate (official, end-year)	67.7	59.0	54.6	57.9	72.2	62.0	na
Exchange rate (official, annual average)	66.8	64.2	57.5	58.7	67.2	67.0	na
External sector			*(In millions of US dollars)*				
Current account	-528.0	-2,502.0	-3,122.0	-3,302.0	-2,418.0	-3,700.0	-4,160.0
Trade balance	-2,834.0	-4,111.0	-5,565.0	-6,643.0	-5,563.0	-6,200.0	-8,000.0
Merchandise exports	2,003.0	2,075.0	2,477.0	3,726.0	4,647.0	6,500.0	7,000.0
Merchandise imports	4,837.0	6,186.0	8,042.0	10,369.0	10,210.0	12,700.0	15,000.0
Foreign direct investment, net	165.0	475.0	1,360.0	966.0	1,481.0	4,400.0	3,000.0
Gross reserves, excluding gold (end-year)	1,169.0	2,280.0	3,550.0	4,245.0	5,843.0	11,888.0	na
External debt stock	11,125.0	11,230.0	13,575.0	14,099.0	15,467.0	19,606.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	2.7	4.0	4.9	4.4	5.9	9.6	na
			(In per cent of exports of goods and services)				
Debt service	3.9	6.3	12.9	18.8	27.4	22.9	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million) [1]	7.5	7.5	7.5	7.5	7.5	7.5	na
GDP (in billions of dinars)	708.4	919.2	1,095.4	1,310.3	1,630.0	1,926.5	2,150.0
GDP per capita (in US dollars)	1,413.0	1,909.8	2,542.3	2,977.1	3,233.8	3,834.7	na
Share of industry in GDP (in per cent)	27.2	34.3	26.0	25.7	24.6	na	na
Share of agriculture in GDP (in per cent)	17.2	19.3	13.7	15.0	13.5	na	na
Current account/GDP (in per cent)	-5.0	-17.5	-16.4	-14.8	-10.0	-12.9	-12.0
External debt - reserves (in US$ million)	9,956.0	8,950.0	10,025.0	9,854.0	9,624.0	7,718.0	na
External debt/GDP (in per cent)	105.0	78.4	71.2	63.1	63.8	68.2	na
External debt/exports of goods and services (in per cent)	405.6	385.4	389.6	272.1	246.9	228.0	na

[1] Excluding Kosovo.

Slovak Republic

Key challenges

- Transition is well advanced but the new government needs to implement comprehensive health care and social security reforms.
- Labour market reforms should focus on containing labour costs, maintaining flexibility and reducing high levels of unemployment. More investment is needed in education and research and development to speed up implementation of the Lisbon Agenda.
- The government is committed to meeting the Maastricht criteria and joining the euro in January 2009. However, to achieve this, as well as maintaining investor confidence and sustaining high growth rates over the longer term the government needs to advance reforms and ensure greater fiscal flexibility.

Country data	
Population (in millions)	5.4
Area ('000 sq km)	49.0
GDP (in billion US$, 2006)	55.2
GDP per capita in 2006 at current international US$ (PPP)	17,812
National currency	Slovak koruna

Progress in structural reform

Liberalisation and privatisation

Recent economic success can be attributed to remarkable progress with privatisation and improvements in the business climate. However, following elections in June 2006 the new government decided not to proceed with pending privatisations of strategic companies that had been initiated by the previous government.

These included the sale of a 66 per cent stake in Bratislava airport, a 100 per cent stake in ZSKK Cargo (the freight arm of the state-owned Slovak railway company), a 51 per cent stake in each of the six state-owned district heating plants in the largest cities, and the remaining 51 per cent state-owned holding in each of the three regional energy distributors. The government is also reviewing several other privatisations announced by its predecessor, including the sale of the Bratislava Stock Exchange. The delay in privatising these entities has already resulted in lost revenue and contributed to lower inflows of FDI.

In a related development, the government has said it would like to retain management rights in the Slovak oil pipeline company Transpetrol. A 49 per cent stake of this was auctioned on 16 August 2007 by Yukos Finance, a Dutch registered subsidiary of the bankrupt Russian oil group, following a decision by a Russian creditors' committee. The stake was acquired by Promneftstroj, allegedly backed by the state-owned Russian oil company Rosneft, but the sale is still being disputed.

Business environment and competition

In the World Bank's Doing Business 2008 survey, the Slovak Republic was ranked 32nd out of 178 countries, ahead of the Czech Republic, Hungary, Poland and Slovenia, but behind the Baltic states. The key weaknesses identified in the Slovak Republic include the poor quality of public administration and judicial systems, and the high administrative burden on SMEs.

In October 2006 the new government increased the minimum wage by 10 per cent and is considering further increases. In July 2007 it approved a new labour code that tightens labour protection laws and increases workers' rights. The new code introduces strict limits on short-term contracts and overtime, increases severance pay and makes collective bargaining agreements binding for all enterprises operating in a given sector. Moreover, the government is considering increasing income taxes to boost government revenues. It is unclear what effect these changes will have, but they may not help to reduce the high level of unemployment (much of which is structural).

Although unemployment has fallen from a peak of 19.2 per cent of the labour force in 2001 to 10.8 per cent in May 2007, it is now the highest in the European Union (EU). Moreover, strong regional disparities persist; unemployment in 2006 ranged from 4.3 per cent in Bratislava to 20-21 per cent in the more eastern regions of Banska Bystrica and Kosice. As with other EU member states, Slovakia needs to speed up the implementation of the Lisbon Agenda and invest more in education and research and development activities.

Social sector

Results from the recent EBRD/World Bank Life in Transition Survey suggest that satisfaction with life and optimism about the future are very high, even among the over-65s and those on lower incomes. Moreover, household access to public services was perceived to be fairly high, even among the lower income groups.

However, there are still a number of important challenges to face, particularly in the health sector. The government has recently reversed some of the reforms introduced by the previous government in 2003-04; for example, fees to visit to the doctor have been scrapped, prescription charges have been lowered, VAT on medicines and medical services reduced and limits on operating costs for insurance companies introduced. This U-turn is likely to add to the pressures on overall funding of the health care system. The government is also considering reducing the role of private health insurers.

Macroeconomic performance

The Slovak Republic has witnessed particularly strong growth in recent years and the government is committed to joining the euro in 2009. Growth of real GDP accelerated to 8.3 per cent in 2006, driven by continued robust domestic demand and a significant increase in net external demand. Growth in the first half of 2007 continued to be high at 9.2 per cent, reflecting higher output from the automotive and electronics industries, among others, much of which was export-oriented.

Although employment levels have risen, record investment has spurred productivity while the continued high level of structural unemployment and decentralised bargaining structure have slowed wage growth, ensuring that the growth of real wages continues to lag that of productivity by a wide margin. As a result, the profitability of non-financial enterprises has increased continuously since 2002.

Strong growth has also enabled the government to achieve a consolidated general government deficit of 3.4 per cent of GDP in 2006. Notwithstanding higher social spending and farming subsidies, the target for the 2007 budget deficit is 2.9 per cent of GDP (including the second pillar pension costs, which are equivalent to 1.1 per cent of GDP). Given high revenue performance at the beginning of the year, the government looks likely to achieve this goal.

The outlook for inflation seems to have improved. The 12-month rolling harmonised index of consumer price inflation has been declining since December 2006 and stood at 2.4 per cent in August 2007. As a result, the National Bank of Slovakia (NBS) has lowered its policy rate by 50 basis points in two steps since the end of March 2007.

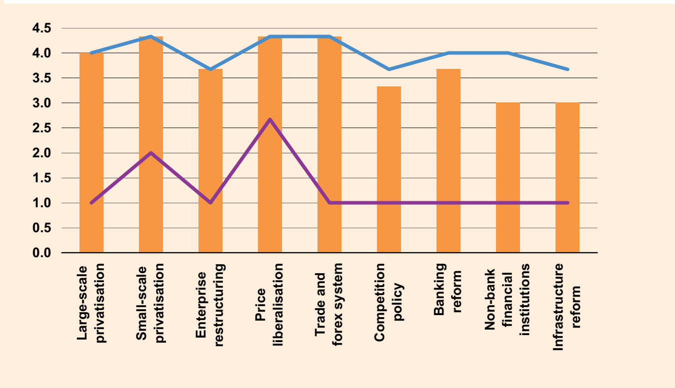
External imbalances are also contained. Although the current account deficit remained largely unchanged at 8.3 per cent of GDP in 2006, it is forecast to narrow significantly in 2007 as auto exports increase. FDI continues to finance a large share of the current account deficit.

The Slovak koruna has participated in the European Exchange Rate Mechanism II (ERM II) since November 2005. Following the shift in market sentiment that led to a sell-off of the koruna in mid-2006, the new government has been striving to regain the confidence of foreign investors and has reaffirmed its commitment to adopting the euro in 2009. Over the past year, the koruna has appreciated well above its original ERM II parity and in March 2007 the parity was revalued by 8.5 per cent to 35.4424 koruna per euro.

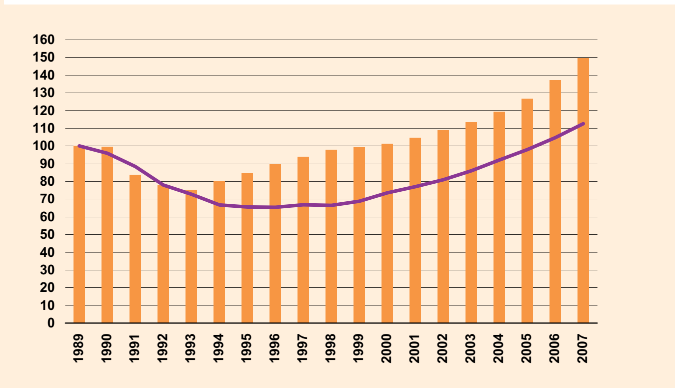
Outlook and risks

Real GDP is forecast to grow by 8.5 per cent in 2007. The Slovak Republic is committed to achieving its goal of adopting the euro in January 2009 but the authorities will have to carefully manage the adoption process and implement policies that will ensure fulfilment of the Maastricht criteria and help to sustain high growth in the future. Suspension of the privatisation programme and the recent changes in the labour and health care sectors constitute policy reversals. This makes continued structural reforms, ambitious fiscal consolidation and increased labour market flexibility even more necessary in order to maintain investor confidence and sustain robust growth over the longer term.

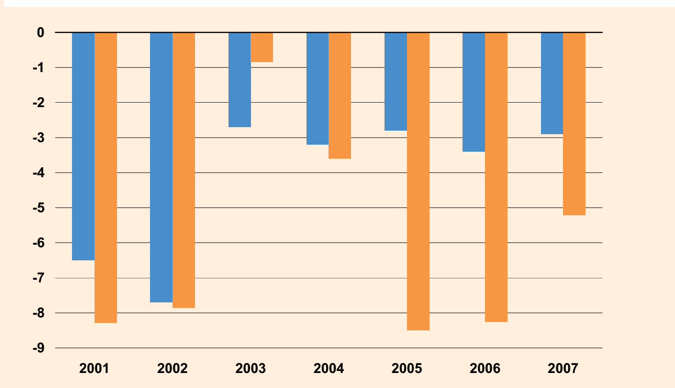
Transition indicators, 2007



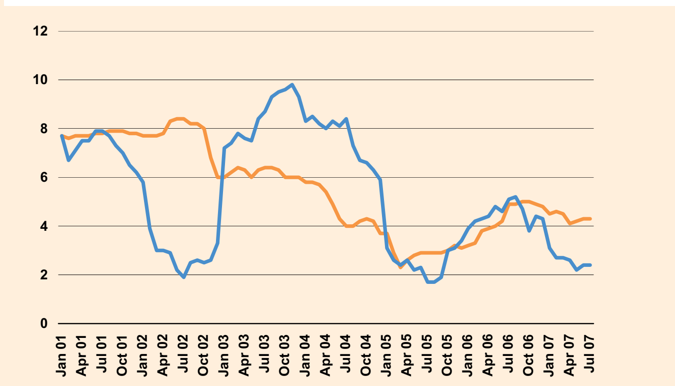
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no**

Interest rate liberalisation – **full**

Exchange rate regime – **managed float in ERM II**

Wage regulation – **no**

Tradeability of land – **full except non-EU foreigners**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **medium**

Secured transactions law – **advanced**

Quality of corporate governance law – **medium**

Infrastructure

Independent telecoms regulator – **fully**

Independent electricity regulator – **fully**

Separation of railway infrastructure from operations – **fully**

Independence of the road directorate – **fully**

Quality of concession laws – **medium**

Financial sector

Capital adequacy ratio – **8 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **high**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **2.9 per cent** (1996)

Government expenditure on health – **5.3 per cent of GDP** (2004)

Government expenditure on education – **4.4 per cent of GDP** (2005)

Household expenditure on power and water – **9.5 per cent** [1]

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	19.2	33.7	34.7	35.1	35.1	35.2	na
Private sector share in GDP (in per cent)	80.0	80.0	80.0	80.0	80.0	80.0	80.0
Private sector share in employment (in per cent)	75.0	75.0	75.0	75.0	75.0	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	2.2	1.5	1.7	1.9	1.3	1.4	na
Share of industry in total employment (in per cent)	29.6	30.1	29.3	29.5	29.3	29.0	na
Change in labour productivity in industry (in per cent)	5.9	4.3	6.2	2.7	2.7	7.2	na
Investment/GDP (in per cent)	29.6	29.0	24.6	26.0	29.2	29.0	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of enterprise reform	3.0	3.3	3.3	3.3	3.7	3.7	3.7
Markets and trade							
Share of administered prices in CPI (in per cent)	17.8	21.1	20.7	19.9	21.9	23.4	na
Number of goods with administered prices in EBRD-15 basket	3.0	3.0	3.0	2.0	2.0	2.0	na
Share of trade with non-transition countries (in per cent)	62.0	63.5	66.1	62.6	61.7	61.5	na
Share of trade in GDP (in per cent)	129.9	125.9	134.4	135.1	139.6	156.5	na
Tariff revenues (in per cent of imports) [2]	0.5	0.5	0.5	0.2	0.1	0.0	na
EBRD index of price liberalisation	4.0	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	3.0	3.0	3.0	3.3	3.3	3.3	3.3
Financial sector							
Number of banks (foreign-owned)	21 (12)	20 (15)	21 (16)	21 (16)	23 (16)	24 (16)	na
Asset share of state-owned banks (in per cent)	4.9	1.9	1.5	1.3	1.1	1.3	na
Asset share of foreign-owned banks (in per cent)	78.3	84.1	96.3	96.7	97.3	97.0	na
Non-performing loans (in per cent of total loans)	24.3	11.2	9.1	7.2	5.5	na	na
Domestic credit to private sector (in per cent of GDP)	32.9	30.7	31.8	30.2	35.1	39.2	na
Domestic credit to households (in per cent of GDP)	5.1	5.5	7.0	8.6	11.2	13.1	na
Of which mortgage lending (in per cent of GDP)	0.4	1.0	2.2	2.9	3.6	4.1	na
Stock market capitalisation (in per cent of GDP)	7.4	6.8	7.5	9.5	9.5	8.9	na
Stock trading volume (in per cent of market capitalisation)	na	na	29.4	19.8	1.6	1.9	na
Eurobond issuance (in per cent of GDP)	1.1	0.0	0.5	2.9	0.0	0.0	na
EBRD index of banking sector reform	3.3	3.3	3.3	3.7	3.7	3.7	3.7
EBRD index of reform of non-bank financial institutions	2.3	2.3	2.7	2.7	2.7	3.0	3.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	28.9 (39.9)	26.1 (54.4)	24.1 (68.4)	23.2 (79.4)	22.2 (84.1)	21.6 (90.6)	na
Internet users (per 100 inhabitants)	12.5	16.0	25.6	30.7	35.3	41.8	na
Railway labour productivity (1989=100)	62.4	60.6	60.5	61.7	64.8	71.1	na
Residential electricity tariffs (USc kWh)	5.7	7.1	10.9	13.7	14.9	na	na
Average collection rate, electricity (in per cent)	102	95	na	na	na	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	3.5	3.8	3.7	3.9	na	na	na
EBRD index of infrastructure reform	2.3	2.7	3.0	3.0	3.0	3.0	3.0
Electric power	3.0	4.0	4.0	4.0	4.0	4.0	4.0
Railways	2.3	2.7	2.7	2.7	3.0	3.0	3.0
Roads	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Telecommunications	3.0	3.3	3.3	3.3	3.7	3.7	3.7
Water and waste water [2]	2.3	2.3	2.7	3.0	3.0	3.3	3.3

[1] Estimate based on the poorest 25 per cent of households (lowest income quartile).

[2] Refers to import tariffs, customs duties and import surcharge.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			(Percentage change in real terms)				
GDP	3.2	4.1	4.2	5.4	6.0	8.3	8.5
Private consumption	5.2	5.2	0.2	4.2	7.0	6.1	na
Public consumption	5.2	5.2	3.9	2.0	-0.6	4.1	na
Gross fixed capital formation	12.9	0.3	-2.3	5.0	17.5	7.3	na
Exports of goods and services	6.8	4.7	15.9	7.9	13.8	20.7	na
Imports of goods and services	13.5	4.6	7.6	8.8	16.6	17.8	na
Industrial gross output	7.0	6.3	5.1	3.9	3.9	10.1	na
Agricultural gross output	-4.0	10.9	4.4	1.2	na	na	na
Employment			(Percentage change)				
Labour force (end-year)	1.7	-0.9	0.2	0.9	-0.5	0.3	2.4
Employment (end-year)	1.0	0.2	1.8	0.3	2.1	3.8	2.0
			(In per cent of labour force)				
Unemployment (end-year)	19.2	18.5	17.4	18.1	16.2	13.3	na
Prices and wages			(Percentage change)				
Consumer prices (annual average)	7.3	3.3	8.5	7.5	2.7	4.5	2.5
Consumer prices (end-year)	6.5	3.4	9.3	5.9	3.7	4.2	2.3
Producer prices (annual average)	6.6	2.2	8.9	3.4	3.9	8.0	na
Producer prices (end-year)	3.8	2.1	9.6	3.4	5.9	na	na
Gross average monthly earnings in economy (annual average)	8.2	9.3	6.3	10.2	9.2	8.6	na
Government sector			(In per cent of GDP)				
General government balance [1]	-6.5	-7.7	-2.7	-2.4	-2.8	-3.4	-2.9
General government expenditure	43.8	43.3	40.3	37.8	38.0	37.3	na
General government debt	49.2	43.3	42.7	41.6	34.5	30.8	na
Monetary sector [2]			(Percentage change)				
Broad money (M2, end-year)	11.9	3.4	-4.9	9.5	7.3	14.5	na
Domestic credit (end-year)	13.3	-12.7	9.3	6.9	12.0	13.4	na
			(In per cent of GDP)				
Broad money (M2, end-year)	66.6	63.2	55.1	54.0	53.4	55.5	na
Interest and exchange rates			(In per cent per annum, end-year)				
Refinancing rate	7.8	6.5	6.0	4.0	3.0	4.8	na
3-month BRIBOR	7.8	6.0	6.0	3.7	3.1	4.8	na
Deposit rate [3]	4.8	3.5	3.0	2.0	1.4	2.0	na
Lending rate [3]	9.8	8.8	7.7	6.4	5.9	7.0	na
			(Korunas per US dollar)				
Exchange rate (end-year)	48.2	41.1	33.6	29.1	31.9	26.2	na
Exchange rate (annual average)	48.4	45.3	36.8	32.3	31.0	29.6	na
External sector			(In millions of US dollars)				
Current account	-1,746.5	-1,924.2	-275.6	-1,507.4	-4,025.6	-4,561.9	-3,500.0
Trade balance	-2,125.2	-2,116.6	-637.3	-1,536.2	-2,385.2	-3,082.6	-2,000.0
Merchandise exports	12,644.5	14,382.2	21,843.2	27,621.2	31,914.8	41,695.6	53,500.0
Merchandise imports	14,769.7	16,498.8	22,480.4	29,157.4	34,299.9	44,778.2	55,500.0
Foreign direct investment, net	1,519.6	4,130.1	736.5	1,402.6	1,950.5	3,797.1	2,600.0
Gross reserves, excluding gold (end-year)	4,141.0	8,808.7	11,678.1	14,417.5	14,922.7	12,684.8	na
External debt stock	11,268.5	13,188.0	18,090.2	23,763.6	27,052.5	32,206.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	3.0	5.6	5.5	5.3	4.7	3.1	na
			(In per cent of exports of goods and services)				
Debt service due	19.5	11.7	11.6	12.1	8.0	5.0	na
Memorandum items			(Denominations as indicated)				
Population (end-year, million)	5.4	5.4	5.4	5.4	5.4	5.4	na
GDP (in billions of korunas)	1,020.6	1,111.5	1,212.7	1,355.3	1,471.1	1,636.4	1,828.2
GDP per capita (in US dollars)	3,910.4	4,558.6	6,130.5	7,810.6	8,817.0	10,250.8	na
Share of industry in GDP (in per cent)	25.2	23.5	24.3	25.9	25.6	25.4	na
Share of agriculture in GDP (in per cent)	4.5	4.0	3.6	4.0	3.9	3.6	na
Current account/GDP (in per cent)	-8.3	-7.8	-0.8	-3.6	-8.5	-8.3	-5.2
External debt - reserves (in US$ million)	7,127.5	4,379.4	6,412.1	9,346.1	12,129.8	19,521.2	na
External debt/GDP (in per cent)	53.4	53.8	54.9	56.6	57.0	47.3	na
External debt/exports of goods and services (in per cent)	74.5	76.8	72.0	75.8	74.5	68.4	na

[1] The general government balance excludes privatisation revenues and is calculated according to Eurostat methodology (ESA95). In line with the Eurostat derogation the second pillar pension funds are included from 2005.

[2] Until 2002 monetary data are compiled according to national methodology. From 2003 they are compiled in the harmonised ECB methodology.

[3] Weighted average over all maturities.

Slovenia

Key challenges

- Privatisation of large enterprises and banks has proceeded slowly in recent years. Therefore existing privatisation plans need to be implemented without delay – especially in banking and telecommunications – to enhance the economy's overall efficiency.
- Further progress is needed in reducing obstacles to setting up and running a business. This should be accompanied by other measures to increase market flexibility, especially the labour market.
- While the current macroeconomic position is relatively positive, substantial pension and health care reforms are necessary to ensure the long-term sustainability of public finances.

Country data

Population (in millions)	2.0
Area ('000 sq km)	20.5
GDP (in billion US$, 2006)	38.2
GDP per capita in 2006 at current international US$ (PPP)	24,261
National currency	Euro

Progress in structural reform

Liberalisation and privatisation

Privatisation has been slow over the last couple of years although some progress has been made. A 55.4 per cent stake in steel company SIJ was sold to the Russian company Koks in March 2007. Half the proceeds were used to increase the capital in Nova Ljubljanska banka (NLB), preserving the state's share at 35.4 per cent (45.5 per cent together with the state-run Pension Fund Management (KAD) and Restitution Fund (SOD)), following NLB's acquisition of three regional banks. The government views its investment in NLB as important for the ability of Slovenia to supervise its financial system.

The first phase of the privatisation of the second largest bank, Nova Kreditna banka Maribor (NKBM), of which the government directly owns 90 per cent, is expected by the end of 2007. The state intends to keep 25 per cent plus one share in NKBM as well as in other strategic companies, such as insurance company Zavarovalnica Triglav, the energy company Holding Slovenske elektrarne (HSE) and Telekom Slovenije (TS). Privatisation of TS is proceeding after a partial listing on the Ljubljana Stock Exchange in October 2006. The total stake to be sold has been increased to 49.1 per cent and a public tender was published on 31 August 2007.

KAD and SOD sold their stakes in 41 companies in the first seven months of 2007. At that time, SOD and KAD had stakes in 71 and 107 companies, respectively.

Business environment and competition

"One-stop shops" (dedicated offices or via the internet) for the registration of individual private entrepreneurs have been open for two years and the number of individual private entrepreneurs in July 2007 had increased by 8.7 per cent compared with July 2005. The expansion of one-stop shops for the registration of limited liability companies and general partnerships is expected to start in November 2007. The business community is also calling for a more flexible labour market, reinstatement of tax breaks for investment in equipment not used for research (which were axed with the tax reforms last year), less red tape and more efficient vocational education. Measures to address most of these concerns are currently being prepared.

Infrastructure

The Act on public-private partnerships (PPPs) came into force in March 2007 and consequently the number of PPPs is expected to rise. The government is already discussing PPP investment for the railways with Deutsche Bahn. The government finally implemented several delayed EU railway directives that aim to liberalise rail freight transport and strengthen rail transport safety.

Privatisation of energy company HSE is not expected until 2008/2009, although restructuring has already started. Two groups of energy companies are in the process of being created: one headed by HSE and the other by Gen energija. Gen energija is to remain in state ownership because of its stake in the Krško nuclear power plant.

The European Union (EU) has assessed the fixed telephony market as largely non-competitive, as Telekom Slovenije's market share remains close to 100 per cent. The telecoms regulator designated mobile phone companies Mobitel and Simobil as dominant companies in the mobile telephony market in April 2007. As a result, they have had to adjust their prices to ensure a closer correlation with actual costs. Mobitel's market share has fallen slightly to a little above 70 per cent, while Simobil gained from mobile number portability and increased its share from 23 per cent at the end of 2005 to about 25 per cent in the first quarter of 2007.

Social sector

The much-needed amendments to the pension and disability insurance law (in particular the penalty for early retirement and the bonus for working beyond the mandatory retirement age) were removed from the government's agenda owing to a lack of coordination between the interested parties and protests by the unions. The unions are strongly against privatisation in health care (as well as education and other public services). A consensus on the new Labour Relations Act was reached in July 2007. However, it was criticised by the employers' organisations for bringing in only minor changes that will not really improve flexibility in the labour market. In addition, an education reform package is being discussed in the parliament. The intention is to create a single level of higher education and research, and boost funding to 5 per cent of GDP. The package also proposes reforms to facilitate the establishment of private schools and improve quality and choice.

Macroeconomic performance

Despite slow privatisation of the remaining state-owned companies, real GDP grew by 5.7 per cent in 2006. Preliminary figures for the first and second quarter of 2007 (7.2 and 5.9 per cent year-on-year, respectively) suggest similar growth in 2007. The main drivers were exports and gross fixed capital formation, in particular construction (of motorways, especially), and was supported by the positive effects of EU membership.

On 1 January 2007 Slovenia became the first of the new EU members to enter the European Economic and Monetary Union and, without any difficulties, the euro became the official currency. In August 2007 the annual rate of inflation climbed to 3.5 per cent from 2.8 per cent at the end of 2006, owing mostly to higher prices of both food and holiday packages. The financial system remains relatively stable and its exposure to risk has decreased after the adoption of the euro. Banks under majority foreign ownership increased their market share from 22.6 per cent of all assets in 2005 to 29.5 per cent in 2006.

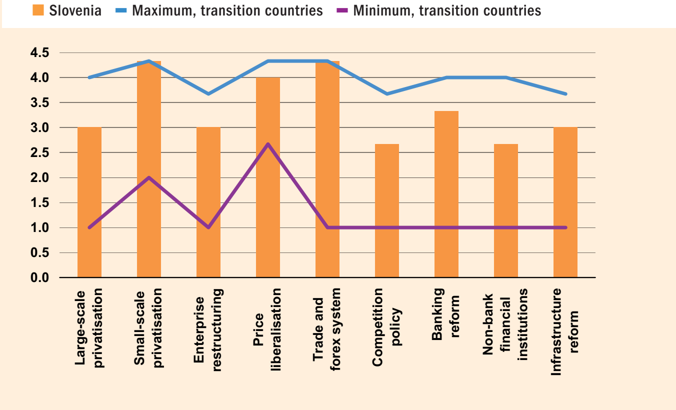
The general government deficit decreased slightly to 1.4 per cent of GDP in 2006 (ESA95). The target for 2007 was a deficit of 1.5 per cent of GDP, but recent estimates indicate a substantially lower deficit as a result of good economic performance. Substantial reforms of the pension, social welfare and health care systems are needed. This is because of several factors, including a rapidly ageing population, one of the lowest average retirement ages, one of the highest pension-to-wages ratios in Europe, relatively high and inefficient spending on health care and wide coverage of social benefits, and ineffective means-testing.

The current account deficit grew to 2.5 per cent of GDP in 2006, up by 0.6 percentage points compared with 2005, and it is expected to increase further in 2007. There was an outflow of net FDI of 0.9 per cent of GDP, mostly due to Slovenian investors investing abroad, especially in the countries of ex-Yugoslavia. If the proposed privatisation of TS goes ahead this year, a net inflow of FDI is expected. Gross external debt increased to 78.5 per cent of GDP by the end of 2006 and is projected to grow to almost 86 per cent of GDP by the end of 2007.

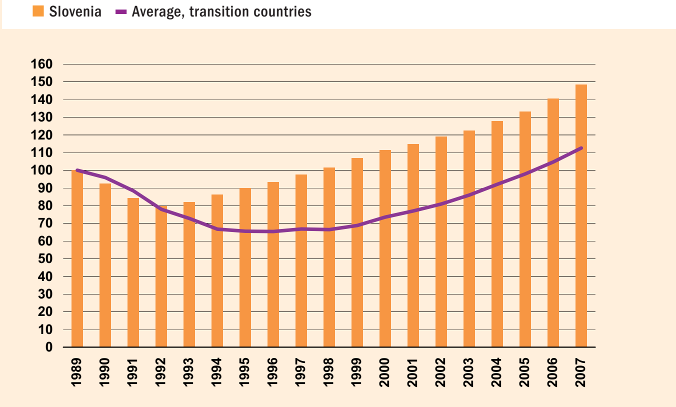
Outlook and risks

The short-term economic outlook is positive and high growth is likely to continue being fuelled by the favourable external environment and supported by funding from the EU's structural funds. A new social agreement between the government, employers and the unions on matters such as wages, workers' rights and working conditions (signed in October and valid until 2009) includes a compromise envisaging real wage growth based on inflation and gains in productivity at both industry and company level. Competitiveness could be at risk if the growth of real wages follows that of productivity too closely. However, despite the trend of increasing inflation, the risk seems moderate in light of the recent estimates that indicate a lower than planned general government deficit. Nevertheless, faster progress in structural reform and privatisation is needed to ensure the risk does not increase should the environment change.

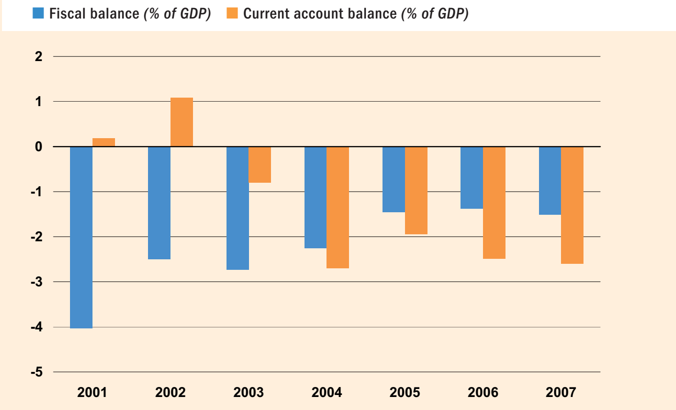
Transition indicators, 2007



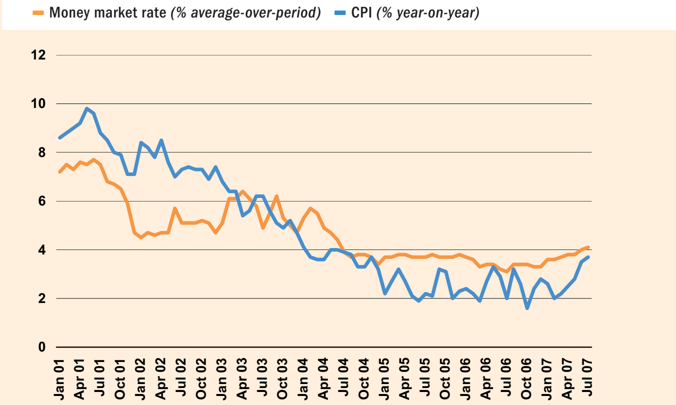
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation	Business environment and competition	Infrastructure	Financial sector	Social reform
Current account convertibility – **full**	Competition office – **yes**	Independent telecoms regulator – **fully**	Capital adequacy ratio – **8.0 per cent**	Share of population living in poverty – **<2.0 per cent** (1998)
Controls on inward direct investment – **no** [1]	Quality of insolvency law – **low**	Independent electricity regulator – **fully**	Deposit insurance system – **yes**	Government expenditure on health – **6.5 per cent of GDP** (2005)
Interest rate liberalisation – **full**	Secured transactions law – **inefficient**	Separation of railway infrastructure from operations – **fully**	Quality of securities market laws – **high**	Government expenditure on education – **6.6 per cent of GDP** (2005)
Exchange rate regime – **floating**	Quality of corporate governance law – **medium**	Independence of the road directorate – **partially**	Private pension funds – **yes**	Household expenditure on power and water – **9.1 per cent**
Wage regulation – **yes**		Quality of concession laws – **na** [2]		
Tradeability of land – **full except non-EU foreigners**				

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	2.5	4.6	4.7	4.8	4.9	5.0	na
Private sector share in GDP (in per cent)	65.0	65.0	65.0	65.0	65.0	65.0	70.0
Private sector share in employment (in per cent)	70.0	70.0	69.0	69.0	69.0	70.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	3.2	2.8	2.9	3.6	3.8	3.9	na
Share of industry in total employment (in per cent)	32.2	32.6	31.1	30.2	30.8	29.5	na
Change in labour productivity in industry (in per cent)	-1.5	0.7	8.9	2.6	0.3	9.4	na
Investment/GDP (in per cent)	25.0	24.1	25.5	27.7	27.3	28.4	na
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	3.0	3.0	3.0	3.0	3.0	3.0	3.0
EBRD index of enterprise reform	2.7	3.0	3.0	3.0	3.0	3.0	3.0
Markets and trade							
Share of administered prices in CPI (in per cent)	13.2	14.0	15.4	16.1	16.7	17.4	na
Number of goods with administered prices in EBRD-15 basket	1.0	1.0	1.0	1.0	1.0	1.0	na
Share of trade with non-transition countries (in per cent)	76.7	77.6	77.7	77.1	74.6	74.5	na
Share of trade in GDP (in per cent) [3]	105.9	98.6	94.6	100.7	107.0	115.6	na
Tariff revenues (in per cent of imports)	1.1	1.2	1.2	0.6	0.2	0.3	na
EBRD index of price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Financial sector							
Number of banks (foreign-owned) [4]	24 (5)	22 (6)	22 (6)	22 (7)	25 (9)	25 (10)	na
Asset share of state-owned banks (in per cent)	48.9	13.3	12.8	12.6	12.0	12.6	na
Asset share of foreign-owned banks (in per cent)	15.2	16.9	18.9	20.1	22.6	29.5	na
Non-performing loans (in per cent of total loans)	10.0	10.0	9.4	7.5	6.4	5.6	na
Domestic credit to private sector (in per cent of GDP) [5]	39.3	39.2	42.0	48.8	57.3	67.1	na
Domestic credit to households (in per cent of GDP)	10.9	10.5	10.8	12.2	14.8	17.0	na
Of which mortgage lending (in per cent of GDP)	1.8	2.0	2.3	2.8	4.2	4.5	na
Stock market capitalisation (in per cent of GDP)	17.0	24.5	28.9	36.3	28.0	49.9	na
Stock trading volume (in per cent of market capitalisation)	30.5	27.9	12.7	14.7	9.0	8.5	na
Eurobond issuance (in per cent of GDP)	3.2	0.0	0.0	0.7	0.0	0.0	na
EBRD index of banking sector reform	3.3	3.3	3.3	3.3	3.3	3.3	3.3
EBRD index of reform of non-bank financial institutions	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	40.2 (73.7)	40.5 (83.5)	40.7 (87.1)	41.3 (93.3)	41.5 (89.4)	42.6 (92.6)	na
Internet users (per 100 inhabitants)	30.1	37.6	40.1	48.0	55.4	63.6	na
Railway labour productivity (1989=100)	122.7	135.7	150.3	163.2	155.4	175.8	na
Residential electricity tariffs (USc kWh)	8.7	9.3	11.5	12.9	13.1	13.3	na
Average collection rate, electricity (in per cent)	na	97	93	na	90	96	na
GDP per unit of energy use (PPP in US dollars per kgoe)	5.1	5.3	5.2	5.4	na	na	na
EBRD index of infrastructure reform [6]	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Electric power	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Railways	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Roads	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Telecommunications	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Water and waste water	3.3	3.3	3.3	3.3	3.3	3.3	3.3

1 Direct investment by non-residents in the production or trading of armaments and military equipment requires a government licence.

2 A new concession law came into force in March 2007. It has not been evaluated within the EBRD Concession Assessment Project but is considered as conforming with the internationally accepted standards.

3 Ratio calculated in euros.

4 Two foreign branches are included in the figure.

5 Source: Bank of Slovenia.

6 Series has been revised.

	2001	2002	2003	2004	2005	2006 *Estimate*	2007 *Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	3.1	3.7	2.8	4.4	4.1	5.7	5.5
Private consumption	2.6	1.8	3.4	3.0	2.7	4.0	na
Public consumption	3.9	3.4	1.9	3.1	3.2	4.4	na
Gross fixed capital formation	1.4	1.0	7.4	7.3	2.5	8.4	na
Exports of goods and services	6.4	6.8	3.1	12.5	10.1	12.3	na
Imports of goods and services	3.1	4.9	6.7	13.3	6.7	12.2	na
Industrial gross output	2.9	2.4	1.4	5.5	3.3	6.1	na
Agricultural gross output [1]	0.1	12.1	-15.8	15.1	-4.4	-3.8	na
Employment [2]			*(Percentage change)*				
Labour force (end-year)	1.1	-2.9	3.1	2.6	2.4	-1.5	na
Employment (end-year)	0.5	-2.5	2.9	2.9	1.6	0.3	na
			(In per cent of labour force)				
Unemployment (end-year)	6.9	6.5	6.7	6.4	7.2	5.6	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	8.4	7.5	5.6	3.6	2.5	2.5	3.2
Consumer prices (end-year)	7.0	7.2	4.6	3.2	2.3	2.8	2.9
Producer prices (annual average)	8.9	5.1	2.5	4.3	2.7	2.3	na
Producer prices (end-year)	7.5	3.7	2.1	4.9	1.8	2.8	na
Gross average monthly earnings in economy (annual average) [3]	11.9	9.8	7.5	4.4	4.9	4.8	na
Government sector [4]			*(In per cent of GDP)*				
General government balance	-4.0	-2.5	-2.7	-2.3	-1.4	-1.4	-1.5
General government expenditure	48.1	47.1	47.2	46.5	46.0	45.2	na
General government debt	27.7	28.5	28.1	28.4	27.7	27.2	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	29.9	11.0	6.2	6.6	7.8	8.2	na
Domestic credit (end-year)	16.9	14.1	14.4	24.1	20.2	21.6	na
			(In per cent of GDP)				
Broad money (M2, end-year)	52.7	52.5	51.3	50.7	51.6	51.8	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Discount rate	7.8	7.3	5.0	3.3	3.8	3.8	na
Interbank market rate (average)	6.9	4.9	5.6	4.4	3.7	3.4	na
Deposit rate (average 31-90 days)	9.8	8.2	6.0	3.8	3.2	2.7	na
Lending rate (average short-term working capital)	15.1	13.2	10.8	8.7	7.8	7.4	na
			(Euro per US dollar)				
Exchange rate (end-year)	1.1	1.0	0.8	0.7	0.8	0.8	na
Exchange rate (annual average)	1.1	1.1	0.9	0.8	0.8	0.8	na
External sector			*(In millions of US dollars)*				
Current account	37.2	243.8	-215.1	-892.4	-682.0	-941.5	-1,123.4
Trade balance	-614.9	-247.7	-622.1	-1,257.5	-1,258.2	-1,426.4	-1,622.5
Merchandise exports	9,348.3	10,471.1	12,916.3	16,064.6	18,145.8	21,397.1	25,611.5
Merchandise imports	9,963.2	10,718.9	13,538.5	17,322.1	19,404.0	22,823.5	27,235.4
Foreign direct investment, net	225.6	1,508.0	-174.1	281.1	-88.3	-376.9	1,011.8
Gross reserves, excluding gold (end-year)	4,107.7	6,846.0	8,567.3	8,743.3	8,454.5	6,987.0	na
External debt stock	9,246.7	12,104.8	16,703.2	20,940.1	24,517.5	31,464.9	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year) [5]	4.3	5.9	5.9	4.8	4.5	3.1	na
			(In per cent of exports of goods and services)				
Debt service	14.9	16.5	14.6	12.7	14.4	17.4	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	2.0	2.0	2.0	2.0	2.0	2.0	na
GDP (in billions of euros)	20.4	22.8	24.7	26.7	28.2	30.4	31.9
GDP per capita (in US dollars)	9,227.7	10,745.4	14,021.3	16,650.4	17,951.1	19,218.5	na
Share of industry in GDP (in per cent)	25.9	25.3	25.4	24.9	23.9	24.0	na
Share of agriculture in GDP (in per cent)	2.5	2.7	2.2	2.3	2.2	2.0	na
Current account/GDP (in per cent) [5]	0.2	1.1	-0.8	-2.7	-1.9	-2.5	-2.6
External debt - reserves (in US$ million)	5,139.0	5,258.8	8,135.8	12,196.8	16,063.0	24,477.9	na
External debt/GDP (in per cent) [5]	50.9	50.6	53.5	57.5	69.4	78.5	na
External debt/exports of goods and services (in per cent) [5]	82.2	85.2	95.3	97.6	110.1	116.2	na

1 Agricultural value-added.
2 Data based on labour force surveys.
3 Data for enterprises employing three or more persons until 2004. From 2005 onwards, data for legal persons with 1 or 2 employees in the private sector also taken into account.
4 Since 2000, calculated according to Eurostat methodology (ESA95).
5 Ratio calculated in euros.

Tajikistan

Key challenges

- A sound regulatory framework for the energy sector is required for the country to fully benefit from new investments in generation capacity and to foster regional power trade.
- Diversification of agricultural production and a deepening of land reform would contribute to more sustainable growth, increase rural incomes and reduce inflationary pressures.
- Important bilateral investments and loan commitments have improved the country's medium-term growth prospects, but room for further sovereign borrowing is limited as external debt is hitting sustainability levels.

Country data

Population (in millions)	6.6
Area ('000 sq km)	143.1
GDP (in billion US$, 2006)	2.8
GDP per capita in 2006 at current international US$ (PPP)	1,468
National currency	Somoni

Progress in structural reform

Liberalisation and privatisation

Privatisation of small enterprises has been completed. Land reform is under way, with the publication of a decree in 2007 that allows for the transferability of land certificates. It also provides for a comprehensive strategy to resolve the debt of cotton farms, which is being carried out in collaboration with international financial institutions and donors. The pace of progress nevertheless depends on political commitment to overcome vested interests.

There has been some progress with large-scale privatisation. In June 2007 Tajikkhimprom, a large chemical company, was sold to a British-registered company, Enjik Chemical (the only bidder) through an international tender for an estimated US$ 2.9 million. The government plans to restructure other large state-owned companies such as Tajikistan State Air Company, Tajiktelecom and Tajikcement and privatise them by 2010.

Business environment and competition

The business environment continues to be difficult. Tajikistan ranks 153rd out of 178 countries in the World Bank's survey Doing Business 2008 and corruption remains an obstacle both to business and reform. Weak governance, barriers to entry and the cost of dealing with the government are the other main constraints on businesses. Some progress is expected when the government adopts the Private Sector Development Strategy in 2007, which provides for a new law on licensing aimed at reducing the number of business inspections and extending the duration of permits. The private sector in Tajikistan remains underdeveloped, its share of GDP remains at around 55 per cent and private investment is limited at about 5 per cent of GDP.

Infrastructure

Large investments have recently been made in the energy sector, focusing mainly on the upgrading and development of hydro power stations and power transmission lines. The Sangtuda I power station is expected to become operational in 2008. It will be 51 per cent owned by RAO UES of Russia and 25 per cent by the Republic of Tajikistan, with the balance expected to come from private investors. The feasibility study for the Rogun power station has been completed but there is now uncertainty after the departure of Rusal, the principal potential investor. China's Eximbank has committed loans amounting to approximately US$ 1 billion for hydro power, power transmission lines and transport. Infrastructure modernisation is benefiting greatly, although there are some concerns over the generally opaque nature of the Chinese loans, the terms of which lack procurement standards.

Further reforms in the energy sector are essential, especially in view of the large foreign involvement in power generation. The generation, distribution and transmission functions need to be unbundled and the policy-making and regulatory functions of the Ministry of Energy should be separated. The government has agreed to an increase in electricity and gas tariffs in line with the 2007-10 schedule agreed with the World Bank. Nevertheless, collection rates, particularly from state entities, remain low.

Important projects are under consideration to develop Tajikistan's export potential. The authorities, working with international financial institutions, are developing a regional energy network that will allow Tajikistan to export its power surplus during summer months and import energy during winter months. In particular, the Asian Development Bank is backing a transmission line project with Afghanistan and power purchase agreements are being developed between Tajikistan and Afghanistan.

Financial sector

There has been further consolidation in the banking sector, the number of microfinance institutions has risen and the volume of household deposits has increased sharply over the past two years, albeit from a very low base. The creation of a mortgage law and a credit bureau in the near future is likely to improve household access to finance. However, the financial sector remains weakly capitalised and banks carry significant foreign exchange risks in their portfolios. Foreign participation in the sector is so far limited to Kazkommersbank from Kazakhstan, which has received approval from the National Bank of Tajikistan (NBT) to open a branch.

Macroeconomic performance

Steady economic growth has continued with GDP increasing by 7.6 per cent in 2006 and 7.3 per cent over the first six months of 2007. Growth largely reflects a substantial inflow of remittances from workers abroad, strong aluminium exports and large investments in energy and infrastructure. The volume of officially recorded remittances has significantly increased from 0.1 per cent of GDP in 2000 to 32 per cent in 2006, although the unofficial figure may amount to as much as 42 per cent of GDP, according to World Bank estimates. Russia's decision to impose quotas on Tajik migrants, which would cut the number of Tajik workers in Russia by 40 per cent, would have serious adverse consequences for GDP growth as well as for the current account balance. However, as of mid-2007, this has not translated into binding restrictions.

The same factors contributed to a large rise in inflation, which increased to 12.7 per cent at the end of 2006. The NBT responded by increasing its refinancing rate to 13 per cent in January 2007, but the effectiveness of monetary policy is constrained by the low level of monetisation of the economy, at around 9.4 per cent of GDP. Nevertheless, the 12-month rate of inflation eased below 10 per cent over the first half of 2007.

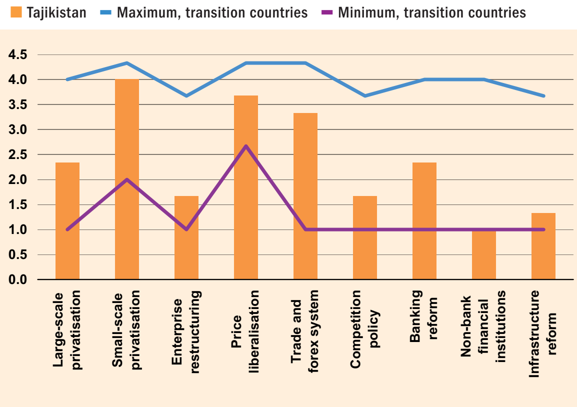
Fiscal policy improved greatly in 2006, resulting in a fiscal surplus of 1.7 per cent of GDP, compared with a deficit of 2.9 per cent in 2005. This was mainly because of increased grants associated with the Multilateral Debt Relief Initiative. The revenue ratio remained flat at 19 per cent of GDP and it is one of the lowest in the transition region. On the expenditure side, the government has substantially increased public sector wages and it plans to expand social spending over the medium term.

The current account deficit increased in 2006 as domestic consumption rose, domestic agricultural production stagnated and prices of grain and energy imports increased. This trend continued during the first half of 2007, particularly after the sharp hike in Uzbek gas prices at the beginning of the year, which led to a near doubling of the gas import bill. After the external debt-to-GDP ratio halved between 2003 and 2006, it is projected to increase in 2007 and approach 60 per cent by 2009 due to an undertaking of large externally funded infrastructure projects.

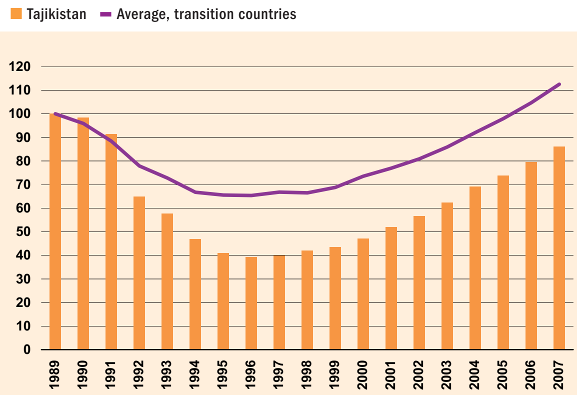
Outlook and risks

In the short to medium term, high investment in infrastructure projects will continue to buoy up the construction and services sectors, and the country is likely to achieve growth of 7–9 per cent per year. However, a development strategy that involves a rapid accumulation of external debt raises concerns over debt sustainability in the event of adverse macroeconomic conditions. The long-term economic benefit of large infrastructure investments is also contingent on further reforms in agriculture and energy, as well as improvements in the business environment that foster the development of private businesses.

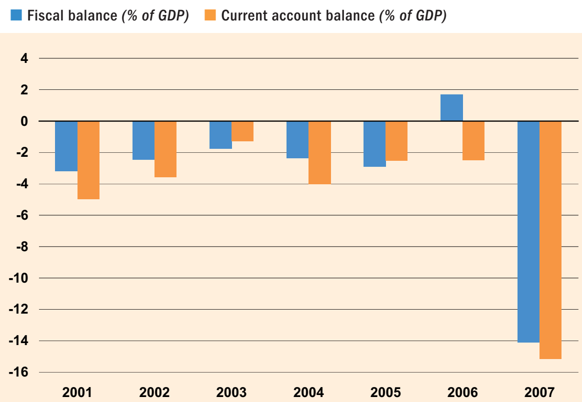
Transition indicators, 2007



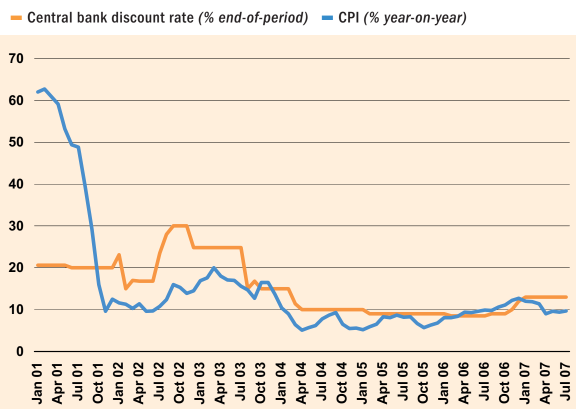
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no** [1]

Interest rate liberalisation – **full**

Exchange rate regime – **managed floating**

Wage regulation – **yes**

Tradeability of land – **limited de jure**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **low**

Secured transactions law – **inefficient**

Quality of corporate governance law – **very low**

Infrastructure

Independent telecoms regulator – **no**

Independent electricity regulator – **no**

Separation of railway infrastructure from operations – **no**

Independence of the road directorate – **no**

Quality of concession laws – **very low**

Financial sector

Capital adequacy ratio – **12 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **low**

Private pension funds – **no**

Social reform

Share of population living in poverty – **42.8 per cent** (2003) [2]

Government expenditure on health – **1.4 per cent of GDP** (2006)

Government expenditure on education – **4.2 per cent of GDP** (2006)

Household expenditure on power and water – **6.0 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	4.9	5.8	6.3	6.7	7.2	7.6	na
Private sector share in GDP (in per cent)	45.0	50.0	50.0	50.0	55.0	55.0	55.0
Private sector share in employment (in per cent) [3]	41.6	44.7	45.8	51.2	52.4	51.9	na
Budgetary subsidies and current transfers (in per cent of GDP)	0.5	0.5	0.4	0.4	0.4	0.6	na
Share of industry in total employment (in per cent) [3]	6.7	6.6	6.1	5.6	5.7	5.5	na
Change in labour productivity in industry (in per cent)	12.5	7.2	16.6	10.9	5.8	9.4	na
Investment/GDP (in per cent)	15.8	13.9	13.1	14.9	14.8	13.5	na
EBRD index of small-scale privatisation	3.7	3.7	3.7	3.7	4.0	4.0	4.0
EBRD index of large-scale privatisation	2.3	2.3	2.3	2.3	2.3	2.3	2.3
EBRD index of enterprise reform	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Markets and trade							
Share of administered prices in CPI (in per cent)	0.0	0.0	0.0	0.0	0.0	0.0	na
Number of goods with administered prices in EBRD-15 basket	0.0	0.0	0.0	0.0	0.0	0.0	na
Share of trade with non-transition countries (in per cent)	38.3	32.7	46.3	45.4	45.9	45.5	na
Share of trade in GDP (in per cent)	137.5	129.3	122.5	112.3	56.9	60.0	na
Tariff revenues (in per cent of imports)	2.8	2.6	2.3	2.7	5.0	3.8	na
EBRD index of price liberalisation	3.7	3.7	3.7	3.7	3.7	3.7	3.7
EBRD index of forex and trade liberalisation	3.3	3.3	3.3	3.3	3.3	3.3	3.3
EBRD index of competition policy	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Financial sector							
Number of banks (foreign-owned)	15 (3)	14 (3)	15 (4)	12 (3)	12 (3)	na	na
Asset share of state-owned banks (in per cent)	4.8	4.5	6.1	12.2	9.7	na	na
Asset share of foreign-owned banks (in per cent)	70.3	1.8	3.6	6.2	8.9	na	na
Non-performing loans (in per cent of total loans)	12.5	84.2	73.6	18.7	13.8	na	na
Domestic credit to private sector (in per cent of GDP)	14.8	16.2	14.0	17.4	17.2	16.0	na
Domestic credit to households (in per cent of GDP)	na	na	0.5	1.1	1.3	na	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	na	na
Stock market capitalisation (in per cent of GDP)	na	na	na	na	na	na	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	na	na	na	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	na	na	na	na	na
EBRD index of banking sector reform	1.0	1.7	1.7	2.0	2.0	2.3	2.3
EBRD index of reform of non-bank financial institutions	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	3.7 (0.0)	3.7 (0.2)	3.8 (0.7)	3.8 (2.1)	3.8 (4.1)	4.3 (na)	na
Internet users (per 100 inhabitants)	0.1	0.1	0.1	0.1	0.3	0.3	na
Railway labour productivity (1994=100)	57.2	50.3	47.3	38.0	38.4	42.3	na
Residential electricity tariffs (USc kWh)	0.5	0.5	0.5	0.6	0.6	0.6	na
Average collection rate, electricity (in per cent)	na	65	73	85	74	96	na
GDP per unit of energy use (PPP in US dollars per kgoe)	1.8	1.9	2.1	2.1	na	na	na
EBRD index of infrastructure reform	1.0	1.0	1.0	1.3	1.3	1.3	1.3
Electric power	1.0	1.0	1.0	1.7	1.7	2.0	2.0
Railways	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Roads	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Telecommunications	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Water and waste water	1.0	1.0	1.0	1.0	1.0	1.0	1.0

1 Approval from the National Bank of Tajikistan is required.

2 According to the national poverty definition of US$ 2.15 per day at PPP, the poverty rate in 2003 was 64 per cent.

3 Data from registered enterprises.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	10.2	9.1	10.2	10.6	6.9	7.6	8.5
Industrial gross output	14.4	6.3	9.9	13.8	8.5	6.7	na
Agricultural gross output	11.0	14.0	9.1	11.3	3.1	4.8	na
Employment			*(Percentage change)*				
Labour force (annual average) [1]	4.3	1.7	1.5	10.4	1.0	1.4	na
Employment (annual average) [1]	4.8	1.5	1.5	10.9	1.1	1.2	na
			(In per cent of labour force)				
Unemployment (annual average) [2]	2.3	2.5	2.4	2.0	1.9	2.2	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	38.6	12.2	16.3	7.1	7.0	10.0	10.1
Consumer prices (end-year)	12.5	14.5	13.7	5.7	7.1	12.7	9.0
Producer prices (annual average)	28.7	10.1	15.0	17.1	10.7	42.7	na
Producer prices (end-year)	9.4	19.0	14.1	15.1	5.6	54.3	na
Gross average monthly earnings in economy (annual average)	50.7	38.0	37.6	36.3	41.1	36.7	na
Government sector [3]			*(In per cent of GDP)*				
General government balance	-3.2	-2.5	-1.8	-2.4	-2.9	1.7	-14.1
General government expenditure	18.4	19.2	19.1	20.3	23.0	21.7	na
General government debt	101.3	89.4	64.8	43.1	41.9	33.6	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	35.0	40.5	40.9	9.8	25.9	59.7	na
Domestic credit (end-year)	95.0	14.0	-6.5	52.7	16.3	21.1	na
			(In per cent of GDP)				
Broad money (M2, end-year)	7.9	8.4	8.3	7.0	7.6	9.4	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Monetary policy rate	23.4	21.0	15.0	10.0	9.0	12.0	na
Deposit rate (up to 3 months)	5.2	11.6	14.6	8.6	8.6	8.2	na
Lending rate (up to 3 months)	21.1	13.4	15.6	21.3	25.6	26.7	na
			(Tajik somoni per US dollar)				
Exchange rate (end-year)	2.5	3.0	2.9	3.0	3.2	3.4	na
Exchange rate (annual average)	2.4	2.8	3.1	3.0	3.1	3.3	na
External sector			*(In millions of US dollars)*				
Current account	-52.3	-42.9	-19.9	-83.0	-58.0	-70.0	-476.0
Trade balance	-104.5	-93.9	-103.1	-151.2	-622.0	-986.0	-1,477.0
Merchandise exports	672.6	730.4	900.0	1,087.8	346.0	350.0	383.0
Merchandise imports	777.0	824.3	1,003.2	1,239.0	968.0	1,336.0	1,860.0
Foreign direct investment, net	9.5	36.1	31.6	272.0	55.0	66.0	70.0
Gross reserves, excluding gold (end-year)	95.7	96.0	135.0	189.0	235.0	252.0	na
External debt stock	1,273.0	1,272.0	1,298.0	1,146.0	1,166.0	1,150.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	1.4	1.2	1.4	1.6	2.3	1.8	na
			(In per cent of exports of goods and services)				
Debt service	13.5	13.3	11.2	28.1	15.7	29.6	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	6.2	6.3	6.4	6.4	6.5	6.6	na
GDP (in millions of somoni)	2,512.0	3,345.0	4,758.0	6,158.0	7,201.0	9,272.0	10,867.0
GDP per capita (in US dollars)	169.3	191.0	244.4	322.1	355.1	426.5	na
Share of industry in GDP (in per cent) [4]	22.7	22.1	20.9	19.6	21.3	28.0	na
Share of agriculture in GDP (in per cent) [4]	26.5	26.3	25.2	21.6	17.2	22.0	na
Current account/GDP (in per cent)	-5.0	-3.6	-1.3	-4.0	-2.5	-2.5	-15.2
External debt - reserves (in US$ million)	1,177.0	1,176.0	1,163.0	957.0	931.0	898.0	na
External debt/GDP (in per cent)	120.7	105.8	83.5	55.3	50.5	40.9	na
External debt/exports of goods and services (in per cent)	173.2	159.1	131.8	94.7	193.8	172.0	na

[1] Data from registered enterprises.
[2] Officially registered unemployed.
[3] Includes externally financed public investment programmes.
[4] Figures are based on current prices. Variations in the shares reflect changes in relative prices.

Turkmenistan

Key challenges

- To enhance entrepreneurship and competition privatisation needs to progress significantly, price controls should be abolished and subsidies removed.
- Substantial investments in the hydrocarbon sector are needed to ensure continued production growth. These must be accompanied by more concrete steps to improve the business environment, attract investment to sectors outside the oil and gas industry and diversify the economic base.
- The positive initial steps of opening the economy to foreign trade and investment need to be followed by more widespread economic liberalisation.

Country data

Population (in millions)	6.5
Area ('000 sq km)	488.0
GDP (in billion US$, 2006)	10.2
GDP per capita in 2006 at current international US$ (PPP)	na
National currency	Manat

Progress in structural reform

Business environment and competition

Despite the introduction of a streamlined and simplified tax code in 2004 and some tax incentives for private companies in 2005, the business environment in Turkmenistan remains extremely difficult. There has been little progress in structural and institutional reforms in the last year and the new government's policy agenda does not seem very ambitious. Price controls and the free provision of utilities continue to underpin the system. Corruption remains widespread, according to Transparency International's latest Corruption Perceptions Index, where Turkmenistan ranks in the bottom 5 per cent. However, a number of recent high-level dismissals may indicate an increase in political will to deal with this issue.

Significant restrictions on trade, including wide-ranging import restrictions and very limited access to foreign exchange, continue to have an adverse effect on the business environment. Companies still struggle to secure enough foreign currency to conduct trade transactions. Therefore FDI continues to focus mainly on the hydrocarbon sector with small exceptions in infrastructure investments, such as water and railways. The new government shows significantly more interest than its predecessor in increasing FDI into the hydrocarbon sector. Existing investors such as Dragon Oil, Petronas and Burren Energy all plan to increase their involvement. Potential new investors such as US firm Chevron, Kazakhstan's state hydrocarbon company KazMunayGaz, Russia's Lukoil (jointly with ConocoPhillips) and the Russian-British joint venture TNK-BP all held high level discussions with the government.

The government has also indicated a greater openness to FDI in several industries outside oil and gas. The government-led initiative to establish "free economic zones" along the Caspian shore is one example. Investors in these zones would be offered privileges such as an easier visa regime, exemption from various registration and import duties, tax benefits and long-term land leases. In the medium term these initial privileges need to be extended to the whole economy to make most use of potential FDI.

Infrastructure

The new government has made the diversification of its gas distribution network a priority and negotiations have advanced on all the possible gas pipelines, notably the Trans-Caspian, Pre-Caspian, Chinese, and TAPI (Turkmenistan-Afghanistan-Pakistan-India) options. Arguably most progress has been made on the gas pipeline to China given that both countries signed a gas production sharing contract in July and started construction in August 2007. Under the sale and purchase agreement, Turkmenistan will export 30 billion cubic metres of gas each year to China through the planned Central Asia gas pipeline for 30 years.

However, the whole hydrocarbon sector is in immediate need of FDI, not only to develop its capacity for more onshore exploration but more crucially to fully exploit its Caspian offshore resources and fulfil its export commitments. In an attempt to increase existing foreign commitments and attract new investment the government has set up an agency to manage the hydrocarbon sector and intensify bilateral negotiations.

Transport also urgently needs investment, not only to foster regional integration but also to diversify the economy. The government has started negotiations with Russia and Kazakhstan to join large transport projects and to consider building additional railway lines connecting Yeralievo (Kazakhstan) and Turkmenbashi. Turkmenistan has been upgrading its electricity generating and distribution network for several years but supply disruptions remain frequent.

Social sector

In July 2007 the new government adopted a new social welfare code that increases the minimum pension and generally reviews the procedures for calculating pensions and other benefits for Turkmen citizens. In January 2006 Turkmenistan had stopped paying pensions to the disabled, former members of collective farms and some other groups. State pensions were paid only to women who had worked for at least 20 years and men who had worked for at least 25 years. The pensions were based on a system introduced in 1998. Optional pensions were set at 2 per cent of wages received in Turkmenistan or abroad. Now, however, pensions are based on the average earnings for the past five years of employment.

In education, the period of compulsory secondary education has been increased to 10 years and university education from five to six years as a first step to enable Turkmen degrees to be accepted throughout the region. The requirement for students to work before tertiary education has also been abolished. Additionally, teachers' salaries have risen by 40 per cent as of 1 September 2007.

Macroeconomic performance

The hydrocarbon industry remained the main driver for growth in 2006 and the first half of 2007. GDP rose by some 20 per cent in 2006 according to official statistics from the central bank, but a more realistic figure is probably closer to the IMF estimate of 9 per cent. For the first half of 2007 official statistics again report an overall GDP increase of 20 per cent. Turkmenistan has benefited from higher energy prices and strong demand from Russia and China and has been able to negotiate higher prices as well as larger off-take volumes.

The state budget for 2007 was approved with a small surplus of Manat 349 billion (US$ 67 million at the official exchange rate) after including the increase in spending that will arise from the 40 per cent wage rise for teachers and the reinstatement of public pensions. However, much of the additional expenditure will probably be covered by increased earnings from the hydrocarbon sector. Many operations, and particularly those generating export earnings, are still carried out in non-transparent means through the use of extra-budgetary funds, making the official budget an unreliable indicator of actual fiscal developments. The closure of one of the presidential accounts in July 2007 (the Niyazov international fund) was a first sign of possible improvements in fiscal transparency.

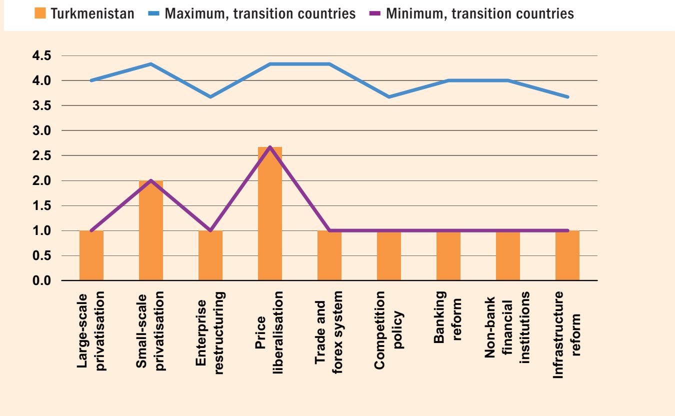
Large trade surpluses, fuelled by high hydrocarbon prices, reached an unprecedented level of approximately 21 per cent of GDP in 2006. The growth of imports of capital goods slowed in 2006 but the envisaged industrial projects with Chinese and Russian companies will increase demand for imported machinery and equipment in 2007. The agreement reached in May 2007 with Russia and Kazakhstan to construct a Caspian Shore pipeline will on the one hand increase Turkmenistan's export capacity, but on the other hand deepen export dependency on Russia. So far the government has kept all other pipeline options open for discussion.

The official exchange rate remains fixed at Manat 5,200 per US dollar, about one-fifth of the black-market rate that has remained rather stable since 2005 at around Manat 24,000 to the dollar. Large inflows of foreign currency from oil and gas exports and restrictions on access to foreign exchange have enabled the government to maintain the official rate. The dual exchange rate has had only a small effect on foreign investment in the hydrocarbon sector, but has discouraged FDI in other sectors, thus inhibiting the necessary diversification of the economy.

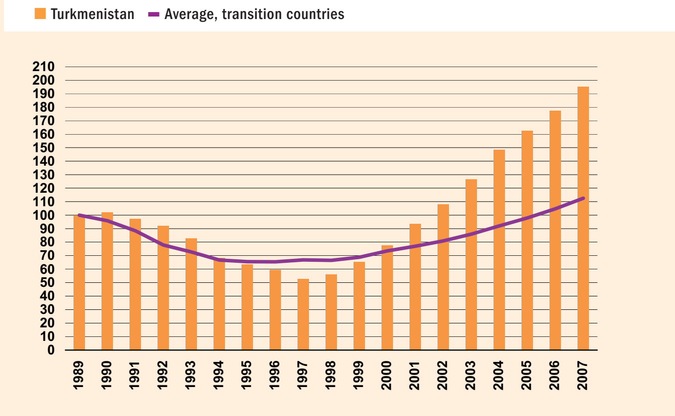
Outlook and risks

Economic growth continues to be highly dependent on developments in the hydrocarbon sector. Higher investment, both to diversify export routes and more crucially to continue with the full exploration of the existing export network, are key to maintaining GDP growth above 5 per cent in the medium term. However, over-dependency on the hydrocarbon sector, paired with wide-ranging import restrictions and other constraints, limit the rate of diversification and leave the economy vulnerable to external economic shocks.

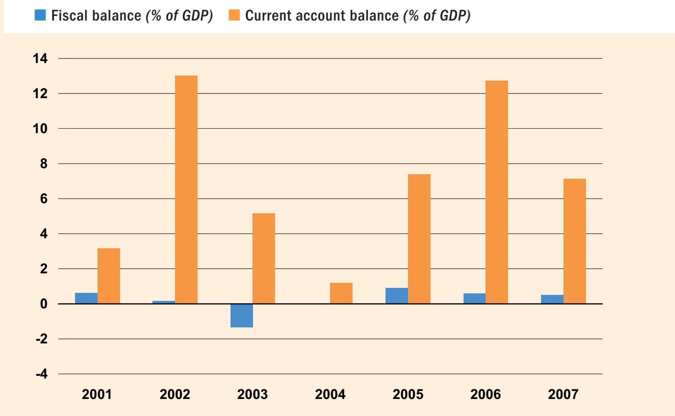
Transition indicators, 2007



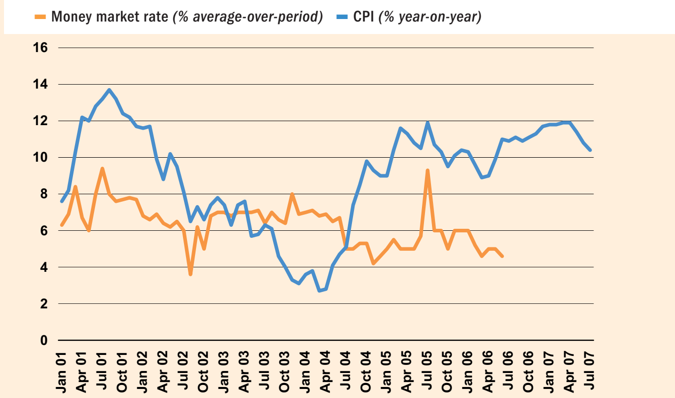
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



No money market rate data were available from July 2006–July 2007.

Liberalisation and privatisation

Current account convertibility – **limited**

Controls on inward direct investment – **no** [1]

Interest rate liberalisation – **limited de jure**

Exchange rate regime – **fixed**

Wage regulation – **yes**

Tradeability of land – **limited de jure**

Business environment and competition

Competition office – **no**

Quality of insolvency law – **low**

Secured transactions law – **malfunctioning**

Quality of corporate governance law – **low**

Infrastructure

Independent telecoms regulator – **no**

Independent electricity regulator – **no**

Separation of railway infrastructure from operations – **no**

Independence of the road directorate – **no**

Quality of concession laws – **low**

Financial sector

Capital adequacy ratio – **10 per cent** [2]

Deposit insurance system – **no**

Quality of securities market laws – **very low**

Private pension funds – **no**

Social reform

Share of population living in poverty – **44.0 per cent** (1998)

Government expenditure on health – **2.0 per cent of GDP** (2005)

Government expenditure on education – **5.4 cent of GDP** (2005)

Household expenditure on power and water – **0.3 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	0.6	0.6	0.6	0.6	0.6	na	na
Private sector share in GDP (in per cent)	25.0	25.0	25.0	25.0	25.0	25.0	na
Private sector share in employment (in per cent)	na	na	na	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	na	na	na	na	na	na	na
Share of industry in total employment (in per cent)	13.5	13.8	13.8	14.0	na	na	na
Change in labour productivity in industry (in per cent)	10.6	7.5	10.7	12.0	na	na	na
Investment/GDP (in per cent)	31.7	27.6	25.3	23.8	na	na	na
EBRD index of small-scale privatisation	2.0	2.0	2.0	2.0	2.0	2.0	2.0
EBRD index of large-scale privatisation	1.0	1.0	1.0	1.0	1.0	1.0	1.0
EBRD index of enterprise reform	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Markets and trade							
Share of administered prices in CPI (in per cent)	6.8	6.8	6.7	6.7	na	na	na
Number of goods with administered prices in EBRD-15 basket	4.0	4.0	4.0	4.0	4.0	na	na
Share of trade with non-transition countries (in per cent)	50.1	54.7	54.4	51.2	43.3	44.1	na
Share of trade in GDP (in per cent)	129.0	104.8	102.1	99.9	102.8	97.4	na
Tariff revenues (in per cent of imports)	na	na	na	na	na	na	na
EBRD index of price liberalisation	2.7	2.7	2.7	2.7	2.7	2.7	2.7
EBRD index of forex and trade liberalisation	1.0	1.0	1.0	1.0	1.0	1.0	1.0
EBRD index of competition policy	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Financial sector							
Number of banks (foreign-owned)	13 (4)	13 (4)	12 (4)	11 (4)	11 (4)	na	na
Asset share of state-owned banks (in per cent)	96.5	95.7	96.1	na	na	na	na
Asset share of foreign-owned banks (in per cent)	1.3	1.7	1.6	na	na	na	na
Non-performing loans (in per cent of total loans)	0.3	0.3	0.3	na	na	na	na
Domestic credit to private sector (in per cent of GDP)	1.8	1.9	1.9	1.6	1.4	na	na
Domestic credit to households (in per cent of GDP)	na	na	na	na	na	na	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	na	na
Stock market capitalisation (in per cent of GDP)	na	na	na	na	na	na	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	na	na	na	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	na
EBRD index of banking sector reform	1.0	1.0	1.0	1.0	1.0	1.0	1.0
EBRD index of reform of non-bank financial institutions	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	8.0 (0.2)	7.7 (0.2)	7.7 (0.2)	7.7 (1.0)	7.7 (2.2)	8.2 (na)	na
Internet users (per 100 inhabitants)	0.2	0.3	0.4	0.7	1.0	1.3	na
Railway labour productivity (1989=100)	26.9	32.7	34.4	34.0	37.7	40.2	na
Residential electricity tariffs (USc kWh)	0.5	0.5	0.5	0.5	0.4	na	na
Average collection rate, electricity (in per cent)	na	63	na	na	na	na	na
GDP per unit of energy use (PPP in US dollars per kgoe)	1.3	1.5	1.3	na	na	na	na
EBRD index of infrastructure reform	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Electric power	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Railways	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Roads	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Telecommunications	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Water and waste water	1.0	1.0	1.0	1.0	1.0	1.0	1.0

[1] Investors are required to register with the State Service for Foreign Investments.

[2] Calculated with a risk weight of zero for all loans to state-owned enterprises. These are assumed to be implicitly guaranteed by the state.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP [1]	20.4	15.8	17.1	17.2	9.6	9.0	10.0
Private consumption	na	na	na	na	na	na	na
Public consumption	na	na	na	na	na	na	na
Gross fixed capital formation	na	na	na	na	na	na	na
Exports of goods and services	4.8	13.0	4.0	na	na	na	na
Imports of goods and services	20.1	-3.7	4.3	na	na	na	na
Industrial gross output	16.8	12.8	13.5	16.4	8.5	na	na
Agricultural gross output	23.0	9.5	9.5	13.0	4.0	na	na
Employment			*(Percentage change)*				
Labour force (end-year)	3.2	3.2	3.0	3.0	0.0	na	na
Employment (end-year)	2.0	2.5	2.2	na	na	na	na
			(In per cent of labour force)				
Unemployment [2]	28.8	29.3	29.8	30.2	na	na	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	11.6	8.8	5.6	5.9	10.7	10.5	11.1
Consumer prices (end-year)	11.7	7.8	3.1	9.0	10.4	11.7	10.4
Producer prices (annual average)	na	na	na	na	na	na	na
Producer prices (end-year)	na	na	na	na	na	na	na
Gross average monthly earnings in economy (annual average)	47.1	8.2	84.2	5.7	21.6	na	na
Government sector [3]			*(In per cent of GDP)*				
General government balance	0.6	0.2	-1.3	0.0	0.9	0.6	0.5
General government expenditure	21.1	18.1	19.4	19.6	18.8	17.9	na
General government debt	na	na	na	na	na	na	na
Monetary sector			*(Percentage change)*				
Broad money (M3, end-year)	16.7	1.5	40.9	13.4	27.2	17.7	na
Domestic credit (end-year)	7.7	-2.9	-0.6	3.6	0.6	3.0	na
			(In per cent of GDP)				
Broad money (M3, end-year)	16.1	13.0	13.9	12.9	13.0	12.7	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinance rate	12.0	12.0	10.0	5.0	5.0	na	na
Interbank market rate	7.7	7.0	6.9	4.6	6.0	na	na
Deposit rate (6-12 months) [4]	16.9	17.8	15.4	11.3	8.6	na	na
Lending rate (6-12 months) [4]	26.7	21.9	20.4	17.3	17.3	na	na
			(Manats per US dollar)				
Exchange rate (end-year) [5]	10,060.0	10,150.0	10,390.0	10,540.0	10,870.0	10,690.0	na
Exchange rate (annual average)	9,827.9	10,097.5	10,033.5	10,375.0	11,015.2	10,881.9	na
External sector			*(In millions of US dollars)*				
Current account	116.0	583.0	305.0	84.0	615.5	1,295.5	900.0
Trade balance	515.0	1,030.0	886.0	706.0	1,302.0	1,963.0	1,800.0
Merchandise exports	2,623.0	2,862.0	3,465.0	3,854.0	4,939.0	5,935.0	6,300.0
Merchandise imports	2,108.0	1,832.0	2,579.0	3,148.0	3,637.0	3,972.0	4,500.0
Foreign direct investment, net	170.0	276.0	226.0	354.0	418.2	730.9	753.0
Gross reserves, excluding gold (end-year) [6]	2,055.0	2,346.0	2,673.0	2,714.0	3,442.0	5,425.4	na
External debt stock	1,865.0	1,660.0	1,519.0	1,273.0	1,007.0	805.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	9.1	11.8	9.5	8.0	8.9	13.0	na
			(In per cent of exports of goods and services)				
Debt service [7]	17.3	14.3	11.6	9.6	5.6	4.6	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	5.6	5.8	6.2	6.5	6.5	6.5	na
GDP (in billions of manats)	36,051.6	45,240.0	59,404.8	72,706.4	91,863.2	110,637.5	135,244.8
GDP per capita (in US dollars)	650.4	774.5	954.9	1,078.1	1,283.0	1,564.2	na
Share of industry in GDP (in per cent)	39.8	40.9	39.7	38.6	na	na	na
Share of agriculture in GDP (in per cent)	23.0	21.8	19.6	18.4	na	na	na
Current account/GDP (in per cent)	3.2	13.0	5.2	1.2	7.4	12.7	7.1
External debt - reserves (in US$ million)	-190.0	-686.0	-1,154.0	-1,441.0	-2,435.0	-4,620.4	na
External debt/GDP (in per cent)	50.8	37.1	25.7	18.2	12.1	7.9	na
External debt/exports of goods and services (in per cent)	64.8	53.9	40.8	30.2	18.9	12.7	na

1 Official statistics until 2004, but EBRD estimates for 2005 and 2006.

2 Officially registered unemployed.

3 Significant off-budget expenditures occur through extra-budgetary funds and lending.

4 Unweighted average deposit and lending rates for individuals (in local currency) of state commercial banks.

5 Turkmenistan operates a dual exchange rate system. The series refers to a weighted average between the official exchange rate and the commercial rate (given as the black market rate). Weights are variable depending on official and shuttle trade.

6 Includes foreign exchange reserves of the central bank plus the foreign exchange reserve fund.

7 Excludes rescheduled amounts.

Ukraine

Key challenges

- Lowering barriers to entry and reducing the tax and regulatory burden on enterprises would help to improve the country's competitiveness.
- Approval of the long-awaited new joint-stock company law, better enforcement of property rights and greater financial transparency are key prerequisites for the further development of the domestic capital market.
- Stronger banking supervision and greater exchange rate flexibility could mitigate the risks of a potential terms-of-trade or adverse external financial shock.

Country data

Population (in millions)	47.1
Area ('000 sq km)	603.7
GDP (in billion US$, 2006)	106.4
GDP per capita in 2006 at current international US$ (PPP)	7,556
National currency	Hryvnia

Progress in structural reform

Liberalisation and privatisation

In January 2007 parliament approved the privatisation strategy for the year, according to which the government plans to sell stakes in the fixed-line telecommunications company Ukrtelecom, the Odessa chemical plant and minority stakes in several power generation and distribution companies. The government expects to raise up to Hryvnia 10.5 billion (US$ 2 billion) from the sales, although privatisation revenues amounted to only Hryvnia 1.627 billion (US$ 320 million) in the first eight months of the year.

At the end of May 2007 parliament fast-tracked the approval of the remaining 11 bills that were necessary for completing negotiations for World Trade Organization (WTO) accession. By July 2007, the Kyrgyz Republic remained the only country with which Ukraine had not yet signed a bilateral protocol for WTO accession, although it recently declared its readiness to drop all outstanding claims in exchange for humanitarian and technical assistance. Accession to the WTO is now expected by the end of 2007/early 2008. This will pave the way for negotiations on a Free Trade Area with the European Union (EU) and the abolition of the EU import quota for Ukrainian steel. The latter was increased to 1.3 million tons in 2007, reflecting Bulgaria and Romania's entry into the EU.

Business environment and competition

Favourable macroeconomic and external conditions have encouraged Ukrainian companies to invest more to modernise their production facilities and improve energy efficiency, which had become essential as cheap supplies of labour and energy dwindle. However, further investment growth may be constrained by the burdensome tax and regulatory regime, inconsistent enforcement of property and contract rights, weak minority shareholder protection and widespread corruption. Hostile takeovers and illegal corporate raids are still common.

Delays in VAT reimbursement to exporters persist. State interference in sensitive sectors of the economy, such as agriculture, continues. In June 2007, parliament approved one-off budgetary transfers to farmers affected by the drought and increased support for the coal sector. In addition, the cabinet re-introduced a temporary ban on wheat, barley and rye exports.

Infrastructure

In late 2006 the cabinet approved the long-awaited railway reform programme. Under this plan, the commercial functions will be separated from regulatory functions (although an independent regulator will not be created yet). The natural monopoly will be unbundled and tariffs reformed. The first phase of the programme has begun, which involves the corporatisation of the railway operator and transfer of the regulatory function to the Ministry of Transport.

Following the approval of a new tariff methodology for water and waste-water services in July 2006, tariffs and bill collection rates have risen.

Financial sector

The financial sector is growing in importance, helped by the entry of major foreign banks that have been active in consumer and retail lending and that have also supported the development of the leasing and insurance markets. In July 2007 Unicredit Group signed an agreement to buy a 95 per cent stake in Ukrsotsbank, Ukraine's fourth largest bank in terms of assets, for US$ 2.2 billion. The deal, the largest in the Ukrainian banking sector to date, is expected to be finalised by the end of the year as it requires approval by the National Bank of Ukraine (NBU) and the Anti-monopoly Committee.

The strong growth in bank lending has been funded by banks' increased external borrowing, mainly on a short-term basis, while the share of bank deposits in total bank liabilities had shrunk to less than 60 per cent by mid-2007.

These developments have been supported by some improvements in regulation and supervision. In November 2006 the parliament approved a bill on banks and banking – part of the package of WTO-related legislation – which allows foreign banks to open branches in Ukraine. In April 2007 the NBU introduced new regulations to discourage borrowing in foreign currency, although this has continued to grow.

The Law on Securities and the Stock Exchange, adopted in February 2006, lays the foundations for the development of a securities market by extending the range of regulated financial services, setting information disclosure requirements and strengthening requirements on statutory capital of non-banking financial institutions. However, weak enforcement of property rights, the absence of a joint stock company law and lack of progress in pension and health care reforms remain major obstacles to the further development of the domestic capital market. The first securitisation of mortgage loan receivables took place in early 2007 by Privat Bank.

Macroeconomic performance

GDP growth remains strong, reaching 7.1 per cent in 2006 and 7.5 per cent (year-on-year) in the first eight months of 2007, supported by favourable external conditions, a boom in consumption and high investment growth. The strength of domestic demand has in turn resulted in growing internal imbalances (rising inflation and very high increases in asset prices) and a large trade deficit, contributing to a switch in the current account balance from a large surplus in 2004 to a small deficit of 1.5 per cent of GDP in 2006.

Sustained high net FDI inflows have eased the financing of Ukraine's external imbalances and contributed to a substantial build-up in the level of foreign reserves, which reached US$ 28.9 billion by the end of August 2007. In June 2007, the government raised US$ 500 million through a five-year eurobond carrying a coupon of 6.4 per cent.

The consolidated government budget recorded a small deficit of 1.3 per cent of GDP in 2006. However, changes in the composition of the budget have led to an expansion in domestic demand. More recently, amendments to the 2007 budget law foresee an increase in spending to match buoyant revenue inflows, as well as rapid growth of public wages and state benefits. The producer and consumer price indices rose by 18.9 and 11.6 per cent respectively in the year to August, and inflationary pressures may intensify due to expectations of a poor harvest this year.

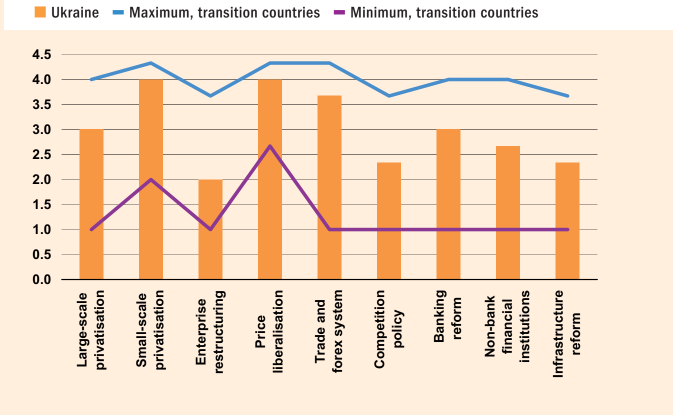
Outlook and risks

The short-term economic outlook for Ukraine remains positive. However, metal prices are expected to stabilise, gas prices are likely to rise from the current level of US$ 130 per thousand cubic metres and nominal wages have doubled over the past two years. Ukraine's competitive advantage in terms of cheap energy and labour is diminishing rapidly. Moreover, the relatively high inflation rate has led to an appreciation of the real effective exchange rate, which is also gradually eroding the country's international competitiveness.

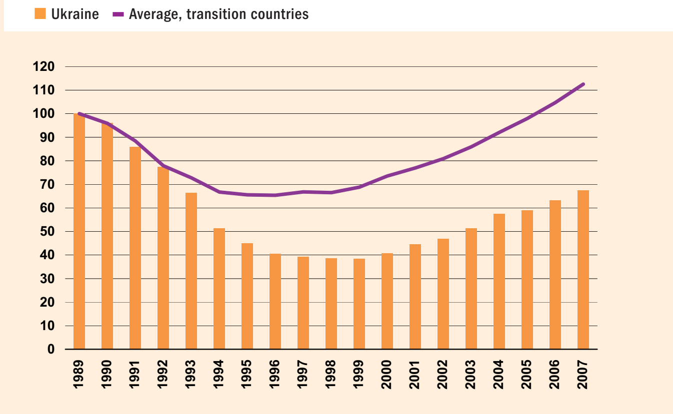
The rapid growth in private external borrowing and bank lending in foreign currency, coupled with the high degree of dollarisation in the economy, are also sources of economic vulnerability. This is especially so if global interest rates remain high and the price of emerging market risk is re-assessed in light of the recent turmoil in global financial markets.

In the long term, it is the lack of reform progress that is likely to be the main constraint on growth potential. Much will depend on whether the country can diversify the supply base and switch to an investment-led growth strategy from the current emphasis on consumption. Achieving this will require an improved business environment to attract further FDI, stronger competition to improve efficiency, a reduced tax and regulatory burden and a limited use of administrative controls. Significant investment will also be needed to overcome existing infrastructure and transport bottlenecks. Ukraine's qualification to co-host with Poland UEFA's 2012 European football championship may act as a catalyst for much needed investment in these areas.

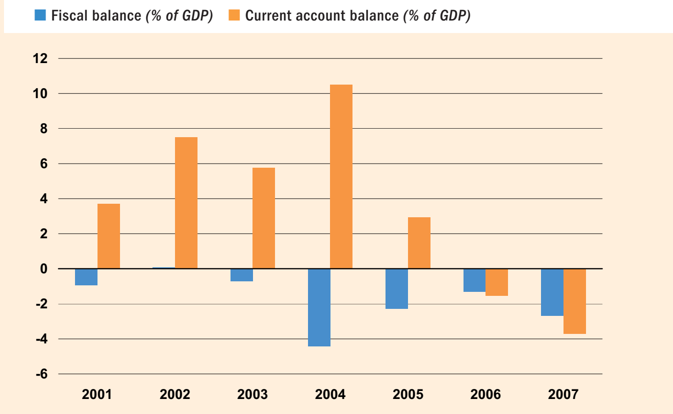
Transition indicators, 2007



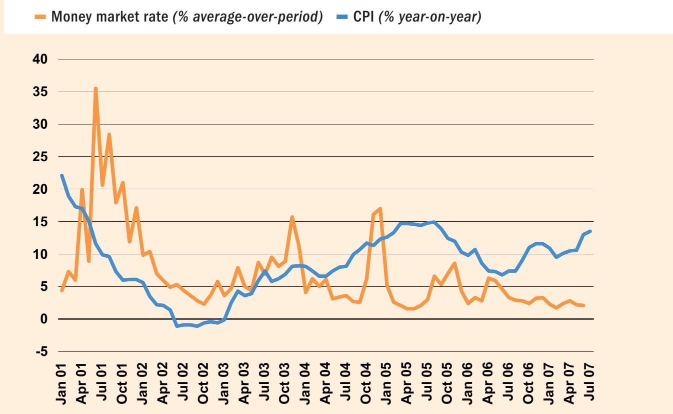
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **full**

Controls on inward direct investment – **no** [1]

Interest rate liberalisation – **full**

Exchange rate regime – **managed float**

Wage regulation – **no**

Tradeability of land – **limited de facto**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **low**

Secured transactions law – **some defects**

Quality of corporate governance law – **very low**

Infrastructure

Independent telecoms regulator – **partially**

Independent electricity regulator – **partially**

Separation of railway infrastructure from operations – **no**

Independence of the road directorate – **partially**

Quality of concession laws – **medium**

Financial sector

Capital adequacy ratio – **10 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **high**

Private pension funds – **yes**

Social reform

Share of population living in poverty – **4.9 per cent** (2003) [2]

Government expenditure on health – **4.0 per cent of GDP** (2004)

Government expenditure on education – **6.2 per cent of GDP** (2005)

Household expenditure on power and water – **3.2 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	5.5	6.0	7.1	10.1	15.1	15.2	na
Private sector share in GDP (in per cent)	60.0	65.0	65.0	65.0	65.0	65.0	65.0
Private sector share in employment (in per cent)	30.5	35.6	37.7	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	1.3	1.2	2.2	2.2	2.2	2.7	na
Share of industry in total employment (in per cent)	21.0	20.4	20.4	20.1	18.9	na	na
Change in labour productivity in industry (in per cent)	4.4	9.4	23.2	13.8	7.8	na	na
Investment/GDP (in per cent)	21.8	20.2	20.3	21.2	22.2	na	na
EBRD index of small-scale privatisation	3.3	3.7	4.0	4.0	4.0	4.0	4.0
EBRD index of large-scale privatisation	3.0	3.0	3.0	3.0	3.0	3.0	3.0
EBRD index of enterprise reform	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Markets and trade							
Share of administered prices in CPI (in per cent)	na	na	na	na	na	na	na
Number of goods with administered prices in EBRD-15 basket	3.0	3.0	6.0	6.0	6.0	5.0	na
Share of trade with non-transition countries (in per cent)	49.6	47.5	52.9	48.3	48.6	50.6	na
Share of trade in GDP (in per cent)	89.3	86.4	95.2	97.4	82.6	78.1	na
Tariff revenues (in per cent of imports) [3]	2.7	3.0	3.0	3.2	3.6	3.3	na
EBRD index of price liberalisation	4.0	4.0	4.0	4.0	4.0	4.0	4.0
EBRD index of forex and trade liberalisation	3.0	3.3	3.3	3.3	3.7	3.7	3.7
EBRD index of competition policy	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Financial sector							
Number of banks (foreign-owned)	152 (16)	157 (15)	158 (19)	160 (19)	165 (23)	170 (27)	na
Asset share of state-owned banks (in per cent)	11.8	12.0	9.8	8.0	9.4	8.9	na
Asset share of foreign-owned banks (in per cent)	12.1	12.3	12.1	12.1	21.3	35.0	na
Non-performing loans (in per cent of total loans)	6.3	4.5	3.4	3.2	2.2	1.7	na
Domestic credit to private sector (in per cent of GDP)	13.0	17.6	24.3	25.2	32.2	44.9	na
Domestic credit to households (in per cent of GDP)	0.8	1.6	3.7	6.6	8.1	15.3	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	na	na
Stock market capitalisation (in per cent of GDP)	3.6	7.4	8.6	18.1	28.6	40.3	na
Stock trading volume (in per cent of market capitalisation)	13.9	14.9	2.9	2.5	3.6	3.5	na
Eurobond issuance (in per cent of GDP)	0.0	8.8	6.3	3.6	2.5	2.8	na
EBRD index of banking sector reform	2.0	2.3	2.3	2.3	2.7	3.0	3.0
EBRD index of reform of non-bank financial institutions	2.0	2.0	2.0	2.3	2.3	2.3	2.7
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	22.0 (4.6)	22.6 (7.7)	23.4 (13.7)	25.8 (29.2)	25.8 (64.5)	26.8 (106.7)	na
Internet users (per 100 inhabitants)	1.2	1.9	5.3	8.0	9.8	12.1	na
Railway labour productivity (1989=100)	46.5	49.9	56.5	60.1	56.9	57.5	na
Residential electricity tariffs (USc kWh)	2.6	2.7	2.7	2.7	2.5	2.6	na
Average collection rate, electricity (in per cent)	78	83	94	na	99	100	na
GDP per unit of energy use (PPP in US dollars per kgoe)	1.7	1.8	1.9	2.0	na	na	na
EBRD index of infrastructure reform	2.0	2.0	2.0	2.0	2.0	2.0	2.3
Electric power [4]	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Railways	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Roads	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Telecommunications	2.3	2.3	2.3	2.3	2.3	2.7	2.7
Water and waste water	1.7	1.7	1.7	1.7	1.7	1.7	2.0

[1] Registration of foreign investment is required.

[2] Income based.

[3] Refers to taxes on international trade and transactions.

[4] Series has been revised.

	2001	2002	2003	2004	2005	2006 *Estimate*	2007 *Projection*
Output and expenditure			*(Percentage change in real terms)*				
GDP	9.2	5.2	9.6	12.1	2.6	7.1	6.8
Private consumption	9.0	9.5	11.5	13.1	16.6	14.4	na
Public consumption	10.4	-6.7	6.9	1.8	2.7	4.8	na
Gross fixed capital formation	6.2	3.4	22.5	20.5	3.9	18.7	na
Exports of goods and services	3.5	7.4	10.3	21.3	-12.2	-4.9	na
Imports of goods and services	6.0	3.3	16.4	15.5	6.4	6.5	na
Industrial gross output	14.2	7.0	15.8	12.5	3.1	6.2	na
Agricultural gross output	10.2	1.2	-9.9	19.1	0.4	1.0	na
Employment			*(Percentage change)*				
Labour force (end-year)	-0.1	0.5	0.3	0.0	0.4	-0.5	na
Employment (end-year)	1.7	0.3	-6.0	0.7	1.9	0.2	na
			(In per cent of labour force)				
Unemployment (end-year) [1]	3.7	3.8	3.6	3.5	3.1	2.7	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	12.0	0.8	5.2	9.0	13.5	9.1	11.5
Consumer prices (end-year)	6.1	-0.6	8.2	12.3	10.3	11.6	10.6
Producer prices (annual average)	8.7	3.0	7.6	20.4	16.7	9.6	na
Producer prices (end-year)	0.9	5.7	11.1	24.1	9.5	14.1	na
Gross average monthly earnings in economy (annual average)	35.2	20.9	22.9	27.9	36.4	29.7	na
Government sector [2]			*(In per cent of GDP)*				
General government balance	-0.9	0.1	-0.7	-4.4	-2.3	-1.3	-2.7
General government expenditure	34.4	35.6	37.2	39.5	42.0	43.0	na
General government debt	36.9	33.5	29.3	25.9	19.7	16.5	na
Monetary sector			*(Percentage change)*				
Broad money (M2, end-year)	43.2	42.3	46.9	32.8	53.9	34.3	na
Domestic credit (end-year)	21.9	28.0	38.4	24.8	34.3	69.4	na
			(In per cent of GDP)				
Broad money (M2, end-year)	22.1	28.5	35.3	36.4	43.8	48.2	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	12.5	7.0	7.0	9.0	9.5	8.5	na
Deposit rate [3]	11.0	7.9	7.0	7.8	8.6	7.6	na
Lending rate [3]	32.3	25.4	17.9	17.4	16.2	15.2	na
			(Hryvnias per US dollar)				
Exchange rate (end-year)	5.3	5.3	5.3	5.3	5.1	5.1	na
Exchange rate (annual average)	5.4	5.3	5.3	5.3	5.1	5.1	na
External sector			*(In millions of US dollars)*				
Current account	1,402.0	3,173.0	2,891.0	6,804.0	2,531.0	-1,617.0	-4,680.3
Trade balance	198.0	710.0	-269.0	3,741.0	-1,135.0	-5,194.0	-8,180.3
Merchandise exports	17,091.0	18,669.0	23,739.0	33,432.0	35,024.0	38,949.0	44,791.4
Merchandise imports	16,893.0	17,959.0	24,008.0	29,691.0	36,159.0	44,143.0	52,971.6
Foreign direct investment, net	769.0	698.0	1,411.0	1,711.0	7,533.0	5,336.0	5,500.0
Gross reserves, excluding gold (end-year)	2,955.0	4,241.0	6,731.0	9,302.0	19,413.0	22,300.0	na
External debt stock [4]	12,098.0	12,771.0	23,811.0	30,647.0	39,619.0	54,286.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	1.7	2.4	2.9	3.2	5.3	5.0	na
			(In per cent of exports of goods and services)				
Debt service [5]	8.7	5.7	6.2	4.6	4.9	5.1	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	48.5	48.0	47.6	47.3	47.1	47.1	na
GDP (in billions of hryvnias)	204.2	225.8	267.3	345.1	441.5	537.7	640.1
GDP per capita (in US dollars)	785.3	883.1	1,053.3	1,371.2	1,830.9	2,258.6	na
Share of industry in GDP (in per cent)	27.1	27.4	27.2	25.8	25.6	na	na
Share of agriculture in GDP (in per cent)	14.4	13.0	10.9	10.8	9.2	9.2	na
Current account/GDP (in per cent)	3.7	7.5	5.8	10.5	2.9	-1.5	-3.7
External debt - reserves (in US$ million) [4]	9,143.0	8,530.0	17,080.0	21,345.0	20,206.0	31,986.0	na
External debt/GDP (in per cent) [4]	31.8	30.1	47.5	47.3	46.0	51.0	na
External debt/exports of goods and services (in per cent) [4]	57.4	54.7	82.2	77.2	89.3	108.1	na

[1] Officially registered unemployed. According to ILO methodology, the rate of unemployment in Ukraine is higher than the official rate.

[2] General government includes the state, municipalities and extra-budgetary funds.

[3] Weighted average over all maturities.

[4] Until end-2002, medium and long-term external debt only. From 2003 onwards, the series also includes short-term external debt.

[5] Refers to payments on official debt only.

Uzbekistan

Key challenges

- To promote private sector-led growth the authorities should reduce market distortions created by the complex regulatory regime, limit their direct involvement in businesses and implement the new privatisation programme as scheduled.
- A strong financial sector is crucial for further private sector development. Reforms should be accelerated to fully liberalise interest rates, improve the quality of banks' balance sheets and privatise the main banks.
- The authorities could combat inflation through the nominal appreciation of the currency rather than rely on cash restrictions, which have become an additional burden on business.

Country data

Population (in millions)	26.0
Area ('000 sq km)	448.9
GDP (in billion US$, 2006)	17.0
GDP per capita in 2006 at current international US$ (PPP)	2,295
National currency	Sum

Progress in structural reform

Liberalisation and privatisation

In July 2007 Uzbekistan announced an extensive privatisation plan for more than 1,400 enterprises in most sectors over the next four years. The state will nevertheless retain majority control in strategic sectors such as telecommunications, energy, oil and gas and mining, and between 25 per cent (blocking minority stake) and 50 per cent in the banking, textile and automotive sectors. Full privatisation is envisaged in tourism, services, light industries (excluding textiles) and SMEs. The state will retain a "golden share" (which grants it the right to participate in the management of privatised enterprises) in some agro-processing industries, including cotton processing. UzMetKombinat – the only steel producer in the country – and Uzbekistan Airways are excluded from the programme. The programme aims to attract foreign investments that will bring technology and know-how.

Tariff and non-tariff barriers to trade remain high, reflecting the country's strategy of promoting growth through import substitution. However, according to a survey of over 1,500 businesses conducted by the Uzbek Chamber of Commerce in 2006, only 20 per cent of these businesses supported import restrictions to protect domestic industry. A large majority favoured reductions in customs duties for imports of raw materials/ intermediate goods and final goods.

Business environment and competition

Businesses continue to be hindered by various regulatory barriers. Officially registered importers of consumer goods are still limited in their access to foreign exchange and they face delays in customs clearance. Cash availability for businesses remains restricted and this problem is especially acute for small businesses that require cash for working capital. Firms are still legally required to surrender cash every day to their bank accounts. The value of cash in local currency is now 15-20 per cent above the equivalent amount in bank deposits while the local currency trades at a premium on the black market compared with the official exchange rate.

The Newmont Mining Corporation has settled its dispute with the government and will receive US$ 80 million for its 50 per cent stake in the Zarafshan-Newmont Joint Venture (ZNJV). In 2006, following the abolition of tax benefits provided to certain foreign joint ventures, the Uzbek government claimed back US$ 49 million from ZNJV and the company was later declared bankrupt. The settlement could send a positive signal to investors in Uzbekistan who were becoming increasingly concerned about government policy reversals. In the first half of 2007, the country attracted FDI of US$ 309 million, 2.4 times the amount it attracted in the same period in 2006.

Financial sector

Total domestic credit fell from 37 per cent of GDP in 2001 to 17 per cent in 2006. This reflects the ongoing restructuring of assets at state-owned banks, which accounted for 84 per cent of total banking sector assets at the end of 2006. The quality of assets held by state-owned banks is questionable, given their role in funding state-sponsored projects that may not necessarily be financially viable. Only in recent years have state-owned banks started to initiate bankruptcy procedures against non-performing borrowers and the National Bank of Uzbekistan (NBU) has successfully restructured some bankrupted companies and sold them in the last 12 months. Nevertheless, further restructuring of their balance sheets may be required before they can increase their lending again. The government plans to partially privatise two large state-owned banks – Asaka bank (by 2009) and the NBU (by 2010) – that together account for over half of total banking assets. In September 2007, BNP Paribas was appointed for the valuation of the state's 51 per cent stake in Asaka bank.

Social sector

The draft Welfare Improvement Strategy (WIS) for 2007-10, which is scheduled to be finalised by the end of 2007, will focus on alleviating poverty and reducing inequality and consider how the wider population could benefit from strong economic growth. According to household budget surveys, the percentage of the population consuming fewer than 2,100 kilocalories per day fell to 25.8 per cent in 2005 from 27.2 per cent in 2003. The WIS aims to reduce this figure to 20 per cent and 14 per cent by 2010 and 2015, respectively. It will shift the focus from import substitution-led growth to one based on public and private investment for which the banking sector is considered to be the key channel. Medium-term budgeting will be introduced for the first time and the WIS will also outline strategies for the development of each region.

Macroeconomic performance

During the first half of 2007, GDP grew by 9.7 per cent in real terms, up from 7.3 per cent in 2006. Growth is driven by strong domestic and external demand. Buoyant consumption and investment in property continue to be supported by strong remittance flows (7 per cent of GDP in 2006) and favourable commodity prices (gold and hydrocarbon). Export volume grew by 39 per cent year-on-year in the first half of 2007.

According to official data, inflation is on a downward trend with prices increasing by 2.7 per cent during the first half of 2007 (5.5 per cent on an annualised basis) compared with 3.5 per cent in the same period the previous year. According to revised IMF forecasts, end-year inflation is expected to decline from 11.4 per cent in 2006 to 11 per cent in 2007. The central bank has continued to intervene in the foreign exchange market to maintain the nominal depreciation of the national currency so that the exchange rate remains stable in real terms. This effort was helped by the increase in foreign assets held by commercial banks and the Reconstruction and Development Fund. Net international reserves grew by 63 per cent in 2006, up from 30 per cent in 2005 but this was partially offset by the accumulation of government deposits with the central bank. Broad money growth declined from 54 per cent in 2005 to 37 per cent in 2006, dampening inflationary pressures.

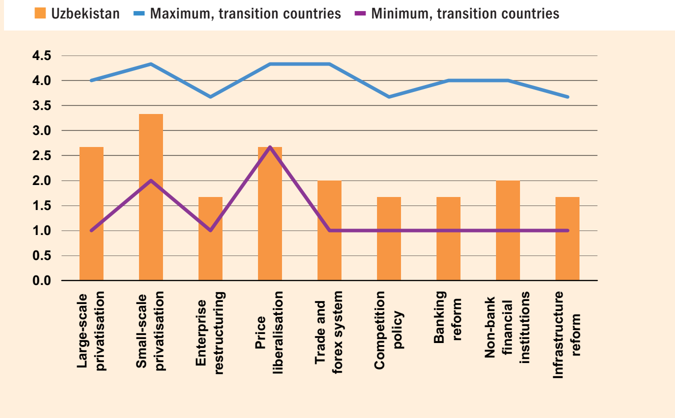
The consolidated fiscal surplus (including the Reconstruction Fund) increased from 1.2 per cent of GDP in 2005 to 5.2 per cent in 2006 reflecting higher tax and other revenues. Social spending (education, health and pensions) has increased whereas cuts were made in public investments. In 2007 the government has targeted an overall fiscal surplus of 2.9 per cent of GDP after allowing for wage increases for civil servants, higher pensions and social benefits.

The current account surplus widened from 13.1 per cent of GDP in 2005 to 18.8 per cent in 2006 reflecting a trade surplus of 12 per cent of GDP and remittances from workers abroad. Exports were driven by both favourable international commodity prices and increased volumes of gold, energy and automobiles, although cotton exports have been relatively stagnant in terms of prices and volume. Buoyant export performance continued in the first half of 2007 with the trade surplus widening to 16 per cent of GDP. Total external debt continued to decline from 29.1 per cent of GDP in 2005 to 22.8 per cent in 2006.

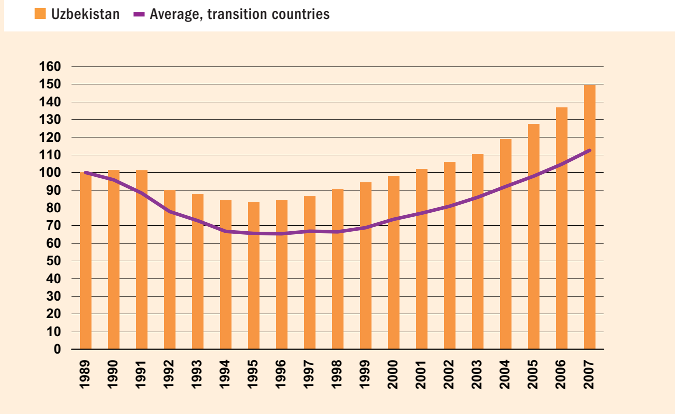
Outlook and risks

The outlook for 2007 is positive with real GDP expected to grow by 9.3 per cent. As the growth is relatively broad-based, Uzbekistan should be in a better position than its Central Asian neighbours to withstand adverse external shocks. In the medium term, however, various distortions in the economy and the weak banking sector could undermine economic growth potential unless these issues are addressed. The authorities should take advantage of the current buoyant economic environment to hasten the implementation of structural reforms.

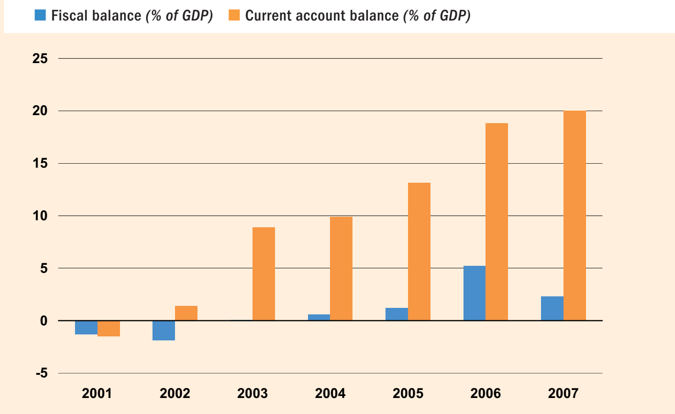
Transition indicators, 2007



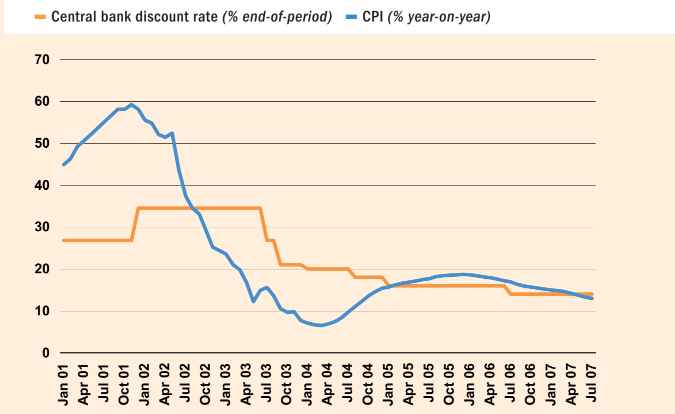
Real GDP (1989=100)



Fiscal balance and current account balance



Interest rates and inflation



Liberalisation and privatisation

Current account convertibility – **limited**

Controls on inward direct investment – **yes**

Interest rate liberalisation – **limited de jure**

Exchange rate regime – **managed float**

Wage regulation – **yes**

Tradeability of land – **limited de jure**

Business environment and competition

Competition office – **yes**

Quality of insolvency law – **low**

Secured transactions law – **malfunctioning**

Quality of corporate governance law – **medium**

Infrastructure

Independent telecoms regulator – **no**

Independent electricity regulator – **no**

Separation of railway infrastructure from operations – **partially**

Independence of the road directorate – **no**

Quality of concession laws – **low**

Financial sector

Capital adequacy ratio – **10 per cent**

Deposit insurance system – **yes**

Quality of securities market laws – **high**

Private pension funds – **no**

Social reform

Share of population living in poverty – **26.0 per cent** (2003)

Government expenditure on health – **2.4 per cent of GDP** (2006)

Government expenditure on education – **6.2 per cent of GDP** (2006)

Household expenditure on power and water – **5.2 per cent**

	2001	2002	2003	2004	2005	2006	2007
Enterprises							
Privatisation revenues (cumulative, in per cent of GDP)	2.9	3.5	4.0	4.7	5.2	5.6	na
Private sector share in GDP (in per cent)	45.0	45.0	45.0	45.0	45.0	45.0	45.0
Private sector share in employment (in per cent)	na	na	na	na	na	na	na
Budgetary subsidies and current transfers (in per cent of GDP)	2.1	1.9	1.9	1.8	1.8	1.6	na
Share of industry in total employment (in per cent)	12.7	12.7	12.4	13.0	13.2	13.4	na
Change in labour productivity in industry (in per cent)	6.7	5.5	5.6	1.4	2.1	6.4	na
Investment/GDP (in per cent)	21.1	21.2	20.8	24.5	23.0	22.1	na
EBRD index of small-scale privatisation	3.0	3.0	3.0	3.0	3.0	3.3	3.3
EBRD index of large-scale privatisation	2.7	2.7	2.7	2.7	2.7	2.7	2.7
EBRD index of enterprise reform	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Markets and trade							
Share of administered prices in CPI (in per cent)	53.0	53.0	53.0	53.0	na	na	na
Number of goods with administered prices in EBRD-15 basket	8.0	8.0	8.0	8.0	4.0	na	na
Share of trade with non-transition countries (in per cent)	48.4	48.6	57.2	54.1	49.3	44.9	na
Share of trade in GDP (in per cent)	69.5	68.9	57.1	59.7	56.9	56.6	na
Tariff revenues (in per cent of imports) [1]	1.9	2.2	3.6	3.1	3.1	3.7	na
EBRD index of price liberalisation	2.7	2.7	2.7	2.7	2.7	2.7	2.7
EBRD index of forex and trade liberalisation	1.7	1.7	1.7	1.7	2.0	2.0	2.0
EBRD index of competition policy	2.0	2.0	1.7	1.7	1.7	1.7	1.7
Financial sector							
Number of banks (foreign-owned)	38 (6)	35 (6)	33 (5)	31 (5)	na	na	na
Asset share of state-owned banks (in per cent)	80.4	73.7	70.0	67.6	na	na	na
Asset share of foreign-owned banks (in per cent)	2.4	3.2	4.3	4.4	na	na	na
Non-performing loans (in per cent of total loans)	na	8.5	10.9	9.3	8.9	8.8	na
Domestic credit to private sector (in per cent of GDP)	na	na	na	na	na	na	na
Domestic credit to households (in per cent of GDP)	na	na	na	na	na	na	na
Of which mortgage lending (in per cent of GDP)	na	na	na	na	na	na	na
Stock market capitalisation (in per cent of GDP)	0.6	0.4	0.1	0.0	0.3	4.3	na
Stock trading volume (in per cent of market capitalisation)	na	na	na	na	na	5.8	na
Eurobond issuance (in per cent of GDP)	0.0	0.0	0.0	0.0	0.0	0.0	na
EBRD index of banking sector reform	1.7	1.7	1.7	1.7	1.7	1.7	1.7
EBRD index of reform of non-bank financial institutions	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Infrastructure							
Fixed-line (mobile) penetration rate (per 100 inhabitants)	6.7 (0.5)	6.7 (0.7)	6.7 (1.3)	6.7 (2.1)	6.7 (2.7)	6.7 (na)	na
Internet users (per 100 inhabitants)	0.6	1.1	1.9	2.6	3.3	6.3	na
Railway labour productivity (1989=100)	35.6	51.1	51.8	47.9	45.6	65.0	na
Residential electricity tariffs (USc kWh)	1.0	1.2	1.7	na	2.6	2.9	na
Average collection rate, electricity (in per cent)	na	72	95	na	60	54	na
GDP per unit of energy use (PPP in US dollars per kgoe)	0.8	0.8	0.8	0.8	na	na	na
EBRD index of infrastructure reform	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Electric power	2.0	2.0	2.0	2.0	2.3	2.3	2.3
Railways	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Roads	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Telecommunications	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Water and waste water	1.0	1.7	1.7	1.7	1.7	1.7	1.7

[1] Refers to custom duties and export taxes.

	2001	2002	2003	2004	2005	2006 Estimate	2007 Projection
Output and expenditure			(Percentage change in real terms)				
GDP [1]	4.1	4.0	4.2	7.7	7.0	7.3	9.3
Industrial gross output	7.6	8.3	6.0	9.4	7.2	10.8	na
Agricultural gross output	4.2	6.0	7.3	8.9	5.4	6.2	na
Employment			(Percentage change)				
Labour force (end-year)	1.5	2.4	2.7	3.4	2.8	2.6	na
Employment (end-year)	1.5	2.4	2.7	3.4	2.9	2.7	na
			(In per cent of labour force)				
Unemployment (end-year) [2]	0.4	0.4	0.3	0.4	0.3	0.3	na
Prices and wages			(Percentage change)				
Consumer prices (annual average) [3]	27.3	27.3	11.6	6.6	10.0	14.2	12.2
Consumer prices (end-year)	26.5	21.6	7.8	9.1	12.3	11.4	11.0
Producer prices (annual average)	42.2	na	na	na	na	na	na
Producer prices (end-year)	43.9	46.1	27.4	26.5	28.2	24.0	na
Gross average monthly earnings in economy (annual average)	58.2	111.8	28.2	62.7	47.7	45.2	na
Government sector [4]			(In per cent of GDP)				
General government balance	-1.3	-1.9	0.1	0.6	1.2	5.2	2.3
General government expenditure	35.8	37.6	38.4	31.6	29.5	29.2	na
General government debt	59.4	54.6	41.6	35.1	28.2	20.8	na
Monetary sector			(Percentage change)				
Broad money (M3, end-year)	54.3	29.7	27.1	47.8	53.8	36.8	na
Domestic credit (end-year)	90.8	40.9	-0.6	2.1	3.1	-40.3	na
			(In per cent of GDP)				
Broad money (M3, end-year)	12.4	10.6	10.3	12.2	14.4	15.1	na
Interest and exchange rates			(In per cent per annum, end-year)				
Refinancing rate	26.8	34.5	20.0	20.0	16.0	14.0	na
Treasury bill rate (3-month maturity)	17.1	17.1	na	na	na	na	na
Deposit rate (1 year)	21.2	26.0	20.3	16.1	15.5	15.0	na
Lending rate (1 year)	27.6	33.4	23.9	21.2	19.9	21.0	na
			(Sums per US dollar)				
Exchange rate (end-year) [5]	937.6	1,068.3	979.0	1,056.6	1,180.0	1,240.0	na
Exchange rate (annual average) [5]	646.3	885.0	995.5	999.2	1,072.3	1,219.8	na
External sector			(In millions of US dollars)				
Current account	-112.7	117.0	880.0	1,214.0	1,950.0	3,198.0	3,981.0
Trade balance	186.0	324.0	835.0	1,202.0	1,447.0	2,001.0	2,479.0
Merchandise exports	2,740.0	2,510.0	3,240.0	4,263.0	4,757.0	5,615.0	6,864.0
Merchandise imports	2,554.0	2,186.0	2,405.0	3,061.0	3,310.0	3,614.0	4,385.0
Foreign direct investment, net	83.0	65.0	70.0	187.0	88.0	195.0	260.0
Gross reserves, excluding gold (end-year)	1,212.0	1,215.0	1,659.0	2,146.0	2,895.0	4,665.0	na
External debt stock	4,457.0	4,260.0	4,249.0	4,322.0	4,133.0	3,872.0	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	4.6	5.4	6.4	6.6	8.5	12.6	na
			(In per cent of exports of goods and services)				
Debt service	25.8	24.6	22.5	16.9	13.4	11.1	na
Memorandum items			(Denominations as indicated)				
Population (end-year, million)	24.9	25.6	26.0	26.0	26.0	26.0	na
GDP (in billions of sums)	4,925.0	7,450.0	9,837.8	12,261.0	15,923.0	20,759.3	25,458.0
GDP per capita (in US dollars) [6]	305.6	329.3	380.3	472.3	572.0	655.0	na
Share of industry in GDP (in per cent)	14.1	14.5	15.8	17.5	20.7	22.1	na
Share of agriculture in GDP (in per cent)	30.0	30.1	28.6	26.4	25.0	24.1	na
Current account/GDP (in per cent)	-1.5	1.4	8.9	9.9	13.1	18.8	20.0
External debt - reserves (in US$ million)	3,245.0	3,045.0	2,590.0	2,176.0	1,238.0	-793.0	na
External debt/GDP (in per cent)	58.5	44.1	43.7	37.3	31.3	22.8	na
External debt/exports of goods and services (in per cent)	139.2	142.7	112.6	89.4	76.3	60.7	na

1 EBRD estimate. Official figures differ.
2 Officially registered unemployed.
3 Unofficial estimates; official figures are lower.
4 Includes extra-budgetary funds, but excludes local government.
5 Dual exchange rates were in operation until October 2003. Data show a weighted average of the official, bank and parallel market rates.
6 Calculated at the weighted exchange rate for periods in which dual exchange rates were in effect.

Methodological notes

The transition indicator scores in Chapter 1 reflect the judgment of the EBRD's Office of the Chief Economist about country-specific progress in transition.

The scores range from 1 to 4+ and are based on a classification system that was originally developed in the 1994 *Transition Report*, but has been refined and amended in subsequent Reports. "+" and "–" ratings are treated by adding 0.33 and subtracting 0.33 from the full value. Averages are obtained by rounding down, for example, a score of 2.6 is treated as 2+, but a score of 2.8 is treated as 3-.

Overall transition indicators

(see Table 1.1 on page 6)

Large-scale privatisation

1 Little private ownership.

2 Comprehensive scheme almost ready for implementation; some sales completed.

3 More than 25 per cent of large-scale enterprise assets in private hands or in the process of being privatised (with the process having reached a stage at which the state has effectively ceded its ownership rights), but possibly with major unresolved issues regarding corporate governance.

4 More than 50 per cent of state-owned enterprise and farm assets in private ownership and significant progress with corporate governance of these enterprises.

4+ Standards and performance typical of advanced industrial economies: more than 75 per cent of enterprise assets in private ownership with effective corporate governance.

Small-scale privatisation

1 Little progress.

2 Substantial share privatised.

3 Comprehensive programme almost ready for implementation.

4 Complete privatisation of small companies with tradeable ownership rights.

4+ Standards and performance typical of advanced industrial economies: no state ownership of small enterprises; effective tradeability of land.

Governance and enterprise restructuring

1 Soft budget constraints (lax credit and subsidy policies weakening financial discipline at the enterprise level); few other reforms to promote corporate governance.

2 Moderately tight credit and subsidy policy, but weak enforcement of bankruptcy legislation and little action taken to strengthen competition and corporate governance.

3 Significant and sustained actions to harden budget constraints and to promote corporate governance effectively (for example, privatisation combined with tight credit and subsidy policies and/or enforcement of bankruptcy legislation).

4 Substantial improvement in corporate governance and significant new investment at the enterprise level, including minority holdings by financial investors.

4+ Standards and performance typical of advanced industrial economies: effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring.

Price liberalisation

1 Most prices formally controlled by the government.

2 Some lifting of price administration; state procurement at non-market prices for the majority of product categories.

3 Significant progress on price liberalisation, but state procurement at non-market prices remains substantial.

4 Comprehensive price liberalisation; state procurement at non-market prices largely phased out; only a small number of administered prices remain.

4+ Standards and performance typical of advanced industrial economies: complete price liberalisation with no price control outside housing, transport and natural monopolies.

Trade and foreign exchange system

1 Widespread import and/or export controls or very limited legitimate access to foreign exchange.

2 Some liberalisation of import and/or export controls; almost full current account convertibility in principle, but with a foreign exchange regime that is not fully transparent (possibly with multiple exchange rates).

3 Removal of almost all quantitative and administrative import and export restrictions; almost full current account convertibility.

4 Removal of all quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement in exports and imports by ministries and state-owned trading companies; no major non-uniformity of customs duties for non-agricultural goods and services; full and current account convertibility.

4+ Standards and performance norms of advanced industrial economies: removal of most tariff barriers; membership in WTO.

Competition policy

1 No competition legislation and institutions.

2 Competition policy legislation and institutions set up; some reduction of entry restrictions or enforcement action on dominant firms.

3 Some enforcement actions to reduce abuse of market power and to promote a competitive environment, including break-ups of dominant conglomerates; substantial reduction of entry restrictions.

4 Significant enforcement actions to reduce abuse of market power and to promote a competitive environment.

4+ Standards and performance typical of advanced industrial economies: effective enforcement of competition policy; unrestricted entry to most markets.

Banking reform and interest rate liberalisation

1 Little progress beyond establishment of a two-tier system.

2 Significant liberalisation of interest rates and credit allocation; limited use of directed credit or interest rate ceilings.

3 Substantial progress in establishment of bank solvency and of a framework for prudential supervision and regulation; full interest rate liberalisation with little preferential access to cheap refinancing; significant lending to private enterprises and significant presence of private banks.

4 Significant movement of banking laws and regulations towards BIS standards; well-functioning banking competition and effective prudential supervision; significant term lending to private enterprises; substantial financial deepening.

4+ Standards and performance norms of advanced industrial economies: full convergence of banking laws and regulations with BIS standards; provision of full set of competitive banking services.

Securities markets and non-bank financial institutions

1 Little progress.

2 Formation of securities exchanges, market-makers and brokers; some trading in government paper and/or securities; rudimentary legal and regulatory framework for the issuance and trading of securities.

3 Substantial issuance of securities by private enterprises; establishment of independent share registries, secure clearance and settlement procedures, and some protection of minority shareholders; emergence of non-bank financial institutions (for example, investment funds, private insurance and pension funds, leasing companies) and associated regulatory framework.

4 Securities laws and regulations approaching IOSCO standards; substantial market liquidity and capitalisation; well-functioning non-bank financial institutions and effective regulation.

4+ Standards and performance norms of advanced industrial economies: full convergence of securities laws and regulations with IOSCO standards; fully developed non-bank intermediation.

Infrastructure reform

The ratings are calculated as the average of five infrastructure reform indicators covering electric power, railways, roads, telecoms, water and waste water. The classification system used for these five indicators is detailed below.

Infrastructure transition indicators

(see Table 1.3 on page 10)

Electric power

1 Power sector operates as government department with few commercial freedoms or pressures. Average prices well below costs, with extensive cross-subsidies. Monolithic structure, with no separation of different parts of the business.

2 Power company distanced from government, but there is still political interference. Some attempt to harden budget constraints, but effective tariffs are low. Weak management incentives for efficient performance. Little institutional reform and minimal, if any, private sector involvement.

3 Law passed providing for full-scale restructuring of industry, including vertical unbundling through account separation and set-up of regulator. Some tariff reform and improvements in revenue collection. Some private sector involvement.

4 Separation of generation, transmission and distribution. Independent regulator set up. Rules for cost-reflective tariff-setting formulated and implemented. Substantial private sector involvement in distribution and/or generation. Some degree of liberalisation.

4+ Tariffs cost-reflective and provide adequate incentives for efficiency improvements. Large-scale private sector involvement in the unbundled and well-regulated sector. Fully liberalised sector with well-functioning arrangements for network access and full competition in generation.

Railways

1 Monolithic structure operated as government department, with few commercial freedoms. No private sector involvement and extensive cross-subsidisation.

2 Rail operations distanced from state, but weak commercial objectives. Some business planning, but targets are general and tentative. No budgetary funding of public service obligations. Ancillary businesses separated, but little divestment. Minimal private sector involvement.

3 Commercial orientation in rail operations. Freight and passenger services separated and some ancillary businesses divested. Some budgetary compensation available for passenger services. Improved business planning with clear investment and rehabilitation targets, but funding unsecured. Some private sector involvement in rehabilitation and/or maintenance.

4 Railways fully commercialised, with separate internal profit centres for freight and passenger services. Extensive market freedoms to set tariffs and investments. Implementation of medium-term business plans. Ancillary industries divested. Private sector participation in freight operation, ancillary services and track maintenance.

4+ Separation of infrastructure freight and passenger operations. Full divestment and transfer of asset ownership implemented or planned, including infrastructure and rolling stock. Rail regulator established and access pricing implemented.

Roads

1 Minimal degree of decentralisation and no commercialisation. All regulatory, road management and resource allocation functions centralised at ministerial level. New investments and road maintenance financing dependent on central budget allocations. Road user charges not based on the cost of road use. Road construction and maintenance undertaken by public construction units. No public consultation in the preparation of road projects.

2 Moderate degree of decentralisation and initial steps in commercialisation. Road/highway agency created. Improvements in resource allocation and public procurement. Road user charges based on vehicle and fuel taxes, but not linked to road use. Road fund established, but dependent on central budget. Road construction and maintenance undertaken primarily by corporatised public entities, with some private sector participation. Minimal public consultation/participation on road projects.

3 Fair degree of decentralisation and commercialisation. Regulation and resource allocation functions separated from road maintenance and operations. Level of vehicle and fuel taxes related to road use. Private companies able to provide and operate roads under negotiated commercial contracts. Private sector participation in road maintenance and/or through concessions to finance, operate and maintain parts of highway network. Limited public consultation/participation and accountability on road projects.

4 Large degree of decentralisation. Transparent methodology used to allocate road expenditures. Track record in competitive procurement of road design, construction, maintenance and operations. Large-scale private sector participation in construction, operations and maintenance directly and through public-private partnerships. Substantial public consultation/ participation and accountability on road projects.

4+ Fully decentralised road administration. Commercialised road maintenance operations competitively awarded to private companies. Road user charges reflect the full costs of road use and associated factors, such as congestion, accidents and pollution. Widespread private sector participation in all aspects of road provision. Full public consultation on new road projects.

Telecoms

1 Little progress in commercialisation and regulation. Minimal private sector involvement and strong political interference in management decisions. Low tariffs, with extensive cross-subsidisation. Liberalisation not envisaged, even for mobile telephony and value-added services.

2 Modest progress in commercialisation. Corporatisation of dominant operator and some separation from public sector governance, but tariffs are still politically set.

3 Substantial progress in commercialisation and regulation. Telecommunications and postal services fully separated; cross-subsidies reduced. Considerable liberalisation in the mobile segment and in value-added services.

4 Complete commercialisation, including privatisation of the dominant operator; comprehensive regulatory and institutional reforms. Extensive liberalisation of entry.

4+ Effective regulation through an independent entity. Coherent regulatory and institutional framework to deal with tariffs, interconnection rules, licensing, concession fees and spectrum allocation. Consumer ombudsman function.

Water and waste water

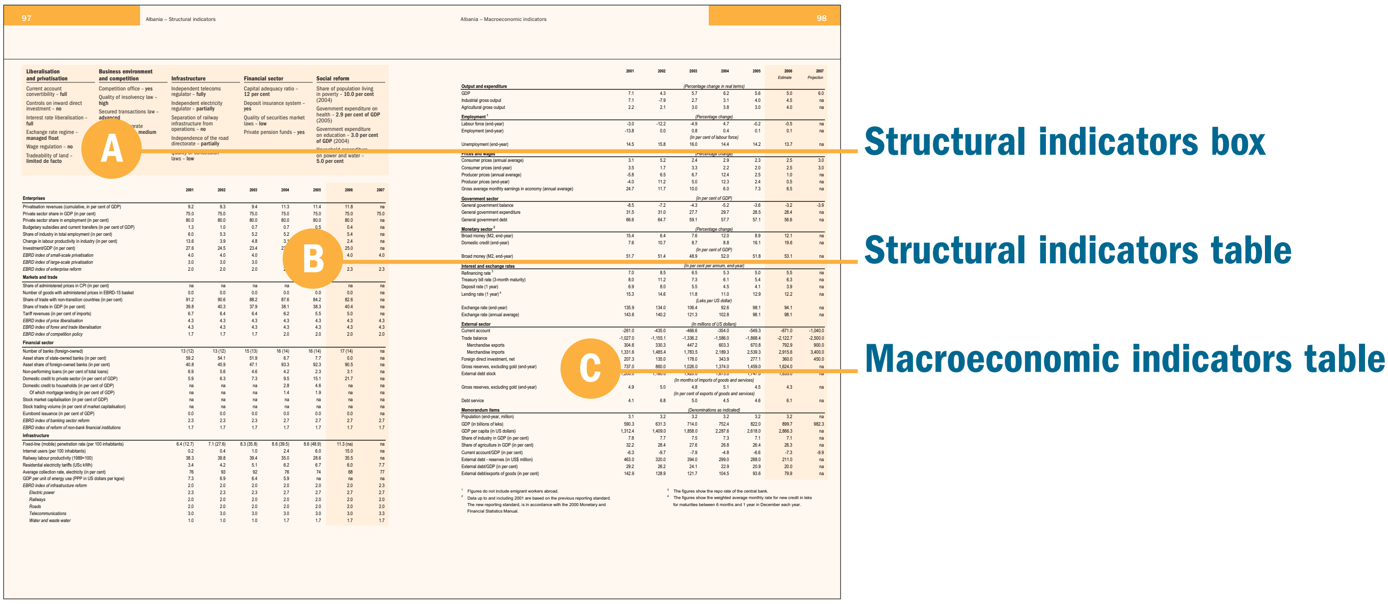
1 Minimal degree of decentralisation; no commercialisation. Services operated as vertically integrated natural monopolies by government ministry or municipal departments. No financial autonomy and/or management capacity at municipal level. Low tariffs, low cash collection rates and high cross-subsidies.

2 Moderate degree of decentralisation; initial steps towards commercialisation. Services provided by municipally owned companies. Partial cost recovery through tariffs; initial steps to reduce cross-subsidies. General public guidelines exist regarding tariff-setting and service quality, but both under ministerial control. Some private sector participation through service or management contacts, or competition to provide ancillary services.

3 Fair degree of decentralisation and commercialisation. Water utilities operate with managerial and accounting independence from municipalities, using international accounting standards and management information systems. Operating costs recovered through tariffs, with a minimum level of cross-subsidies. More detailed rules drawn up in contract documents, specifying tariff review formulae and performance standards. Private sector participation through the full concession of a major service in at least one city.

4 Large degree of decentralisation and commercialisation. Water utilities managerially independent, with cash flows – net of municipal budget transfers – that ensure financial viability. No cross-subsidies. Semi-autonomous regulatory agency able to advise and enforce tariffs and service quality. Substantial private sector participation through build-operate-transfer concessions, management contacts or asset sales in several cities.

4+ Water utilities fully decentralised and commercialised. Fully autonomous regulator exists with complete authority to review and enforce tariff levels and quality standards. Widespread private sector participation via service/management/lease contracts. High-powered incentives, full concessions and/or divestiture of water and waste-water services in major urban areas.



A: Structural indicators box – definitions and data sources

Liberalisation and privatisation

Current account convertibility

Options: full (full compliance with Article VIII of IMF Agreement); limited (restrictions on payments or transfers for current account transactions).

Source: International Monetary Fund, Annual report on exchange arrangements and exchange restrictions.

Controls on inward direct investment

Options: yes (controls on foreign ownership, and/or minimum capital requirements); no (no restrictions on inward foreign direct investment, except in some cases on arms production and military equipment).

Source: International Monetary Fund, Annual report on exchange arrangements and exchange restrictions.

Interest rate liberalisation

Options: full (banks free to set deposit and lending rates); limited de facto (no legal restrictions on banks to set deposit and lending rates, but limitations arise from substantial market distortions, such as directed credits or poorly functioning or highly illiquid money or credit markets); limited de jure (restrictions on banks to set interest rates through law, decree or central bank regulation).

Source: EBRD staff assessments.

Exchange rate regime

Options: currency board; fixed; fixed with band; crawling peg; crawling peg with band; managed float; floating.

Source: International Monetary Fund, Annual report on exchange arrangements and exchange restrictions.

Wage regulation

Restrictions or substantial taxes on the ability of some enterprises to adjust the average wage or wage bill upward. Options: yes; no.

Source: EBRD staff assessments.

Tradeability of land

Options: full (no substantial restrictions on tradeability of land rights beyond administrative requirements; no discrimination between domestic and foreign subjects); full except foreigners (as “full”, but with some differential treatment of foreigners); limited de facto (substantial de facto limitations on tradeability of land, for example, limited enforceability of land rights, a non-existent land market, or significant obstruction by government officials); limited de jure (legal restrictions on tradeability of land rights); no (land trade prohibited).

Source: EBRD staff assessments.

Business environment and competition

Competition office

Competition or anti-monopoly office exists separately from any ministry, though it may not be fully independent. Options: yes; no.

Source: EBRD staff assessments.

Quality of insolvency law

Level of compliance of insolvency laws with international standards, such as the World Bank’s Principles and guidelines for effective insolvency and creditor rights systems, the UNCITRAL working group on legislative guidelines for insolvency law, and others. Options: very high; high; medium; low; very low.

Source: EBRD Legal Sector Assessment 2004.

Secured transactions law

Level of reform assessed in relation to the EBRD Model Law on secured transactions and the EBRD 10 core principles of secured transactions laws. Options: advanced; some defects; inefficient; malfunctioning.

Source: EBRD Regional Survey of Secured Transactions 2005.

Quality of corporate governance law

Level of compliance of corporate governance laws with international standards, such as the OECD Principles of corporate governance. Options: very high; high; medium; low; very low.

Source: EBRD Legal Sector Assessment 2005.

Infrastructure

Independent telecoms regulator

Options: fully (institutional, financial, managerial and decision making independence granted); partially (some elements of independence, but not all four dimensions); no (no regulator with institutional independence).

Source: EBRD staff assessments.

Independent electricity regulator

Options: fully (institutional, financial, managerial and decision making independence granted); partially (some elements of independence, but not all four dimensions); no (no regulator with institutional independence).

Source: EBRD staff assessments.

Separation of railway infrastructure from operations

Separate entities responsible for track infrastructure and for freight and passenger operations. Options: fully (institutional separation); partially (accounting only); no.

Source: EBRD staff assessments.

Independence of the road directorate

A road management agency that is separate from the government. Options: fully (institutional, managerial and decision-making independence and an independent account); partially (some elements of independence, but not all four dimensions); no (part of a government body).

Source: EBRD staff assessments.

Quality of concession laws

Level of compliance of concession laws with international standards, in particular the UNCITRAL Legislative guide on privately financed infrastructure projects. Options: very high; high; medium; low; very low.

Source: EBRD Legal Sector Assessment 2005.

Financial sector

Capital adequacy ratio

Ratio of bank regulatory capital to risk-weighted assets; regulatory capital includes paid-in capital, retentions and some forms of subordinated debt.

Source: EBRD staff assessments.

Deposit insurance system

Deposits in all banks covered by formal deposit insurance scheme. Options: yes; no.

Source: EBRD staff assessments.

Quality of securities market laws

Level of compliance of securities market laws with international standards, mainly the objectives and principles of securities regulation issued by the International Organization of Securities Commissions (IOSCO). Options: very high; high; medium; low; very low.

Source: EBRD Legal Sector Assessment 2004.

Private pension funds

Options: yes; no.

Source: EBRD staff assessments.

Social reform

Share of population living in poverty

Percentage of population living on less than US$ 2 (in 1993 US$ at purchasing power parity) a day per person. Selected years.

Source: World Bank, World Development Indicators.

Government expenditure on health

Expenditures by general government, excluding state-owned enterprises, on health services including hospitals, clinics, public health, medicaments, medical equipment and applied research related to the sector. Expenditures are expressed as percentage of GDP. Latest available year.

Source: National authorities.

Government expenditure on education

Expenditures by general government, excluding state-owned enterprises, on education services including pre-primary and primary education, secondary and tertiary education, and subsidiary services to education. Expenditures are expressed as a percentage of GDP. Latest available year.

Source: National authorities.

Household expenditure on power and water

Share of total household expenditures used on electric power and water/waste-water services. Estimate based on the poorest 10 per cent of households (lowest income decile), latest available year.

Source: EBRD staff estimates, based on household survey data.

B: Structural indicators table – definitions and data sources

Enterprises

Privatisation revenues (cumulative, in per cent of GDP)

Government revenues from cash sales of enterprises, not including investment commitments.

Sources: National authorities and IMF country reports.

Private sector share in GDP (in per cent)

"Private sector share" in GDP represent rough EBRD estimates, based on available statistics from both official (government) sources and unofficial sources. The underlying concept of private sector value added includes income generated by the activity of private registered companies, as well as by private entities engaged in informal activity in those cases where reliable information on informal activity is available.

Source: EBRD staff estimates.

Private sector share in employment (in per cent)

"Private sector share" in employment represent rough EBRD estimates, based on available statistics from both official (government) sources and unofficial sources. The underlying concept of private sector employment includes employment in private registered companies, as well as in private entities engaged in informal activity in those cases where reliable information on informal activity is available.

Source: EBRD staff estimates.

Budgetary subsidies and current transfers (in per cent of GDP)

Budgetary transfers to enterprises and households, excluding social transfers.

Sources: National authorities and IMF country reports.

Share of industry in total employment (in per cent)

Industry includes electricity, power, manufacturing, mining and water.

Sources: ILO, Labour Statistics Yearbook, UN, National Account Statistics, national authorities and IMF country reports.

Change in labour productivity in industry (in per cent)

Labour productivity is calculated as the ratio of industrial production to industrial employment. Changes in productivity are calculated on the basis of annual averages.

Sources: National authorities and IMF country reports.

Investment/GDP (in per cent)

Gross domestic investment consists of additional outlays to the economy's fixed assets, plus net changes in inventory levels. Fixed assets include: land improvements (fences, ditches, drains, and so on); plant, machinery and equipment purchases; and the construction of roads, railways, schools, offices, hospitals, private residential dwellings, commercial and industrial buildings, and so on. Inventories are stocks of goods held by firms to meet temporary or unexpected fluctuations in production or sales and "work in progress". Net acquisitions of valuables are also considered capital formation.

Source: See the macroeconomic indicators tables.

Markets and trade

Share of administered prices in CPI (in per cent)

Administered prices include: directly regulated prices (price set up directly by the state); partly regulated prices (state has co-determination right in setting the price); quasi-regulated prices (in the case of goods which are subject to specific customer taxes); and indirectly regulated prices (goods for which the state guarantees a purchase quote).

Sources: EBRD survey of national authorities and IMF country reports.

Number of goods with administered prices in EBRD-15 basket

EBRD-15 basket consists of flour/bread, meat, milk, gasoline/petrol, cotton textiles, shoes, paper, cars, television sets, cement, steel, coal, wood, rents, intercity bus service.

Source: EBRD survey of national authorities.

Share of trade with non-transition countries (in per cent)

Ratio of merchandise exports and imports with non-transition economies to total trade (exports plus imports).

Source: IMF, Directions of Trade Statistics.

Share of trade in GDP (in per cent)

Ratio of exports plus imports to GDP.

Source: See the macroeconomic indicators tables.

Tariff revenues (in per cent of imports)

Tariff revenues include all revenues from international trade. Imports are those of merchandise goods.

Sources: National authorities and IMF country reports.

Financial sector

Number of banks (foreign-owned)

Number of commercial and savings banks, excluding cooperative banks. Foreign-owned banks are defined as those with foreign ownership exceeding 50 per cent, end-of-year.

Source: EBRD survey of central banks.

Asset share of state-owned banks (in per cent)

Share of majority state-owned banks' assets in total bank sector assets. The state includes the federal, regional and municipal levels, as well as the state property fund and the state pension fund. State-owned banks are defined as banks with state ownership exceeding 50 per cent, end-of-year.

Source: EBRD survey of central banks.

Asset share of foreign-owned banks (in per cent)

Share of total bank sector assets in banks with foreign ownership exceeding 50 per cent, end-of-year.

Source: EBRD survey of central banks.

Non-performing loans (in per cent of total loans)

Ratio of non-performing loans to total loans. Non-performing loans include sub-standard, doubtful and loss classification categories of loans, but excludes loans transferred to a state rehabilitation agency or consolidation bank, end-of-year.

Source: EBRD survey of central banks.

Domestic credit to private sector (in per cent of GDP)

Ratio of total outstanding domestic credit to private sector at end-of-year, to GDP.

Domestic credit to private sector comprises the claims on non-financial, majority private-owned, enterprises and households by: banking institutions; other banking institutions, which include institutions that do not accept deposits but perform financial intermediation (for example, mortgage banks, microfinance institutions); and the monetary authorities.

Sources: IMF, International Financial Statistics (IFS) and country reports.

Domestic credit to households (in per cent of GDP)

Ratio of total outstanding bank credit to households, at end-of-year, to GDP.

Source: EBRD survey of central banks.

Mortgage lending (in per cent of GDP)

Ratio of mortgage lending to households, at end-of-year, to GDP.

Source: EBRD survey of central banks.

Stock market capitalisation (in per cent of GDP)

Market value of all shares listed on the stock market, calculated by multiplying the share price by the number of shares outstanding; presented as a percentage of GDP, end-of-year. Listed domestic companies are the domestically incorporated companies listed on the country's stock exchanges at the end of the year.

Source: Standard & Poor's/IFC Emerging Stock Markets Factbook, Federation of Euro-Asian Stock Exchanges and local stock exchanges.

Stock trading volume (in per cent of market capitalisation)

Total value of shares traded during the period, divided by the average market capitalisation for the period.

Source: World Bank World Development Indicators, Standard & Poor's/IFC Emerging Stock Markets Factbook and local stock exchanges.

Eurobond issuance (in per cent of GDP)

Total value of the bond issuance (including sovereign, municipality and corporate issuance) denominated in a currency different to that of the country in which the bond was issued.

Source: JP Morgan.

Infrastructure

Fixed-line (mobile) penetration rate (per 100 inhabitants)

Fixed line refers to the number of telephone lines connecting a customer to the Public Switched Telephone Network (PSTN) and which have a dedicated port on a telephone exchange. Mobile refers to users of portable telephones subscribing to an automatic public mobile service using cellular technology that provides access to the PSTN.

Source: International Telecommunications Union.

Internet users (per 100 inhabitants)

Number of internet users per 100 inhabitants, based on nationally reported data.

Source: International Telecommunications Union.

Railway labour productivity (1989=100)

Productivity measured as the ratio of the number of traffic units (passenger-kilometres plus freight tonne-kilometres) and the total number of railway employees.

Sources: National authorities and World Bank.

Residential electricity tariff, US cents per kilowatt-hour

Average tariff paid by residential consumers; where data on residential tariffs are not available, average retail tariff.

Sources: International Energy Agency, Energy Regulators Association and EBRD survey of national authorities.

Average collection rate, electricity (in per cent)

Collection rate is defined as the ratio of total electricity payments received in cash and total electricity charges.

Source: EBRD survey of national authorities.

GDP per unit of energy use (PPP in US dollars per kgoe)

PPP of GDP per kilogram of oil equivalent for commercial energy use. GDP is converted to international US dollars using purchasing power parity exchange rates.

Source: World Bank, World Development Indicators.

C: Macroeconomic indicators table – definitions and data sources

Data represent official estimates of out-turns as reflected in publications from the national authorities, the International Monetary Fund, the World Bank and other sources. Data for the current year are EBRD staff estimates.

Output and expenditure

Official estimates of GDP, industrial and agricultural production. Growth rates can lack precision in the context of transition due to large shifts in relative prices, the failure to account for quality improvements and the substantial size and change in the informal sector. Some countries have started to incorporate the informal sector into their estimates of GDP.

Employment

For most countries, data reflect official employment records from the labour registries. In many countries, small enterprises are not recorded by official data. A number of countries have moved towards ILO-consistent labour force surveys in recording changes in labour force, employment and unemployment. Where available these data are presented.

Prices and wages

Data sourced from statistical offices or the IMF. In some countries, notably Belarus, Turkmenistan and Uzbekistan, official CPI data may underestimate underlying inflation because of price controls and inadequate measurement of price increases in informal markets. Wage data are from national authorities and often exclude small enterprises as well as the informal sector.

Government sector

Data for the general government, including local government and extra-budgetary funds, incorporated where available. Data for most countries are from IMF country reports. Budget balance data can differ from official estimates due to different budgetary accounting, in particular with respect to privatisation revenues and foreign lending.

Monetary sector

Broad money is the sum of money in circulation outside banks and demand deposits other than those of the central government. It also includes quasi-money (time, savings and foreign currency deposits of the resident sectors other than the central government). Data sourced from the IMF, International Financial Statistics, IMF country reports and monetary authorities.

Interest and exchange rates

Deposit and lending rates from most countries are weighted averages across maturities. For some countries, weighted averages are not available and rates are quoted for the most frequently used instruments. Data sourced from the IMF, International Financial Statistics, IMF country reports and monetary authorities.

External sector

Trade data in many countries can differ between balance of payments and customs statistics, because of differences in recording and of informal border trade, which is typically not recorded by customs statistics. Trade data are on a balance of payments basis as published by the monetary authorities and in IMF country reports.

Abbreviations

BOT	Build-operate-transfer
CEB	Central eastern Europe and the Baltic states (see map on page ii)
CEFTA	Central European Free Trade Agreement
CIS+M	Commonwealth of Independent States and Mongolia (see map on page ii)
COMTRADE	United Nations Commodity Trade Statistics Database
CPI	Consumer price index
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
EIB	European Investment Bank
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism
EU	European Union
EU-15	The 15 member states before EU expansion in 2004
FDI	Foreign direct investment
FYR Macedonia	Former Yugoslav Republic of Macedonia
GDP	Gross domestic product
HIPC initiative	Heavily Indebted Poor Countries initiative
ICRG	International Country Risk Guide
IFI	International financial institution
IFRS	International Financial Reporting Standards
ILO	International Labour Organization
IMF	International Monetary Fund
IPO	Initial public offering
IRR	Internal rate of return
LIS	Legal Indicator Survey
LiTS	Life in Transition Survey
na	Not available
NGO	Non-governmental organisation
OECD	Organisation for Economic Cooperation and Development
OTC	Over-the-counter
PPP	Purchasing power parity
PPPs	Public-private partnerships
PSU	Primary sampling unit
SAA	Stabilisation and Association Agreement
SEE	South-eastern Europe (see map on page ii)
SMEs	Small and medium-sized enterprises
UN	United Nations
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNICEF	United Nations Children's Fund
VAT	Value added tax
WTO	World Trade Organization
WVS	World Values Survey

Further copies of the *Transition Report* can be obtained from good booksellers, or by mail, fax and telephone from:

EBRD Publications Desk
One Exchange Square
London EC2A 2JN
United Kingdom
Tel: +44 20 7338 7553
Fax: +44 20 7338 6102
Email: pubsdesk@ebrd.com
Web site: www.ebrd.com/pubs

To subscribe to an electronic version of the *Transition Report,* visit: www.transitionreport.co.uk.

One Exchange Square
London EC2A 2JN
United Kingdom
Web site: www.ebrd.com

ISBN: 978 1 898802 29 7
ISSN: 1356-3424
price £30

Designed and produced by the EBRD – *ref: 7075 Transition Report* – November 2007.

Cover and interior printed on Core Silk/Gloss. The paper used in this report is manufactured to the strictest environmental standards from Elemental Chlorine Free pulps in a mill which holds ISO 14001 and EMAS environmental accreditations.

Printed in England by Spin Offset Limited, using environmental waste and paper recycling programmes. Spin Offset Limited is ISO 14001 accredited.

Photography:

Aleksandar Andjic	cover
Mike Ellis	cover, contents, 1, 20, 46
Jack Hill	2
Ib Katznelson	cover
Jon Page	vi, 92

Transition report 2007

The *Transition Report* offers an in-depth analysis of economic progress in 29 countries from central Europe to central Asia. Drawing on the EBRD's experience as one of the largest investors in the transition region, the Report provides comprehensive analysis of the transition from centrally planned to market economies.

This year's Report makes extensive use of the 2006 EBRD/World Bank Life in Transition Survey (LiTS), which comprised interviews with 29,000 people in 29 countries. The survey provides a unique insight into how the transition has affected people's everyday lives and attitudes. Are they happier now than they were in 1989? Have their living standards improved or deteriorated and what are their expectations for the future?

The Report analyses how people's levels of satisfaction, well-being and views about the role of government vary across the transition region. It identifies the groups that have benefited or suffered most and investigates how the changes in people's lives have affected their attitudes towards markets, democracy and support for further reform.

The dramatic changes that have taken place in the labour market are also analysed, from the job losses that accompanied the closure of lumbering state-run enterprises to the emergence of new opportunities in the private sector. The Report analyses how changes in the job market have influenced people's attitudes and outlook, their levels of trust and expectations for government policy. It also examines how public services can be improved and modified to meet some of these expectations. It discusses ways of involving the private sector in the delivery of traditional public services and looks in particular at the opportunities to forge public-private partnerships in areas such as health care.

The final part of the *Transition Report* consists of country-by-country assessments of the latest progress in structural reform and macroeconomic developments for each of the EBRD's 29 countries of operations. Extensive tables and charts provide the latest data on GDP, employment, inflation, the trade balance, foreign direct investment and many key economic indicators.

ISBN: 978 1 898802 29 7 ISSN: 1356-3424 £30