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Three-year IMF Program: Current Policy Impacts

Dr. Svetlana Alexandrova

In mid-July the International Monetary Fund assessed the implementation of the 1998-2001 Extended Fund Facility (EFF) for Bulgaria. My colleague, George Stoev, has summarized the outcome of the mission (see the Supplement to this issue). The EFF and its implementation matrix are available on the Government's web page (www.government.bg). Here I will discuss the EFF's impact on the government's economic policy and give a detailed overview of the progress made in different areas. Despite both the Russian and Kosovo crises, in mid-1999 Bulgaria emerged as a country capable of weathering external shocks and catching up with market reform. The key reason was and still is the IMF program.

The IMF Board approved Bulgaria's three-year agreement in September 1998. Its implementation required a number of pre-conditions, successfully fulfilled by the Cabinet (reduction of off-budget accounts volume, outlining of government service reforms, unification of tax-registration, etc.). The agreement is a broad but detailed policy document, which aims at the acceleration of structural reform and the establishment of a market-oriented, private sector-led, competitive economy.

The measures in the IMF program target fiscal policy, the banking system, structural reform and foreign trade liberalization, as well as the improvement of the agricultural sector. Assessment of to what degree the IMF agreement has been fulfilled gives an indication of the way in which reform is proceeding. Thus we can outline the reform's progress or lack thereof in various areas, in which the pace of implementation has been uneven. I take as a measurement criterion the degree of fulfilment of the policies agreed upon with the IMF. There are three degrees of fulfilment: progress of implementation, slow progress, and no progress. My assessment is in some aspects different from that of the parties to the agreement. It is divided into the following groups:

Fiscal sector

The 1999 budget law incorporates the IMF agreement measures aimed at maintaining a broadly balanced budget. The 1999 Budget Act foresees a 2.5% deficit which will generally be spent on structural reform (maintenance of enterprises under isolation and coverage of the social costs of the enterprises' restructuring). Privatization revenues could be used for financing the budget deficit and for restructuring and management of the debt. They may not be used for expenditures.

In the Budget Act, the total amount of outstanding government guarantees and the amount of new guarantees have been defined by the respective budget allocations. State guarantees for the credit agreement on the state enterprises is also limited. The treasury system is at the stage of being established. The creation of the treasury will be a prerequisite for budget transparency.

The IMF agreement includes measures for a government accountability system. The extra-budgetary funds have been consolidated. The number of extra-budgetary funds has been decreased, from 82 to 28. Budget expenditures are made on the basis of the institutional budgetary account. Rationalization of expenditure policy and improvement of investment planning are underway and are connected to the recently-formed treasury system and its functions. A public debt register is ready; it requires technical improvement. A team at the Ministry of Finance is working on the improvement of debt management. The law on debt and state quarantine is not ready yet; work on it continues. The law will be ready by the end of the year. All measures related to the rationalized expenditure policy and improvement of public investment planning are in progress and abide by the deadlines in the IMF agreement.

The schedule for the reduction of large tax debts was completed at the end of 1998 and the state enterprises under the isolation program are not allowed to increase their outstanding tax arrears.

Tax policy

The measures to improve the efficiency of the tax system aim to change and improve existing tax legislation.

The tax preferences in the Foreign Investment Law have been removed. In the Personal Income Tax Law, the link between the deductible allowance and the minimum wage as per Art.20(2), has been removed; those proposed in the draft for the Voluntary Pension Insurance Act, Art. 91(1) set a deductible allowance of a fixed amount.

The VAT regime has been harmonized with the EU requirements with regard to reduction of the existing exemption and maintenance of a single rate.

According to tax legislation, progressive taxes have been slowed down but on the whole the tax burden has not been significantly reduced.

Bank Supervision

As of 1998, all banks meet the 8% capital adequacy requirement. At present, capital adequacy requirement is at 10%; by the end of year it has to be 12%.

The Supervisory Board of the BNB has prepared and presented the regulation on large exposure of the commercial banks in the first quarter of March 1999.

The regulation on consolidated supervision has been prepared in accordance with the IMF agreement timetable.

The Supervisory Board is working on an act containing guidelines on interest rate risk.

The Supervisory Board of the BNB has prepared regulations requiring a comprehensive financial disclosure by banks.

The Supervisory Board of the BNB is following the plan of the IMF agreement's measures, moving toward prudent regulations and the implementation of a program for the development of further banking supervision.

The register of credits and collateral has functioned since 1998.

Trade policy

The foreign trade regime is a mixture of registration and permission regimes. Liberalization of trade policy continues. The tariff duty on sunflower oil has been abolished; Most Favorable Nation (MFN) tariffs on all of the commodities have been reduced.

The average tariffs on agricultural products have decreased. The import surcharge tax has been eliminated. There are no registration requirements for livestock, meat and dairy products, as well as others (see table).

The liberalization of household gas supply is in progress.

Quality restrictions have been abolished, except for the export quotas for livestock and wool to Canada and the United States.

Securities

A new Security Act is drafted and currently debated in the Parliament. The process of improving information sharing among the BNB, the Securities and Stock Exchanges Commission (SSEC) and non-bank institutions, as well as the training of experts, are being fulfilled according to the plan.

Modernization of the legal and regulatory framework for securities and secure enforcement was planned to be completed by 1999; the deadline has not been strictly followed.

Insignificant progress

Tax administration reform is going slowly. There has been no progress concerning the collection of taxes and the improvement of the tax administration. The Unified Identification Number, which is to replace statistical, tax and customs registration

numbers has not been introduced yet.

Tax Administration

The process of computerizing and improving the information link between the Regional Tax Offices (RTOs) and the General Tax administration directorate is ongoing. Information on the improvement of efficiency in tax collection and the implications of the measures taken in that area is not available.

The computerization of RTOs has not finished yet. Computerization of the General Tax Administration Directorate is ongoing and will be finished at the end of 1999. The reallocation of local tax authorities into only 19 units is in progress. (The reorganization of the tax administration does not have a definite term.) Activity connected with the fulfilment of tax administration improvement measures and those for provision of taxpayer services by local tax authorities is ongoing. Tax administration improvement reform will be completed by the end of 1999.

The Tax Procedure Code was accepted by the Ministry of Finance.

Most of the requirements of the IMF regarding the tax administration will probably be fulfilled by the end of 1999.

The process of developing a strategy for collection, audit, fraud investigation, and strengthening of taxpayer services will be prolonged to 2000.

Social Security System

The IMF agreement measures in the social security area are expected to be fulfilled by the end of 1999. Reform of the pension system has not begun yet, and thus the three-pillar pension system and the voluntary contribution scheme have not yet been implemented.

There has not been any progress in the improving cost efficiency in the provision of health services. No significant steps have been taken toward the setting up of a social security system that functions according to market rules.

Reference to pensions

The deadline for the reform of the existing pay-as-you-go system, as well as for increasing the retirement age, has not been adhered to.

Capital liberalization

The plan for capital account liberalization is to be accomplished by year 2000.

The new Currency Act is ready but has not yet been adopted by the Parliament. It will establish conditions for a more liberal exchange rate policy and is a prerequisite for the implementation of current account liberalization in the future.

Agriculture sector

All flour mills and bakeries are in the process of privatization; moreover, state-owned agricultural enterprises are under liquidation.

The land market began to develop in 1999. The deadline for the completion of 80 percent of land restitution in 1998 was not adhered to, but that amount was reached in the first quarter of 1999. The final legally-binding titles on 18% of the arable land eligible for restitution were provided. The conveyance tax on the purchase and sale of agricultural land was eliminated and the restriction on land-leasing was removed.

The Ministry of Agriculture, together with the US Agency for International Development ACIDI/VOCA Program, prepared a system for using the warehouse receipts as collateral in the first quarter of 1999. The first public grain warehouse opened in June 1999. There has been some progress in trade liberalization for agricultural products.

Information

The improvement of statistical databases in order to meet the full implementation of the General Data Dissemination System (GDDS) requirements is in progress. The deadline is the end of year 2000.

Banking sector

Though recently the authority responsible for bank privatization, the Bank Consolidation Company (BCC), has begun planning to speed up bank privatization, the latter seems to be the most significant delay in Bulgaria's privatization schedule.

On August 14, 1998, the BCC signed an agreement for the sale of 78.23% of the share capital of Bulgarian Post Bank (the buyers were the American Life Insurance Company (ALICO) and the Greek Consolidated Euro-Finance Holdings). The deal was officially finalized in November 1998.

The supervision audit of Hebrosbank and the formulation of a management strategy for Hebrosbank were completed by the end of 1998. All parties interested in purchasing Hebrosbank have to submit their final proposals by mid-September 1999.

The management contract for Biochim bank was signed in 1998. Biochim was placed under a Management Agreement with a British management team, Glendale Consulting Ltd., in September of 1998. At the end of July 1999, the BCC decided to cancel the contract with Glendale. The explanation was that the environment at present was favorable for the acceleration of Biochim's privatization. The plans provide for Biochim to be sold at the beginning of the year 2000.

According to the agreement reached with the IMF, the World Bank and the EU, the last Bulgarian state-owned bank, the State Savings Bank, should enter privatization procedures by the year 2001. The State Savings Bank is fully licensed. A technical assistance program started in 1998.

According to the government's agreement with the IMF, tenders for Expressbank and Bulbank had to be issued by the end of October of 1998. The deadlines were then additionally extended. The potential buyers of Expressbank were short-listed at the end of March 1999 and it is expected that the bank will be sold by the end of August 1999. The BCC is expecting to receive prospective buyers' offers for Bulbank by the end of September. Bulbank's privatization is being coordinated by a consortium of CreditAnstalt Investment Bank, Credit Suisse First Boston and Arthur Andersen.

Non-bank financial sector

There has been no progress in the creation of an appropriate regulatory framework for the non-financial sector. Nothing at all has been completed within the defined term.

On the positive side of non-financial sector development, some amendments included in the Pension Law are applicable, such as:

- legal separation of the pension fund and the pension fund manager;
- legal separation of cash and voucher funds;
- establishment of a minimum of 50 percent for the share of investment in government securities; and
- limiting investment in equity to shares listed on the regulated segment of the Stock Exchange.

Privatization

There has been no significant progress in terms of state enterprise privatization.

- Parliament has not yet submitted a legislative basis for the reduction of the ZUNK-related debts of enterprises;
- the restrictions on debt-equity swaps have not been removed yet;
- Parliament has submitted a draft amendment to the Restitution Law that allows for restitution payments in the form of vouchers for enterprises that have been privatized;
- 50% of all enterprises have been privatized or liquidated; and
- some restrictions on debt-equity swaps have remained. (The IMF requirement has not been adhered to.)

Transparency of privatization

- The announcement of a list of the minimum

fixed assets to be sold through vouchers was fulfilled in 1998;

- the part of the IMF agreement concerning abolishing the preferences enjoyed by management-employee buyouts (MEBOs) by the introduction of appropriate discounts in the valuations of their bids by different payments has not been fulfilled. There is no list of enterprises that are ineligible for MEBOs (the deadline was the end of 1998);
- the preparation of a procedure for concessions granting that is compatible with privatization was not fulfilled within the defined term (1998);
- the central share register was ready in 1998;
- the isolation program for group B has not been completed yet (the deadline was mid-1999);
- the liquidation of insolvent enterprises has not been completed in accordance with the IMF agreement timetable.

No progress

There has not been any progress in implementation of the measures regarding the energy sector. At present, the problem is the lack of an energy strategy and plan. There has been no privatization in the energy sector.

The process of public expenditure rationalization has not started yet.

At present, health-care reform is at the stage of the creation of the preconditions necessary for the implementation of a health insurance system.

Conclusions

Most of the measures related to fiscal reform, the tax system, trade policy, bank supervision improvement and, to some extent, the agricultural sector, have been fulfilled according to the terms of the IMF agreement.

Bank privatization and state-owned enterprise privatization have been delayed with respect to the agreed-upon deadlines.

Pension and health-care reform are going very slowly in relation to the deadlines set in the IMF-agreement measures.

Reform of the energy sector has not started.

Balkans in 2010:

Romania Background

by Assenka Yonkova,
IME

Acknowledgments

This paper is based on statistical information from the National Statistics Commission of Romania, EBRD, Standard & Poor's Sovereign Ratings Service, the World Bank, the OECD, and data provided in answer to a standardized questionnaire by Mihaela Cimpoeasu of Freemarkonsult International, Bucharest. Further opinions and conclusions provided are based on an interview with Mr. David Boren of Montpelier Asset Management, as well as the official country presentation made during the EBRD's Annual Meeting in London, on April 17-20, 1999.

General information

Romania is located in Southeastern Central Europe. With an area of 238,391 sq.km. the country is the eleventh-largest in Europe.

Borders:

- North-East and East: Republic of Moldova (681.3 km.), with 4 border-crossing points;
- North and East: the Ukraine (649.4 km.), with 5 border-crossing points;

- South-East: the Black Sea (193.5 km.);
- South: Bulgaria (631.3 km.), with 4 border-crossing points;
- South-West: Yugoslav Federation (546.4 km.), with 4 border-crossing points;
- West: Hungary (448.0 km.), with 6 border-crossing points.

Romania is a country with five ethnic groups; 89.4% of population are Romanians and 7.1% are Hungarians. The other ethnic groups include: Germans, 0.5%; Ukrainians, 0.3%; and Jews, 0.04%. There are no signs that Romania might face ethnic problems and related civil disturbances in the near future. Romania has territorial claims against the Ukraine, but significant problems are not likely to arise in the near future. The age structure of Romania's population shows the availability of a comparatively large labor force. The labor force is well skilled; 8.1% of employees possess higher education and 29.8% have graduated from high school.

The country is becoming one of the most significant business transportation areas in Central and Southern

Table 1: Basic economic indicators

	1992	1993	1994	1995	1996	1997
Nominal GDP (in US \$millions*)	19,575.3	26,362.76	30,074.44	35,482.29	35,157.61	34,842.38
Gross fixed capital formation (% of GDP)	19.2	17.9	20.3	21.4	23.1	19.2
Investments (% of GDP)	14.74	14.08	16.08	18.02	19.32	n/a
Retail sales as share of GDP** (%)	27.82	26.78	26.85	30.83	32.58	n/a

* computed based on data in lei a

Table 2: Number of companies registered

	1992	1993	1994	1995	1996	1997
Number of active enterprises in industry, construction, trade and other services*	130,076	217,857	286,501	304,359	312,067	N/A
Number of registered companies**	174,787	317,192	428,619	487,952	548,873	593,562

* 1997 Statistical Yearbook
** National Bank of Romania – Annual Report 1997

Europe; at the same time only 4,500 km. of a total 72,859 km. public roads are classified as European-class roads; only 113 km. are motorways. Considering increased transport traffic flows, improvement in the condition of the road network and restructuring the railways are very important. Romania has comparatively sufficient border-crossing system, but it has to be upgraded to ensure adequate flow of international road traffic. This is especially important for border-crossing points between Romania and Bulgaria (1 bridge and 3 ferries). Romania's population totals

Table 3: Trade flows between Romania and other Balkan countries in US \$millions

		1992	1993	1994	1995	1996
Greece	export	116	84	141	205	177
	import	75	69	89	158	186
Albania	export	2	3	5	7	23
	import	*	*	*	*	13
Bulgaria	export	116	103	103	71	71
	import	89	71	65	77	73
Bosnia & Herz.	export	49	7	*	1	3
	import	22	15	*	*	1
Croatia	export	4	4	9	10	14
	import	2	4	1	3	4
Macedonia	export	20	19	27	38	10
	import	11	19	20	20	4
Yugoslavia	export	131	8	20	31	137
	import	124	*	*	*	31
Turkey	export	219	277	251	348	390
	import	176	147	151	251	219

* magnitude less than 0.5

22,500,000 (July 1, 1997), or 94.4 inhabitants per sq.km. According to the census returns of January 7, 1992, the population was 22,810,035. A total of 55% of the country's population is urban. About 8 million Romanians live abroad.

Education: in 1997/1998 school attendance was 4,643,000, or 20.6% of the country's population. The number of public university students was 361,000 and 111,000 were attending private universities.

Economic indicators

According to the statistics, only 56.8% of registered **companies** in Romania were active in 1996. For the 4-year period 1992-1996 the number of registered companies increased by some 240%, while the number of active enterprises rose by 140%. The majority (72%) of active companies in 1996 were in the trade sector, 10.3% in industry and only 0.15% in finance. The total number of private enterprises in Romania increased by 664% during the 1990-1997 period (from 76,277 in 1990 to 582,411 in 1997). There has been steady growth in the private sector share of GDP; it was 26.4% in 1992, 34.8% in 1993, 38.9% in 1994, 45% in 1995, 52% in 1996, and up to 58% in 1997. About 98% of small trade and service-oriented businesses are

privately owned. Private sector activity made up 75% of GDP in the trade sector, 24% in industry and 71% in construction in 1996. In 1996 (the latest available data) investments by the public sector was 51% of total investments, and the private sector invested 39.7%.

During the 1994-1996 period Romania's GDP rose by 3.5%, 7.1%, and 3.9%, respectively. In 1998 Romania recorded a decline for the second successive year, by 7.3% in real GDP, after a 6.6% decline in 1997. The reduction of industrial activity led to a reduction in the sector's portion of GDP from 35.5% in 1997 to 31.7% in 1998. The share of agriculture in GDP declined by 2.1% to 16%, while the share of services increased from 33.2% to 37.8%. GDP per capita is estimated at US \$1,697 for 1998.

About 42% of **household** income in Romania comes from salaries (bonuses and benefits included), about 30% from equivalent value of consumption of agricultural products from own resources, 15.6% from social payments, 5% from the sale of goods, land, buildings, 3.7% from own-account activity, and 0.4% from other activities.

Foreign trade: in 1996 the total of Romania's exports amounted to US \$8,060 million, of which US \$825 million (10.23%) was directed toward Balkan countries. About 2/3 of Romania's exports in 1998 were directed toward OECD countries, 65% toward the European Union, 4.4% toward CEFTA countries, and about 3% toward Russia. For the same period, 57.6% of total imports came from the European Union. Among Romania's principal trading partners are Italy, Germany, France, Turkey, etc.

In 1997 **employees** in the public sector accounted for 41.2% of all employees, while the private sector employed 53% of all employees in the country. For comparison, in 1993 this proportion was 51.6% of employees in the public sector and 43.7% in the private sector.

Infrastructure: roads, production and transmission of electricity, and gas transmission are public monopolies. The country has a well-developed infrastructure. With an area of 238,391 sq. km., Romania has a total length of public roads of 72,859 km., or a density per 100 sq. km. of 30.6. The country has two ports on the Black Sea, 11 ports on the Danube, and 18 airports. In November 1998, a 35% stake in the Romtelecom telephone company was privatized. The government plans to prepare Romania's utilities for privatization over the course of 1999.

The government's investment program intentions (planned public investments for coming 1-3 years) include road infrastructure (rehabilitation of roads, modernization of railways), development of the energy system, dwellings, water network, etc.

The two-tier **banking system** was formally established in March 1991. The major feature of the banking system is a predominance of state-owned banks with high debt burdens. The banking system currently includes over 40 fully-operational banks, including the repre-

sentative offices of several major foreign banks. Branches of the following international banks operate in Romania: Societe Generale, ING Bank, ABN AMRO, Raiffeisen Bank, BNP Dresdner Bank, Daewoo Bank, Frankfurt Bukarest, Bank, Banque Franco-Roumaine, GE, and Citibank (Chase Manhattan Bank is leaving). As far as banks from Balkan countries, there is a presence of Greek and Turkish banks only.

Institutional

In Romania *property registers* are centralized and based on property. Bankruptcy procedures last over 18 months on the average and are rarely used. Bankruptcy procedures for banks last even longer, at over 24 months, and thus they, too, are rarely used. The estimated time necessary to collect claims in court is over 18 months, and application is bad. In the field of public procurement there is wide use of open tenders, but application is estimated as unfair. In Romania political influence in deciding winners is observed with regard to tender procedure. There also is political protection in privatization and in access to subsidies.

Political aspects

Romania is a constitutional republic with a multi-party *parliamentary system*. During the last 10 years Romania has been ruled by five governments. The current government is a center-right coalition composed of the Democratic Convention, Social Democratic Union, and Hungarian Democratic Union. The last of those is an ethnic party of Hungarians. There also exists an ethnic party of Roma ethnicity.

Comments

Romania is a country that has had one of the longest and most painful transition processes among Balkan countries. Although most of the necessary legal framework (abolishment of most subsidies, adoption of contemporary tax legislation and tariff-based trade regime, prudent banking regulations, liberalization of most prices, etc.) and reform programs have already been adopted, Romania has a long way to go in restructuring of the economy and establishment of a real market economy. After a period of visible progress (1994-1996), when GDP rose by 3.5%, 7.1%, and 3.9%, respectively, there was a reverse movement, as Romania recorded a decline in real GDP for the second year running, estimated at 7.3% in 1998, after a 6.6% decrease in 1997. Currently the economy is moving toward a third year of decline, with a 2% decrease in GDP forecast, mainly due to the restructuring programs that are expected over the year. The reduction of industrial activity led to a reduction in the sector's share of GDP, from 35.5% in 1997 to 31.7% in 1998. The share of agriculture in GDP declined by 2.1% to 16%, while the share of services increased from 33.2% to 37.8%. One of the reasons for such developments might be found in the non-competitive nature of Romanian industry and low domestic demand.

Sectors that have *prospects* for future growth are:

- agriculture: the potential of the sector stems from

Romania's 10 million hectares of fertile arable land and excellent conditions for animal husbandry, as well as the government policy of supporting farmers through tax relief, attractive producer prices, etc.;

- processing: the potential stems first from the good potential of agriculture, and second from foreign investment and the large number of joint-ventures in this sector;
- services: although standards in the sector are far below European standards, there is good potential for development in hotel and restaurant services and tourism.

With its population of 22,500,000, the country has a large market for consumer and industrial goods. The main problem of Romania's economy is its *structural weakness*. Obstacles to achieving macro-stability may be seen in the existence of loss-making state-owned enterprises and a fragile, state-dominated banking system.

Table 4: Employment by sectors, 1996, in thousands

	total	private sector
Total	9,379	4,828
Agriculture	3,249	3,000
Industry*	2,741	604
Construction	475	282
Trade	772	582
Transport	448	98
Education	441	10
Health and social assistance	337	4
Other)	373	170

* incl. electric and thermal energy, gas and water

The *state sector* still is predominant in Romania's economy and accounts for about 80% of industrial production. At the same time most state-owned enterprises have antiquated, inefficient and energy-intensive assets, and new investments have not been made for decades. Most of the enterprises already privatized were sold to their management and employees, which means that most of these enterprises might suffer a lack of sufficient financing over the next few years.

There is a tendency toward rapid growth in *private sector* activity. The total number of private enterprises in Romania increased by 664% over the 1990-1997 period. Steady growth in the private sector share of GDP has been observed, from 26.4% in 1992 to 58% in 1997. About 98% of small trade and service-oriented businesses are privately owned. Private sector activity is also increasing in construction and agribusiness. In 1997 employees in the private sector accounted for 53% of all employees in the country. The main problem facing the future development of the private sector is its small potential for generation of sufficient investment capital. The state still owns the main stake in productive resources in the country and provides more than half of total public investment (in 1996



investment by the public sector was 51% versus 39.7% from the private sector). The worsening economy affects the SME sector and especially the ability of companies to service their debt. As a result the amount of non-performing loans in the banks has increased substantially, and thus threaten the stability of the banking system.

Another problem for Romania's economy is an expanding *trade deficit*. There is a strong tendency toward reduced exports. In 1998 imports rose by 4.8% while exports fell by 1.6%. The current account deficit in 1998 is estimated at 7.7% of GDP. Romania has sought association with the EU and the European Free Trade Association (EFTA). A total of 65% of the country's exports in 1998 were directed toward the EU. Among Balkan countries Romania's main trading partners are Turkey, Greece, Bulgaria and Yugoslavia (although there was a temporary contraction in trade flows in 1993-1995 due to the embargo). Foreign trade is expected to be the sector most affected by the Kosovo crisis. On the whole direct trade links with the other Balkan countries are small, but the interruption of navigation on the Danube, which is one of the main routes for trade with EU and Central European countries, will have a negative impact on external trade. The alternative routes are longer, which will raise the transportation cost. On other hand Romania might indirectly benefit from intensified transit flows through its territory.

Table 5: Foreign investment in US \$ thousands as of July 1998

Total foreign investmen	3,360,849.5
of which from Balkan countries:	
T urkey	161,583.6 (4.8%)
Greece	80,692.4 (2.4%)
Yugoslavia	17,004.0 (0.5%)
Bulgaria	7,992.3 (0.2%)
Serbia & Montenegro	211.3
Bosnia-Herzegovina	91.6
Albania	73.2
Slovenia	60.9
Macedonia	45.8
Croatia	8

Another reason for Romania's *vulnerable external position* is its large debt service payments. External debt payments are considered to be one of the biggest challenges over 1999. Official foreign currency reserves (US \$ 1.24 billion by end-March 1999, versus US \$2.3 billion at the end of 1998) are able to cover only 30% of the projected current account deficit. According to EBRD estimates, Romania will need capital inflows of US \$4-5 billion this year if it is to meet existing external obligations and the cost of necessary imports, including energy products and vital inputs for industry. It is anticipated that even if Romania manages to receive financial support from international financial institutions and private-sector

creditors, the reserves will cover up to 50% of the external financing gap in the years ahead. Given the country's downgraded credit rating it is obvious that Romania is going to have difficult access to the international capital market. For this reason, privatization revenue is going to become very important.

After the visible progress in privatization in 1998, in 1999 planned revenue from privatization (including committed investments) is US \$1.8 billion. The *privatization program* is focusing on banks, large enterprises and the tourism sector. The sale of the oil company Petrom could be implemented via public offer by the end of 1999. The rest of the telecom company Romtelecom (35% was sold to the Greek telecom company OTE) will be sold in annual trenches over the next three years. The Romanian National Tobacco Corporation will also be privatized. The government intends to sell all state farms in 1999.

Total *foreign investment* by July 1998 was US \$3.36 billion. Of this, 4.8% came from Turkey and 2.4% from Greece. The bulk of these Greek and Turkish investments were directed to the banking system. It is expected that one of the results of an eventual long-lasting crisis in Kosovo would have a negative impact on foreign direct investment inflows.

Although there are more than 40 banks operating in Romania, the six state-owned banks are still dominant. These banks are heavily burdened by non-performing loans, which resulted from the pre-1997 policy requiring banks to extend low-interest loans to the agricultural and energy sectors, as well as from the general economic collapse, which had a negative effect on firms' capacity to service their loans. Currently, the banking sector is fragile, credit activity is seriously contracted, and banks demand high collateral and charge wide margins. There is no serious experience in risk management and assessment. After years of delay, bank privatization finally started in March 1999 with the sale of a controlling stake in the Romanian Development Bank to Societe Generale. The government still plays an active role in the economy. In Romania political influence in deciding winners is observed with regard to procurement procedures. There is also political protection in privatization and in access to subsidies. There are complaints of corruption at all levels of government.

Corruption might constitute an actual business risk. Economic development in the country throughout 1998 and early 1999 make it obvious that Romania is at a crossroads. Given the long track-record of political instability and political infighting, it is not sure whether the governing coalition will keep up the pace of reform. Restructuring of the economy and the liquidation of loss-making state-owned enterprises are connected with painful mass lay-offs, which makes them politically difficult. There are parliamentary and presidential elections scheduled for November 2000, and this leads to uncertainty as to whether the government will implement unpopular economic measures, which would probably diminish their chances of winning elections next year.

Balkans in 2010:

Greece Background

by **Andrey Ivanov, PhD**
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Acknowledgments

This paper is based on the official statistical information of the National Statistical Service of Greece and the Hellenic Ministry of the National Economy. Other sources of the data used include the Bank of Greece Economic Research

unevenly distributed among the different peripheries, being most concentrated in Attica (where Athens is located), with 33% of the population and 37% of GDP, and Central Macedonia (Thessaloniki is the capital of the periphery), with 17% of the population and 17% of GDP. The uneven territorial distribution may cause internal

Table 1: Gross Domestic Product

	1994	1995	1996	1997	1998*	1999**
Nominal GDP in GRD (billions)	23,984	26,895	29,698	32,752	35,536	37,917
Average exchange rate GRD/USD	242.6	231.7	240.7	273.1	295.0	286.0
Nominal GDP in USD (billions)	98.86	116.07	123.38	119.92	120.46	132.57

*Estimated
**Forecast
Source: Moody's report on the Greek economy published in "Imerisia," February 15, 1999.

Department's Bulletin of Conjunctural Indicators, March 1999; the World Bank's "World Development Report 1998/99"; International Financial Statistics Yearbook, 1997; "Greek Peripheries," "EPILOGI," 1998; "Greece in Figures," Greek Financial Directory, ICAP 1999; the Greek press and reports by consulting companies. Special acknowledgments are due to Ilias Flegas, Economic Analyst at NAFTEMPORIKI, for his assistance in the compilation of information used.

General

Greece is a country with stable political institutions and a medium-sized economy. The periods of political instability of the 1970s are over, and there is virtually no chance of political destabilization due to internal conflicts (ethnically or economically motivated). The country's population is roughly 11 million, the area of its territory is 129,000 sq. km, with a population density of 81 persons per sq. km, GNP of USD 126.2 billion in 1997 and average annual GNP growth rate of 3.4% in 1996-97. Similar growth trends are also likely for the next few years. The country is divided into 13 provinces (peripheries), each of which is subdivided into several sub-peripheries (52 total). Both population and GDP generation are extremely

Table 2: Number of existing companies by sector (1994)

	Number	%
Industrial companies and workshops	51,190	22.14
Wholesale trade companies	40,131	17.35
Retail trade companies	89,965	38.91
Companies in the service sector	49,913	21.58
Total	231,199	100

Source: "Greek Peripheries," "EPILOGI," 1998.

tensions (due to the differentiation in levels of income). It could also stimulate deeper involvement of the state as an economic actor, on the basis of the assumption that only state-monitored redistribution is capable of overcoming existing disparities.

Economic aspects

Economic trends have been stable over the last 10 years, with a modest rate of growth and high level of inflation. The average growth of GDP both in 1980-90 and in 1990-97 was 1.8; that of agriculture value added was 0.1 and 3.1, respectively; that of industry value added was 1.3 and 0.8, respectively. The dynamics of inflation are best illustrated in the table 6.

Table 3: Foreign trade with Balkan countries in USD

Foreign trade with Albania (USD millions)	1992	1993	1994	1995	1996	1997	1998
Greece imports from	18.0	15.4	35.3	37.5	35.0	35.8	-
Greece exports to	41.2	126.3	213.2	261.2	324.0	286.9	-
Trade balance	23.2	110.9	177.9	223.7	289	251.1	-
Foreign trade with Bulgaria (USD millions)	1992	1993	1994	1995	1996	1997	1998
Greece imports from	160.9	198.2	317.7	483.8	368.3	411.3	-
Greece exports to	167.2	303.3	413.1	447.3	323.7	316.0	-
Trade balance	6.3	105.1	95.4	-36.5	-44.6	-95.3	-
Foreign trade with Bosnia-Herz. (USD m)	1992	1993	1994	1995	1996	1997	1998
Greek exports to	-	15.33	0.49	0.24	1.36	4.13	-
Foreign trade with FYR Macedonia (USD m)	1992	1993	1994	1995	1996	1997*	1998**
Greece imports from	48.9	29.1	4.8	14.6	39.2	60.1	12.9
Greece exports to	43.9	139.6	14.2	25.6	232.1	273.0	71.5
Trade balance	-5.0	110.5	9.4	11.0	192.9	212.9	58.6
Foreign trade with Croatia (USD millions)		1993	1994	1995	1996	1997	
Greek exports to		8.09	9.44	13.79	13.73	27.48	
Foreign trade with Slovenia (USD millions)	1992	1993	1994	1995	1996	1997*	1998**
Greece imports from	2.2	17.1	14.1	30.0	26.5	23.7	5.3
Greece exports to	2.2	8.1	9.4	44.6	12.4	18.6	2.6
Trade balance	0	-9.0	-4.7	14.6	-14.1	-5.1	-2.7
Foreign trade with Romania (USD millions)	1992	1993	1994	1995	1996	1997	
Greece imports from	67.3	65.7	93.2	134.2	143.8	133.4	
Greece exports to	107.3	89.0	93.4	180.4	173.8	200.8	
Trade balance	40.0	23.3	0.2	46.2	30.0	67.4	
Foreign trade with Turkey (USD millions)		1993	1994	1995	1996	1997	
Greece imports from		138.6	170.6	209.7	230.0	292.8	
Greece exports to		148.4	138.0	221.1	354.3	432.9	
Trade balance		9.8	-32.6	11.4	124.3	140.1	
Foreign trade with Yugoslavia (USD millions)	1992	1993	1994	1995	1996	1997	
Greece imports from	6.2	-	-	1.1	77.5	-	
Greece exports to	15.8	-	-	21.8	168.5	200.8	
Trade balance	9.6	-	-	20.7	91.0	-	

* Preliminary figures

** First quarter only

Source: National Statistics Service of Greece

Table 4: Newly established companies (SA and LTD) in Greece by number and capital (in GRD millions)

New establishments		1993	1994	1995	1996	1997	1998
Industry	Number	824	848	860	968	1,039	4,539
	Capital	42,227	45,189	44,706	56,566	48,778	237,467
Trade	Number	1,429	1,596	1,703	1,681	1,923	8,332
	Capital	33,646	30,998	36,833	28,940	55,239	185,658
Services	Number	1,219	1,318	1,491	1,428	1,822	7,278
	Capital	46,901	34,623	53,443	90,342	51,249	276,560
Tourism	Number	288	255	276	329	318	1,466
	Capital	18,553	16,029	20,184	33,522	19,815	108,105
Total	Number	3,760	4,017	4,330	4,406	5,102	21,615
	Capital	141,327	126,842	155,167	209,371	175,082	807,791

The business environment is comparable to that in the other EU countries. Most of its vital elements are in place and operational (efficient banking system, protection of property rights, efficient contract enforcement). The tax burden is definitely high (the highest marginal tax rate for individuals applied for income over USD 68,820 in 1997), and the highest corporate tax rate is 40%. The levels of fiscal revenues over the last nine years are shown in the table 7:

The economy is definitely open. The presence of foreign banks contributes to a better business climate. The element of the "foreign presence" needs to be taken into account when analyzing both the country's economy and possible long-term economic scenarios. Being a member of the EU, Greece benefits from the structural funds of the union, annually receiving significant transfers:

Although the business environment is definitely market-oriented, Greece's economy seems to still be a peculiar combination of private initiative and active state involvement. Most sectors have been privatized, but the state retains its important role as an economic agent, mostly in the field of infrastructure investment. This tendency is reflected in the share of public investment in total investment in the country, which has constantly risen since 1990, as seen in the table 9.

Such investment involvement on the part of the state is probably one of the reasons for the increasing budget deficit, from 4.1% in 1980 to 13.8% in 1996. During the same period the share of current tax revenues decreased from 22.6% to 19.7%, the share of total expenditure for goods and services fell from 44.6% to 28.8% and for social services from 51.5% to 35.4%. One of the main focuses of public investment policy is infrastructure – especially transport and oil transportation. The major projects in this field are the Egnatia highway and (partially) the Bourgas-Alexandroupolis pipeline (with predominant private participation). The

Table 5: Final consumption expenditure per household (1994)

	GRD (thousands)	Percentage
Food	80.8	27.83
Restaurants	19.7	6.78
Beverages and tobacco	10.5	3.61
Clothing and footwear	30.8	10.60
Rent, fuel, water	34.4	11.84
Durable goods for household consumption	24.2	8.33
Furniture, carpets etc.	4.6	1.58
Other furnishing equipment	4.2	1.44
Household appliances	3	1.03
Utensils	3.1	1.06
Direct consumption goods	6.4	2.20
Health and personal care	22.9	7.88
Health care	16.4	5.64
Personal care	6.4	2.20
Education, recreation, entertainment etc.	20.9	7.19
Education	7.1	2.44
Books, newspapers, magazines	4.8	1.65
Recreation items	1.3	0.44
Transport and communication	42.8	14.74
Transport	12	4.13
Communication	5.1	1.75
Other goods and services	23	7.92
TOTAL	290.3	100

Source: National Statistical Service of Greece, Household Budget Survey, 1994.

Egnatia highway is perceived as a priority project, both in terms of expenditure and expected economic impact. After its completion it will be over 680 km long and will connect five seaports and eight airports. Almost a fifth of the project is complete, and final completion is scheduled for 2004.

Table 6: Wholesale and consumer price indices (1990 = 100)

Year:	1988	1989	1990	1991	1992	1993	1994	1995	1996
Wholesale prices	76.0	86.3	100	116.7	130	145.4	158.1	170.4	180.9
Consumer prices	73	83.1	100	119.5	138.4	158.4	175.7	191.4	207.1

Source: International Financial Statistics Yearbook, 1997

Table 7: Tax revenues (GDR millions)

Year	Indirect tax	Direct tax	Number of taxpayers	Taxable income declared
1988	1,224,818	495,713	2,324,250	2,398,188
1989	1,356,982	558,464	2,405,769	2,946,831
1990	1,836,049	798,068	2,521,529	3,675,240
1991	2,327,654	997,730	2,655,396	4,594,478
1992	2,868,562	1,178,129	2,904,160	5,627,578
1993	3,132,883	1,319,816	3,096,420	6,473,341
1994	3,413,824	1,751,025	3,218,723	7,435,625
1995	3,784,006	2,101,325	3,840,071	9,748,059
1996	4,232,214	2,277,447	3,986,316	11,074,800
1997	4,846,500	2,202,500	4,268,609	12,494,320

Table 8: Net EU Transfers (USD millions)

Year	Amount
1993	4,085.0
1994	4,307.0
1995	4,968.0
1996	5,057.0
1997	4,622.0
1998 (Jan.-Aug.)	2,831.4

Source: Bank of Greece, Economic Research Department, Bulletin of Conjunctural Indicators, March 1999

Table 9: Investments (GRD billions)

Year	Private	Public	Total	% of public
1988	1,542.6	424.1	1,966.7	21.6
1989	1,918	529.4	2,447.4	21.6
1990	2,451.6	575.5	3,027.1	19.0
1991	2,868.7	781.6	3,650.3	19.6
1992	3,033.2	950.6	3,983.8	23.9
1993	3,186.8	1,080.3	4,267.1	25.3
1994	3,368.3	1,123.1	4,491.4	25.0
1995	3,769.5	1,326.1	5,095.6	26.0
1996	4,293.7	1,542.0	5,835.7	26.4
1997	4,906.6	1,911.5	6,818.1	28.0

As of December 1998, the construction of 497 km had been contracted (GRD 963 billion worth). The project will have a significant impact on the Balkans as a whole. Since it runs East-West, it is expected to connect remote parts of Greece and neighboring countries (Bulgaria and FYR Macedonia) with the Central Macedonia Periphery and Thessaloniki. This would enable Thessaloniki to become a major Balkan economic and transit center, especially if the transit corridors to Western Europe through Yugoslavia remain cut in the coming decade. This means that the Greek economy has the capability to turn into a "Balkan engine" in economic terms. Being a "regional rival" of other Balkan countries, Greece acquired specific "comparative advantages" after the Kosovo war and the virtual isolation of FYR Macedonia from Western Europe (Bulgaria also faces the issue of isolation, although to a lesser degree). In terms of regional development, this means that on national level a certain re-focusing of business activities can be expected. The possible emergence of Thessaloniki as a regional center for economic growth may stimulate trans-border cooperation between neighboring regions in Greece, FYR Macedonia and Bulgaria. The same applies to the Bourgas-Alexandroupolis pipeline. In fact, today, after the destabilization around Albania, it is emerging as much more competitive than the Bourgas-Vlora pipeline. This means that Bulgaria can be bypassed in terms of transit (again in favor of the possibly emerging new center of growth around Thessaloniki). These issues inevitably have a common denominator with the issue of the possible EU membership of other Balkan countries and the possible "Marshall Plan" for the Balkans. Although Greece to a certain extent is Bulgaria's and Turkey's competitor in terms of EU membership (at least related to the matter of EU transfers), a certain level of compatibility of interests exists. It seems that the attractiveness of Thessaloniki as a center of growth could be augmented if transit corridor No 4 existed, providing access to Western Europe. This means that a compromise on the volume and purpose of EU funding can be reached only if Greece is the "major player" in such a compromise.

Such a negotiated "division of regional economic roles" seems necessary for the next decade, since Greece seems to be emerging as the country with the fewest losses, compared to the other economies in the Balkans, after the war in Kosovo.