ANNEX A

COUNTRY PROFILES

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Cyprus

Since the Turkish invasion of 1974, Cyprus has been divided into two parts. This political division is reflected in the different economic structure of the south (Greek Cypriot or Government-Controlled Area (GCA)) and the north (Turkish Cypriot Area). The former is more populated, with GDP per capita almost three times higher than in the latter. As there is no reliable data available on the northern part, EU documents focus mainly on the southern part of Cyprus. In the GCA, economic growth has been high during the nineties, with a few slowdowns: GDP growth decreased to 2% in 1997 before rebounding to 5% in 1998.

The negotiations on accession concern Greek Cyprus only, as "the invitation of the Cyprus government to include representatives of the Turkish Cypriot community in the negotiations [has] so far not been taken up". Since mid-December 1997, the Turkish Cypriot leader has refused to meet EU representatives.

Main indicators of economic structure (1998)	
Capital city	Lefkosia (Nicosia)
Currency	Cypriot Pound
Total area	9251 km2
Population	746 100
of which GCA	657 900
GDP at current prices (GCA)	8.1 bn EUR
GDP per head (GCA)	12 200 EUR
GDP per head, as % of EU average	57%
GDP per head at PPP (1997)	14 787 EUR
GDP per head, as % of EU average, at PPP (1997)	78%
Structure of production:	
Agriculture (% GDP)	4,6%
Industry (% GDP)	13,9%
Construction (% GDP)	8,0%
Services (% GDP)	73,5%
Gross foreign debt/GDP (%)	80,0%
Exports/GDP (%)	43,5%
Monetisation of the economy (M2/Y) (1997)	106%

Source: Commission services, national sources, IMF.

Phasing and time-scale of the accession process

- 1973: Association Agreement: establishment of a customs union in two stages –the second phase entered into force on January 1, 1998.
- July 3, 1990: application for membership of the European Union
- May 1993, "Commission Opinion on the Application by the Republic of Cyprus for Membership"
- March 31, 1998: opening session of the accession negotiations in Brussels
- October/November 1998: Cyprus Accession Conference
- 1999: (foreseen) Accession Partnership

Copenhagen Criteria

The political status of Cyprus is still not clear and, while some believe EU-membership could provide a solution, the Turkish Republic of Northern Cyprus (TRNC) affirms this step is likely to have negative consequences on the island's political stability. Indeed, the "objective (of the EU) remains a bi-communal, bi-zonal federation on the basis of a comprehensive political settlement in accordance with UN Security Council Resolutions"[1]. But the TRNC does not want such a close union, and would prefer to found a mere confederation with the south (as proposed in August 1998) and warns the EU that it "will bear the responsibility and consequences for the consolidation and perpetuation of the division of the island"[2]. The TRNC's main argument is that "agreeing to become a member of the EU, of which Turkey is not a full member, while Greece (…) is, will mean the destruction of the balance between the two motherlands over Cyprus. This will be tantamount to (…) unification (…) with Greece". The TRNC sets thus the condition of Turkish membership for agreeing to take part in the negotiations. Moreover, the EU's most important countries (like France) only want to let a unified Cyprus in[3].

Nevertheless, the European Commission considers in its 1999 *Regular Report*[4] that Cyprus fulfils the Copenhagen political criteria. As regards the economic criteria, Cyprus is a properly functioning market economy, and would be able to cope with the competitive pressures and market forces within the union.

Opinion of the Government of Cyprus

The Cypriot Government takes 2003 as a working hypothesis for EU membership.

Independent commentators

Cyprus is one of the "first wave" countries. Accession is likely to take place between 2004 and the end of the next decade, depending on the resolution of the country's political division.

Prospects of meeting the Maastricht criteria

As noted in *Agenda 2000,* the Maastricht convergence criteria[5] are not a precondition for membership; they are only a condition for participating in the final phase of EMU. The

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[1] *Regular Report from the Commission on Cyprus' Progress towards Accession,* 1998.

[2] Turkish Republic of Northern Cyprus, "Government Statement", 13/11/98.

[3] "Cyprus – Keep on Trying", *The Economist*, July 24-30, 1999.

[4] *Regular Report from the Commission on Cyprus' Progress towards Accession,* 1999.

[5] ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1,5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

The Interest Rate Convergence Criterion: the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);

The ERM Criterion: the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

The Budget Deficit Criterion: a country's budget deficit should not exceed 3% of its GDP;

following economic developments were reported in the European Commission's 1998 and 1999 *Regular Reports:*

- **Inflation** has not diverged much from the EU-11 figure since 1992. It has continuously declined during this period and amounted to 2,2% in 1998. Some price controls have been removed. The Government's five years Strategic Development Plan (1999-2003) of 1998, intends to keep inflation at 2,5%.
- **Long-term interest rates** (in existence since 1997) have been somewhat higher than the EU-11 rates, but with rates of 6.9% in 1997 (against 5.99% for the EU-11), Cyprus does comply with the Maastricht criterion.
- The **government deficit** has declined in the first years of the decade up to 1995, when it reached 1% of GDP, due to lower expenditures combined with higher revenues fostered by the introduction of VAT in 1992. However, the Government engaged in fiscal expansion to counteract the economic slowdown of 1996 and this led the deficit to increase to 5,5% in 1998. The government has proposed a fiscal programme, which aims at reducing the budget deficit to 2% of GDP by the end of 2002.
- **Public debt**, amounting to 59,7% of GDP in 1998, is slightly beneath the Maastricht benchmark of 60%. It has increased by 9%-points in the last four years. However, the pattern of Cyprus' public debt has, during this decade, closely shadowed the development of economic growth, and we can expect that, with the resumption of growth in 1998, public debt will come down again. The government's fiscal programme aims at keeping public debt below the Maastricht benchmark.
- The Cypriot Pound, successfully pegged to the ECU in 1992 and to the Euro as from January 1999, is a very stable currency. The country is likely to be able to comply with the **exchange rate** criterion in the short term.

Summarising, Cyprus presently complies with all of the Maastricht criteria, with the exception of the government deficit criterion. Nevertheless, as most current EMU members did not comply with all the five criteria, we could state that Cyprus would not encounter any difficulties (from the side of the convergence criteria) when it comes to joining the Eurozone.

Main elements of the *Acquis* to be completed

"Because of the political situation the Commission's examination of the *Acquis* (screening) could not cover Cyprus as a whole"[6]: the following presentation of the accession efforts does not concern the TRNC, about which no information has been released.

Transposition has been relatively slow in Cyprus; nevertheless, its pace is expected to increase in the near future, as Cyprus recently adopted a parliamentary fast track procedure in this respect.

Cyprus has made great efforts to comply with its duties falling under the **Customs Union.** The state of affairs concerning the **Single Market** legislation is as follows:

- Public procurement legislation has been subject to reform in 1997 and implementation has substantially progressed. However, the regime for public utilities needs to be harmonised. Notable progress has been recorded on patents, the legislation in this field is

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The Stock of Debt Criterion: the stock of outstanding government debt should not exceed 60% of that country's GDP.

[6] *Regular Report from the Commission on Cyprus' Progress Towards Accession,* (1998).

fully compatible with EU standards since April 1998. However, further transposition in the field of intellectual property rights is needed. Legislation in other important fields is currently awaiting approval: standards and certification, fiscal measures and the abolition of the interest rate ceiling.

- The harmonisation of competition law has been mostly completed. However, merger control remains to be established. Cyprus has still to align its legislation on state aid, and to set up an independent state aid monitoring authority.
- Other areas of concern are maritime transport, social policy, the environment, justice and home affairs and telecommunications. Cyprus has requested a transitional period of 1 year (i.e. until December 2003, if 2002 is taken as the accession year) for the liberalisation of the telecommunications sector.

Of special importance with regard to EMU are two of the “four freedoms” in force in the Internal Market without Frontiers:

- **Free Movement of Capital.** Capital account liberalisation is still far from being complete. A three-phase plan has been drawn by the national bank of Cyprus. Some transactions have been liberalised in 1996-1997, concerning direct investment, port investment and personal capital movements. The level of FDI permitted now amounts to 100%, except in agriculture, utilities and education. In some sectors (financial services, tourism, trade, oil refining), case by case decisions have to be taken by the authorities. Outward capital movements are still subject to restrictions in the fields of direct investment, real estate, portfolio, financial credits and opening of deposits abroad. The two other liberalisation phases are planned for 2000 and 2003.

- The rather developed **financial system** would certainly benefit from liberalisation. The most notable restriction is the interest rate ceiling on loans (in force since 1944), which has led to discrimination against risky investments. The authorities have planned to remove this restriction by the end of 1998, but have still not managed to do so. An issue, which is some cause of concern, is that co-operative banks do not fall under the scope of the 1997 Banking Law, or under the supervisory authority of the central bank. They are subject to less stringent rules and probably have a level of non-performing loans two to three times higher than commercial banks.

- **Free Movement of Services.** The Banking Law of 1997 intended to harmonise the Cypriot legislation with the EU Banking Directives. As stated above, it is not applicable to co-operatives. Co-operative societies also benefit from tax free status. Furthermore, it has not always been applied to the offshore business, as the central bank is not legally obliged to do so. Progress has been made in 1999 on legislation to combat money laundering and on deposit guarantee schemes. Alignment is still needed in supervision on a consolidated basis and on capital adequacy. Progress has been made in the field of securities. Concerning the relatively well developed insurance sector, further approximation is required.

Main economic issues still to be resolved

- Cyprus suffers from increasing **macroeconomic and financial imbalances**.

- Cyprus is suffering from a **structural trade deficit** due to the small manufacturing base. The value of re-exports is increasingly higher than that of exports, as Cyprus is developing into a transit and reprocessing centre.
- **Wage pressures and rigidity** are still common features of the Cypriot economy. The trade unions are quite powerful.
- Cyprus has witnessed a **loss of competitiveness in traditional sectors** (tourism and industry). The positive development in this respect is that the country has increased its efforts to reduce the dependence of the economy on tourism.
- State monopolies and (partially) government-owned firms are common features in Cyprus. The government has started to implement some **structural reforms**: privatisation of airports and preparatory work for the liberalisation of the telecommunications sector as well as price and trade liberalisation.
- The services sector is growing, especially **offshore banking**. The European Commission suspects legislation and especially implementation not to be in line with the *Acquis*. The EU estimates this could be one of the most delicate issues encountered during negotiations with Cyprus. In this respect, the government recently adopted a regulatory framework in order to combat money laundering.
- If Northern Cyprus is to be integrated with the Southern part, **infrastructure** in the TRNC will need major improvements.

Preferred exchange rate regime and preparations for EMU

- The **Central Bank of Cyprus.** Separate central banks exist in the northern and the southern parts of Cyprus. The Turkish Lira circulates in the TRNC. The Law on the Central Bank of 1963 is not in line with Treaty provisions, as the central bank is not independent from the government. A representative of the Ministry of Finance may take part in the decision-making of the Board. The Bank has two objectives: monetary stability and "such credit and balance of payment conditions as are conducive to the orderly development of the economy of the Republic"[7]. The law is not compatible either with the Treaty provisions on the financing of budget deficits. The financing by the central bank has been subject to a ceiling since 1994, which has been revised downward every year. Cyprus intends to have accomplished the revision of the Law, in order to make it compatible with the Treaty provisions, before June 30, 2002. Until 1998, the public sector benefited from privileged access to financial institutions, through the compulsory investment of at least 20% of insurance companies' funds in government securities.
- **Exchange rates** The Cyprus Pound has been pegged to the ECU since 1992, with a central rate of 1,7086 and fluctuation bands of +/-2,25%. With the introduction of the Euro last January, the Cyprus Pound has been pegged to the new European currency.
- **Preparations for EMU membership.** Cyprus' position paper on EMU has been submitted to the European Commission in May 1999.

7 European Parliament, "EMU and Enlargement", May 1999.

CYPRUS

	1992	1993	1994	1995	1996	1997	1998 *	
Output								
GDP growth rate at constant prices (%)	9,4	0,7	5,9	6,1	2,0	2,5	5,0	
Monetary indicators								
M0 growth (%)	6,9	0,3	11,9	-2,3	-10,5	0,7	-3,2#	
M1 growth (%)	9,3	8,8	4,8	6,8	6,4	7,8	-7,4#	
M2 growth (%)	13,9	16,4	12,5	11,5	10,5	11	9,3#	
Lending rate (% per annum, end-year)	-	9,0	8,5	8,5	8,5	8,0	-	
Treasury bill rate (% p.a., end-year; except 1996&1997: average)	6,0	6,0	6,0	6,0	6,1	5,4	-	
Foreign trade and exchange rates								
Export growth (%)	17,6	-1,7	7,9	4,2	3,4	1,8	-10,1	
Imports growth (%)	18,9	-18,5	8,7	11,5	6,4	-1,0	-0,9	
Share EU trade: Exports (% of total exports)	-	37,4	52,2+	59,0	55,4	48,0	50,4	
Share EU trade: Imports (% of total imports)	-	51,9	55,5+	59,0	57,2	56,3	61,9	
Openness: exports and imports as % of GDP	110,0	95,0	95,6	96,9	99,7	97,9	94,5	
Current account (% GDP)	-4,3	1,6	1,8	-2,8	-5,3	-2,7	-8,2	
Exchange rate, Pound per ECU, annual average	-	0,5819	0,5839	0,5916	0,5919	0,5826	0,5774	
Real exchange rate, 1990=100	-	-	109,6	113,8	116	116,9	123,2	*values*
Maastricht Criteria								*Jan.1998*
General government budget balance (% GDP)	-4,8	-2,4	-1,4	-1,0	-3,4	-5,1	-3,2	*3%*
Government debt (% GDP)	55,9	58,4	53,5	51,8	53,2	55,7	59,7	*60%*
Government foreign debt (% GDP)	21,4	19,2	15,3	12,1	9,7	11,6	-	
Inflation rate: consumer prices, annual average (%)	-	4,9	4,7	2,6	3,0	3,6	2,2	*2,7%*
Long-term bond yield (% p.a., end-year; from 1997 on: 10-year bond)	8,0	8,0	7,0	7,0	7,0	6,9	-	*7,8%*
Other macro indicators								
Unemployment rate, end-year, ILO definition (%)	1,8	2,7	2,7	2,6	3,1	3,4	3,3	
Gross foreign debt (% GDP)	-	37,6	65,3+	60,7	64,7	91,9	80,0	

Sources: Commission services, Eurostat, IMF, Cyprus Ministry of Finance, Cyprus National Bank, Department of Statistics and Research.
* figures for January-September published by *Cyprus National Bank* and provisional figures from the *Department of Statistics and Research,*
#Q1-Q3, annual seasonally adjusted +statistical break

The Czech Republic

Economic upturns and downturns have followed each other in the Czech Republic over the last decade. Growth slowed down after the separation with Slovakia (1993) but had already begun to recover in the following year. 1998 has shown a severe economic downturn, with GDP declining by –2,7%. The beginning of 1999 did not see any recovery, as industrial output continued to contract and retail and industrial sales declined. However, the rapid fall in inflation is fostering average real wages growth, which could lead to a rebound in demand. In the face of these difficulties, the Czech National Bank has eased monetary policy; but the already low interest rates do not represent a stimulus for the economy, as banks, having problems with their portfolios, are reluctant to lend more. The main stimulus might occur through a currency deprecation. The second quarter of 1999 showed a slow recovery, with real GDP growth becoming slightly positive again.

Main indicators of economic structure (1998)	
Capital city	Prague
Currency	Koruna (CZK)
Total area	78 866 km2
Population	10,3 million
GDP at market prices	49 099 mn EUR
GDP per head	4767 EUR
GDP per head, as % of EU average	24%
GDP per head at PPP	12 200 EUR
GDP per head, as % of EU average at PPP	61%
Structure of production	
Agriculture (% GDP)	5,5%
Industry (% GDP)	31,5%
Construction (% GDP)	9,8%
Services (% GDP)	53,1%
Gross foreign debt/GDP (%)	19,9%
Exports/GDP (%)	60%
Stock of FDI	8,5 bn EUR
Stock of FDI per head	829 EUR
Monetisation of the economy (M2/Y)	73%

Source: Commission services, national sources, EBRD, WIIW, Erste Bank.

Phasing and time-scale of the accession process

- July 1992: EFTA membership;
- March 1993: Member of the Central European Free Trade Association;
- January and December 1995: WTO and OECD membership;
- February 1, 1995: entry into force of the Europe Agreement;
- January 17, 1996: application for membership of the European Union;
- March 1998 & June 1999: National Programmes for the Adoption of the *Acquis;*
- March 31, 1998: opening session of the accession negotiations in Brussels.

Copenhagen Criteria

The Czech Republic already presented the features of a functioning market economy in 1997, according to the European Commission[8], which estimated it was "able to cope with competitive pressures and market forces within the Union in the medium term, provided that change at the enterprise level is accelerated". The Commission's 1999 *Regular Report*[9] concludes again that the country will be able cope with these pressures in the medium term "provided that the government accelerates implementation of legal and structural reforms"

Opinion of the Czech Government

The Czech Republic assumes it will be eligible for membership of the EU between 2003 and 2005. "The long-term economic strategy" of the Czech authorities, "an integral part of which will be the price and monetary stability target, is to a large extent predetermined by the demands and the time horizon of EU and EMU accession". While remaining very cautious as to the date of EMU accession, the Czech National Bank states that "it is also possible that there will be no significant gap between the Czech Republic's entry into the EU and into EMU", which would mean an EMU accession between 2005 and 2007[10].

Independent commentators

The Czech Republic is one of the "first wave" countries. Accession is likely to take place between 2004 and 2006.

Prospects of meeting the Maastricht criteria

As noted in *Agenda 2000*, the Maastricht convergence criteria[11] are not a precondition for membership; they are only a condition for participating in the final phase of EMU. The Commission was not able, in 1997, to draw any conclusions about the Czech Republic meeting these criteria by the time of its accession. The latest economic developments in the Czech Republic come from the *Economic Reform Monitor* of the European Commission's Directorate General Economic and Financial Affairs [12]:

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8 Commission of the European Union, Brussels, "Agenda 2000", 1997.

9 Commission of the European Union, "Regular Report from the Commission on Czech Republic's progress towards accession", 1999.

10 Czech National Bank Monetary Strategy, Document approved by the Board of the CNB on 8 April 1999.

11 ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1,5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

The Interest Rate Convergence Criterion: the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);

The ERM Criterion: the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

The Budget Deficit Criterion: a country's budget deficit should not exceed 3% of its GDP;

The Stock of Debt Criterion: the stock of outstanding government debt should not exceed 60% of that country's GDP.

12 European Commission, Economic and Financial Affairs Documentation, *European Economy*, Supplement C. "Economic Reform Monitor", No.2, May 1999.

- The first months of 1999 have witnessed a rapid fall in **inflation** with year-on inflation amounting to 1.4% in August. This was due to the economic recession, lower import and food prices, a halt in deregulation of administered prices and the central bank's anti-inflationary policy. The inflation rate was still 10.7% in 1998. The targeted inflation for 1999, between 4% and 5%, remains above the Maastricht benchmark. However, this target is very likely to be undershot. The Czech National Bank has declared that "the long-term inflation target must be consistent with the strategy for (…) integration into European institutions, and above all with the demands of EU and EMU accession"[13]. The long-term inflation target for 2005 is situated around 2% (+/-1%). The authorities expect that administered prices will have completely been absorbed by this date.
- There still are no **long-term interest rates** in the Czech Republic. As to short-term rates, they declined due to the easing of monetary policy in 1998. The main monetary policy instrument, the two-weeks repo-rate is now 6.9%. Nevertheless, the Czech National Bank wants to keep interest rates relatively high because it fears short-term capital outflow from the Czech Republic and foreign exchange markets volatility.
- The 1998 **government deficit** amounted to 1.9% GDP, respecting the boundary of the Maastricht criterion, after two years of non-compliance. Until March of this year, the Czech Republic showed a balanced budget, but the expected total deficit for 1999 will nevertheless be higher than planned (3.5% against 2.5%), according to the Czech Ministry of Finance, due to the unfavourable economic situation. But these figures could be misleading, as an exercise by the Czech Ministry of Finance showed. The continuation of current trends implies a risk of unsustainable deficits in the near future. Moreover, off-budget funds and institutions have accumulated deficits that will press on the state's budget. This also reveals the lack of transparency of public finances.
- **Public debt** is relatively low and is expected to remain under the 30% in 1999. However, it has more than doubled since 1996 and this rate of increase needs to be reduced.
- Concerning the **exchange rate stability** of the Koruna, the peg to a basket of USD and DEM, between 1993 and 1997, proved unsustainable. After a rebound in 1998, the Koruna depreciated again by around 10% in the first months of 1999.

Summarising, the Czech Republic presently complies with one of the five Maastricht criteria: the public debt criterion.

Main elements of the *Acquis* to be completed

By the time of *Agenda 2000*, the Czech Republic had adopted "significant elements" of the **Europe Agreement**, within the given timetable. The *Regular Report* of 1998 noted their uneven implementation. However, the trade issues identified by the *Agenda 2000* document had been solved, especially the Import Deposit Scheme.

Agenda 2000 estimated the rate of transposition of the **White Paper** as satisfactory. Some legislative work still had to be done. The legislation concerning the Single Market was already in place. Compared to other transition countries, the administrative infrastructure of the Czech Republic was functioning relatively well, but improvements could still be made. The Commission's 1998 and 1999 *Regular Reports* took a close look at the progress made by the Czech Republic since 1997. The short-term priorities of the Accession Partnerships have been insufficiently implemented. Good progress has been made on standardisation and

[13] Czech National Bank Monetary Strategy, Document approved by the Board of the CNB on 8 April 1999.

certification, industrial property, intellectual property rights and accounting. No progress has been made in public procurement, copyright, data protection, insurance, anti-trust and state-aid. Public procurement is nevertheless relatively well aligned, except for the national preference clause and the utilities sector, which is not covered by the law.

The **other parts of the *Acquis*** would not present any major difficulty in implementation, according to *Agenda 2000*, except for agriculture, environment and energy.

Of special importance with regard to EMU are two of the "four freedoms" in force in the Internal Market without Frontiers:

- **Free Movement of Capital.** The degree of liberalisation of capital movements has been substantial. Most of capital inflows had been liberalised before 1997, exceeding even the objectives set by the Europe Agreements. Current account convertibility is in force since the Foreign Exchange Law of October 1995. The amendment to the Foreign Exchange Act of January 1999 introduced liberalisation in the fields of financial credits and guarantees, foreign securities on the Czech market, operations in money market instruments and derivatives, and the purchase abroad of currency by residents. The acquisition of real estate is still not free, nor are number of outward capital movements.
- **Free Movement of Services.** *Agenda 2000* estimated the rate of transposition of the *Acquis* in the banking sector as satisfactory. The Government planned to have achieved the transposition of EU legislation by the year 2000 for the banking sector and by 1998 for the insurance sector. Since then, some improvements have indeed been made in the approximation of the Second Banking Directive: since February 1998 banks are not allowed to hold controlling stakes in companies other than banks. Since September 1, 1998, the terms for banking licensing have been tightened and domestic and foreign investors are subject to the same treatment with regard to the acquisition of bank shares. The Bankruptcy Act has been amended in December 1998. The privatisation process of the remaining three large banks in which the State holds a stake is progressing. The existence of anonymous saving accounts is not in line with the EU money-laundering directive. The legislation of the *Acquis* on the securities markets has recently been approximated. No progress has been made at all in the insurance sector, still characterised by a state monopoly.

Main transition issues still to be resolved

- *Agenda 2000* already draws attention to the **macroeconomic imbalances** in the Czech Republic in 1997, especially to the deficient corporate governance, the weak financial system and insufficient enterprise restructuring.
- The **banking sector** is oligopolistic (few big state-owned banks) and not competitive. Privatisation and restructuring has been too slow and bankruptcy procedures have not been effectively enforced. The *Regular Report* stresses that "one of the key weaknesses of the Czech economy" is still the **financial sector**, which is a very negative feature with regard to future EMU membership. Bad loans are still a major problem: they amount to as much one third of the loan portfolio. The strong links between banks and enterprises act against clean up of portfolios and restructuring of both sectors. In March 1999, the government announced a clear timetable for the privatisation of the remaining state-owned banks. The authorities have started to tackle the non-performing loans problem; but this has had some short-term negative effects on the lending behaviour of banks, thus aggravating the recession.

- In the **capital market**, the recently established Securities Commission has to deal with non-transparent deals and price manipulation. The capital market, being very illiquid, remains a negligible source of enterprise finance.
- **Enterprise restructuring** is too slow: the low number of bankruptcies, the low level of unemployment and the poor profitability of Czech enterprises all point to this. Most companies are privately owned, but the state still possesses a significant number of them. The government adopted on April 15, 1999, a “Programme for the Revitalisation of Industry”, stating that restructuring plans should stem from compromises between enterprise-owners and (state-held) banks. Direct state aid to enterprises is not ruled-out. The Commission, in the *Economic Reform Monitor,* questions the quality of the chosen criteria (how to distinguish solvent enterprises with temporary problems from loss-making ones?) and the enforcement capacities of the government. The number of eligible enterprises will determine the fiscal cost of the programme.
- **Agricultural co-operatives** hamper the development of a functioning market for land.

In May 1999, the government drew up an “Economic Strategy of the Accession to the European Union”, which served as basis for the Joint Assessment of the country’s medium-term economic policy priorities.

Preferred exchange rate regime and preparations for EMU

Agenda 2000 stated that the Czech Republic “should be in a position at the appropriate time to participate in the third stage of EMU”, but refrained from setting a concrete timetable.

- **The Czech Central Bank** is relatively independent in the conduct of monetary policy. The Governor is appointed and dismissed by the President of the Republic. The statutory objective of the Bank is the stability of the national currency, which has been interpreted as price stability. The 1998 Amendments to the Banking Act strengthened the supervisory powers of the CNB. However, the provisions of this act are still not in line with the Treaty requirements on budget deficit financing as the central bank can grant short-term credit to the government. This provision has never been used because of the relatively sound budget record of the Czech government.
- **Exchange rate regime.** Between May 1993 and May 1997, the Koruna was pegged to a basket constituted for 35% of USD and for 65% of DEM. The peg provided a nominal anchor and helped to bring down inflationary expectations. But the massive speculative capital inflows of the years 1994-1995 caused continuous money supply growth and hampered the decline in inflation. In February 1996, the bands around central parity were widened. The currency crisis of May 1997, due to the widening current account deficit, led the CNB to abandon its peg regime and replace it by a managed float with an exchange rate target of 17 to 19.5 crown per mark. Between April 4 and June 13, 1997, the Koruna had fallen by 8.1% against the DEM and by 11.1% against the USD. After a rebound in 1998, the Koruna depreciated by around 10% in the first months of 1999, before strengthening again in June, after the government had announced the privatisation of a large state-owned bank.
- **Preparing EMU membership.** The CNB emphasises the “necessity of creating preconditions for closer links of our currency with the Euro”.

Czech Republic

	1992	1993	1994	1995	1996	1997	1998 *	1999 **	2000 **	2001***	Reference values Jan.1998
Output											
GDP growth rate at constant prices (%)	-3,3	0,6	3,2	6,4	3,9	1,0	-2,7	-1,5	2,0	3,5	
Monetary indicators											
M0 growth (%)	19,5	1,5	16,9	7,5	14,0	0,3	-	-	-	-	
M1growth (%)	19,6	17,5	17,2	7,47	4,85	-6,35	-3,3(Nov)	-	-	-	
M2 growth (%)	20,7	19,8	19,9	19,8	9,2	10,1	5,7(Nov)	-	-	-	
Lending rate (% per annum, end-year) #	13,3	14,1	12,8	12,7	12,5	13,9	10,5	-	-	-	
Foreign trade and exchange rates											
Exports growth (%)	10,8	50,4	8,0	19,9	1,2	4,0	17,7***	8,7***	8,7***	16,9	
Imports growth (%)	46,6	23,9	16,4	39,5	9,8	-1,9	7,8***	9***	10,8***	14,6	
Share EU trade: Exports (% of total exports)	-	41,6	42,6	60,9	60,9	58,2	64,2	-	-	-	
Share EU trade: Imports (% of total imports)	-	42,6	45,0	61,1	62,4	61,5	63,3	-	-	-	
Current account (%GDP)	-1,0	0,3	-0,1	-2,7	-7,6	-6,2	-1,9	-2,8	-3,5***	-3,5	
Openness: exports and imports as % of GDP	62,6	76,6	72,8	92,6	87,2	96,3	100,5	-	-	-	
Exchange rate, Koruna per ECU, annual average	36,60	34,19	34,15	34,70	34,46	35,93	36,32	37,09 (June)	-	-	
Real effective exchange rate, index 1995=100	-	-	95,8	100	102,2	99,5	101,0	-	-	-	
Maastricht Criteria											
General government budget balance (% GDP)	-3,1	0,5	-1,2	-1,8	-1,2	-2,1	-2,7	-3,5	-1,0***	-1,0	*3%*
Government debt (% GDP)	-	19,2	18,1	16,2	13,2	19,4	28,1	-	-	-	*60%*
Inflation rate: consumer prices, annual average (%)	11,1	20,8	10,0	9,1	8,8	8,4	10,7	4,0	5,0	5,0	*2,7%*
Long term interest rates	-	-	-	-	-	-	-	-	-	-	*7,8%*
Other macro indicators											
Unemployment rate, end-year, registered (%)	2,6	3,5	3,2	2,9	3,5	5,2	7,5	10	11,0	8,5	
External debt (% GDP)	23,7	24,7	20,5+	25,3	24,9	20,1	19,9	-	-	-	
FDI net inflow (bn ECU)	0,8	0,5	0,6	1,9	1,1	1,1	2,2	1,9	-	-	

Sources: Commission services, EBRD, Eurostat, IMF, WIIW, Czech National Bank, Erste Bank.

* estimate ** projection or mid-year figure; except GDP, inflation, unemployment: WIIW forecasts June 1999 *** Erste Bank forecast

For 1999: annual average replaced by mid-year (June) exchange rates: 1 EUR = 1,0378 US$ = 37,0939 CZK

weighted average over all maturities +statistical break

Estonia

Estonia's economy experienced a sharp slowdown in the last quarter of 1998 and the first of 1999, which was mainly caused by the Russian economic and financial crisis and the consequent fall in exports to Russia and to the neighbouring Baltic states. The amplitude of the economic cycle in Estonia can be explained by Estonia's fundamental choices in economic policy, such as the currency board arrangement and the full liberalisation of capital movements. Indeed, while GDP growth had amounted to 10,4% in 1997, the figure for 1998 was only 4%. Nevertheless, the consequences of the Russian crisis seem to be fading, as imports and industrial production began to pick up again in March 1999. Forecasters expect that Estonian GDP growth will remain moderate in the coming years.

Main indicators of economic structure (1998)	
Capital city	Tallinn
Currency	Kroon (EEK)
Total area	45 230 km2
Population	1 445 000
GDP at current prices	4,64 bn EUR
GDP per head	3211 EUR
GDp per head, as % of EU average	16%
GDP per head at PPP	7300 EUR
GDP per head, as % of EU average, at PPP	37%
Structure of production (1997):	
Agriculture	9,4 % GDP
Industry	26,2 % GDP
Construction	7,3 % GDP
Services	57,1 % GDP
Gross foreign debt/ GDP (%)	36,8%
Exports/GDP (%)	51%
Stock of FDI	1,2 bn EUR
Stock of FDI per head	817 EUR
Monetisation of the economy (M2/Y)	28%

Source: Commission services, national sources, EBRD, Erste Bank.

Phasing and time-scale of the accession process

- November 24, 1995: application for membership of the European Union;
- January 1, 1995: entry into force of the Free Trade Agreement with the EU;
- June 1996: EFTA membership;
- Action Plan drawn up by the Estonian Government, preparing accession;
- February 1, 1998: entry into force of the Europe Agreement;
- March 31, 1998: opening session of the accession negotiations in Brussels;
- April 1998 & May 1999: National Programmes for the Adoption of the *Acquis;*
- Free Trade Agreements with several EFTA-countries, the Czech Republic, Slovenia, Slovakia and Turkey. Negotiations concluded with Poland and Hungary. A Baltic Common Economic Area is being introduced. WTO member since October 1999.

Copenhagen Criteria

Agenda 2000[14] concluded, in 1997, that Estonia could be considered as a functioning market economy and would be able to cope with the competitive pressures and market forces within the union in the medium term. Since that date, major structural reforms have been undertaken and the country's competitiveness has continued to increase. The 1999 *Regular Report*[15] concluded that Estonia would be able to cope with the above mentioned pressures in the medium term "provided it completes the remaining key structural reforms".

Opinion of the Estonian Government

The Estonian Government takes 2003 as a working hypothesis for accession to the EU. With regard to the EMU, it considers that "Estonia has been a *de facto* member of what is now called the Eurozone already for six years", as the currency board provides the Estonian Kroon with a fixed peg to the Euro. Nevertheless, membership of the Eurozone is not a priority, as "the accession to the Union and entering the Eurozone are two different events that theoretically may occur simultaneously but, most likely, the latter will follow the former with a considerable time span"[16].

Independent commentators

Estonia is one of the "first wave" countries. Accession is likely to take place between 2004 and 2005.

Prospects of meeting the Maastricht criteria

As noted in *Agenda 2000*, the Maastricht convergence criteria[17] are not a precondition for membership; they are only a condition for participating in the final phase of EMU. The Commission was not able, in 1997, to draw any conclusions about Estonia meeting these criteria by the time of its accession. The most recent developments of the Maastricht indicators are taken from the *Economic Reform Monitor*[18] of the European Commission's Directorate General for Economic and Financial Affairs:

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14 Commission of the European Union, Brussels, "Agenda 2000", 1997.

15 Commission of the European Union, "Regular Report from the Commission on Estonia's Progress towards Accession", 1999.

16 Tanel Ross, Bank of Estonia, "The Euro and its Implications for Estonia", Seminar on the Euro and its Implications for Estonia, Tallinn, January 25, 1999.

17 ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1,5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

The Interest Rate Convergence Criterion: the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);

The ERM Criterion: the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

The Budget Deficit Criterion: a country's budget deficit should not exceed 3% of its GDP;

The Stock of Debt Criterion: the stock of outstanding government debt should not exceed 60% of that country's GDP.

18 European Commission, Economic and Financial Affairs Documentation, *European Economy*, Supplement C.. "Economic Reform Monitor", No.2, May 1999.

- **Inflation** has continued to follow a downward path in 1998 and the beginning of 1999. While average inflation for 1998 still attained a two-digit level (10,6%), year-on-year inflation has slumped to a mere 2,6% in August 1999. This sharp decline has been mainly caused by falling import prices, to which Estonia is very much exposed, due to the country's high share of imports in GDP (73%). The only price increases were recorded in non-tradable goods and services, including administered prices. However, the Government's *Medium-term Strategy* implies average annual inflation rates of 5-6% [19].
- **Long-term interest rates** still do not exist in Estonia. Short-term rates have increased in 1998, but they resumed their downward path in the first months of 1999.
- The **government deficit** has been very limited in Estonia, due to the country's strict fiscal policies. It amounted to 0,2% in 1998. However, the recent economic downturn, combined with the increase in pensions and wages, has put pressure on the 1999 budget. Despite the supplementary budget, decided by the Government in May, cutting expenditures by 3,5%, the budget deficit amounted to 3,1% of GDP for the first half of 1999 and is expected reach about 2-3% of GDP this year. The new Government aims to keep a balanced budget from 2000 onwards. Clear rules still need to be set with regard to the use of privatisation proceeds, as the proceeds from the partial privatisation of the Telecommunications Company have been used to replenish the 1999 budget.
- **Public debt** is very low in Estonia, as it has remained under 5% of GDP.
- The **stability of the national currency** is guaranteed by a currency board arrangement.

Summarising, Estonia would be capable of meeting the Maastricht fiscal criteria. The inflation criterion will probably be met in the short-run. Nevertheless, meeting the Maastricht criteria is not a goal *per se* for the Estonia Government, which considers real convergence as a priority. Thus, "if Estonia should be ready for joining European Union by, say, 2003, that should not be interpreted as a commitment to fulfil Maastricht criteria by that time".

Main elements of the *Acquis* to be completed

Estonia had met its obligations under the Free Trade Agreement and even approximated some legislation under the **Europe Agreements** before they came into force.

By the time of *Agenda 2000*, Estonia was progressing in the field of **Single Market** legislation. The Estonian administration seemed too weak to the European Commission to implement the new legislation in a satisfactory way, despite the high quality of its staff. According to the 1999 *Regular Report,* the pace of alignment has slowed in internal market legislation, notably in the fields of standards and certification and customs. Progress is still needed in enforcement of industrial and intellectual property rights, data protection and public procurement. However, concerning public procurement, with the 1998 amendments to the Public Procurement Act Estonia has improved the approximation of the *Acquis* in this field, ruling out the prevailing domestic preferences. With regard to state aid, Estonia needs to improve the level of alignment, as well as the enforcement capacity.

The **other aspects of the *Acquis*** were not due to pose major problems, except for statistics, fisheries, consumer protection and customs. Substantial efforts were considered necessary for agriculture and the environment –in this latter field, full compliance with the *Acquis* will not be possible in the medium-term.

[19] Tanel Ross, Bank of Estonia, "The Euro and its Implications for Estonia", Seminar on the Euro and its Implications for Estonia, Tallinn, January 25, 1999.

Of special importance with regard to EMU are two of the "four freedoms" in force in the Internal Market without Frontiers:

- **Free Movement of Capital.** Estonia has full convertibility for both current and capital account transactions. Full capital account convertibility was achieved as early as 1993. Some restrictions remain in real estate for non-residents and in FDI in strategic sectors; these will be eliminated in the near future. Estonia requested derogation regarding special restrictions towards third countries on the free movement of capital[20].
- **Free Movement of Services.** The new Credit Institutions Law, in force since July 1999, improved the supervision of the Bank of Estonia (Eesti Pank) and enhanced the harmonisation of Estonian banking legislation with EU provisions, as did the Deposit Insurance Law of October 1998. Eesti Pank considers that Estonia has already implemented most European Banking Directives[21]. The European Commission agreed with this in its latest *Regular Report*. The European Commission's *Regular Report* notes the lack of a supervisory authority for non-bank financial institutions. In response, the Estonian Government plans to implement an integrated supervisory authority with the function of supervising banking, insurance and securities; this new institution would begin to operate in 2002 at the soonest[22]. The *Acquis* is almost totally approximated in the area of insurance.

In December 1998 the screening of the EMU *Acquis* had been completed. In May 1999 Estonia presented its position on EMU.

Main transition issues still to be resolved

The new Government's economic programme expressed the intent to start with the second generation structural reforms: pension and health sector reforms (some laws have been voted on in 1998) and restructuring of the energy and oil-shale mining sector.

One of the most delicate issues is the restructuring of the **oil-shale mining and electricity sectors**. These are under-capitalised and work with outdated and highly polluting production techniques. The output prices are still controlled by the State. The restructuring of these sectors is a difficult issue, as the two largest electricity plants provide 94% of the country's total production and as both employ an important number of workers, in regions where unemployment is high. The Government would like to find a quick solution; however, discussions on a restructuring plan began two years ago. Since the beginning of 1998, two distribution networks have been privatised and two restructuring operations have started[23].

Progress has been made in price liberalisation; 20% of the CPI basket is still subject to **administered prices**.

- ▲ Estonia is still highly dependent, for some industries, on the **Russian and CIS markets**. However, this is changing, as exports to EU markets rose by 10% in the first quarter of 1999 compared to the same period one year earlier.

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[20] Id, 1999.

[21] Statement of the Board of Eesti Pank regarding the launch of the Economic and Monetary Union third stage and the

introduction of the Euro, December 10, 1998.

[22] Statement by Mr. Lehmussaari on Republic of Estonia, June 24, 1999.

[23] Estonia's Progress Report for the Commission Review 1999.

- ▲ Nearly all **state-owned enterprises** are now in private hands, except for infrastructure-related enterprises, which the Government is planning to privatise in the coming years.
- ▲ "The **banking sector** is healthy and expanding strongly" (*Agenda 2000).* Consolidation has occurred through numerous mergers and failures. However, the recent months have witnessed an upward trend in the share of non-performing loans (from 0,9% in July 1998 to 3,2% in March 1999), due to the increase in real interest rates. Estonia has showed its commitment to reform by sticking to market practices in this respect, as the Eesti Pank did not, as a general rule, bail out insolvent banks. Scandinavian strategic foreign investors have heavily invested in Estonia's banking sector. The Eesti Pank estimates that the introduction of the Euro will have as one of its consequences an increased integration of the Estonian financial sector in European capital markets. EMU has already brought some durable effects in the banking sector, most notably concentration and internationalisation (strategic foreign investors and Estonian banks investing abroad, in Lithuania and Latvia).
- ▲ The capital market remains too small to fulfil its role in the provision of enterprise finance.

Preferred exchange rate regime and preparations for EMU

- The **Bank of Estonia** is largely independent from the government. The Chairman of the Bank Board, who is nominated by the President of the Republic, nominates in his turn the Governor of the Central Bank. Both are appointed by Parliament. The Central Bank has to report to Parliament. Its formal objective is the stability of the currency, but it also has to support the policies of the Government, insofar they do not conflict with the first objective. Estonia still needs to change the provisions regarding the composition of the supervisory board, in order to comply fully with the *Acquis.* The Law on the Central Bank is compatible with the Treaty provisions on deficit financing.
- ▲ Estonia adopted a fixed **exchange rate regime** under a currency board arrangement, introduced in June 1992. Base money is backed by foreign reserves: initially gold, then DEM-denominated assets. In May 1998, the foreign reserve cover amounted to 125%[24]. The exchange rates has been fixed against the DEM (8 EEK= 1 DEM) and, as from January 1, 1999, against the Euro (1EUR = 15,6466 EEK).
- The **Stabilisation Reserve Fund** (SRF) acts as a supplementary cover for the currency board, above the central bank's reserves. It is funded by budget surpluses and by privatisation revenues. In fact, its main purpose is the financing of other highly needed structural transformations, like the current pension reform. Despite the expected increase in this year's budget deficit, the Government has ruled out the use of the SRF for budget deficit financing, and preferred to cut back its projected expenditures.
- **Preparations for EMU**. According to its economic programme, the Estonian Government intends to keep the CBA until Estonia joins the EMU[25]: "the currency board provides a sound monetary policy framework for the preparation for the adoption of the Euro, and also provides the right signals for the real economy during the pre-Euro period"[26]. By the end of 1999, the Bank of Estonia will prepare a medium term plan for

[24] Pautola, N. & Backé, P., "Currency Boards in Central and Eastern Europe: Past Experience and Future Perspectives", Österreichische Nationalbank, 1998.

[25] IMF Concludes Article IV Consultation with Estonia, PIN No.99/55, July 1, 1999.

[26] Id.

joining ERMII and, eventually, EMU membership. The intention of the Estonian authorities, as expressed in the *Policy Guidelines for 1998-2000* is to "develop monetary and banking policy within the European Union guidelines"[27]. In May 1999, the Bank of Estonia decided to remunerate fully the bank's required reserves at the ECB deposit rate. However, Estonia will focus on real convergence in order to attain sustainable growth levels and a permanent reduction in inflation. Nominal convergence and the Maastricht criteria are considered merely as "reference points for medium and long-term policy planning"[28].

[27] European Parliament, "EMU and Enlargement", 19 May 1999.

[28] Estonia's Progress Report for the Commission Review 1999.

ESTONIA

	1992	1993	1994	1995	1996	1997	1998 *	1999 **	2000 **	*Reference values Jan.1998*
Output	Erste Bank forecasts a GDP growth of 4% in 2001									
GDP growth rate at constant prices (%)	-14,2	-9,0	-2,0	4,3	4,0	10,6	4,0	3,0	2,5	
Monetary indicators										
M0 growth (%)	-	-	11,5	19,1	21,6	37,7	6,4	-	-	
M1 growth (%)	-	-	20,9	29,8	31,1	22,9	-3,6	20,7 (June)	-	
M2 growth (%)	59,0	93,0	40,0	34,0	36,0	42,0	7,0	9,0	-	
Lending rate (% per annum, end-year) #	-	-	17,5	15,8	13,9	11,2	17,3	-	-	
Foreign trade and exchange rates										
Exports growth (%)	-	95,24	48,57	25,93	10,03	41,71	18,62	-1,0	11,7	
Imports growth (%)	-	92,52	62,77	35,81	25,41	33,08	12,58	0,0	13,0	
Share EU trade: Exports (% of total exports)	-	17,8	19,0	54,0	51,0	48,6	55,1	-	-	
Share EU trade: Imports (% of total imports)	-	23,3	23,9	66,0	64,6	59,2	60,1	-	-	
Current account (%GDP)	-	1,3	-7,3	-4,4	-9,1	-12,0	-8,6	-8,0	-	
Openness: exports and imports as % of GDP	95,5	108,1	123,2	114,7	107,3	122,3	125,0	-	-	
Exchange rate, Krooni per ECU, annual average	-	15,46	15,40	14,99	15,28	15,72	15,75	15,64 (June)	-	
Real effective exchange rate 1995=100	-	-	85,50	100,00	108,00	115,10	153,80	-	-	
Maastricht Criteria										
General government budget balance (% GDP)	-0,3	-0,7	1,3	-1,3	-1,5	1,9	-0,3	-3,6	0,0	*3%*
Government debt (% GDP)	-	-	-	6,7	6,9	5,6	4,6	5,2	5,0	*60%*
Inflation rate: consumer prices, annual average (%)	1076,0	90,0	48,0	29,0	23,0	11,1	10,6	4,5	5,5	*2,7%*
Long term interest rates	-	-	-	-	-	-	-	-	-	*7,8%*
Other macro indicators										
Gross foreign debt (% GDP)	-	9,9	8,8+	9,4	10,7	24,4	36,8	-	-	
Unemployment rate, end-year, ILO methodology (%)	-	6,5	7,6	9,7	10,0	9,7	9,6	-	-	
FDI net inflow (mln ECU)	-	133,2	178,2	152,1	87,4	114,6	504,0	337,3	-	

Sources: Commission services, EBRD, Eurostat, IMF, Erste Bank.

* estimate ** projection or mid-year figure; except GDP, inflation, unemployment: WIIW forecasts June 1999

For 1999: annual average replaced by mid-year (June) exchange rates: 1 EUR = 1,0378 US$

#Weighted average annual interest on kroon loans +statistical break

Hungary

Economic growth resumed in Hungary in 1994. In 1998, GDP grew by 5.1%, especially due to domestic factors like high investment and growing consumption. For the first time since 1989, employment rebounded, incomes rose, with a direct influence on retail sales. However, the increase in imports, coupled with slower export growth (which still remains relatively high), has caused a deterioration in the current account. The economic consequences caused by the recent war in the former Yugoslavia will not remain unnoticed in Hungary, but the effects will probably be limited to the sectors of tourism and transport.

Main indicators of economic structure (1998)

Capital city	Budapest
Currency	Forint (HUF)
Total area	93 030 km2
Population	10 092 000
GDP at market prices	42 575 mln EUR
GDP per head	4219 EUR
GDP per head, as % of EU average	21%
GDP per head at PPP	9800 EUR
GDP per head, as % of EU average, at PPP	49%
Structure of production	
Agriculture (% GDP)	5,9%
Industry (% GDP)	28,1%
Construction (% GDP)	4,6%
Services (% GDP)	61,4%
Gross foreign debt/GDP (%)	47,0%
Exports/GDP (%)	55%
Stock of FDI (bn ECU)	14,1 bn EUR
Stock of FDI per head (ECU)	1395 EUR
Monetisation of the economy (M2/Y)	34%

Source: Commission services, national sources, EBRD, WIIW, Erste Bank.

Phasing and time-scale of the accession process

- March and October 1993: CEFTA and EFTA membership
- February 1, 1994: entry into force of the Europe Agreement
- March 31, 1994: application for membership of the European Union
- January 1995: WTO membership
- 1995: adoption of a Plan for the implementation of the White Paper of May 1995 on the Internal Market – revision of this Plan in 1997
- May 1996: OECD membership
- 1997 to 1998: Free Trade Agreements with Bulgaria, Lithuania, Estonia, Turkey and Israel.
- March 1998 & July 1999: National Programmes for the Adoption of the *Acquis*. Expression of wish to join the Schengen Agreement

Copenhagen Criteria

Agenda 2000[29] *described the Hungarian economy as a functioning market economy. Progress had been made in liberalisation and privatisation. The number of new private firms has rapidly increased. Restructuring of banks and enterprises was progressing ahead of schedule and the competitiveness of Hungarian enterprises was a remarkable feature. According to the European Commission's 1999 Regular Report*[30]*, Hungary would be able to cope with competitive forces within the Union in the medium term, "provided the macroeconomic conditions supporting investment growth and restructuring remain in place".*

Opinion of the Hungarian Government

Hungary's time-scale for EMU accession is based on a best-case scenario for EU accession: the year 2002; the target date for joining the Euro is situated somewhere between 2005 and 2007[31]. There is a broad consensus on becoming a full EMU member shortly after having joined the EU.

Independent commentators

Hungary is one of the "first wave" countries. Accession is likely to take place in 2003 or 2004.

Prospects of meeting the Maastricht criteria

As noted in *Agenda 2000*, the Maastricht convergence criteria[32] are not a precondition for membership; they are only a condition for participating in the final phase of EMU. The Commission was not able, in 1997, to draw any conclusions about Hungary meeting these criteria by the time of its accession. The latest economic developments in Hungary are taken from the *Economic Reform Monitor* of the European Commission's Directorate General for Economic and Financial Affairs:

- **Inflation** decreased substantially during 1998 (the CPI rose by 14,3%) and the first months of 1999, reaching even single digits with a 8,9% year-on-year inflation in May of this year. This decline is caused both by external factors like low energy and agricultural prices and by the credibility of the authorities' commitment to disinflation. The European

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[29] Commission of the European Union, "Agenda 2000", 1997.

[30] Commission of the European Union, " Regular Report from the Commission on Hungary's Progress towards Accession", 1999.

[31] Backé, P. & Radzyner, O., "The Introduction of the Euro: Implications for Central and Eastern Europe-The Case of Hungary and Slovenia", Österreichische Nationalbank, 1998.

[32] ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1,5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

The Interest Rate Convergence Criterion: the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);

The ERM Criterion: the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

The Budget Deficit Criterion: a country's budget deficit should not exceed 3% of its GDP;

The Stock of Debt Criterion: the stock of outstanding government debt should not exceed 60% of that country's GDP.

Commission thinks that this will be put to the test in 1999 by rising oil prices. The 1999 inflation target is 9%[33].

- The **interest rate** policy of the National Bank of Hungary (NBH) can be characterised as prudent. The benchmark rates have been reduced in April, following the cut in interest rates decided by the ECB. Hungary has been the first CEEC to launch a 10-year bond denominated in domestic currency (in January 1999) and a global bond (in April).
- The **government deficit** amounted to 4,7% of GDP in 1998. The target for 1999 is 4% of GDP. However, in May of that year, the deficit had already reached 85% of this target, due to lower revenues (VAT and NBH revenues) and higher expenditures (agricultural subsidies and health fund costs).
- Hungary's **public debt** has substantially declined since the beginning of the nineties. In 1998, with a level of 60.3% of GDP, it could almost comply with the Maastricht criterion.

▲ Hungary has followed a crawling peg **exchange rate** regime since 1995. The pace of devaluation of the Forint central rate has been 0,6% per month until recently, it decreased to 0,4% per month last October. In the face of mounting devaluation pressures following last year's emerging markets crisis, the NBH had to intervene and raise interest rates to prevent the Forint from overshooting the rate of crawl.

Both the former Finance Minister and the Governor of the central bank have estimated that fiscal convergence in line with Maastricht would be reachable by 2002, while the monetary and exchange rate criteria would take a few more years to fulfil[34]. The Budapest Government expects that it will not take longer than the two compulsory years of ERMII membership, before Hungary can join the third phase of EMU[35].

Main elements of the *Acquis* to be completed

- *Agenda 2000*[36] concluded in 1997 that Hungary had almost totally complied with the **Europe Agreements**.
- The rate of transposition of the **White Paper** had been good and the legislation on the **Single Market** was almost completely in place even in the most delicate areas. The *Regular Reports* of 1998[37] and 1999 emphasised the progress made in the framework of the **Accession Partnerships** in company law and certification and the quite advanced harmonisation of standards. The tax concessions, which had been considered by the European Commission as export aid, were removed in January 1998. Efforts are still needed in the enforcement of intellectual property rights and public procurement, for which local preferences should be abolished. The new State aid legislation, introduced in May 1999, is relatively well aligned, and efforts have been made to increase its transparency and the functioning of the monitoring authority. On January 1, 1998 foreign companies gained the right to establish branches in Hungary.

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[33] National Bank of Hungary, *Monetary Policy Guidelines 1999.*

[34] Backé, P. & Radzyner, O., "The Introduction of the Euro: Implications for Central and Eastern Europe-The Case of Hungary and Slovenia", Österreichische Nationalbank, 1998.

[35] Endre Juhász, ambassador of the Hungarian Mission in Brussels.

[36] Commission of the European Union, Brussels, "Agenda 2000, The Effects on the Union's Policies of Enlargement to the Applicant Countries of Central and Eastern Europe", 1997.

[37] Commission of the European Union "Regular Report from the Commission on Slovakia's Progress Towards Accession", 1998.

- According to *Agenda 2000*, Hungary will not encounter any difficulties in applying the **other parts of the *Acquis*** except for consumer protection and custom controls; in the medium-and-long run, environment and energy will also require much effort.

Of special importance with regard to EMU are two of the “four freedoms” in force in the Internal Market without Frontiers:

- **Free Movement of Capital:** Already by 1997 already much progress had been made, as the Forint was convertible for current account transactions as from January 1, 1996. Hungary has made early progress in freeing capital movements, especially when the country became member of the OECD in 1996. The liberalisation of inward flows has been fast and is mostly complete (with the exception of short-term capital), while outward flows are still subject to numerous restrictions. January 1998 saw the amendment of the Law on Foreign Exchange: only a few restrictions on capital market transactions remain, especially on short-term and money market transactions, as well as on portfolio investments abroad by insurance companies and pension funds. Hungary planned to remove all remaining restrictions by the year 2000, but decided to revise this plan in the wake of the Russian financial crisis. The date of accession is now the deadline set for the removal of the remaining restrictions. Hungary demanded a derogation of ten years from the EU for the acquisition of arable land by foreigners.
- With regard to the **Free Movement of Services,** foreign institutions have been allowed to operate as branches since January 1, 1998. The provisions of the Capital Adequacy Directive, which was the only major missing piece of the Acquis, according to the European Commission, has been in force since Jan 1,1999. However, the persistence of anonymous banking accounts is not in line with the money-laundering Directive. Universal banking has become possible this year. Further efforts are still needed on supervision on a consolidated basis, prudential regulations and capital adequacy requirements. Insurance directives have been almost totally approximated. However, a few restrictions persist on investments abroad, as well as the obligation to invest in certain State debt instruments.

Main transition issues still to be resolved

Hungary’s most appreciable strength is its general commitment to market reforms and its ability to take painful decisions when necessary. The economic slowdown brought about by the 1995 adjustment measures was only temporary and the subsequent recovery was fuelled to a considerable extent by export growth.

- Hungary began to implement a comprehensive **pension reform** in January 1998 which strengthened the role of private agents. A similar reform is greatly needed in the health care sector, as expenditures are systematically overshooting targets.
- According to *Agenda 2000,* the mass **privatisation** programme was already completed by 1997. Its revenues were allocated to the reimbursement of foreign debt. Nevertheless, the State intends to keep a stake in an important number of enterprises.
- **FDI** has been a driving force behind the modernisation of key sectors of the economy. However, Hungary was affected by last year’s decline in investor confidence in emerging markets.
- The 1996 **Competition Act** is still not sufficiently enforced and the regulatory environment is too weak.

- The Hungarian **banking sector** is relatively sound, as only 10% of banks' assets were potentially bad loans in 1997. Privatisation has been almost completed, except for minority interests. The banks play their role as intermediaries and they are increasingly providing finance for small enterprises. Since January 1998, branches of foreign institutions are allowed to operate in the financial sector. Foreign investors played an important part in the privatisation of the Hungarian banking sector, as 60% of the sector was in foreign hands at the end of 1997. Competition is increasing, as average market lending and deposit rates are continuously declining, as is their spread. However, this year saw one case of failure in this process: Postabank had to be re-nationalised because of mismanagement. Mandatory reserve requirements are still too high and hamper the creation of a level playing field between domestic and foreign banks.

▲ The Hungarian **market for government bonds and Treasury bills** is among the most developed in CEE.

Preferred exchange rate regime and preparations for EMU

Agenda 2000 stated that Hungary "should be in a position at the appropriate time to participate in the third stage of EMU", but refrained from any conclusions about when this appropriate time would be.

- **The National Bank of Hungary** is formally independent of the government. However, *Agenda 2000* noted the coincidence of governor appointments with changes of government. This simultaneous replacement did not take place after the 1998 general elections, however. Price stability is not the only objective of the NBH Law, but has certainly been pursued since the launch of the 1995 stabilisation package. With regard to budget deficit financing by the central bank, the Hungarian central bank can still grant short-term credits to the government (this facility has not been used since 1995) and the authorities have privileged access to finance.

- **The exchange rates regime**

  The Hungarian exchange rate regime is a crawling basket peg, with fluctuation bands of +/- 2,25%. The composition of the basket has shifted over time: the USD had a constant 30% share, while the remaining 70% were made of ECU until the end of 1996 and of DEM until January 1,1999. The Euro replaced the DEM at that date. As the NBH was expecting the Euro to appreciate, it decided to keep the share of the European currency low, in retain export competitiveness. The monthly devaluation rate has systematically been reduced from 1.9% to 0.4%. The Finance Ministry and the NBH wish to keep the crawl at least until inflation reaches single digits, which had initially been planned for 2000.

  Since the stabilisation programme of March 1995, the exchange rate of the Forint has stabilised inflationary pressures in the economy. Nevertheless, during the international financial crisis of August 1998, pressure on the Forint, led the NBH to intervene for the first time since 1995 by raising interest rates.

  The new government announced during the pre-election period that it was in favour of a change in regime, as the crawling peg was said to be responsible for inflation[38]. However, once in place, the government stated that such a shift would only be a sensible decision if combined with a broad anti-inflation package.

[38] Backé, P. & Radzyner, O., "The Introduction of the Euro: Implications for Central and Eastern Europe-The Case of Hungary and Slovenia", Österreichische Nationalbank, 1998.

- **The Path to EMU.** The authorities have not made any announcement on their eventual participation in an EU exchange rate co-operation mechanism. However, they seem to have an inclination for ERM II membership simultaneous to EU membership[39]. The most plausible scenario implies the reduction of the rate of devaluation on average every half year. This process, coupled with improvement in fiscal policy and a disinflation of 2 to 4 %- points per year, could lead to a peg of the Forint to the Euro within a few years. Hungary has expressed its intention to shift to a complete Euro crawling peg by January 1, 2000.

[39] Backé, P. & Radzyner, O., "The Introduction of the Euro: Implications for Central and Eastern Europe-The Case of Hungary and Slovenia", Österreichische Nationalbank, 1998.

HUNGARY

	1992	1993	1994	1995	1996	1997	1998 *	1999 **	2000 **	2001***	*Reference values Jan.1998*
Output											
GDP growth rate at constant prices (%)	-3,1	-0,6	2,9	1,5	1,3	4,6	5,1	3,7	4,0	4,5	
Monetary indicators											
M0 (currency outside banks, HUF) growth (%)	23,8	15,2	10,6	8,1	12,1	12,6	19,0	1,6(April)	-	-	
M1 growth (%)	32,6	11,2	8,0	6,40	19,39	22,66	4,62	5,7(April)	-	-	
M2 growth (%)	27,3	16,8	13,0	18,4	21,2	23,2	-	-	-	-	
M3 growth (%)	27,6	15,3	13,0	20,1	22,5	19,4	15,4	0,77 (April)	-	-	
Lending rate: one year (% per annum, end-year)	28,8	25,6	29,7	32,2	24,0	20,8	19,2	-	-	-	
Treasury bill rate (three-month maturity) (% per annum, end-year)	14,7	24,3	31,6	30,1	21,7	19,2	16,1	-	-	-	
Foreign trade and exchange rates											
Exports growth (%)	4,5	-16,6	20,5	20,2	1,7	21,8	20,4***	8,3***	4,8***	16,9	
Imports growth (%)	-2,8	13,6	15,8	5,4	5,0	17,1	21,2***	9,3***	3,2***	15,5	
Share EU trade: Exports (% of total exports)	-	46.5	51.0	62.8	69.7	71.2	72.9	-	-	-	
Share EU trade: Imports (% of total imports)	-	40.1	45.3	61.5	62.3	62.8	64.1	-	-	-	
Current account (% GDP)	0,9	-9,0	-9,4	-5,6	-3,7	-2,1	-4,7	-4,1			
Openness: exports and imports as % of GDP	53,7	50,3	45,3	62,9	68,6	89,7	101,9	-	-	-	
Exchange rate, Forints per ECU, annual average	102,1	107,7	125,0	164,5	193,7	211,7	240,6	249,35 (June)	-	-	
Real effective exchange rate index 1990=100	-	71,1	64,6+	50,2	42,9	38,6	32,0	-	-	-	
Maastricht Criteria											
General government budget balance (% GDP)	-7,6	-8,9	-8,6	-6,2	-3,1	-4,9	-4,9	-3,9	-4,0***	-3,5	*3%*
Government gross debt (% GDP)	77,6	87,9	85,2	84,3	71,5	62,9	60,3	-	-	-	*60%*
Inflation rate: consumer prices, annual average (%)	23,0	22,5	18,8	28,2	23,6	18,3	14,2	9,7	8,0	7,5	*2,7%*
Long term interest rates	-	-	-	-	-	-	-	-	-	-	*7,8%*
Other macro indicators											
Gross foreign debt (% GDP)	57,6	63,7	69,0+	65,5	60,8	46,3	43,3	-	-	-	
Unemployment rate, end-year, registered (%)	12,3	12,1	10,4	10,4	10,5	10,4	9,1	10	9,0	8,5	
FDI net inflow (bn ECU)	1,2	2,0	0,9	3,4	1,6	1,5	1,5	1,7	-	-	

Sources: Commission services, EBRD, Eurostat, IMF, WIIW, National Bank of Hungary, Erste Bank.

* estimate ** projection or mid-year figure; except GDP, inflation, unemployment: WIIW forecasts June 1999 *** Erste Bank forecast +statistical break

M2 monetary aggregates have not been published for 1998 due to changes in the definition of M2

For 1999: annual average replaced by mid-year (June) exchange rates: 1 EUR = 1,0378 US$

Poland

Since 1992, Poland has experienced continuous growth. However, growth slowed down by the end of 1998 (the annual growth rate was 4,8%, against 6,9% in 1997), due to adverse external developments: the Russian financial crisis and a slowdown in exports to the EU, coupled to a decline in domestic demand and a tightening of both monetary and fiscal policies. GDP growth is expected to reach a level of 4% in 1999. The authorities responded to the continuing decline in industrial output in the first months of 1999 by easing monetary policy. In March, industrial production rose again on a year-on-year basis and good prospects for recovery in second semester of 1999. The European Commission warns that keeping fiscal policy tight (as it has been until now) is essential to prevent the return of rates of high inflation[40].

Main indicators of economic structure (1998)	
Capital city	Warsaw
Currency	Zloty (PLN)
Total area	312 683 km2
Population	38 667 000
GDP at market prices	140 919 mln EUR
GDP per head	3644 EUR
GDP per head, as % of EU average	17%
GDP per head at PPP	7800 EUR
GDP per head, as % of EU average, at PPP	39%
Structure of production	
Agriculture (% GDP)	4,8
Industry (% GDP)	27,9
Construction (% GDP)	8,6
Services (% GDP)	58,7
Gross foreign debt/GDP	15,9
Exports/GDP	23,7%
Stock of FDI	12,9 bn EUR
Stock of FDI per head	334 EUR
Monetisation of the economy (M2/Y)	40,50%

Source: Commission services, national sources, EBRD, Erste Bank.

Phasing and time-scale of the accession process

- February 1, 1994: entry into force of the Europe Agreement
- March and November 1993: CEFTA and EFTA membership
- April 5, 1994: application for membership of the European Union
- July 1995: WTO membership
- November 1996: OECD membership
- May 1998 &May 1999: National Programmes for the Adoption of the *Acquis*
- March 31, 1998: opening session of the accession negotiations in Brussels

[40] *Economic Reform Monitor*, May 1999.

Copenhagen Criteria

According to *Agenda 2000*[41], Poland was already a functioning market economy in 1997. In its 1999 *Regular Report*[42], the European Commission considered that the country would be "able to cope with competitive pressure and market forces within the Union in the medium term, provided it keeps up the pace of economic restructuring and proceeds with trade liberalisation".

Opinion of the Polish Government

Poland considers 2002 as a working hypothesis for EU accession. The Monetary Policy Council (RPP), in its *Medium-Term Strategy of Monetary Policy (1999-2003)* assumes that Poland will become a member of the EU in 2002, and of the EMU "later". These memberships are considered as "the strategic goal" of the country.

Independent commentators

Poland is one of the "first wave" countries. It is likely to join the EU between 2003 and 2005.

Prospects of meeting the Maastricht criteria

As noted in *Agenda 2000*, the Maastricht convergence criteria[43] are not a precondition for membership; they are only a condition for participating in the final phase of EMU.

- Monetary policy has been quite successful in Poland, as **inflation** has steadily declined, from almost 20% in 1996 to 11,8% in 1998. The recent fall in the prices of food and services has led to a revision of the 1999 inflation forecasts: consumer prices will grow by 7% according to the government and by 6.6-7.8% according to the Monetary Policy Council (RPP). Poland has chosen a strategy of direct inflation targeting (no intermediate targets) for the period 1999-2002[44]. The medium-term target is to reduce inflation to below 4% by 2003[45], focusing on the CPI. The 1999 target had been set at 8-8.5%. The band is quite narrow, because a wider band could undermine the credibility of the RPP's commitment, given the fact that inflation targets were fixed points until this year. The tolerance bands will be gradually widened. The RPP intends to publish its "Inflation Report", which is now semi-annual, on a quarterly basis in future.

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41 European Commission, "Agenda 2000", 1997.

42 European Commission, "Regular Report from the Commission on Poland's progress towards accession", 1999.

43 ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1,5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

The Interest Rate Convergence Criterion: the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);

The ERM Criterion: the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

The Budget Deficit Criterion: a country's budget deficit should not exceed 3% of its GDP;

The Stock of Debt Criterion: the stock of outstanding government debt should not exceed 60% of that country's GDP.

44 Monetary Policy Council (RPP), *Medium-Term Strategy of Monetary Policy (1999-2003)* (1999).

45 RPP *Medium-Term Strategy of Monetary Policy (1999-2003).*

- Poland has no **long-term interest rates** yet. Despite the cut in nominal short-term interest rates in July 1998 and in January 1999, real rates remain relatively high (at about 7%) although they declined by almost 3% in one year.
- Regarding the **budget deficit** criterion, Poland has a relatively sound record, with the deficit staying around the 3% benchmark: it was 3.1% in 1997 and 3.0% in 1998. However, the 1999 budget was based on the assumption of a GDP growth of 5.1% and in May 1999, 78% of the deficit planned for the whole year had already been reached. The target of a deficit beneath the 2.15% of GDP will require the resumption of economic growth and limiting expenditure. The *Medium-term Financial Strategy* of March 1998 assumes that the fiscal deficit will be eliminated by 2003.
- **Government debt** is 43% of GDP and declining. It had been reduced by half in the first years of the decade by debt relief via the Paris club: public debt amounted to nearly 150% of GDP in 1992.
- The **exchange rate** regime of the Zloty has been a crawling peg since 1991, set against a basket of 45% USD and 55% Euro. However, the currency reacted quite quickly to the Russian financial crisis, which caused it to depreciate by almost 10%. Stability will probably not be achieved soon.

Summarising, in the short-run, Poland would only be in a state of complying with the fiscal criteria. By 2003, the country intends to be able to comply with the inflation criterion as well.

Main elements of *Acquis* to be completed

By the time of *Agenda 2000* significant elements of the **Europe Agreement** had been implemented. Some trade problems had arisen, but had mostly been resolved. The rate of transposition of the **White Paper** had been satisfactory. Substantial progress still had to be made on legislation on the **Single Market**. Although the administrative infrastructure was functioning relatively well, effort is still needed, especially with regard to implementation. *Agenda 2000* considered that Poland would not encounter any special difficulties in the medium-term in approximation of other parts of the *Acquis*. Full compliance of EU legislation on the environment would only be possible in the long term. Particular effort and investment were needed for agriculture, environment and transport.

The **Special Economic Zones**, created in order to attract FDI in depressed regions, are not in conformity with the *Acquis* and will have to be phased out.

Since last year, Poland has not progressed in adopting and implementing essential internal market legislation. The 1999 *Regular Report* notes the poor level of compliance in the field of free movement of goods. Substantial efforts are still needed in the fields of public procurement (the national preference clause has to be abolished) and State aid. The problem of indirect aid (arrears) or aid given by local authorities is a major concern. Some progress has been made in the field of competition with the January 1999 amendment to the Law on Counteracting Monopolistic Practices

Of special importance with regard to EMU are two of the “four freedoms” in force in the Internal Market without Frontiers:

- **Free movement of capital**. Poland has had full current account convertibility since 1995. The country has chosen a strategy of gradual liberalisation of capital movements. The liberalisation of all medium- and long-term capital movements was achieved by the end of 1998. The new Foreign Exchange Law of January 1999 liberalised the vast majority of outward capital transactions by residents. Short-term capital movements between Poland

and OECD countries will be free by the end of 1999. The approximation of the *Acquis* has accelerated with the new Banking Act of 1998, with the Law on Investment Funds and with the Law on Public Trading, all drawn up to comply with Poland's liberalisation obligations related to its OECD membership. Investment in real estate remains an issue. A clear timetable for further liberalisation is lacking.

- **Free movement of services**. In 1997, the State banks still controlled over 50% of banks' assets. Privatisation has progressed since then, as the State sold majority stakes in three of the biggest banks. The new Banking Act and the Act on the NBP, designed according to EU and OECD standards, entered into force on January 1, 1998. As from January 1, 1999, foreign banks were allowed to operate as branches. Provisions on money laundering have been strengthened. However, the banking sector is still relatively segmented and state dominated, and bankruptcy procedures are still cumbersome. Some efforts are still needed on the transposition of Directives related to bank accounts, supervision on a consolidated basis and capital adequacy. With regard to insurance, progress has been made in the treatment of foreign companies. The level of alignment in the field of securities is quite high.

Main transition issues still to be resolved

- At the time of *Agenda 2000,* **pension and social security system reform** were urgently needed. The government has since engaged in a comprehensive plan of pension reform, giving the private sector a greater role to play. However, social security reform is lagging behind. The pension reform will have positive consequences on the development of **capital markets**.
- The increasing foreign participation in the **banking sector** (60% of total assets are in foreign hands) has had positive consequences for the sector as a whole. Non-performing loans represent less than 10% of total assets. Access of households and small enterprises to credit is slowly improving. Substantial progress has been made in the privatisation of banks.
- The large, loss-making **state-owned companies** are a major problem. The government plans to privatise 70% of all remaining State assets by the end of 2001. The two largest state banks will only be privatised by the end of that period.
- **Restructuring** is slow. The steel sector and the coal mining sector, as well as the defence industry need to be restructured.
- **Agriculture** is heavily in need of modernisation, as well as the agri-food business, traditionally a key sector in the Polish economy.
- **Obsolete infrastructure**
- **Trade policy** is a permanent issue, as Poland is sometimes reluctant to open its borders. The current account reveals an important number of unclassified transactions. 25% of trade on the Eastern borders and 15-20% on the border with the EU goes unrecorded. The value of imports is often under-reported.
- Poland's impressive growth record is mainly due to the **dynamism of small private enterprises**, of which the number is still growing (as new enterprises are created and enterprises operating previously in the "grey zone" are registered)
- **FDI** increased exponentially in recent years and played an important role in the development and the shaping of Poland's economy.

Preferred exchange rate regime and preparations for EMU

- **The National Bank of Poland (NBP)**

  By the time of *Agenda 2000,* the National Bank of Poland (NBP) was independent in terms of the appointment procedure of the Governor, but not in the conduct of monetary policy and the central bank law was not compatible with the Treaty provisions on deficit financing. Since then, the new Law on the National Bank of Poland entered into force on January 1, 1998. Independence has been enhanced, price stability has become the primary objective of the NBP and lending to the government has been prohibited as from November 1998. The Monetary Policy Council within the NBP, created in 1998, determines the monetary policy guidelines and chooses the instruments.

- **The exchange rate regime**

  The exchange rate regime of the Zloty (PLN) is a crawling peg, with fluctuation bands around the central parity. The reference basket is made of 45% US Dollar and 55% Euro since January 1, 1999.

  The peg was used as a nominal anchor between 1991 and 1995; the currency was subject to occasional devaluations, so as to restore the country's competitiveness. The massive capital inflow of 1995, due to the relative success of the transition process and to real exchange rate appreciation expectations, had a negative consequence for the development of inflation, which was higher than expected. In March 1996, bands were introduced around the central parity in order to introduce some flexibility in the system. Speculative inflows disappeared and the NBP regained control over the money supply.

  The Russian crisis led to a depreciation of the Zloty by almost 10% in 1998. However, the Polish currency bounced back above parity when the RPP decided to cut monthly devaluation to 0.5%, in order to fight inflation. Nevertheless, the currency dropped by 14.4% against the USD between December 1998 and March 99. In March 1999, the rate of crawl was reduced from 0.5 to 0.3% and the fluctuation band was widened to +/- 15%, in preparation of a move to a full float within a year.

- **Preparations for EMU**

  The RPP has a clear and consistent exchange rate policy. Its strategy excludes the fixing of the exchange rate for the time being. The entry into ERMII needs to occur at the market exchange rate, which is not possible to determine if the exchange rate has not been left free for a while in the opinion of the NBP. It is its intention to prepare EMU membership by gradually reducing the crawling devaluation and expanding the bands until the exchange rate regime is transformed in a free float. At that moment, the exchange rate will converge to the equilibrium rate, at which time the PLN could be pegged to the Euro within ERMII.

POLAND

	1992	1993	1994	1995	1996	1997	1998 *	1999 **	2000 **	2001***	*Reference values Jan.1998*
Output											
GDP growth rate at constant prices (%)	2,6	3,8	5,2	7,0	6,1	6,9	4,8	3,5	4,0	5,5	
Monetary indicators											
M0 growth (%)	39,3	56,73	9,87	16,44	7,22	13,80	20,98	10,59 (May)	-	-	
M1 growth (%)	38,9	24,76	15,81	19,39	15,70	8,64	7,84	6,58 (May)	-	-	
M2 growth (end year) in %	57,5	36,0	38,2	34,9	29,4	29,1	25	5,7 (May)	-	-	
Lending rate (% per year, end-year) #	39,0	35,0	31,0	24,0	23,3	25,8	-	-	-	-	
Treasury bill rate (3 months maturity) (% per annum, end-year)	41,4	33,7	27,0	24,2	18,8	23,5	-	-	-	-	
Foreign trade and exchange rates											
Exports growth (%)	-11,5	7,7	23,0	22,6	9,7	24,8	12,7	24,2	4	12,8	
Imports growth (%)	2,5	30,6	10,2	26,2	35,9	32,3	15,3	19,5	6,1	12,5	
Share EU trade: Exports (% of total exports)	-	64.3	62.7	70.0	66.3	64.2	68.3	-	-	-	
Share EU trade: Imports (% of total imports)	-	57.6	57.5	64.6	63.9	63.8	65.9	-	-	-	
Current account (% GDP)	1,1	-0,7	2,5	4,6	-1,0	-3,1	-4,5	-5,5	-4,0 ***	-4,5	
Openness: exports and imports as % of GDP	32,6	34,3	37,5	40,1	42,4	48,4	51,6	-	-	-	
Exchange rate, Zloty per ECU, annual average	1,77	2,12	2,70	3,17	3,42	3,72	3,92	4,09 (June)	-	-	
Real exchange rate index 1990=100	-	61,0	46,9+	40,4	37,3	33,7	31,9	-	-	-	
Maastricht Criteria											
General government budget balance (% GDP)	-6,7	-3,1	-3,1	-2,8	-3,3	-3,1	-3,0	-3,0	-2,0***	-2,5	*3%*
Public debt (% GDP)	147,3	108,6	69,0	59,0	53,6	49,4	43,0	-	-	-	*60%*
Inflation rate: consumer prices, annual average(%)	43,0	35,3	32,2	27,8	19,9	14,9	11,8	8,0	7,0	5,5	*2,7%*
Long-term interest rates	-	-	-	-	-	-	-	-	-	-	*7,8%*
Other macro indicators											
External debt (% GDP)	56,4	54,9	34,7+	28,4	23,4	24,8	15,9	-	-	-	
Unemployment rate, end-year, registered (%)	13,6	16,4	16,0	14,9	13,2	10,5	10,4	12,0	11,0	9,5	
FDI net inflow (bn ECU)	0,2	0,5	0,4	0,8	2,2	2,6	5,9	6,4	-	-	

Sources: Commission services, EBRD, Eurostat, IMF, WIIW, National Bank of Poland, Erste Bank.

* estimate ** projection or mid-year figure; except GDP, inflation, unemployment: WIIW forecasts June 1999 *** Erste Bank forecast +statistical break

For 1999: annual average replaced by mid-year (June) exchange rates: 1 EUR = 1,0378 US$

Until 1995: lowest rate charged to prime borrowers; after 1995: weighted average for lowest risk loans.

Slovenia

Slovenia's economic condition is relatively favourable. GDP growth has been positive since 1993: it amounted to 4.6% in 1997 and to 3.9% in 1998. However, like in many other CEECs, industrial production has showed a downward trend in the last months of 1998 and the first months of 1999.

Main indicators of economic structure (1998)	
Capital city	Ljubljana
Currency	Tolar (SIT)
Total area	20 256 km2
Population	1 983 000
GDP at market prices	17 450 mln EUR
GDP per head, as % of EU average	44%
GDP per head at PPP	13 700 EUR
GDP per head, as % of EU average, at PPP	69%
Structure of production:	
Agriculture (% GDP)	3,9%
Industry (% GDP)	32,0%
Construction (% GDP)	5,7%
Services (% GDP)	58,3%
Gross foreign debt/GDP (%)	15,2%
Exports/GDP (%)	56,7%
Stock of FDI	1 bn EUR
Stock of FDI per head	515 EUR
Monetisation of the economy (M2/Y)	39%

Source: Commission services, national sources, EBRD, WIIW.

1 Phasing and time-scale of the accession process

- July 1995 and January 1996: EFTA, WTO and CEFTA membership
- June 10, 1996: application for membership of the European Union
- March 1998 and May 1999: National Programmes for the Adoption of the *Acquis*
- March 31, 1998: opening session of the accession negotiations in Brussels
- February 1,1999: entry into force of the Europe Agreement, which replaced the Interim Agreement, in force since the signature of the former, in June 1996

Copenhagen criteria

Agenda 2000[46] already described Slovenia as a functioning market economy, having achieved stabilisation and the creation of market institutions. The European Commission's

[46] Commission of the European Union, Brussels, "Agenda 2000", 1997.

1999 *Regular Report*[47] considers that Slovenia will be able to cope with the competitive pressures and market forces within the Union in the medium term, “provided it continues to make further progress on structural reforms”.

Opinion of the Government of Slovenia

Slovenia considers the year 2003 as a working hypothesis for EU membership.

The idea of joining the EMU before the EU could not count on any support at all amongst current EU members. The Council of the Bank of Slovenia proclaimed, in January 1998, that EU and full EMU membership would necessarily be successive. In the 1997 NPA*A* and the national strategy for EU integration, Slovenia stated its objective to be to join the Eurozone in 2005. However, the Minister for Economic Affairs declared recently that even 2005 was too optimistic and that 2007-2008 would provide a more realistic timeframe[48].

Independent commentators

Slovenia is one of the “first wave” countries. Accession is likely to take place between 2004 and 2007.

2 Prospects of meeting the Maastricht criteria

As noted in *Agenda 2000*, the Maastricht convergence criteria[49] are not a precondition for membership; they are only a condition for participating in the final phase of EMU. The Commission was not able, in 1997, to draw any conclusions about Slovenia meeting these criteria. The latest economic developments are taken from the *Economic Reform Monitor* of the European Commission’s Directorate General for Economic and Financial Affairs:

▲ *Agenda 2000* already stressed the effectiveness of Slovenian monetary policy with regard to **inflation**. Slovenia has had single digit inflation rates since 1996. It averaged 7.9% in 1998, against 8.4% in 1997. The decline is steadily continuing as the year-on inflation rate amounted to 4.6% in April of this year. However, the introduction of VAT on July 1, 1999 is expected to have a one-off repercussion on inflation. A wage agreement ensures

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[47] Commission of the European Union, “Regular Report from the Commission on Slovenia’s Progress towards Accession”, 1999.

[48] Backé, P. & Radzyner, O., “The Introduction of the Euro: Implications for Central and Eastern Europe-The Case of Hungary and Slovenia”, Österreichische Nationalbank, 1998.

[49] - ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1.5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

- ***The Interest Rate Convergence Criterion:*** the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);

- ***The ERM Criterion:*** the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

- ***The Budget Deficit Criterion***: a country's budget deficit should not exceed 3% of its GDP;

- ***The Stock of Debt Criterion***: the stock of outstanding government debt should not exceed 60% of that country’s GDP.

that workers' wages will be indexed to 85% of inflation following the introduction of VAT.

- ▲ There are still no **long-term interest rates** in Slovenia. Short term interest rates declined in 1998 due to increased competition among banks and to the opening of the banking market to foreign competition. The Treasury bill rate for 1998 has been estimated at 8.7% by the EBRD (Tolar part of twin bills).
- ▲ The **government deficit** criterion of the Maastricht Treaty should not represent any difficulty for Slovenia, as the country has a tradition of balanced budgets. However, the 1.1% of GDP deficit of 1997 did not seem a good sign to the Commission. The 1998 deficit was nevertheless no more than 0.8% GDP and the 1999 budget foresees a deficit of 0.6% GDP, which is, however, not realistic, due to lower growth prospects.
- ▲ The EBRD estimated the 1998 **public debt** to be as low as 24% of GDP, which is well under the Maastricht benchmark
- ▲ Slovenia has had a managed-float **exchange rate** regime since 1992. The Slovenian Tolar has shadowed the DEM, and is now shadowing the EUR since January 1999; but the currency is regularly losing value against it. Slovenia has declared its intention to join ERM II at the same time as or after EU accession[50].

To conclude, it is clear that Slovenia would be able to meet the two Maastricht fiscal criteria in the short run. It would probably be able to comply with the inflation criterion and the exchange rate criterion in the medium run.

3 Main elements of the *Acquis* to be completed

- ▲ *Agenda 2000* estimated the rate of transposition of the **White Paper** as satisfactory. The legislative structure was already in place for most of the sectors in 1997. However, deficiencies in implementation and administrative monitoring needed to be tackled. Major efforts were needed in the areas of public procurement, competition, insurance, freedom of capital movements, product conformity and standardisation. The introduction of VAT deserved top priority. The other parts of the *Acquis* were not thought to lead to any particular difficulties. Only in the fields of environment, employment and social affairs and energy would Slovenia have to make substantial improvements.
- ▲ The **1999 *Regular Report*** shows that Slovenia has recently adopted key parts of the internal market legislation (standards and certification, data protection, company law, VAT, anti-trust). Indeed, a Law on the Prevention of Limiting Competition, relatively well aligned with the *Acquis,* has taken effect in June 1999 and VAT and excise duties were introduced in July. Significant progress in the field of the free movement of goods is due notably to the relatively low level of approximation until this year. Efforts are still needed in public procurement (where national preference has to be abolished), intellectual and industrial property and state aid. Rules on state aid to loss-making enterprises are still not satisfactory. These latter would amount to as much as 4,4% of Slovenia's GDP and they are not transparent, as there is no special monitoring institution. Administrative and judicial capacity has to be improved.

[50] Backé, P. & Radzyner, O., "The Introduction of the Euro: Implications for Central and Eastern Europe-The Case of Hungary and Slovenia", Österreichische Nationalbank, 1998.

- Slovenia is planning to implement a programme of price liberalisation before 2000. The country's main problems concern the enforcement of laws, and the proper functioning of institutions.

Of special importance with regard to EMU are two of the "four freedoms" in operation in the Internal Market without Frontiers:

- **Free Movement of Capital**. The liberalisation of capital movements has been very slow and the restrictive measures of the central bank hinder the alignment of legislation. By the time of *Agenda 2000*, the Slovenian economy had been hit by massive speculative capital inflows between 1992 and 1994, due to the high level of indexation of the economy and also due to positive inflation differential. The government responded by the introduction of capital controls in 1996, which was in contradiction to the (interim) Europe Agreement. Controls had already been introduced in 1995 on foreign non trade-related loans and early 1997 on portfolio investment. Since then, some measures have been taken in the fields of portfolio investment, external credits and loans. Following the entry into force of the **Europe Agreement**, some capital controls were eliminated by the Foreign Exchange Laws of March 1999. Major restrictions still remain on short-term capital movements. The authorities intend to complete full liberalisation of capital movements by 2001.
- **Free Movement of Services**. The new Banking Law of January 1999 allows foreign banks to open branches, and improves regulation and supervision. By the end of March 1999, the cartel agreement on maximum interest rates came to an end, allowing banks to compete for deposits. The June 1999 Securities Act allows foreign brokerage houses to operate in Slovenia. No progress has been made in insurance.

4 Main transition issues still to be resolved

- The Slovenian economy is suffering from the lack of competition in some sectors, especially in the **financial sector**. By the time of *Agenda 2000*, the banking sector was weakened by non-performing loans. Since then, Slovenian banks regained profitability and non-performing loans have declined. The sector performs its function sufficiently well but would not be able to cope with international competition. Efforts are needed to develop the insurance sector, as well as the money and capital markets. The government is planning to privatise the two state banks.
- **Enterprise restructuring** has been slow, because decisions are mostly taken by consensus. However, according to the *Economic Reform Monitor*[51], the privatisation of socially-owned enterprises has been completed in 1998; although 1/3 of total assets still belong to state owned-enterprises. Financial institutions and public utilities still have to be privatised. The links of banks with enterprises has often delayed restructuring.
- Wage growth has slowed down export growth and, in part, explains the low level of FDI in Slovenia. The country has a major **labour market problem**, as unemployment affects nearly 15% of the working population. Even if real wage growth is now declining, this has not yet helped the country to overcome its structural problems (long-term unemployment, low skills of the unemployed).

[51] European Commission, Economic and Financial Affairs Documentation, *European Economy*, Supplement C, "Economic Reform Monitor", No.2, May 1999.

- The 1998 *Regular Report* remarked that the profitability of Slovenian enterprises was improving: aggregate net profits were close to zero in 1997, with losses occurring essentially in state-owned enterprises and state institutions. The bankruptcy mechanism is working but remains cumbersome.
- One of the major challenges that the Slovenian government has to tackle, the reform of the pension system, has begun with the reaching of a multilateral agreement in May 1999. Legislation will follow in the last months of 1999.

5 Preferred exchange rate regime and preparations for EMU

- The **National Bank of Slovenia** is relatively independent, although the Governor is appointed by and responsible to Parliament. Its goal is the stability of the currency (which implicitly means price stability). The Law on the Central Bank is not compatible with the Treaty provisions of budget deficit financing, as the Slovenian National Bank can grant short-term loans to the government. But the sound fiscal record of the latter has prevented any such deficit financing from occurring.
- The **exchange rate regime** has been a managed float since mid-1992. The Slovenian Tolar has shadowed the Deutsche Mark, with a nominal depreciation against the DEM of 6.9% between Jan 1, 1996 and Dec 31, 1997. The National Programme for the Adoption of the *Acquis* stated that the policy objectives related to EMU accession implied the stabilisation of the exchange rate of the Tolar under the current floating exchange rate regime, followed by a regime change at the end of the pre-accession period or after accession. Slovenia has declared its intention to join ERM II at the same time or after EU accession[52].

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[52] Backé, P. & Radzyner, O., “The Introduction of the Euro: Implications for Central and Eastern Europe-The Case of Hungary and Slovenia”, Österreichische Nationalbank, 1998.

SLOVENIA

	1992	1993	1994	1995	1996	1997	1998 *	1999 **	2000 **	*Reference values Jan.1998*
Output										
GDP at constant prices (bn ECU)	9,70	10,83	12,09	14,33	14,85	16,05	17,45	17,89	18,42	
GDP growth rate at constant prices (%)	-5,5	2,8	5,3	4,1	3,3	3,8	3,9	2,5	3,0	
Monetary indicators										
M0 growth (%)	163,0	13,3	61,4	10,3	6,4	11,8	19,8	0,0 (May)	-	
M1 growth (%)	110,6	13,3	44,6	14,9	4,2	12,6	20,1	5,88 (May)	-	
M2 growth (%)	131,6	64,2	50,8	32,2	19,4	23,8	20,9	31,88 (May)	-	
Lending rate (% per annum, end-year)#	72,2	42,6	38,5	28,0	18,3	20,3	12,5	-	-	
Treasury bill rate (on tollar part of twin bills) (% p.a.)	50,9	30,2	26,3	19,4	10,3	14,5	8,7	-	-	
Foreign trade and exchange rates										
Exports growth (%)	72,7	-12,3	10,5	11,2	3,2	12,5	9,5	14,0	5,3	
Imports growth (%)	42,6	17,3	13,1	18,1	2,4	11,1	8,8	15,3	8,0	
Share EU trade: Exports (% of total exports)	-	42,6	59,2	67,0	64,6	63,6	65,5	-	-	
Share EU trade: Imports (% of total imports)	-	46,2	57,1	68,8	67,5	67,4	69,4	-	-	
Openness: exports and imports as % of GDP	107,9	97,2	97,3	94,2	93,5	96,6	96,9	108,4	-	
Current account (% GDP)	7,4	1,5	4,2	-0,1	0,2	0,2	0,0	-0,7	-0,5	
Exchange rate, Tollar per ECU, annual average	105,00	132,56	153,27	155,00	171,96	181,10	186,20	195,48 (June)	-	
Real Effective Exchange Rate index 1995=100	-	-	100,4	100	90,2	85,4	83,2	-	-	
Maastricht Criteria										
General government budget balance (% GDP)	0,2	0,1	-0,3	-0,5	-0,2	-1,1	-0,6	-0,7	-1,5	*3%*
Government debt (% GDP)	-	21,1	18,6	18,8	23,2	23,5	24,0	24,6	-	*60%*
Inflation rate: consumer prices, annual average (%)	207,3	32,9	21,0	13,5	9,9	8,4	7,9	7,0	6,0	*2,7%*
Long-term interest rates	-	-	-	-	-	-	-	-	-	*7,8%*
Other macro indicators										
Gross foreign debt (% GDP)	13,9	14,8	11,0+	11,0	19,1	12,9	15,2	-	-	
Unemployment rate, end-year, registered (%)	11,5	14,4	14,4	13,9	13,9	14,8	14,6	14	13,0	
FDI net inflow (mln ECU)	-	-	108,0	135,0	146,0	283,0	148,0	-	-	

Sources: Commission services, EBRD, Eurostat, IMF, WIIW, Bank of Slovenia.

* estimate ** projection or mid-year figure; except GDP, inflation, unemployment: WIIW forecasts June 1999 *** Erste Bank forecast +statistical break

For 1999: annual average replaced by middle-year (June) exchange rates: 1 Euro = 1,0378 US$ = 195,4837 SIT

For the monetary aggregates: May 1999 data converted with the exchange rate of 1 Euro = 193,7697 SIT

Short-term working capital

Bulgaria

Macroeconomic stabilisation is quite recent in Bulgaria, as necessary reforms were not undertaken before the election of a new government, in 1997. After the deep recession of 1996-1997, growth recovered in 1998, amounting to 3,4%. However, this year, the spillovers from the Kosovo-crisis are likely to hamper economic growth, especially because of increased transport costs and the decline in regional trade. Forecasted growth for 1999 is 1.5%.

Main indicators of economic structure (1998)	
Capital city	Sofia
Currency	Lev (BGL)
Total area	110 993 km2
Population	8,3 mln
GDP at current prices	11 bn EUR
GDP per head	1300 EUR
GDP per head, as % of EU average	7%
GDP per head at PPP	4600 EUR
GDP per head, as % of EU average, at PPP	23%
Structure of production	
Agriculture (% GDP)	21.1
Industry (% GDP)	25.0
Construction (% GDP)	3.7
Services (% GDP)	50.2
External debt (% GDP)	65.7%
Exports/GDP (%)	45.2%
Stock of FDI	1.3 bn EUR
Stock of FDI per head	160 EUR
Monetisation of the economy (M2/Y)	63%

Source: Commission services, national sources, EBRD, WIIW, Erste Bank.

1 Phasing and time-scale of the accession process

- July 1993: EFTA membership
- December 14, 1995: application for membership of the EU
- February 1995: Europe Agreements entered into force
- December 1996: WTO membership
- 20 March 1998: Accession Partnership –Council Regulation 622/98, OJ L 85
- 30 March 1998: Bulgaria presented its first National Programme for the Adoption of the *Acquis* to the Commission; a second programme followed in May 1999.
- January 1, 1999: full member of the Central European Free Trade Association

Copenhagen Criteria

Agenda 2000[53] was very cautious, stating that Bulgaria was not yet ready to cope with competitive pressures and market forces within the Union. According to the 1998 and 1999 *Regular Reports*[54], Bulgaria will not be able to fulfil the Copenhagen economic criteria in the medium term, as competitive pressures and market forces within the union would be unsustainable for the country. Nevertheless, if the government perseveres in its policies, further progress will certainly materialise, allowing the criteria to be fulfilled in the long run. The European Commission proposed on October 13, 1999, that accession negotiations should be opened with Bulgaria, on the condition that the Bulgarian authorities accept the closure of some units of the Kozloduy nuclear power plant.

Opinion of independent commentators

Bulgaria is one of the "second wave" countries and, in our opinion, accession is not likely within the next ten years. Bulgaria will probably enter the EU by the end of the next decade.

2 Prospects of meeting the Maastricht criteria

As noted in *Agenda 2000,* the Maastricht convergence criteria[55] are not a precondition for membership; they are only a condition for participating in the final phase of EMU. The Commission was not able, in 1997, to draw any conclusions about Bulgaria meeting these criteria by the time of its accession. The current situation with regard to these criteria can be summarised as follows[56]:

- **Inflation**, which had been very high until 1997, has been substantially reduced by a currency board arrangement; the fall in international commodity and energy prices also helped in the decline in inflation. The 1998 end-year inflation rate was 1% (against 16% projected), which is well within the limits of the Maastricht criterion. The further development of the inflation rate is likely to be affected by two decisions taken this year by the Bulgarian authorities: the Law on Prices, which provided the legal basis for state intervention, was abolished in July 1999 and the liberalisation of energy prices has been planned for the year 2001.

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[53] Commission of the European Union, Brussels, "Agenda 2000", 1997.

[54] European Commission, "Regular Report from the Commission on Bulgaria's Progress towards Accession", 1998 and 1999.

[55] - ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1.5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

- ***The Interest Rate Convergence Criterion:*** the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);

- ***The ERM Criterion:*** the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

- ***The Budget Deficit Criterion***: a country's budget deficit should not exceed 3% of its GDP;

- ***The Stock of Debt Criterion***: the stock of outstanding government debt should not exceed 60% of that country's GDP.

[56] European Commission, Economic and Financial Affairs Documentation, *European Economy*, Supplement C. "Economic Reform Monitor", No.2, May 1999.

- There are no **long-term interest rates** yet in Bulgaria; Treasury Bills have a maximum maturity of one year. However, short-term interest rates have markedly declined, in line with the decrease in inflation, but also due to the inflow of foreign currency associated with FDI and portfolio investment, as well as due to the increased confidence of the Bulgarian people in the Leva. The improved fiscal position of the government also played a role. This trend is likely to continue in the next few years.
- The **budget deficit** has remained below the level of 3% since 1997. This has mainly been caused by restrained expenditures, relatively low interest rates and unexpectedly high revenues. These latter were due to a change in tax legislation and improved tax collection. Bulgaria even recorded a surplus of 0.9% of GDP (forecast 1,7%) in 1998. The 1999 budget incorporates a 2,8% budget deficit, 1% of GDP being allocated to cover enterprise sector reform.
- **Public debt** has also been steadily declining since 1992 (when it was at a level of 160% of GDP), but remains well above the benchmark value of the Maastricht criterion: it amounted to 76% of GDP in 1998.
- The economic crisis of the years 1996-1997 has been accompanied by a devaluation of the Bulgarian Lev by more than 300%. Since 1997, the domestic currency has been pegged to the DEM and to the EUR as from January 1999. The fixed exchange rate operates under a **currency board regime**.

Summarising, Bulgaria presently complies with the inflation and the budget deficit criteria. It is moving forward in the right direction with regard to the public debt criterion.

3 Main elements of the *Acquis* to be completed

The implementation of the *Acquis* has accelerated recently but, because of the weakness of public administration, application of legislation remains insufficient.

- *Agenda 2000* concluded that Bulgaria had met its obligations under the **Europe Agreements**, respecting fully the timetable for implementation.
- However, only a few parts of the **White Paper on the Single Market** had been implemented before 1999. At the time of *Agenda 2000*, the results concerned the free circulation of goods. In 1998, progress had been made in meeting the short-term priorities of the Accession Partnerships[57]: intellectual and industrial property, financial services, taxation, and legislative framework for state aid and competition law. The new Law on the Protection of Competition of May 12, 1998 provided a legal basis for anti-trust rules.
- The 1999 *Regular Report* notes that Bulgaria has progressed in the fields of internal market legislation, of which intellectual property, standardisation and certification. In August 1999 a new law on public procurement was adopted. VAT and excise taxes have also been introduced.
- No progress has been made in data protection and state aid. Progress in the field of energy has been highly insufficient.
- Enforcement is still too weak. Nevertheless, Bulgaria recently transposed the legal framework necessary for setting up institutions able to apply EU law.

Of special importance with regard to EMU are two of the “four freedoms” in force in the Internal Market without Frontiers:

[57] Commission of the European Union (1998).

- **Free Movement of Capital**. The Lev is convertible for current account transactions. Outward capital transactions are subject to licensing, while there is no discrimination on inward investment. Joint ventures, as well as foreign enterprises are allowed to buy land.
- **Free Movement of Services**: Bulgaria has made a rapid progress in the approximation of legislation, especially on banking supervision, prudential regulations and enforcement capacity. Noticeable progress has also been made in the insurance market, but this market is still underdeveloped, with negligible competition. The Bulgarian Stock Exchange started its operations in 1998. In March 1999, an amendment to the Law on Securities was adopted.

4 Main transition issues still to be resolved

- While stabilisation has been achieved in recent few years, **restructuring** is too slow, as are bankruptcy and liquidation procedures. State-owned monopolies are still subject to insufficient financial discipline and are piling up tax arrears.
- **Privatisation** has also not progressed fast enough. The state still plays an important role in economic life as only 30% of the assets in state-owned enterprises were privatised by the end of 1998. However, the process has accelerated recently: amendments to the Privatisation Law were introduced by the end of 1998 and the government is planning to privatise all commercial enterprises and a substantial number of utilities by the end of 1999 (which represents 70% of the assets subject to privatisation). In July, the Bulgarian Telecommunications Company was successfully privatised.
- The restructuring of the **banking sector** has to be completed: since the proper application of bankruptcy procedures, the financial position of the remaining banks has improved. Privatisation started in 1997 and new regulations were adopted to improve the soundness and performance of the banking system. Non-performing loans have declined. However, the role of banks as financial intermediaries is still very weak. Two of the six remaining state banks were privatised last year, three others are due to be privatised before the end of 1999.
- The **agricultural sector** also badly needs restructuring. Ownership rights have become clearer since ¾ of land has been subject to restitution to previous owners. The liberalisation of food prices in 1997 has had substantial positive effects on production.
- Reform of **public administration** must not be delayed as fighting corruption and enforcing laws deserve to be top priorities on Bulgaria's agenda.
- Last but not least, **trade liberalisation** has been pursued, with the elimination of the import surcharge, the reduction in tariffs, and the improvement of transparency.

5 Preferred exchange rate regime before and after accession

- Bulgaria adopted a fixed exchange rate under a **currency board regime**, as part of a 1-year stand-by agreement with the IMF. This rate was fixed on July 1, 1997 as 1000 BGL (Bulgarian Leva) were set equal to 1 DM. The exchange rate of the Lev was fixed to the EURO on December 31, 1998. 1 EURO is equivalent to 1955, 83 BGL. A new currency unit, the New Lev was introduced on July 1, 1999, one new Lev replacing 1000 old ones.

- **The Bulgarian National Bank** is formally independent from the government with regard to the appointment of the Governor as well as with regard to the conduct of monetary

policy[58]. In June 1997 the Law on the National Bank strengthened the bank's independence and supervisory role, adapting its functions to the currency board. The currency board fixes the volume of Leva in circulation to the central bank foreign exchange and gold reserves. The currency board regime meant the end of deficit financing by the central bank; this latter is explicitly prohibited by the 1998 Banking Law. It also introduced financial discipline for the commercial banks, which could no longer be bailed-out by the National Bank of Bulgaria. However, the use of a currency board does not give the Bulgarian Central Bank the ability to learn to conduct monetary policy using market instruments and to target price stability.

- **Preparations for EMU.** The Bulgaria National Bank sees joining the Eurozone as "the natural way out" from the currency board[59]. This latter facilitates macroeconomic stabilisation and convergence to the Maastricht criteria. The strong peg to the Euro provided by the currency board would render a passage through ERM-II unnecessary. According to the BNB, the optimal path for Bulgaria would be to start preparing participation in the Eurozone, as soon as the country has become a member of the EU.

[58] European Parliament, Task Force on Economic and Monetary Union, EMU and Enlargement, Briefing 38 prepared by the Directorate-General for Research, Luxembourg, May 1999.

[59] Roumen Avramov, "The Role of Currency Boards in Financial Crises: The Case of Bulgaria", Bulgaria National Bank, June 1999.

BULGARIA

	1992	1993	1994	1995	1996	1997	1998*	1999**	2000**	2001***	*values Jan.1998*
Output											
GDP growth rate at constant prices (%)	-7,3	-1,5	1,8	2,1	-10,1	-6,9	3,4	-2,0	2,0	3,5	
Monetary indicators											
M0 growth (%)	53,8	37,7	52,8	60,0	105,4	938,8	32,6	-10,1 (March)	-	-	
M1 growth (%)	40,5	27,8	55,5	43,7	119,3	868,0	23,4	-4,3 (March)	-	-	
M2 growth (%)	53,6	47,6	78,6	39,6	124,5	359,3	17,9	-12,7 (March)	-	-	
Lending rates (< 1year) (% p.a., end-year)	64,6	83,7	117,8	51,4	480,8	6,7	-	-	-	-	
Treasury bill rate (< 1year) (% p.a., end-year)	-	58,4	92,0	42,7	477,2	7,9	-	-	-	-	
Foreign trade and exchange rates											
Exports growth (%)	1,70	-5,10	7,10	34,40	-8,70	0,50	-8,16***	11,1***	15,0***	15,2	
Imports growth (%)	27,60	6,50	-12,00	35,20	-10,30	-3,70	-2***	-2,0***	14,6***	20,0	
Current account (% GDP)	-9,30	-12,80	-2,10	-0,50	1,20	4,20	-1,20	3,90***	4,50***	-4,70	
Share EU trade: Exports (% of total exports)	-	29,9	35,4	37,6	39,1	43,2	49,7	-	-	-	
Share EU trade: Imports (% of total imports)	-	34,2	32,5	37,2	35,1	37,7	45,0	-	-	-	
Openness: exports and imports as % of GDP	94,4	77,4	81,8	73,5	98,8	92,8	85,9	-	-	-	
Nominal exchange rate, Leva per ECU, annual average	30,27	32,41	64,59	86,83	191,65	1901,32	1921,39 (June)	-	-	-	
Real Effective Exchange Rate, index 1995=100	-	98,50	89,20	100,00	86,10	105,10	122,4 (Nov)	-	-	-	
Maastricht Criteria											
General government budget balance (% GDP)	-5,2	-10,9	-5,8	-6,4	-13,4	-2,6	0,9	-2,5***	-1,5***	-1,0	
Public debt (%GDP) excl. public enterprises debt	160,5	149,4	149,9	106,4	111,8	104,4	76,0 (Sept)	-	-	-	*60%*
Gross foreign public debt (% GDP) excl. public enterprises debt	140,4	115,1	107,2	69,1	89,8	89,8	64,6 (Sept)	-	-	-	*-3%*
Inflation rate: consumer prices, annual average(%)	82,0	73,0	96,3	62,0	123,0	1082,0	22,3	6,6	7,0 ***	6,5	*2,7%*
Long term interest rates	-	-	-	-	-	-	-	-	-	-	*7,8%*
Other macro indicators											
Unemployment rate, end-year, registered (%)	15,3	16,4	12,8	11,1	12,5	13,7	12,2	14,5	15,5	14,0	
Gross external debt (% GDP)	-	-	60,3	47,5	55,6	87,5	67,7	-	-	-	
FDI net inflow EBRD data (mln ECU)	32,4	34,2	88,2	62,7	78,7	438,3	324,7	963,6	-	-	

Sources: Commission services, EBRD, Eurostat, IMF, Bulgarian National Bank, Erste Bank.

* estimates ** projections or mid-year figures; except GDP, unemployment: WIIW forecasts June 1999 *** Erste Bank forecasts

For 1999: annual average replaced by mid-year (June) exchange rates: 1 EUR = 1,0378 US$

Latvia

Latvia's economy, still highly dependent on Russia, has suffered greatly from the financial crisis of autumn 1998. Merchandise trade with Russia has been cut by half, affecting not only the export industries, but also the transport sector, which represents a major part of the country's economy. Banks have also been severely hit, but the sector as a whole proved that it was able to survive. Real growth has slowed down, from a healthy 8,6% in 1997, to 3,6% in 1998. As industrial output contracted, in the second half of 1998 and the first half of 1999, unemployment rose, reaching 10% in March 1999. According to the European Commission, in its latest *Regular Report*, the Latvian government has responded to the crisis with a relatively appropriate policy mix.

Main indicators of economic structure (1998)	
Capital city	Riga
Currency	Lat
Total area	64 590 km2
Population	2,5 mln
GDP at current prices	5,62 bn EUR
GDP per head	2248 EUR
GDP per head, as % of EU average	11%
GDP per head at PPP	5500 EUR
GDP per head, as % of EU average, at PPP	28%
Structure of production	
Agriculture	4.7 % GDP
Industry	24.3 % GDP
Construction	5.2 % GDP
Services	65.8 % GDP
Gross foreign debt/GDP	10,8%
Exports/GDP	47,7%
Stock of FDI	1,4 bn EUR
Stock of FDI per head	561 EUR
Monetisation of the economy (M2/Y)	25%

Source: Commission services, national sources, EBRD, Erste Bank.

1 Phasing and time-scale of the accession process

- October 27,1995: application for membership of the European Union
- January 1, 1995: Free Trade Agreement with the European Union
- June 1996: EFTA membership
- December 1996: National Programme for the implementation of the White Paper on the Internal Market
- February 1998: entry into force of the Europe Agreement (signed in June 1995)
- March 1998 and June 1999: National Programmes for the Adoption of the *Acquis*
- Member of the Baltic Free Trade Association and of the WTO

Copenhagen Criteria

In *Agenda 2000*[60], the European Commission remarked that Latvia had made much progress on its way towards becoming a market economy: stabilisation had successfully been completed and prices and trade were already largely liberalised. Nevertheless, the poor administrative infrastructure and the slow restructuring of the economy led to the overall conclusion that Latvia would not be able to cope with competitive pressure and market forces within the Union in the medium run. As to the third stage of EMU, it was also premature to judge whether Latvia, by the time of its accession would be able to join.
One year later, the improvement of Latvia's record was such that the *Regular Report*[61] concluded that "provided Latvia continues with its reform agenda, it should be able to make the progress necessary to cope with the competitive pressures and market forces within the Union in the medium term". The European Commission proposed on October 13, 1999, that accession negotiations should be opened with Latvia.

Opinion of the Latvian Government

The Latvian Government has recently stated that "Latvia must be able to join the EMU at the time of its accession to the EU"[62].

Independent commentators

Latvia is one of the "second wave" countries. It's accession process is likely to gain speed in the coming years, enabling Latvia to accede to the EU in 2005 or 2006.

2 Prospects meeting the Maastricht criteria

As noted in *Agenda 2000*, the Maastricht convergence criteria[63] are not a precondition for membership; they are only a condition for participating in the final phase of EMU. The Commission was not able, in 1997, to draw any conclusions about Latvia meeting these criteria by the time of its accession. The latest economic developments are taken from the

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[60] Commission of the European Union, Brussels, "Agenda 2000, The Effects on the Union's Policies of Enlargement to the Applicant Countries of Central and Eastern Europe", 1997.

[61] Commission of the European Union "Regular Report from the Commission on Latvia's Progress Towards Accession", 1998.

[62] *Latvia's Contribution to the Regular Report from the Commission on Latvia's Progress Towards Accession (National Progress Report)*, Riga 1999.

[63] - ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1.5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

- ***The Interest Rate Convergence Criterion:*** the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);
- ***The ERM Criterion:*** the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;
- ***The Budget Deficit Criterion***: a country's budget deficit should not exceed 3% of its GDP;
- ***The Stock of Debt Criterion***: the stock of outstanding government debt should not exceed 60% of that country's GDP.

Economic Reform Monitor[64] of the European Commission's Directorate General for Economic and Financial Affairs and from the opinion of the Bank of Latvia[65].

- **Inflation** fell rapidly during 1998, due, largely, to external causes. Year-on-year inflation reached 2,1% in August 1999, and even this low figure was mainly caused by the increase in administered prices. The Bank of Latvia predicts that the country, which has already the lowest inflation rate among CEEC, could reach a stable rate below 3% in a couple of years. Medium-term inflation targets are determined by the Bank of Latvia, using the Maastricht criteria as long-term goals.
- There are no **long-term interest rates** yet in Latvia. By 1997, the withdrawal of the government as a major borrower from the commercial banking sector had encouraged a decline in interest rates. During 1998, monetary policy was slightly tightened: broad money decreased and interest rates increased to 16.4 and 15.3% for short and long-term domestic currency loans respectively. The Bank of Latvia expects interests rates to come down significantly in the coming years, as inflation continues to decline and as confidence in the government's economic policy grows.
- The **government balance** (including privatisation proceeds) has recorded a surplus of 0.3% of GDP, thanks to growing tax revenues in the first half of 1998. These were due both to cyclical (GDP growth) and to permanent factors (increases in excise taxes and improved tax collection). After the Russian crisis, this favourable budgetary development went into reverse, with increasing expenditures and decreasing revenues. While the government budget for 1999 foresaw a deficit of 2.8% of GDP, the height of this deficit is now expected to be 3.5%, after a sharp cut in expenditures decided in August. Nevertheless, the Government has the intention of managing fiscal deficits "within the defined limits of the Maastricht Treaty"[66].
- **Public debt** is low: its level amounts to 12% of GDP.
- Latvia has maintained a basket peg exchange rate regime. The national currency, the Lats, is pegged to the SDR basket of currencies and has remained relatively stable with regard to the ECU since 1993. Downward pressures on the Lats followed the Russian financial crisis. Renewed pressures were recorded in the summer of 1999, due to the importance of the budget deficit.

According to Einars Repse, Governor of the Bank of Latvia, the Bank of Latvia does not accept as a general principle that "CEEC are not expected to join the monetary union at the time of their accession to the EU", nor that "the Maastricht criteria have been intended for (…) 'developed' economies and could not be fully applied to pre-accession countries" [67]. Furthermore, the Governor states that the policies of the Bank aim at achieving the Maastricht criteria, considered as principles of sound economic policy, by the time of Latvia's accession. Latvia complies with three out of the five Maastricht criteria (fiscal criteria and exchange rate stability). The inflation rate is also very close to the Maastricht benchmark.

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64 European Commission, Economic and Financial Affairs Documentation, *European Economy*, Supplement C. "Economic Reform Monitor", No.2, May 1999.

65 Einars Repse, Governor of the Bank of Latvia, "The Implications of EMU for the Policies of the Bank of Latvia", 12th Annual European Finance Convention, November 23-27, 1998, Vienna, Austria.

66 *Latvia's Contribution to the Regular Report from the Commission on Latvia's Progress Towards Accession (National Progress Report)*, Riga 1999.

67 Einars Repse (1998).

3 Main elements of the *Acquis* to be completed

- Latvia has been keen to make the necessary efforts: meeting its obligations under the Free Trade Agreement and even approximating some legislation under the **Europe Agreements** before they even came into force.
- By the time of ***Agenda 2000***, Latvia was progressing in the field of **Single Market** legislation. However, much still had to be done in, among others, the areas of intellectual property rights, public markets, personal data, competition (especially the transparency of state aids) and taxation. The European Commission emphasised the deficiencies of the public administration, which was not able to implement and enforce correctly the new laws. The *Acquis* will be most difficult to implement in agriculture and the environment.
- In the ***Regular Report* of 1998**, the European Commission noted special progress in competition, with the new Competition Law of January 1, 1998 and the law on state aid, which both are very close to the EU requirements. Some improvements could nevertheless be made in increasing the transparency of state aid. Latvian administrative infrastructure has also improved and is now able to function in a satisfactory way in a number of fields.
- According to the **1999 *Regular Report***, Latvia has made steady progress in the fields of free movement of goods (standards and certification), competition and state aid. Efforts are still needed in the domains of free movement of persons (mutual recognition of diplomas), data protection, telecommunications, agriculture and fisheries, health and safety at work, customs, regional policy and financial control. As concerns public procurement, preference clauses are still applied.

Of special importance with regard to EMU are two of the “four freedoms” in force in the Internal Market without Frontiers:

- **Free Movement of Capital.** The national currency is fully convertible since the date of its introduction. Latvia has a regime of free movement of money and capital. The provisions for the free movement of capital are thus in line with the EU requirements. However, foreign investors are not allowed to own more than 49% of capital in logging, radio, television and gambling activities, which is not compatible with Art.67 of the Europe Agreements. Other restrictions concern the acquisition of land by foreigners and outward portfolio investment by insurance companies and pension funds. No further liberalisation has taken place in 1999.
- **Free Movement of Services:** Latvia has progressed in legislative alignment on the banking sector. The consolidated supervision of credit institutions has been introduced in January 1999. New laws in the fields of securities and insurance have entered into force in 1998. However, supervision still needs to be strengthened in the insurance sector. The restrictions regarding the establishment of foreign branches still need to be lifted.

4 Main transition issues still to be resolved

- The **strong dependency on Russia** is one of the weaknesses of the Latvian economy. Latvia relies heavily on shipping goods from Russia to the West and the transit sector was much affected by the recent Russian crisis.
- So was the **banking sector**, with overall losses of 79 million ECU in 1998. The central bank has had to close three banks following the Russian crisis. The causes of this weakness were multiple: the Russian default on Treasury bills, in which the Latvian banks had invested, the repercussion of the losses of Latvian enterprises exporting to

Russia and the provisioning requirements imposed by the central bank on non-OECD assets in the wake of the crisis.

- However, the **service sector**, which was strongly exposed to Russia, managed to survive. The growth of this sector is one of the strengths of the Latvian economy. Indeed, transit companies benefit from the geographical position of Latvia, between Russia and the EU, as well as from the good infrastructure of the country. The 1998 *Regular Report* states that it is an important source of competitiveness.
- **Privatisation** has accelerated, with the setting of a deadline for the privatisation of 98% of former state-owned enterprises by July 1, 1999. Most of the state-owned enterprises had effectively been privatised by the end of 1998, but the European Commission thought some delays would be probable in sensitive sectors.
- The **financial sector** is expanding (banks, as well as leasing and insurance companies). Banks' non-performing loans are declining, amounting to 8% of portfolios in 1998. The strong development of the Riga stock exchange has slowed down, however, and eventually reversed after last August's financial crisis. The sector recovered in the second half of 1999 and has been subject to consolidation. The Russian crisis has led to the tightening of prudential regulations.

5 Preferred exchange rate regime and preparations for EMU

- The **Bank of Latvia** is independent, as are the Bank's Board members, according to the Law on the Bank of Latvia. The Governor is appointed by Parliament (the Saeima). The Bank's statutory objective is price stability, to be reached by the control of money in circulation. In 1998, banking supervision was enforced, with stricter disclosure requirements and new standards of internal control. Stricter capital adequacy requirements (forcing banks to take into account market and foreign exchange risk) will be implemented at the end of 1999[68]. The Law on the Bank of Latvia is in line with the Treaty provisions on the financing of government deficits.
- **Exchange rate regime**: The Lat is pegged to the SDR basket of currencies. The Bank of Latvia is satisfied with this choice, because the basket is less prone to damaging fluctuations than a single currency, and it is more representative of Latvia's foreign trade (47% in USD and only 33% in Euro-currencies in 1998). The importance of Latvia's trade with the EU (54%) hides the fact that one third of it occurs with three of the "outs": the UK, Denmark and Sweden. This means that Latvia will be very cautious in switching to a Euro-peg, watching carefully "for possible changes in the behaviour of foreign trade agents and, equally important, closely follow[ing] the performance of the Euro in world financial markets"[69]. The Bank of Latvia will be prepared to take this step in due time, but has no intention of changing the peg in the near future.

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[68] European Parliament, "EMU and Enlargement", 19 May 1999.

[69] Einars Repse (1998).

LATVIA

	1992	1993	1994	1995	1996	1997	1998 *	1999 **	2000 **	2001***	Reference values Jan.1998
Output											
GDP growth rate at constant prices (%)	-34,9	-14,9	0,6	-0,8	3,3	6,5	3,8	4,0	2,0	4,5	
Monetary indicators											
M0 growth (%)	-	-	-	-3,5	25,3	38,3	4,8	8,2	-	-	
M1 growth (%)	-	-	-	-	-	44,8	3,6	6,5	-	-	
M2 growth (%)	169,9	84,1	47,7	-23,1	19,9	38,7	5,9	11	-	-	
Lending rate: <1 year (% per annum, end-year)	-	70,78	36,71	31,13	20,29	12,06	16,39	-	-	-	
Treasury bill rate (3 months maturity) (% p.a., end-year)	-	-	21,5	33,4	10,1	3,6	7,5	-	-	-	
Foreign trade and exchange rates											
Exports growth (%)	-	46,04	-4,58	21,78	12,03	38,34	12,28	7,2***	10,1***	10,7	
Imports growth (%)	-	38,69	23,78	33,99	20,92	31,59	19,39	7,6***	9,5***	8,2	
Share EU trade: Exports (% of total exports)	-	24.4	27.9	44.0	44.7	48.9	56.6	64,8 (Q1)	-	-	
Share EU trade: Imports (% of total imports)	-	17.1	24.9	49.9	49.2	53.2	55.3	55,8 (Q1)	-	-	
Current account (% GDP)	1,7	14,40	-0,20	-3,60	-4,20	-6,20	-11,20	-9,00	-9,5***	-9,0	
Openness: exports and imports as % of GDP	109,3	96,1	64,3	74,8	73,4	81,7	82,7	-	-	-	
Exchange rate, Lats per ECU, annual average	0,87	0,78	0,67	0,69	0,70	0,66	0,66	0,63 (June)	-	-	
Real Effective Exchange Rate index 1993=100	-	100	150,7	301,6	331,8	349,4	540,7	-	-	-	
Maastricht Criteria											
General government budget balance (% GDP)	-0,8	0,6	-4,0	-3,3	-1,4	1,3	0,2	-2,0	-0,5***	-0,5	*3%*
Public debt (% GDP)	-	-	14,6	15,3	14,2	11,2	12,0	-	-	-	*60%*
of which foreign debt (% GDP)	-	-	9,9	9,1	8,1	7,3	7,0***	7,0***	6,0***	5,0***	
Inflation rate: consumer prices, annual average (%)	951,0	108,0	36,0	25,0	17,6	8,4	4,7	2,5	4,0	4,1	*2,7%*
Long-term interest rates	-	-	-	-	-	-	-	-	-	-	*7,8%*
Other macro indicators											
Gross foreign debt (% GDP)	-	-	10,2	12,3	10,2	9,0	10,8	-	-	-	
Unemployment rate, end-year, registered (%)	3,9	8,7	16,7	18,1	19,4	14,8	9,2	-	-	6 (2003)	
FDI net inflow (mln ECU)	33,1	43,6	130,3	186,5	296,1	454,1	178,4	289,1	-	-	

Sources: Commission services, EBRD, Eurostat, IMF, Erste Bank Bank of Latvia.

* estimate ** projection or mid-year figure; except GDP, inflation, unemployment: WIIW forecasts June 1999 *** European Commission-Latvia Joint Assessment of Economic Priorities of Latvia

For 1999: annual average replaced by mid-year (June) exchange rates: 1 EUR = 1,0378 US$

For March 1999: exchange rate set by the Bank of Latvia: 1 EUR = 0.6326730 Lats

Lithuania

GDP growth has remained healthy in Lithuania in 1998, as it amounted to 5.1%; but this aggregate figure hides the strong deceleration of the growth the country experienced in the last quarter of the year, caused by a steep decline in exports to Russia. This external trade shock caused a decline in industrial production as well as a surge in unemployment. The first quarter of 1999 showed a continued output drop equivalent to a negative growth of 5.7% on a year-on-year basis. The Lithuanian authorities responded to the economic slowdown by loosening fiscal policy and using privatisation revenues for one-off expenditures. This policy mix has led the country to a situation of external imbalance, which needs to be tackled rapidly.

Main indicators of economic structure (1998)	
Capital city	Vilnius
Currency	Litas
Total area	65 300 km2
Population	3,7 mln
GDP at constant prices	9,34 bn EUR
GDP per head	2524 EUR
GDP per head, as % of EU average	12%
GDP per head at PPP	6200 EUR
GDP per head, as % of EU average, at PPP	31%
Structure of production	
Agriculture (% GDP)	10.1%
Industry (% GDP)	23.6%
Construction (% GDP)	7.9%
Services (% GDP)	58.3%
Gross foreign debt/GDP (%)	15%
Exports/GDP (%)	47,4%
Stock of FDI	1,3 bn EUR
Stock of FDI per head	355 EUR
Monetisation of the economy (M2/Y)	19,5%

Source: Commission services, national sources, EBRD, WIIW, Erste Bank.

1 Phasing and time-scale of the accession process

- January 1995: EFTA membership
- December 1995: application for membership of the European Union
- February 1998: entry into force of the Europe Agreement, replacing the Free Trade Agreement, in force since 1995
- March 1998 and June 1999: National Programmes for the Adoption of the *Acquis*
- Membership of the Baltic Free Trade Area, application for CEFTA membership, negotiations for WTO membership (probably by 2001).

Copenhagen criteria

The European Commission considered, in *Agenda 2000*[70], that Lithuania had made considerable progress in the creation of a market economy. However, progress was still needed in the fields of price adjustments, privatisation and bankruptcy procedures, in order to comply with this Copenhagen criterion. The enforcement of financial constraints for enterprises remained a major drawback. As for economic and monetary union, it was also considered to pose problems in the medium term. The 1999 *Regular Report*[71], updating the Commission's 1997 Opinion, concluded that Lithuania will "be able to cope with competitive pressures and market forces within the Union in the medium-term, provided it completes the remaining reform agenda".
The European Commission proposed on October 13, 1999, that accession negotiations should be opened with Lithuania.

Opinion of the Lithuanian Government
The country's authorities expect Lithuania to be able to peg its currency to the Euro between 2002-2005. However, this is not necessary synonymous with participation in EMU's stage three.

Independent commentators
Lithuania is currently one of the "second wave" countries. Accession is likely to take place between 2005 and 2008.

2 Prospects of meeting the Maastricht criteria

As noted in *Agenda 2000*, the convergence criteria[72] are not a precondition for membership; they are only a condition for participating in EMU. The Commission was not able, in 1997, to draw any conclusions about Lithuania meeting these criteria by the time of its accession. The latest economic developments are taken from the *Economic Reform Monitor* of the European Commission's Directorate General for Economic and Financial Affairs:

- **Inflation** has been dropping since early in the transition process. It continued its steep decline last year, mainly due to the trade shock and to the excess supply of some products (agricultural products essentially), both of which have their roots in the contraction of exports following the Russian financial crisis of August 1998. While average inflation for

[70] Commission of the European Union, Brussels, "Agenda 2000", 1997.

[71] Commission of the European Union "Regular Report from the Commission on Litany's Progress Towards Accession", 1999.

[72] - ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1.5% the average inflation rate of the three best-performing countries;

- ***The Interest Rate Convergence Criterion:*** the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate;

- ***The ERM Criterion:*** the currencies of future EMU members should have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

- ***The Budget Deficit Criterion***: a country's budget deficit should not exceed 3% of its GDP;

- ***The Stock of Debt Criterion***: the stock of outstanding government debt should not exceed 60% of that country's GDP.

1998 still amounted to 5.1%, year-on-year figures for August 1999 showed a decrease of 0.2%, despite a rise in excise taxes and in administered prices.

- ▲ There are no **long-term interest rates** in Lithuania yet. Short-term rates have shown a regular decline until last year's financial crisis, and are likely to resume their downward path. On February 1, 1999, the first auction of government bonds with a 2-year maturity took place.
- ▲ Until the 1998 *Regular Report,* the European Commission lauded Lithuania for its relatively prudent fiscal policy. Indeed, the **government deficit** was 1.8% of GDP in 1997. Fiscal policy became more expansionary in the second semester of 1998, as privatisation revenues were included in the general budget. These were used especially to set up a savings restitution fund to compensate households for the losses they had incurred in the first years of transition. While the central government's deficit still remained reasonable (2%), the total public sector deficit however, was as high as 5.8% of GDP in 1998. In the first quarter of this year budget revenues appeared to be lower than expected; as a consequence, expenditures have been revised downward. However, even in the most optimistic case, the 1999 budget deficit will not be lower than 5% of GDP. The authorities have nevertheless kept their short-term priority of balancing the State budget in the year 2000[73].
- ▲ **Public debt** is relatively low (17% of GDP). However, the recent stance of fiscal policy and especially the use of privatisation revenues to cover one-off expenditures, reduced the net worth of the public sector. As the European Commission points out, the slowdown of GDP growth reduces the amount of debt that can be raised without increasing the debt to GDP ratio. Lithuania has expressed the medium-term priority of keeping its debt below 24% of GDP.
- ▲ The **stability of the currency** is guaranteed by a currency board arrangement, which has linked the Litas to the US dollar since 1994.

Summarising, Lithuania is only able to comply with the public debt criterion in the short-run; the inflation criterion could also be within reach in the short run.

3 Main elements of the *Acquis* to be completed

- ▲ Lithuania had approximated some legislation under the **Europe Agreements** before they even came into force. The country has complied with its obligations under the Free Trade Agreement according to the timeframe set out in it.
- ▲ By the time of *Agenda 2000*, Lithuania had progressed in the compliance with the **Single Market** legislation. However, progress was still needed in the following fields: intellectual property rights, public markets, liberalisation of capital markets, financial services, taxation and competition. The public administration appeared to be still too weak for the proper enforcement of legislation.
- ▲ **Other aspects of the *Acquis*** were not due to pose major problems, except for statistics, fisheries, telecommunications and customs. Substantial efforts were considered necessary for energy, agriculture and the environment –in this latter, full compliance to the *Acquis* will not be possible in the medium-term. Major efforts were also needed in justice and home affairs, in order to comply with the *Acquis.*

[73] Fragment from "Lithuania's EU Accession Programme (National Programme for the adoption of the Acquis)", May 1999.

- The **1999 *Regular Report*** notes that Lithuania has progressed in the fields of public procurement, intellectual property, company law and auditing. However, effective implementation, especially for copyrights, is lacking. Progress has been recorded as well in competition, with the entry into force of a new law, in April 1999, closely aligned to the Acquis. Lithuania has also made some remarkable progress in the areas of environment and (nuclear) energy. Further efforts are still necessary in the fields of standardisation, market surveillance and taxation. State aids appear to be a major problem, as the legal framework is not yet aligned.

Of special importance with regard to EMU are two of the “four freedoms” in force in the Internal Market without Frontiers.

- **Free Movement of Capital:** Full current account convertibility had already been introduced in 1994. There are no restrictions on inflow or expatriation of capital by companies. Some restrictions subsist on inward investment in sensitive sectors or on acquisition of land by non-residents.
- **Free Movement of Services:** Lithuania has progressed in meeting the *Acquis* in the area of financial services. The 1997 new Banking Law enabled the Bank of Lithuania to complete prudential regulations and in January 1998 supervision was consolidated and anti-money laundering measures were taken. Lithuania has started implementing the capital adequacy directive. The year 1999 saw the continued approximation of the Banking Directives, as well as the introduction of prudential regulations in insurance.

4 Main transition issues still to be resolved

- **Privatisation** has accelerated under the current government. A new privatisation law and a new bankruptcy law came into effect in autumn 1997. Some important banks and big enterprises have recently been privatised. The number of bankruptcies has increased due to the implementation of the 1997 law.
- **Banking reform** has concentrated on supervision and prudential requirements. However, the supervision of the non-bank financial sector is weak. Banking still remains for a large part in public hands, as 40% of all outstanding loans were in public banks by the end of August 1998. However the largest insurance company (which covers almost 55% of the insurance market) has been sold and plans have been made to sell the two remaining state–owned banks.
- The **banking sector** is still weak. However, thanks to its limited direct exposure to Russia, it did not suffer much from last year’s financial crisis. The banking sector is increasingly fulfilling its role as intermediary. Competition has increased, as well as consolidation. Branches of foreign banks are now allowed to operate on the Lithuanian market.
- **Agriculture** urgently needs modernisation. Land restitution has progressed, but still has to be completed.
- Lithuania faces one of its biggest challenges in the field of **energy**, as the country depends heavily on nuclear power. The country is still not able to comply with international standards. The debt piled up by the energy companies represents an important part of the country’s public debt. Nevertheless, restructuring plans for the national utilities are nearly complete.
- The **growth of wages,** which had exceeded labour productivity growth for a long time, has recently slowed down, except for the public sector.

- The **administration** is still very weak, and lacks the resources necessary for the proper implementation of new laws.
- The authorities have recently taken non-market based measures (trade protection, tax arrears etc.) to support companies encountering difficulties caused by the Russian crisis.

5 Preferred exchange rate regime and preparations for EMU

- The **Bank of Lithuania** is largely independent from the Government for the conduct of monetary policy and for the appointment of the Governor. The central bank has one main objective, the stability of the currency, which in fact implies two distinct aims: internal (price) as well as external (exchange rate) stability. The Monetary Policy Programme states that, in case of a conflict arising between these two objectives, "the Bank of Lithuania will give the priority to the external stability of the Litas". Nonetheless, a new central bank law has been proposed, which would make price stability the bank's primary goal[74]. The central bank law is still not in line with the Treaty provisions on the financing of budget deficits.
- The **exchange rate regime** has been a (modified) currency board since April 1994 (when the new currency, the Litas, replaced the Talonas). The CBA links the amount of currency to the size of the foreign reserves, as specified in the Law on the Credibility of the Litas. Lithuania is the only country in the region with a peg to the USD. This feature can be explained by the fact that Lithuania's foreign trade and foreign debt are for the largest part denominated in that currency. 4 Litas (LTL) = 1 USD since 1994. The coverage provided by foreign reserves is nearly 157% (18 May 1999)[75].
- The very restrictive monetary policy carried out under the CBA has been relatively successful in reducing inflation. The sale of Lithuanian Telecom before the Russian crisis provided enough foreign reserves for the currency board to be able to face any pressures on the Litas.

The **Monetary Policy Programme for 1997-1999** plans a gradual exit of the fixed exchange rate regime. The Governor of the Bank of Lithuania considers that "since it is not known how long it will take for Lithuania to become a full member of the EU and EMU, it may be desirable to allow for some flexibility in monetary policy"[76]. However, devaluation is not an option, as Lithuania has committed itself to currency stability and does not want to lose public confidence.

- The **first step**, launched in 1997, consists of the introduction and development of new monetary instruments like open market operations and a Lombard facility.
- Once the central bank is able to use them, the **second step** will be the amendment of the Law on the Credibility of the Litas. This will give the central bank the legal means to play a more traditional role, controlling the money supply and the interest rates. The Central Bank asset base eligible for backing the money supply will be broadened. Draft laws are

[74] Šarkinas, R., "Lithuania: A Monetary Strategy for EU Accession", Speech by the Chairman of the Board of the Bank of Lithuania, Bank of Lithuania, Vilnus, 1999.

[75] Fragment from "Lithuania's EU Accession Programme (National Programme for the adoption of the Acquis)" , May 1999.

[76] Šarkinas, R. (1999).

expected to be debated in the second half of 1999[77]. They had been delayed by the emerging markets crises of 1998.

▲ The **third step** will focus on the exchange rate in the perspective of accession to the EU and to the EMU. This phase seems "not likely to begin before the year 2000"[78]. Strict conditions have been set before this phase can eventually start, like the stability of financial and money markets and a monthly inflation between 0.5% and 0.8% for at least 6 consecutive months. The final stage has been divided into
  - **Short term priorities** (1999-2000): peg the Litas to a currency basket made of 50% EUR and 50% USD, except if transactions in Euro increase swiftly in the coming years, in which case a full Euro peg could be chosen instead. The revision of the peg has been delayed until after 1999.
  - **Medium term priorities** (2001-2002): prepare the introduction of a full Euro peg (in 3-5 years[79]). Lithuania expects to participate to ERMII.

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[77] Fragment from "Lithuania's EU Accession Programme (National Programme for the adoption of the Acquis)" , May 1999.

[78] Šarkinas, R. (1999).

[79] Fragment from "Lithuania's EU Accession Programme (National Programme for the adoption of the Acquis)" , May 1999.

LITHUANIA

	1992	1993	1994	1995	1996	1997	1998 *	1999 **	2000 **	2001 ***	
Output											
GDP growth rate at constant prices (%)	-21,3	-16,2	-9,8	3,3	4,7	7,3	5,1	2,5	2,8		
Monetary indicators										2,7	
M0 growth (%)	-	-	62,4	35	2,2	32,4	28,8	15,9 (May)	-		
M1 growth (%)	-	-	-	42,9	-0,4	33,5	10,4	13,7 (May)	-	-	
M2 growth (%)	-	100,2	63,0	29	-3,5	34,1	14,5	20,1 (May)	-	-	
Lending rate (% p.a., end-year) #	-	88,3	29,8	23,9	16,0	11,9	16,7	15,9	-	-	
Treasury bill rate (three month maturity) (% p.a., end-year)	-	-	-	22,4	10,8	9,4	9,4	11,4	-	-	
Foreign trade and exchange rates										-	
Exports growth (%)	-	96,65	-1,45	21,33	29,90	37,55	1,67	1,0***	6,0***		
Imports growth (%)	-	132,13	0,84	38,63	30,37	38,79	8,30	-3,0***	2,0***		
Share EU trade: Exports (% of total exports)	-	16,7	25,7	36,4	32,9	32,5	38,0	-	-		
Share EU trade: Imports (% of total imports)	-	18,7	26,4	37,1	42,4	46,5	50,2	-	-	10,0	
Current account (% GDP)	10,6	-3,2	-2,2	-10,2	-9,2	-10,2	-13,5	-10,8***	-9,4***	6,0	
Openness: exports and imports as % of GDP	11344,4	156,0	100,9	101,4	97,8	99,4	94,8	-	-	-	
Exchange rate, Talonai (1992) & Litai per ECU, annual average	229,75	5,04	4,76	5,23	5,08	4,54	4,48	-	-	-8,1	*Reference*
Real Effective Exchange Rate, index 1995=100	-	-	-	100	122,8	142,0	170,4	171,1	-	-	*values*
Maastricht Criteria											*Jan.1998*
General government budget balance (% GDP)	0,5	-3,3	-5,5	-4,5	-4,5	-1,8	-5,8	-6,7***	-	-	*3%*
Government debt (% GDP)	-	-	10,4	14,3	15,0	16,2	17,0	-	-	-	*60%*
Government foreign debt (% GDP)	-	-	-	-	11,5	12,0	13,4	16,7***	16,5***		
Inflation rate: consumer prices, annual average (%)	1021,0	410,4	72,1	39,5	24,7	8,9	5,1	2,5	3,5	-	*2,7%*
Long-term interest rates	-	-	-	-	-	-	-	-	-	-	*7,8%*
Other macro indicators										16,4	
Gross foreign debt (% GDP)	3,1	12,2	11,8	12,1	14,1	13,4	15,0	-	-	2,7	
Unemployment rate, end-year, registered (%)	1,3	4,4	3,8	6,2	7,0	5,9	6,4	-	-	-	
FDI net inflow (mln ECU)	-	25,6	26,1	55,0	119,7	289,2	847,5	481,8	-		

Sources: Commission services, EBRD, Eurostat, IMF, Bank of Lithuania.

* estimate ** projection or mid-year figure; except GDP, inflation, unemployment: WIIW forecasts June 1999 ** IMF Fund staff estimates and projections

Weighted average rate of commercial banks

For 1999: annual average replaced by mid-year (June) exchange rates: 1 EUR = 1,0378 US$ =4,2 Talonai

Malta

Malta is an island-state in the Mediterranean with fewer than 400,000 inhabitants. Its economy is very dependent on transit trade and on tourism. GDP growth has remained very healthy during the nineties with an average of 8% a year for the period 1993-1998. GDP grew by 8,2% in 1998.

Main indicators of economic structure (1998)

Capital city	Valletta
Currency	Maltese Lira (MTL)
Total area	315,59 km2
Population	378 thousand
GDP at current prices	3132,3 mln EUR
GDP per head	8276 EUR
GDP per head at PPP	-
GDP per head, as % of EU-15 average	42%
Structure of production:	
Agriculture (% GDP)	2.8
Industry (% GDP)	24.7
Construction (% GDP)	2.8
Services (% GDP)	69.7
Gross foreign debt/GDP (%)	100.7%
Exports/GDP (%)	87.5%
Monetisation of the economy (M3/Y)	159.7%

Source: Commission services, IMF, national sources.

1. Phasing and time-scale of the accession process

- 1971: entry into force of the Association Agreement
- July 1990: application for membership of the European Union
- 1993: European Commission’s Opinion on Malta’s application for membership of the European Union (positive opinion)
- 1995: decision to start the accession negotiations
- 1996: the new government froze Malta’s application. As a consequence: Malta did not take part in the accession process launched in 1997.
- September 1998: reactivation of Malta’s application for membership of the European Union
- Malta is currently preparing its first National Programme for the Adoption of the *Acquis*

Copenhagen criteria

According to the European Commission, Malta is a functioning market economy, able to cope with competitive pressures and market forces within the union, “provided it takes the appropriate measures, in particular by industrial restructuring” [80].

[80] Commission of the European Union, “Regular Report from the Commission on Malta's Application for

The European Commission proposed on October 13, 1999, that accession negotiations should be opened with Malta.

Independent commentators
Malta is likely to accede to the EU between 2004 and 2006.

2. Prospects of meeting the Maastricht criteria

As recalled in *Agenda 2000*, the convergence criteria[81] are not a precondition for membership; they are only a condition for participating in EMU. The Commission was not able to draw any conclusions about Malta meeting these criteria by the time of its accession. The latest economic developments are taken from the Commission's *Regular Reports*, as well as from the Central Bank of Malta.

- ▲ **Inflation** increased to 4% in 1993, the year after the devaluation of the Lira. Since then, it has continued to decline thanks to the Central Bank's strict monetary policy. Consumer prices increased by only 2.4% in 1998, due to lower imported inflation. The year-on-year inflation rate amounted to 1.4% in May 1999, after a slight increase in February following the introduction of VAT.
- ▲ **Long-term interest rates** (10-year bonds) amounted to 6% in 1998.
- ▲ The **government deficit** is a major problem, as it was as high as 10.4% in 1998. This was mostly due to increases in civil servant wages, social security expenditures, bad results of state-owned companies, and the decrease in customs levies and excise taxes. The public sector deficit is expected to stay high in 1999 and its decline is likely to be slow, according to the projections of the Maltese central bank. The targeted budget deficit for 1999 amounts to 8.5% of GDP. The government intends to reduce the budget deficit to 4% of GDP by 2004.
- ▲ The level of **public debt** is increasing rapidly: from 33.2% in 1993 to 55.2% five years later. If one adds the debt of state-owned enterprises, public debt would amount to 92% of GDP.
- ▲ The Maltese Lira has been pegged to a currency basket since 1989. On January 1, 1999, the Euro replaced the ECU. The currency basket currently comprises 56.8% Euro and identical weights (21.6%) for the Pound Sterling and the US Dollar.

Membership"", Brussels, 1999.

[81] - ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1.5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

- ***The Interest Rate Convergence Criterion****:* the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);

- ***The ERM Criterion****:* the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

- ***The Budget Deficit Criterion***: a country's budget deficit should not exceed 3% of its GDP;

- ***The Stock of Debt Criterion***: the stock of outstanding government debt should not exceed 60% of that country's GDP.

It can be concluded that Malta, contrary to most of the Eastern European candidate countries, would be able to meet the monetary Maastricht criteria (inflation and interest rates) as well as the public debt criterion, but not the government deficit criterion.

3. Main elements of the *Acquis* to be completed

- ▲ In its 1993 Opinion, the European Commission stated that the Maltese authorities "do not seem to have got much beyond setting up the administrative machinery". While Malta has made some notable progress in transposing EU legislation, the country has no programme for the implementation of the *Acquis* that would allow Commission to monitor this progress. The main problems concern the implementation of the 1971 Association Agreement, which foresaw a customs union between Malta and the EU: it came to a standstill and neither the elimination of levies on EU imports, nor the alignment to the EU's common external tariff have been realised. In July 1999, the new government adopted a timeframe for lifting levies on non-agricultural goods. The first levies have been lifted in October, but the whole process will not be completed before 2003.
- ▲ In certain fields, some progress has been made in the alignment of legislation: new legislation on public procurement has been enacted and the EU Directives on company and accountancy laws have been approximated. The preferential treatment of local manufacturers was abolished in August 1999. Malta also made some progress on competition policy, with the Competition Act that entered into force on February 1, 1995. But transposing legislation on merger control, state aid, public undertakings and state monopolies should be a priority. The country still has not got a State Aid monitoring authority.
- ▲ Furthermore, progress is heavily needed in intellectual and industrial property rights. Malta does not have any legislation on personal data protection. Substantial work still has to be done especially in the field of internal market. Regarding the free movement of goods, EU legislation has not been approximated and the European Commission advises Malta to adopt a specific approximation programme.

Of special importance with regard to EMU are two of the "four freedoms" in force in the Internal Market without Frontiers.

- **Free Movement of Capital.** Current account liberalisation was completed in 1994. Nevertheless, the liberalisation of capital movements is not complete: restrictions and demand for authorisation remain for inward capital movements other than direct investment and real estate, as well as on outward capital movements. The rules applying to the offshore banking sector are not totally in line with the *Acquis*.
- **Free Movement of Services.** Banking legislation is well aligned. Two of the three state-owned banks have been privatised and the banking market has partially been opened to foreign credit institutions. International standards on risk assessment have been introduced in 1999. Insurance legislation has been modified in 1998 in order to follow EC Directives. As regards the securities markets, EU directives have been largely implemented. Malta has also signed the GATS (General Agreement for Trade in Services) but does not comply with the fourth protocol concerning basic telecommunications.

4. Main economic issues still to be resolved

- **Tax collection** has to be improved and clear long-term policies have to be drawn up. VAT legislation had already been introduced in 1995, but it was replaced, in 1997, by a Customs and Excise tax Act, a system of excise taxes on imports and local production. VAT was reinstated on January 1, 1999.
- The **government deficit** is a major concern.
- The **public sector** has to be reduced (it employs about 40% of the workforce)
- The **financial sector** has to open up to competition from outside. The government still plays an important role as it keeps shares in the two largest banks, which account for 90% of the deposits and loans. Partial privatisation of the Bank of Valetta and recent entry of Midland Bank (UK) has however increased competition.
- **State-owned enterprises** have to be privatised/restructured –this process has only very recently begun with the partial privatisation of telecom and post, as well as the reduction of subsidies on some utilities coupled to tariff increases.
- The **customs union with the EU** has to be established without further foot-dragging, in accordance with a clear timetable.

5. Preferred exchange rate regime and preparations for EMU

- The **Central Bank of Malta** is in principle independent from the government and responsible for monetary policy since 1994. However, in exceptional circumstances, the Minister of Finance is still entitled to give instructions to the bank on the conduct of monetary policy. The Central Bank monitors the Government’s cash positions and can provide it with short-term loans or buy government bonds on the primary market. These possibilities, which are contrary to the Treaty provisions on government financing, have not been used recently. An Amendment to Bank of Malta Act, which still has to enter into force, will abolish the provisions. Malta has made some progress since the 1993 Opinion, as market-based instruments of monetary policy have replaced direct controls on interest rates.
- **The exchange rate regime** is a basket peg – the basket is made of ECU, GBP and USD. According to the IMF[82], this arrangement is appropriate, but would be more effective if the weight of the Euro increased, due to the pattern of trade and to the importance of (mostly European) tourist receipts for the Maltese economy. The authorities intend to raise the weight of the Euro progressively.

[82] Malta: Staff Report for the 1999 Article IV Consultation, IMF Staff Country Report No.99/60, July 1999.

MALTA

	1992	1993	1994	1995	1996	1997	1998 *	1999 **	2000 **	2001***	*Reference values Jan.1998*
Output											
Real GDP growth rate (%)	-	4,0	5,0	7,3	4,2	2,8	3,0	3,5	3,20	4,3	
GDP growth rate at current prices (%)	-	7,5	9,4	11,4	4,9	6,7	8,2	-	-	-	
Monetary indicators											
M0 growth (%)	-	0,5	4,7	-0,9	3,6	4,9	3,7	-	-	-	
M1 growth (%)	0,5	4,0	9,1	-5,6	3,8	5,7	8,6	5,5 (July)	-	-	
M3 growth (%)	9,3	10,3	14,9	7,8	10,4	9,6	8,4	7,2 (July)	-	-	
Lending rate (% p.a.)	-	7,2	7,3	7,5	7,9	8,0	-	-	-	-	
Foreign trade and exchange rates											
Exports growth (%)	21,0	5,6	14,3	13,9	-7,4	0,6	13,2	-	-	-	
Imports growth (%)	9,3	11,1	10,6	12,9	-2,9	-2,3	5,2	-	-	-	
Share EU trade: Exports (% of total exports)	75,3	71,0	73,0	71,0	56,0	54,0	52,8	-	-	-	
Share EU trade: Imports (% of total imports)	76,7	71,0	75,0	72,0	68,0	71,0	69,3	-	-	-	
Current account (% GDP)	-	-3,4	-4,9	-11,0	-10,7	-6,2	-5,1	-3,7	-3,9	-3,7	
Openness: exports and imports as % of GDP	141,6	134,7	138,4	139,1	138,4	127,7	124,3	-	-	-	
Exchange rate, MTL per ECU, annual average	0,4117	0,4475	0,4485	0,4615	0,4576	0,4363	0,4356	-0,43 (March)	-	-	
Real Effective Exchange Rate index 1990=100	-	89,3	93,4	94,5	93,4	94,8	95,8	-	-	-	
Maastricht Criteria											
General government budget balance (% GDP)	-3,4	-3,0	-5,0	-3,9	-8,6	-9,7	-10,4	-8,5	-7,2	-6,6	*3%*
Government gross debt (% GDP)	-	32,4	33,0	35,7	42,8	51,6	55,0	56,3	57,3	58,2	*60%*
Government external debt (%GDP)	5,5	5,4	5,5	4,7	4,3	3,9	3,4	-	-	-	
Inflation rate: consumer prices, annual average (%)	1,6	4,0	4,1	4,0	2,4	3,1	2,4	2,5	2,4	2,4	*2,7%*
Long term interest rates	-	7,0	6,7	7,1	7,2	7,3	6,0	5,96 (March)	-	-	*7,8%*
Other macro indicators											
Gross foreign debt (% GDP)	-	-	59,8	60,9	71,2	89,1	100,7	-	-	-	
Unemployment rate, registered, end-year (%)	4,0	4,2	4,2	3,5	3,7	4,6	4,9	4,5	4,5	4,4	

Sources: Commission services, Eurostat, IMF, Central Bank of Malta.
* estimate ** projection or mid-year figure *** IMF forecast
For 1999: annual average replaced by mid-year (June) exchange rates: 1 EUR = 1,0378 US$

Romania

Since 1997, Romania's economic situation has deteriorated: GDP fell by 7.3% last year and output continued to decline in 1999, albeit at a slower pace. Exports of goods and services also show a downward trend, as well as investment, including FDI. The new government, in place since November 1996, started with a stabilisation and structural reform programme which seemed to promise positive results at the time of *Agenda 2000*, but implementation delays and policy inconsistencies were the cause of its relative failure. Structural reform is lagging behind and Romania has been suffering badly from the lack of political consensus on reform. However, the reform programme seems to be moving forward again in 1999, notably thanks to a new stand-by agreement with the IMF.

Main indicators of economic structure (1998)	
Capital City	Bucharest
Currency	Leu (ROL)
Total area	238 391 km2
Population	22,503 mln
GDP at constant prices	34,06 mln EUR
GDP per head	1545 EUR
GDP per head, as % of EU average	8%
GDP per head at PPP	5500 EUR
GDP per head, as % of EU average, at PPP	28%
Structure of production	
Agriculture (% GDP)	27.6%
Industry (% GDP)	35.0%
Construction (% GDP)	5.7%
Services (% GDP)	41.7%
Gross foreign debt/GDP	27.9%
Exports/GDP	25.7%
Stock of FDI	3.9 bn EUR
Stock of FDI per head	172 EUR
Monetisation of the economy (M2/Y)	27%

Source: Commission services, national sources, EBRD, IMF, WIIW, Erste Bank.

1 Phasing and time-scale of the accession process

- May 1993 and January 1995: membership of the EFTA and of the WTO
- June 22, 1995: application for membership of the EU
- February 1995: Europe Agreements entered into force
- July 1, 1997: membership of CEFTA
- March 1998: Accession Partnership and presentation of Romania's first National Programme for the Adoption of the *Acquis*; a second programme was presented in June 1999

Copenhagen Criteria

Agenda 2000[83] estimated that Romania would not be ready to cope with competitive pressures and market forces within the Union in the short run. Any conclusions about the time-scale of accession thus seemed premature. Moreover, the 1998 *Regular report on Romania's progress towards accession*[84]*,* concludes that Romania's competitiveness has deteriorated since 1997.
The European Commission has proposed on October 13, 1999, that accession negotiations should be opened with Romania, under the condition that the government takes the necessary measures needed to improve the condition of children in childcare institutions.

Independent commentators
Romania is one of the "second wave" countries and, in our opinion, accession is not likely within the next ten years.

2 Prospects of meeting the Maastricht criteria

As noted in *Agenda 2000*, the Maastricht convergence criteria[85] are not a precondition for membership; they are only a condition for participating in the final phase of EMU. The Commission was not able, in 1997, to draw any conclusions about Romania meeting these criteria. The current situation with regard to these criteria can be summarised as follows[86]:

▲ The Bank of Romania works with an **inflation** target and managed to reduce inflation last year by controlling the money base. Indeed, inflation fell from 154,8% in 1997, to 40,6% in 1998. The government's target for December 1999 was a year-on-year inflation of 35%. However, the Commission has recently expressed the fear that Romania might fall back into an inflation spiral[87]: both consumer and producer price inflation have increased in recent months, and the substantial wage increases accorded in March, combined with

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[83] Commission of the European Union, Brussels, "Agenda 2000, The Effects on the Union's Policies of Enlargement to the Applicant Countries of Central and Eastern Europe", 1997.

[84] Commission of the European Union "Regular Report from The Commission on Romania's Progress Towards Accession", 1998.

[85] - ***The Inflation Convergence Criterion***: an inflation rate which should not exceed by more than 1.5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

- ***The Interest Rate Convergence Criterion:*** the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);

- ***The ERM Criterion:*** the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

- ***The Budget Deficit Criterion***: a country's budget deficit should not exceed 3% of its GDP;

- ***The Stock of Debt Criterion***: the stock of outstanding government debt should not exceed 60% of that country's GDP.

[86] European Commission, Economic and Financial Affairs Documentation, *European Economy*, Supplement C. "Economic Reform Monitor", No.2, May 1999.

[87] European Commission, Economic and Financial Affairs Documentation, *European Economy*, Supplement C. "Economic Reform Monitor", No.2, May 1999.

the depreciation of the currency have revived inflationary expectations. Year-on-year inflation amounted to 49.5% in August 1999.

- Romania has no **long-term interest rates**. Short-term interest rates remain high: they amounted to about 80% at the last Treasury bill issue at the end of April 1999.
- The **budget** showed a **deficit** of 3.3% of GDP in 1998, thanks to privatisation revenues, which form an increasing part of the state budget, amounting to 14% of the budget by the end of July 1999. The 1998 deficit would have been 5.7% without these revenues, which corresponds to a fiscal relaxation compared to 1997. The objective for 1999 is a deficit of 2.5%. However, the European Commission fears that fiscal discipline is not sustainable without further structural reforms, as pressures for higher spending are getting stronger. Revenues are lower than expected mostly due to tax arrears and to the shift to indirect taxation. Interest charges represent the highest expenditure for the state budget (more than 30%).
- According to the European Commission, **public debt** is growing in Romania. Exact figures concerning public debt are not available.
- Presently, the Romanian currency, the Leu, is in a free float. The sustained instability of the Leu leads us to the conclusion that Romania will not be able to comply with the **exchange rate** criterion in the medium run. The Leu has been subject to speculative pressures in the last months of 1998 and the first months of 1999 and it lost two-thirds of its value between October and June. This was linked to the poor economic performance of the country and to doubts about its ability to service its external debt obligations. However, the authorities managed to fulfil their obligations, to stabilise the Leu and to avoid a major crisis.

Summarising, Romania does not comply with the inflation, the interest rate, the exchange rate or the budget deficit Maastricht criteria. Figures on public debt are not available.

3 Main elements of the *Acquis* to be completed

- *Agenda 2000* noticed the progress of Romania towards a market economy, especially through the liberalisation of prices. Since 1997, price and trade liberalisation has further been extended (less than 7% of all prices are still controlled today). The main problems remain the ambiguity of the property rights for land and the fragility of the legal system.
- Only a small part of the *Acquis* concerning the **Single Market** had been implemented at the time of *Agenda 2000* except for industrial and intellectual property. However, the weakness of the administration made enforcement highly deficient. The Commission's 1998 *Regular Report* concluded that not much progress had been made since 1997. The Commission considered the restructuring of the financial sector and the creation of appropriate administrative structures able to apply and enforce the *Acquis* effectively as priorities.
- The 1999 *Regular Report* concludes that progress has been made in the fields of standards and certification, banking supervision, public procurement and state aid. A law on state aid, in line with the *Acquis*, has been introduced last summer. However, "disguised" state aid (like tax arrears), endemic in Romania, will render effective implementation of this law a major challenge.
- Progress is still needed in the fields of intellectual property, data protection, free movement of goods and the environment. The Commission notes the particular challenge represented by justice and home affairs, where very few elements of the *Acquis* have been introduced.

- Romania in general lacks enforcement capacity as well as the necessary institutions. The independence of regulatory and supervisory bodies is still not ensured.

Of special importance with regard to EMU are two of the "four freedoms" in force in the Internal Market without Frontiers:

- **Free Movement of Capital**. In March 1998, Romania implemented full current account convertibility, and thus falls under IMF article VIII status. The adoption of a liberalisation programme in July 1999, which is due to be completed before accession, has already led to the liberalisation of capital inflows. Inward direct investment is free, except for sensitive sectors. Outward transactions and short-term inward transactions are still subject to authorisation.
- **Free Movement of Services**. Romania introduced important banking laws in 1998: an improved bankruptcy law and new central bank statutes. The National Bank of Romania has gained more independence and supervisory capacity. New laws on money laundering and on bankruptcy procedures have been introduced in April 1999. No alignment has been noted on insurance or on securities markets where discrimination against foreign companies still prevails.

4 Main transition issues still to be resolved

- Romania has not achieved macroeconomic **stabilisation** yet, due to years of stop-and –go policies.
- The large loss-making state-owned industrial enterprise sector still needs to be restructured. **Privatisation** has been slow, as 60% of industrial enterprises are still in public hands. It has begun to accelerate in 1999, with the privatisation of a few large enterprises and banks.
- The **financial sector** is also heavily in need of reform, as non-performing loans amounted to more than half of the commercial banks' assets in 1997. A massive recapitalisation has recently been carried out.
- Romania experiences difficulties well known in Russia: enterprises are accumulating arrears in periods of tight fiscal policy, loss-making firms are not liquidated, tax collection is weak and banks do not fulfil their traditional economic role, investing mostly in T-bills because of the high returns.
- Romania needs to adopt a clear medium-term economic strategy.

5 Preferred exchange rate regime and monetary policy

- **National Bank of Romania**. *Agenda 2000* emphasised the *relative* independence of Romania's central bank. Its objective, the stability of the Leu, has not always been interpreted, however, as price stability. The recent National Bank Law still permits financing of the budget deficit; moreover, in the past, the Romanian central bank has even provided more finance to the budget than legally authorised. The central bank also continued to provide funds to commercial banks and loss-making state-enterprises. Central bank legislation is not fully compatible with EC rules; monetary and fiscal policies have long remained not oriented towards stability. The framework for monetary policy has improved since *Agenda 2000*. The NBR has not offered any special credits to the ailing sectors of the economy. Central bank independence has been improved. The

foreign exchange market is functioning well and the Leu has been declared fully convertible for current account transactions in March 1998.

- ▲ The Romanian **exchange rate regime** has been a free float since 1991. However, in practice, it has worked like a managed float since 1994, as the central bank regularly intervenes on the foreign exchange market, to prevent large fluctuations of the Leu. The central bank introduced administrative restrictions on the foreign exchange interbank market, when the currency suffered from devaluation pressures. The NBR is considering pegging the Leu to a basket of USD and EUR, the respective weights depending on the country's foreign trade pattern. The NBR has already been swapping foreign exchange reserves and external debt into Euro.

ROMANIA

	1992	1993	1994	1995	1996	1997	1998 *	1999 **	2000 **	2001***	*values Jan.1998*
Output											
GDP growth rate at constant prices (%)	-8,8	1,5	3,9	7,1	4,1	-6,6	-7,3	-5,0	0,0	2,5	
Monetary indicators											
M0 growth (%)	133,1	154,8	109,8	70,9	43,1	70,9	-	-	-	-	
M1growth (%)	47,6	117,0	103,2	56,2	57,7	67,6	-	-	-	-	
M2 growth (%)	76,6	141,0	138,1	71,6	66	75,9	48,9	-	-	-	
Short-term interest (lending) rates (one year) (% per annum, end-year)	49,5	86,4	61,8	47,5	53,6	55,6	56,8	-	-	-	
Treasury bill rate (three-month) (% per annum, end-year)	-	-	-	45,0	55,0	98,0	60,0	-	-	-	
Foreign trade and exchange rates											
Exports growth (%)	2,3	12,1	25,7	28,6	2,2	-2,1	-0,4	-9,5	8,6***	12,5	
Imports growth (%)	8,0	4,2	9,0	44,6	11,3	-7,7	6,0	-3,4	6,8***	11,8	
Share EU trade: Exports (% of total exports)	-	41.3	48.2	54.1	56.6	56.6	64.5	-	-	-	
Share EU trade: Imports (% of total imports)	-	45.3	45.7	50.5	52.3	52.5	57.7	-	-	-	
Current account (% GDP)	-7,8	-4,7	-1,7	-4,9	-7,4	-6,7	-7,9	-5,0	-5,8***	-5,7	
Openness: exports and imports as % of GDP	43,0	37,8	36,2	29,6	48,8	54,1	50,3	-	-	-	
Exchange rate, Lei per ECU, annual average	399,40	891,00	1967,20	2659,70	3908,70	8128,51	9941,03	16419,5 (June)		-	
Real Effective Exchange Rate CPI-based index 1993 = 100	-	100	108	103	93	108	-	-	-		
Maastricht Criteria											
General government budget balance (% GDP)	-4,6	-0,4	-1,9	-2,6	-4,0	-3,6	-5,5	-3,0	-3,5***	-3,5	*3%*
Government debt (% GDP)	-	-	-	-	-	-	-	-	-	-	*60%*
Inflation rate: consumer prices, annual average (%)	210,4	256,1	136,7	32,3	38,8	154,8	59,1	50,0	40,0	15,0	*2,7%*
Long-term interest rates	-	-	-	-	-	-	-	-	-	-	*7,8%*
Other macro indicators											
Gross foreign debt (% GDP)	16,6	16,1	17,4+	16,7	22,6	20,7	17,9	-	-		
Unemployment rate, end-year, registered (%)	8,2	10,4	10,9	9,5	6,6	8,9	10,3	13,0	15,0	13,0	
FDI net inflow (mln ECU)	56,2	82,8	286,6	368,8	207,1	1079,4	1819,8	1349,0	-	-	

Sources: Commission services, EBRD, Eurostat, IMF, National Bank of Romania, Erste Bank.

* estimate ** projection or mid-year figure; except GDP, inflation, unemployment: WIIW forecasts June 1999 *** Erste Bank forecast +statistical break

For 1999: annual average replaced by mid-year (June) exchange rates: 1 EUR = 1,0378 US$

Slovakia

GDP growth has slowed down in Slovakia in 1998, reaching a still respectable 4.4%, down from almost 7% in previous years. The former government had increasingly relied on non-market based mechanisms (high level of public investment, high budget deficit and foreign borrowing, domestic borrowing subject to non-market conditions) to promote economic growth, leaving a difficult economic situation to its successor. The new government's economic policy, introduced in January 1999, aims to reduce the fiscal and external deficits and has already further dampened domestic demand. In the short run, no improvement of Slovakia's economic condition is in sight.

Main indicators of economic structure (1998)	
Capital city	Bratislava
Currency	Koruna (SKK)
Total area	49 036 km2
Population	5 391 000
GDP at market prices	18 166 mln EUR
GDP per head	3369 EUR
GDP per head, as % of EU average	17%
GDP per head at PPP	9300 EUR
GDP per head, as % of EU average, at PPP	47%
Structure of production in 1995:	
Agriculture (% GDP)	4.6%
Industry (% GDP)	28.1%
Construction (% GDP)	5.2%
Services (% GDP)	62.1%
Gross foreign debt/GDP (%)	33.0%
Exports/GDP (%)	63.7%
Stock of FDI	1,5 bn EUR
Stock of FDI per head	280 EUR
Monetisation of the economy (M2/Y)	60.5%

Source: Commission services, national sources, EBRD, WIIW, Erste Bank.

1 Phasing and time-scale of the accession process

- ▲ July 1992 and March 1993: EFTA and CEFTA membership
- ▲ January 1995: WTO membership
- ▲ February 1995: entry into force of the Europe Agreement
- ▲ June 27, 1995: application for membership of the European Union
- ▲ March 1998 and May 1999: National Programmes for the Adoption of the *Acquis* (NPA*A*)

Copenhagen Criteria

In *Agenda 2000*[88], the European Commission concluded that negotiations should be opened as soon as Slovakia could satisfy the Copenhagen criteria. In the medium term, it seems likely that the economic criterion will be fulfilled, as the reforms introduced by the new government will enable to country " to cope with competitive pressures and market forces within the Union in the medium term" [89]. With regard to the political criterion, until the 1998 *Regular Report*, democracy, rule of law and the protection of human rights were not completely ensured in Slovakia. The independence of the judiciary seemed especially compromised, as well as the rights of the opposition. Nevertheless, the positive changes introduced since the parliamentary elections of September 1998 allow Slovakia to fulfil the political criterion at present, according to the European Commission's 1999 *Regular Report*. The European Commission proposed on October 13, 1999, that accession negotiations should be opened with Slovakia.

Opinion of the Slovak Government

The National Bank of Slovakia's 'Strategy for 1999-2005' distinguishes three phases: stabilisation and price deregulation (1999-2000), restructuring (2001-2002) and convergence (2003-2005).

Independent commentators

Slovakia is one of the "second wave" countries. Accession is likely to take place between 2005 and 2008.

2 Prospects of meeting the Maastricht criteria

As noted in *Agenda 2000*, the Maastricht convergence criteria[90] are not a precondition for membership; they are only a condition for participating in the final phase of EMU. The latest economic developments of Slovakia are taken from the *Economic Reform Monitor*[91] of the

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[88] Commission of the European Union, Brussels, "Agenda 2000", 1997.

[89] Commission of the European Union "Regular Report from the Commission on Slovakia's Progress Towards Accession", 1999.

[90] - *The Inflation Convergence Criterion*: an inflation rate which should not exceed by more than 1.5% the average inflation rate of the three best-performing countries (the benchmark inflation rate established by the European Commission for January 1, 1998 was 3%);

- ***The Interest Rate Convergence Criterion:*** the average long-term nominal interest rate should not be more than 2% above the average interest rate of the three countries with the lowest inflation rate (the benchmark interest rate established by the European Commission for January 1, 1998 was 7.8%);

- ***The ERM Criterion:*** the currencies of future EMU members should be have been in the ERM (Exchange Rate Mechanism) without devaluation or revaluation for at least two years;

- ***The Budget Deficit Criterion***: a country's budget deficit should not exceed 3% of its GDP;

- ***The Stock of Debt Criterion***: the stock of outstanding government debt should not exceed 60% of that country's GDP.

[91] European Commission, Economic and Financial Affairs Documentation, *European Economy*, Supplement C. "Economic Reform Monitor", No.2, May 1999.

European Commission's Directorate General for Economic and Financial Affairs and from the 1999 *Regular Report* of the Directorate for Enlargement:

- By 1997, monetary policy had become relatively efficient in reducing **inflation**. In December 1998, yearly inflation was only 5.6% in Slovakia. But it will reach double-digits again this year: in August, inflation was running at 14.4%. The substantial increase in administered prices, and especially in the price of energy, has caused an upturn in inflation in the first months of 1999. The government aims at keeping net inflation (excluding administrated prices) at last year's level, 6%.
- Slovakia does not have **long-term interest rates**. The central bank of Slovakia (SNB) has only started to use market instruments very recently (1996). The difficult control of the money supply led the SNB to increase the reserve requirements and introduce limits to refinancing credits to the banks. This caused liquidity shortages in the interbank market, which partly explain why the interbank interest rates are relatively high. The NBS has also had to restrict monetary policy this year in order to contain inflation, driving interest rates high and hampering credit (and enterprise) growth.
- Slovakia has not been able to comply with the **government deficit** criterion in 1998, despite a sound budget record in previous years. The 1998 deficit was estimated at 5.6% (excluding the high contingent liabilities) of GDP. The new government wants to keep the deficit under the 2% in 1999. However, this is not in line with the current budget and the deficit recorded for the first half of 1999 already amounted to 2.4%, according to government estimates. A budget deficit of 3% for 1999 seems more likely.
- The increase in **public debt** has created imbalances in the supply and the demand for funds, which has led to a rise in interest rates. Even if Slovakia's debt remains reasonable (less than 25% of GDP in 1996) by international standards, the poor development of financial services in the country causes refinancing efforts on the domestic capital market to be difficult.
- Slovakia has had a fixed **exchange rate** regime since 1993. Following speculative pressures caused by the Russian crisis, the fixed exchange rate regime collapsed in October 1998.

Summarising, Slovakia does not comply with any of the Maastricht criteria at present, except for the government debt criterion. However, even this has to be taken with caution, due to the inadequate definition of the budget deficit and to computational problems.

3 Main elements of the *Acquis* to be completed

- According to *Agenda 2000*, Slovakia had already met its **Europe Agreements'** obligations in 1997 according to the timetable.
- The rate of transposition of the **White Paper** was estimated as satisfactory. Significant progress had been made concerning the **Single Market**, especially in company law, banking, free movement of capital and taxation. Substantial efforts were still needed in the following fields: standards and certification, industrial and intellectual property, competition, public procurement and insurance. The administration was still not functioning in a desirable fashion and concrete implementation measures were lacking.
- The European Commission's 1998 *Regular Report*[92] denounced the continuation of restrictive measures like safeguard measures and import restrictions, which are contrary

[92] Commission of the European Union "Regular Report from the Commission on Slovakia's Progress Towards Accession", 1998.

to the Europe Agreement. Major problems concerned state aid policy and its lack of transparency, as well as deficiencies in the law on public procurement.

- The *1999 Regular Report* stresses the introduction of framework legislation in the fields of standards and certification, state aids and public procurement. A law on public procurement has been introduced in September 1999 and a State Aid law, adopted in August 1999, will enter into force in January 2000. The Enterprise Revitalisation Act, which relied on non-transparent mechanisms, has been abolished in November 1998.
- Slovakia has met the short-term Accession Partnership priorities in the areas of state aid and internal market, but not in the fields of administrative capacity and environment. As concerns the internal market, alignment is considered as satisfactory for copyright, but not for industrial property rights or bankruptcy law. Significant efforts concerning the free movement of goods are still needed.
- Important progress has been made in (nuclear) energy.
- The independence of regulatory and supervisory bodies is still not properly ensured.

Of special importance with regard to EMU are two of the “four freedoms” in force in the Internal Market without Frontiers:

- **Free Movement of Capital.** The Slovak Koruna has been fully convertible for current account transactions since 1995 and for FDI inflows. The capital transactions of banks are fully liberalised. By the time of *Agenda 2000,* the Slovak Government expected to liberalise fully capital movements by the year 2000; 2002 now seems a more realistic target. The amendment to the Foreign Exchange Act of February 1998 eliminated barriers in the trading of foreign securities for securities issued in OECD Member states. Since the 1998 Regular Report, no further progress has been made in this field.
- **Free Movement of Services.** *Agenda 2000* stressed the important progress Slovakia had made in approximating banking legislation, expecting that full adoption of the *Acquis* would be in sight by the end of the millennium. In February 1998, Slovakia implemented an amendment to the banking act putting an end to discrimination against non-residents while getting rid of the two-level licensing procedure. Amendments to the Insurance Act still have to be adopted.

4 Main transition issues still to be resolved

The Slovakian authorities have, until last year, increasingly relied on non-market based mechanisms. The new government has engaged in major reforms, abolishing most of the interventionist measures in order to make Slovakia a functioning market economy.

- During the last legislature, **privatisation** often occurred through non-competitive, non-transparent sales. The new government is currently checking the legality of previous privatisation deals. The privatisation of the telecommunications company has been launched. The Strategic Enterprises Act, which prevented the privatisation of enterprises in key sectors of the economy, has been abolished.
- Enterprise **restructuring** has been slow. One of the major causes has been the Enterprise Revitalisation Act, which obliged banks to provide loans even to loss making enterprises through a very obscure and politicised procedure [93]. This law has recently been abolished.

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[93] Makuch, J., “The Monetary Policy of the National Bank of Slovakia -Past and Current Issues”, Report of the National Bank of Slovakia presented at the 6th International Fair of Banking, Finance and Insurance.

- 17.5% of all **prices** have not been liberalised yet, which distorts the overall inflation figures. The recent increase in administered prices has caused some increase in inflation. Household energy subsidies especially will have to be phased out.
- Slovakia preferred to use protectionism against increasing imports, rather than rely on market-based macro-economic policies. The new government introduced on June 1, 1999 a 7% import surcharge for balance of payments and budgetary reasons.
- Since *Agenda 2000*, the poor performance of macro-economic policies has led to a deterioration of the country's stability. High external deficits and worsening budget balances are a source of concern.
- Some improvement has been made with the amendment of the bankruptcy law, in February 1998. While the former procedure was mostly ineffective, it remains to be seen how the change will effectively be implemented.
- **Bankruptcy** laws are not functioning adequately.
- *Agenda 2000* already stressed the need to restructure the non-competitive, state-dominated **banking sector**. The bad loan problem took on important proportions in Slovakia (bad loans still accounted for nearly 1/3 of bank assets in 1998), driving interest rates high and hampering enterprise restructuring. Financial markets were also underdeveloped. The persistence of these deficiencies is put forward in the 1998 *Regular Report*, as well as the *Reform Monitor* of May 1999. The new government intends to complete banking reform by the end of the year 2000.
- The **credit rating** of Slovakia has worsened. The ratio of gross external debt to exports almost doubled since 1995 (and is now nearly 100%). The European Commission has warned against increased reliance on short-term foreign debt.
- **Capital markets** are very under-developed and unattractive for foreign investor since minority shareholders are discriminated against.
- The Slovakian **FDI stock** is still relatively low, due to the slow progress in market-oriented reforms and the discrimination against foreign investors in the privatisation process. Under the new government, committed to more transparency and market-oriented policies, FDI is likely to grow.

5 Preferred exchange rate regime and preparations for EMU

- **National Bank of Slovakia (NBS)**
- The central bank conducts monetary policy independently from the government. The Governor is appointed and dismissed by the President of the Republic. However, the NBS is legally obliged to support the government's economic policy. The latter must be informed of the Board's resolutions and one of its members is entitled to attend meetings of the NBS Board[94]. It is the duty of the NBS to ensure the stability of the currency (the Slovak Koruna) but this has not always been interpreted as price stability. The provisions concerning government deficit financing are not compatible with the Treaty, as the central bank may provide short-term loans and as public authorities have privileged access to state-owned banks. But the authorities' sound record has prevented any budget deficit financing by the central bank.
- The clearing account agreement with the Czech Republic was terminated by the end of 1995 and the Slovak Koruna became convertible for current account payments. The liberalisation of the capital account took place in 1996 (it had initially been scheduled up

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[94] European Parliament, "EMU and Enlargement", 1999.

to the year 2000[95]). The subsequent inflow of foreign capital, which could not be entirely sterilised, has lead to adjustments in the existing instruments of monetary-policy.

- **Exchange rate regime**
- Slovakia had a regime of fixed exchange rates for the Koruna until 1998 (against a basket of 60% DEM and 40% USD), concretely embodied in a peg with fluctuation bands of +/- 7% around the central parity. It had been stable since 1993. After 1996, the fluctuation bands were progressively widened. This regime has been replaced by a free float in October 1998, due to devaluation pressures on the domestic currency. The Koruna has suffered from renewed pressures in May 1999. However, the government's introduction of additional fiscal and structural reforms, restored some confidence in the currency.

[95] Makuch, J., "The Monetary Policy of the National Bank of Slovakia -Past and Current Issues", Report of the National Bank of Slovakia presented at the 6th International Fair of Banking, Finance and Insurance.

SLOVAKIA

	1992	1993	1994	1995	1996	1997	1998 *	1999 **	2000 **	2001***	*Reference values Jan.1998*
Output											
GDP growth rate at constant prices (%)	-6,5	-3,7	4,9	6,9	6,6	6,5	4,4	0,0	-2,0	3,5	
Monetary indicators											
M0 growth (%)	19,8	-21,5	32,0	-0,8	24,4	15,7	-8,2	-11,4 (April)	-	-	
M1 growth (%)	5,3	3,9	7,7	12,9	15,6	-1,3	-20,4	-2,7 (April)	-	-	
M2 growth (%)	9,1	16,8	20,1	19,2	16,5	9,1	2,6	-	-	-	
Lending rate (% per annum, end-year)#	-	14,1	14,4	14,8	13,2	16,2	16,2	-	-	-	
Foreign trade and exchange rates											
Exports growth (%)	13,0	46,80	20,88	16,65	6,02	22,24	11,97	9,10	7,5	12,3	
Imports growth (%)	6,3	32,05	2,32	20,80	30,09	17,99	10,60	2,71	3,3	16,0	
Share EU trade: Exports (% of total exports)	-	24.1	28.4	37.8	41.3	41.7	55.8	-	-	-	
Share EU trade: Imports (% of total imports)	-	20.6	26.2	34.8	37.3	39.6	50.4	-	-	-	
Current account (% GDP)	-	-5,0	4,8	2,3	-11,2	-10,0	-10,9	-6,8	-6,6***	-7,5	
Openness: exports and imports as % of GDP	64,2	98,6	96,2	99,0	104,8	110,7	115,4	121,8	-	-	
Exchange rate, Koruna per ECU, annual average	36,60	36,03	37,90	38,50	38,40	38,43	39,49	45,17 (July)	-	-	
Real Effective Exchange Rate, index 1990=100	-	-	75,3	75,8	76,3	80,2	78,5	-	-	-	
Maastricht Criteria											
General government budget balance (% GDP)	-2,1	-7,0	-1,3	0,2	-1,9	-3,8	-5,6	-3,2	-3,0***	-3,2	*3%*
Public debt (% GDP)	27,4	31,2	29,6	26,2	24,6	-	-	-	-	-	*60%*
Inflation rate: consumer prices, annual average (%)	10,1	23,2	13,4	9,9	5,8	6,1	6,7	10,0	10,0	5,5	*2,7%*
Long-term interest rates	-	-	-	-	-	-	-	-	-	-	*7,8%*
Other macro indicators											
Gross foreign debt (% GDP)	-	-	18,5	19,7	23,2	28,6	33,0	-	-	-	
Unemployment rate, end-year, registered (%)	10,4	12,2	13,7	13,1	11,1	12,5	15,6	17	18,0	15,5	
FDI net inflow (mln ECU)	77,0	91,4	198,3	148,3	156,7	74,1	22,3	385,4	-	-	

Sources: Commission services, EBRD, Eurostat, IMF, WIIW, National Bank of Slovakia, Erste Bank.

* estimate ** projection or mid-year figure; except GDP, inflation, unemployment: WIIW forecasts June 1999 *** Erste Bank forecast

For 1999: annual average replaced by mid-year (June) exchange rates: 1 EUR = 1,0378 US$

For the monetary aggregates: conversion with the exchange rate given by Slovakia's National Bank for April: 1 EUR= 44,89 SKK

Weighted average of all maturities

Annex B

The Portuguese Integration Experience

The Portuguese Republic is an interesting example of successful convergence for Eastern Europe for several reasons. First, it remained a relatively closed economy for almost half a century, due to the fascist dictatorship installed in the 1920s, which was only overthrown by a left-leaning military movement in 1974 –the "Carnation Revolution". Secondly, both the fascist dictatorship and the political movement that initially replaced it were characterised by heavy state intervention in the economy (the "Carnation Revolution" even nationalised most of the large economic and financial groups; it also seized rural estates to undertake a land reform). Thirdly, it started the catching up process with a welfare level far below the Union average (around a quarter, in the early 1970's, as compared to the current 60%). Fourthly, at the beginning of this process, a large share of its labour force (around 15%, as compared to the current 5%) was still in agriculture. Finally, it also had to engage in a fast movement of comprehensive structural reforms, aiming at its accession to the EU and integration into the group of founding members of the Euro.

The immediate post re-democratisation period was characterised by almost a decade of political instability and two IMF stabilisation programs (in 1978/79 and 1983/84), to deal with the external imbalances resulting from inadequate macro policies (external deficits had reached 12.9% of the GDP in 1982). After these programmes, external balance was regained, but by the mid-eighties, at the time of the Portuguese accession to then European Community in (1986), inflation was still at 16.8%, the public deficit was around 6.5% of the GDP and unemployment was at a historically high level of 9%.

By then, a domestic consensus emerged in favour of reforms to enable the development of a *medium-term macro policy* aiming at:

i) a *progressive* fiscal consolidation, coupled with and reinforcing increasingly non-accommodative monetary and exchange rate policies to achieve sustainable disinflation and external balance;

ii) structural changes to strengthen market mechanisms (through re-privatisation, freeing of prices, opening up of the financial sector, liberalisation of capital flows); and,

iii) a reduction of the importance of the primary sector in the economy, a change in the composition of the industrial production and a substantial increase in the importance of the tertiary sector.

The adjustment costs brought about by these reforms were reduced by the increase in growth experienced after the accession. Financial transfers from the Union and sector-specific derogations (of up to 7 years, even after accession) also helped to cushion the blows. The reforms gathered pace in the early 1990s. **The exchange rate regime, based since 1977 on a crawling peg, was replaced in early 1991 by dirty floating with undisclosed bands of intervention, to gauge the "equilibrium value" of the Escudo before its planned integration into the ERM-1**, which took place in early April 1992. This careful approach enabled the Escudo – contrary to the Lira or the Pound - to remain in the currency grid, despite the successive crises in the ERM in late 1992 and early 1993, with a only minor adjustment in the parity.

Monetary policy actions were performed through blunt direct instruments until the early 1990s: direct and investment credit ceilings and interest rates ceilings and high reserve requirements (introduced with the first IMF program). The creation of indirect instruments was a progressive process, finished by the mid-1990s, initiated with the beginning of the re-privatisation and opening-up of the financial system in 1984, followed by the development of a treasury bill and Interbank foreign exchange markets in 1985, the elimination of the credit (finished by January 1991, and accompanied by two mopping up operations to absorb the resulting excessive liquidity, in December 1990 and March 1991) and rate (initiated in 1984 and completed by May 1992) ceilings, the creation of standing facilities for liquidity supply and absorption (respectively, in July 1993 and the second half of 1994) and of repo auctions, and the reduction of reserve requirements (from the massive uniform share of 17% established in 1989 to 2% by late 1994, with a parallel operation of mopping up liquidity) and completed with the liberalisation of capital movements (December 1992). Also, in a series of legal changes between 1990 and 1998, the “Banco de Portugal” (BdP, Portuguese Central Bank) witnessed its legal and actual independence progressively increased, to conform to EMU requirements. The initial phases of this process strikingly resemble the developments in monetary policy throughout Eastern Europe (See Hrnčíř, 1996, Nemenyi, 1996, Kokoszczyński, 1996, Makúch, 1996, Krzak, 1998) during the 1990s. Markets also believed in the convergence process, since the strategy was credible and forward-looking, and communicated clearly to private sectors agents. The sustainable nature of this progressive, a decade and a half long strategy was recognised by the selection of Portugal for Euro participation in 1998: all the EMU criteria were by them fulfilled by the Portuguese Republic.

Annex C

An Example of "Premature Monetary Integration": East Germany

Premature integration into the Eurozone could result in a massive, prolonged and painful economic adjustment. An empirical demonstration of the dangers of premature and inadequate monetary integration (i.e., *immediate adoption of the Euro upon EU accession without an adequate convergence level by the candidate countries*) can be found in Germany in the early 1990s.

The so-called German Economic and Monetary Union (GEMU) can be classified as a truly text book (and, as such, extreme) recent example of integration into a common monetary zone without a previous convergence process, which would enable the reduction of structural heterogeneity and productivity differentials among the integrating regions and, therefore, it clearly exemplifies some of the problems with this type of strategy[96].

On May 18 1990, faced with the political collapse of the communist regime in the DDR, the Government of the BRD published the plan for *immediate and full* re-integration of the two German states, the so-called "Re-Unification Treaty" (*Vertrag über die Schaffung einer Währungs-, Wirtschafts- und Sozialunion zwischen der BRD und der DDR*). As a result of it, the DDR Mark was replaced by the BRD Mark (Deutsch Mark, DEM) on July 1 1990. This had the positive effect of sparing the *Neue Bundesländer* (New German States) the process of monetary stabilisation necessary in virtually all other transition economies. The "stability import" (see Stephan, 1999) or "extension of the West German monetary order" (see Bofinger, 1997) also meant that the restructuring of the financial and banking sector became unnecessary. The former monobank network was taken over by West German private banks (Deutsche and Dresdner), their bad debts were cleaned up by the BRD federal government. Additionally, the institution building process became unnecessary as well, since the whole institutional framework of a functioning and highly developed market economy was transplanted almost overnight.

Among the most negative components - with long lasting effects - of this process was the fact that the exchange rate used to convert the DDR Marks into DEMs was a non-equilibrium one. For political reasons ("East Germans cannot be treated as second class Germans"), they were exchanged at a highly overvalued rate: not quite at a par rate, as is usually believed, which was only used for individual bank accounts up to a certain limit, and for wages, pensions and rents (see ECE, 1990), but at a rate somewhere between 1.6 and 1.8, on the aggregate (see Stephan, 1999). This conversion rate implied an overvaluation of the former DDR Mark in excess of

[96] We must note that most of the available studies (see Hochberg, 1999, Lythe, 1995) indicated that West and East Germany *could be classified as an OCA at the start of the process: both economies shared a high level of factor mobility –increased by a shared common language, a large level of openness to trade, a highly symmetric reaction to exogenous shocks and had the added feature of fiscal federalism* (See Sell, 1995, for the opposite view). Clearly, the mere mechanical fulfilment of the OCA criteria is not enough to assure either a painless or a successful process of monetary integration. As an additional remark on the debatable usefulness of the OCA concept, Hutchinson, M. (see Hutchinson, 1998), estimates that Denmark – a non Euro country - would form an OCA with the EU, while Finland – an Euro participant- would not.

300%.[97] The DDR itself used a long-run export average shadow rate of 3.73 (see Smith, 1998). To make things worse, the DEM itself appreciated further by 5.2% between 1990 and 1992 (and by 8.6% in relative unit labour costs in manufacturing: see Kaser, 1998).

The overvaluation problem was compounded by the extension of the West German's centralised wage bargaining process into East Germany, which resulted in wage levels of around 72% of the West German standards by 1996, for a productivity level of only 55% of the BRD value (up from the original 26% - see Siebert, 1995 - but this magnitude has stagnated at this level since 1993). These figures imply that unit wage costs in East Germany are – even nowadays - at least 30% higher than in West Germany.

The East German productive base was geared mainly to supply its domestic markets and the national markets of the CMEA (Council of Mutual Economic Assistance, the "common market" of the former East Block, which collapsed in 1991, when its members ceased to accept the settlement of trade flows in inconvertible Rubles and started to demand instead the settlement of trades in hard currencies): it lost both, its domestic markets to West German products and CMEA's, with the collapse of the organisation.

The sectoral structure was geared towards the production of industrial goods, according to the non-market (i.e., non-endowment based) national specialisation system defined by the central plans in the former Soviet zone of influence. The twin phenomena of imposing a "hard budget constraint" and artificially high wage levels turned at least 50% of the former DDR's industrial production capacity economically infeasible overnight (see Siebert, 1995).

Since adjustment through prices (i.e., reducing the nominal salary level to compensate for the productivity differential) was impossible, and without a currency exchange mechanism to cushion adjustment, the only possible adjustment was through quantities (i.e., *via massive unemployment and reduction of production*). Such adjustment happened, and it was brutal: unemployment and GDP reduction were much more severe - and long lasting - in East Germany than in any other of the transition economies*: by 1991, GDP had collapsed to 69% of its 1989 level, and industrial production fell to less than 50% during the same period; unemployment topped 30% by the end of 1991*[98]*, and, since the employment figures include several Western financed job-creation schemes, real unemployment may have surpassed 50% of the total East German labour force* (see Smith, 1998, and Stephan, 1999). Even today, almost ten years afterwards, GDP has not reached its 1989 level and, at 20%, unemployment is still twice the West Germany level.

The fiscal costs of this process were astonishing: the only reason why the fall of GDP was not accompanied by a large reduction of aggregate demand, and the massive unemployment didn't result in widespread social unrest was due *only* to the unique scale of net financial transfers from West to East Germany, to the tune of 899.1 *Billion* of DEM for the period 1991-1996 *only*. *This partial figure surpasses the combined GDP of all Applicant Countries together*: fiscal transfers for the former DDR represented a full 37% of the East German GDP in 1995 (down from 52% in 1991) and 4.5% of West German GDP (up from 4% in 1991: see Stephan, 1999). Estimations

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[97] Contrary to the very West "German Model" experience, which was an "export miracle" based, among other things, in a *politically accepted* prolonged undervaluation of the DEM (see Hölscher & Stephan, 1998).

[98] The industrial workforce, the hardest hit, dropped from 3.2 Million in 1989 to 0.6 Million in 1994 (see Kaser, 1998).

show that foreign inflows per capita in East Germany were at least one hundred times greater that the average for Eastern Europe (see Kaser, 1998). Over 60% of these resources were supplied by the German Federal Government, and there is no real end in sight for this unilateral flow of financial transfers[99]. The convergence process of the Eastern towards the Western Bundesländer average income level is estimated to take anything from 10 to 40 years (See Kaser, 1998). The upper bound is even higher than the IMF estimations (see Fischer et al., *ibidem*) for real convergence of the *most backward* of the applicant countries.

The effects of GEMU were felt throughout the whole EU. To prevent economic overheating stemming from the initial, short-lived (West) German unification boom, a restrictive monetary policy, with interest rate hikes, was undertaken by the German Central Bank, the *Bundesbank*. The resulting capital inflows and appreciation of the DEM could have been corrected by a nominal revaluation of the DEM in the parity grid of the old ERM. This was refused and the only adjustment mechanism left was for the whole ERM to undertake a joint effort of real appreciation through restrictive monetary policies. This joint deflationary policy resulted in the Western European economic deceleration of 1992/1993 and in the ERM crisis of the same period.

The East German example highlights the importance of a phased and sustainable convergence process (unsustainable strategies are also inadequate for countries that are already *EU* member states, as the Greek example clearly shows: see Box IV) and of real wage flexibility as an adjustment tool. It suggests that the future Member Countries should continue their efforts towards reform and towards an increased flexibility of labour relations.

[99] Obviously, any other transition economy trapped in a “premature integration” situation would have to face by itself the overwhelming majority of the resulting costs, since the scale of Eastward fiscal transfers that will *inevitable* follow EU accession will be in no way similar to the scale of inter-German financial flows: for example, structural funds for Southern European countries didn’t exceeded, on average, 2.5% of their GDP, on *gross* terms.

Annex D

Table 2.1 EMU Criteria for the Candidate Countries (most recent official data)

Countries	Inflation Rate	Long-Term Interest Rates	Deficit or Surplus as a Share of the GDP	Public Debt as a Share of the GDP	Monetary Authority Status
EMU Criteria	2.8% (1.5+1.3[HICP,ECB, 01-08/99])	7.36% (2.0+5.36[Weighted Average of 10-year Government Bonds in Euroarea, ECB,9/99])	-3% (Value for Euroarea: -2%[Eurostat,98])	60% (Value for Euroarea: 73.7%[Eurostat,98])	Legally Independent Central Bank
Cyprus	2.8 [CPI,CBC, 12/98]	5.5[One Year Treasury Bill,CBC, 09/99](d)	**-5.3**[CBC, 97]	57.7[CBC, 97]	**Non Independent Central Bank (b)**
Czech Republic	2.7[CPI,CNB,08/99]	6.8[One Year Pribor, CNB,08/99]	-1.4[IMF,12/98]	10.7[Central Government,IMF, 12/98]	Legally Independent Central Bank (b)
Estonia	2.8[CPI,BoE,09/99]	6.75[One Year Talibor, BoE, 09/99]	**-6.6[CSO/MoF,06/99]**	11.11[CSO/MoF,Central Government Debt plus Guaranteed Debt, 06/99]	Currency Board Arrangement.
Hungary	**9.52[“Core” PI, MNB, 06/99]**	**15.5[Refinancing One Year Rate, MNB, 07/99]**	**-4.1[General Government, MNB,98]**	**65.8[General Government, MNB,98]**	Legally Independent Central Bank (b)
Poland	**7.2[CPI,NBP,08/99]**	**22.5[Commercial One Year Loan, NBP, 08/99]**	-2.2[NBP Forecast for 1999]	50.1[General Government, IMF, 1997.]	Legally Independent Central Bank.
Slovenia	**6.6[CPI, BoSE, 10/99]**	**9.71[6-Months Treasury Bill, BoSE, 10/99]**	-0.6[BoSE,1998]	25.23[BoSE, QII, 1999]	Legally Independent Central Bank (b).
Malta	2.23[CPI, BoM, 98]	5.29[One Year Treasury Bill, BoM, 06/99]	**-8.8[BoM, 98]**	56.3[IMF Forecast, 08/99]	**Non Independent Central Bank (b).**
Bulgaria	-0.5[CPI, BNB, 07/99]	5.40[Yeld on Government Securities, BNB, 07/99]	0.0[BNB,12/98]	**96.42[Domestic and Foreign Debt, BNB, 01/99]**	Currency Board Arrangement.
Latvia	2.4[CPI, BoLa, 09/99]	**12.25[One Year Treasury Bill, BoLa, 10/99]**	0.1 [BoLa, 12/98]	12.7[Domestic and Foreign Government Debt, BoLa, 06/99]	Legally Independent Central Bank.
Lithuania	1.0[CPI, BoLi,09/99]	**12.0[Three Months Government Securities, BoLi, 10/99]**	**-5.8[IMF,98]**	17.0[IMF,98]	Currency Board Arrangement (b), (c).
Romania	**48.7[BCE,08/99]**	**35.0(a)[BCE,08/99]**	**-2.6[BCE,08/99]**	18.0 [IMF, 97]	Legally Independent Central Bank (b).
Slovakia	**9.4[BoSa,09/99]**	**15.84[BRIBOR Six Months, BoSa, 08/99]**	-2.66[BoSa,98]	20.7[BoSa98]	**Non Independent Central Bank (b).**

Source: BCE, IMF, ECB and respective National Central Banks; (a): Interbank rate; (b) Lending to Government is still permitted; (c) Capable of engaging in some types of open-market operations; (d) Ceiling on domestic interest rate. Values in bold indicate a transgression of the Maastricht criteria.