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Economic consequences of the Georgian-Russian conflict

BY PETER HAVLIK AND VASILY ASTROV

This note discusses the main economic consequences of the conflict between Georgia and Russia. It argues that the conflict bears serious implications, impacting not only on the Caucasus region proper, but quite likely far beyond. Our assessment will briefly address the consequences for the main parties concerned (Georgia, Abkhazia, South Ossetia and Russia), as well as the probable ructions for the EU, EU-Russian relations and the energy trade.

Georgia

Georgia used to be one of the smaller former Soviet republics; its territory covers 69,700 sq. km. At the beginning of the 1990s, the population numbered 5.5 million inhabitants (of whom 540,000 lived in Abkhazia and 100,000 in South Ossetia). Georgia used to be one of the relatively affluent Soviet republics (in 1990 its estimated net material product per capita stood at 74% of the Soviet average);[1] it derived particular benefit from a flourishing agricultural sector, whose produce (wine, grapes, vegetables and citrus fruits) was sold at a huge profit on private *kolkhoz* markets in the cities of Russia and the Ukraine. The collapse of the Soviet Union and the subsequent conflicts (the first war in South Ossetia broke out as far back as January 1991) led to the collapse of the Georgian economy and a *de facto* split of the country. It also led to a massive wave of internal (displaced persons) and external (primarily to Russia) migration.

At the latest count, the population of Georgia stood at some 4.4 million persons as of end-2006 (excluding Abkhazia and South Ossetia); this means that some 400,000 people have left since

[1] See Williamson (1993), p. 45. These official data most likely underestimated the size of the Georgian economy given a sizeable shadow economy and price distortions.

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the early 1990s, many of them to Russia.[2] Since 1995, Georgia's economy has been steadily recovering, even though the country is still one of the poorest in the region (with an estimated per capita GDP of some EUR 3,500 at PPP, corresponding to some 15% of the EU average) and its economy is far below the peak it achieved in the late 1980s (see Annex Table 1). The economic policies pursued have been very liberal, featuring privatization on a massive scale (albeit not very transparent), the unilateral abolition of all import tariffs and the introduction of a 12% flat tax in 2004. Georgia joined the WTO in 2000. To date its main trading partners have been Russia, Turkey, Azerbaijan and the Ukraine (see Annex Table 2). Its key exports to Russia are foodstuffs and those to the EU refined petroleum and metals (see Annex Table 3). Viewed from an EU perspective, however, trade flows have been negligible: a mere EUR 1 billion of EU exports and EUR 0.5 billion imports – mainly energy. Not only with the EU, but also with other trading partners, Georgia has built up large trade deficits (more than 30% of GDP). In the past two years, foreign direct investment (FDI) inflows amounted to some USD 2 billion.[3]

What are the key economic consequences of the conflict for Georgia? Apart from the permanent loss of Abkhazia and South Ossetia (about 18% of Georgia's territory)[4] and the war-related human losses (more than 100 Georgian soldiers and probably a comparable number of civilians perished during the war in August 2008),[5] the estimated costs of the damage to buildings, military and civilian infrastructure are in the order of less than USD 1 billion (about 10% of the country's GDP).[6] These are direct economic losses that Georgia incurred during the recent conflict; potentially more important, however, are the consequences that the conflict bears for the country's economic growth and its trade and investment prospects. On the one hand, given the growing awareness of regional political instability (mirrored *inter alia* in lower credit ratings),[7] FDI inflows will most probably decline – at least temporarily. Moreover, foreign trade is likely to suffer as well. In particular, exports of Georgian wine and mineral water to Russia that have been hit by the Russian embargo since 2006 may well dry up altogether. As far as imports are concerned, the key question is financing and the heavy dependence on Russia, especially in terms of energy (the Georgian electricity grid is majority-owned by Russian investors). The EU could offer an alternative market for Georgian products as a form of assistance.

On the other hand, Georgians working abroad remit sizeable sums of money, amounting to some USD 1.2 – 2 billion per year.[8] Aimed mainly at supporting families back home and thus barely affected by any changes in investment ratings, these remittances are unlikely to drop to any marked degree in the medium and long term. In the short term, however, the reported disruptions of the services of Western Union and other financial providers may play a role. Furthermore, the imposition of tougher restrictions on Georgian workers in Russia cannot be excluded, thus making it harder for them to work, live and travel there.[9] Only a fraction of these losses will be offset by the

2 About 1 million ethnic Georgians currently live in Russia, of which about 300,000 are (partly illegal) migrant workers – see *Vedomosti*, 1 September 2008.

3 For more details see Astrov and Havlik (2008).

4 This 'loss' may, however, not be relevant since in economic terms both Abkhazia and South Ossetia are *de facto* already detached from Georgia, in fact, for almost the past two decades, and both countries use the Russian rouble as their official currency.

5 The number of people displaced by the conflict in South Ossetia reported in *Financial Times* (1 September 2008, p. 3) which cited UNHCR figures (158,000, of which 128,000 had allegedly fled to Georgia and 30,000 to Russia) must be grossly exaggerated since the total population of South Ossetia before the war was a mere 70,000 (see below).

6 See *Vedomosti Smart Money*, 18 August 2008.

7 Fitch and Standard & Poor's downgraded Georgia's sovereign rating in the wake of the military conflict with Russia.

8 See *Vedomosti*, 1 September 2008. From Russia, the officially recorded remittances amounted to USD 560 million in 2007 according to the Russian Central Bank (see www.cbr.ru/statistics).

9 In particular, with the rupture in diplomatic relations, it will be more difficult to commute between Georgia and Russia.

foreign humanitarian aid envisaged. As a consequence, the current account deficit (already more than 15% of GDP) will increase still further.

On balance, economic growth in Georgia is likely to suffer - at least in the short term. Before the war, GDP growth was expected to exceed 10% in 2008; today, however, the expectation is 6% at best. It is estimated that the overall economic losses for Georgia, including damaged infrastructure, loss of output, reduced FDI inflows, fewer remittances and exports, will be in the order of EUR 2 billion. The speed of recovery will depend largely on political stability: something that is far from guaranteed.

Abkhazia

The Republic of Abkhazia first declared its independence as far back as July 1992 – a step that was immediately followed by the unsuccessful, yet bloody Georgian invasion which resulted in more than 250,000 refugees fleeing to Georgia and the conflict ultimately being 'frozen'.[10], A small country located on the Black Sea coast (its territory extends a mere 8,700 sq. km.) with an estimated GDP of some EUR 0.5 billion, the current population of Abkhazia numbers some 340,000: predominantly Abkhaz inhabitants (following the Georgians' exodus during the conflict in the early 1990s). Sukhumi, the capital city, has a population of 75,000.

Thanks to its mild subtropical climate coupled with the Black Sea coast and surrounding mountains, the region was already a popular holiday resort during the Soviet period. Apart from tourism, the republic has few other resources, except for some building materials and a climate conducive to agriculture (citrus fruits, vegetables, etc).

In contrast to Georgia and South Ossetia, Abkhazia has not been directly affected by the latest military conflict (although Abkhaz armed forces took advantage of Georgia's military defeat in South Ossetia to regain control of the much disputed Khodori gorge). Moreover, with official recognition by Russia and the likelihood of political stability, investments stand to gain, in particular with respect to the development and refurbishment of tourist facilities and infrastructure. In fact, investments in those sectors have been pouring into the country (mostly from Russia) over the past couple of years; real estate prices – especially on the Black Sea coast – have been rising rapidly. Abkhazia has one other factor in its favour. Its western border is just 20 km from the Russian resort Sochi: the venue of the 2014 Winter Olympics.

When the Olympics venue was announced in 2007, Russia declared its intention to involve Abkhazia in the preparations for the Winter Olympics. The country will thus benefit from the upcoming investment and construction boom around Sochi; its tourism and agricultural potential should help to sustain it as an independent country (albeit heavily dependent on Russia). Furthermore, formal accession to Russia at some later juncture cannot be ruled out.

South Ossetia

Located north of Georgia on the southern slopes of the Caucasus and contiguous with the Russian republic of North Ossetia, this newly independent republic is tiny; it has a surface area of no more than 3,900 sq km and boasts a population of fewer than 70,000 inhabitants. The conflict with Georgia dates back to January 1991 after the Georgian Parliament stripped the region of its autonomy. As a result, more than 100,000 Ossets fled to the north away from Georgia and South Ossetia; the conflict has since been 'frozen'.[11] According to the latest count, the four-day war cost almost 1,700 South Ossetian lives[12] and more than 30,000 refugees fled to Russia.

The newly independent republic has no viable resources to speak of; in recent years, it has lived

[10] For more details see http://www.circassianworld.com/Abkhazia.html.

[11] For more details see http://www.kafkas.org.tr.

[12] According to South Ossetian authorities – see: http://www.gazeta.ru/news/lastnews/2008/08/28/n_1263719.shtml.

largely on smuggling and other criminal activities. It is ironic that certain representatives of the newly independent republic cite Andorra as a model for their new-born state; they also point to the extensive military experience that the Ossetian guerrillas acquired in the mountains as a good qualification for their employment as guides in the future tourist industry.[13]

South Ossetia's chances of economic sustainability as an independent state are slim on two counts: its lack of domestic resources and its geographic isolation. Russia has none the less announced its readiness to provide generous aid to support reconstruction. Immediately after the cessation of hostilities, Russia allocated RUR 10 billion (almost EUR 300 million) from the federal budget for the reconstruction of South Ossetia. This is a sizeable amount (about EUR 4,000 per inhabitant), yet it is very much a question of how much will be misappropriated in the republic's corruption- and crime-prone environment. Furthermore, pensions and salaries in the South Ossetian public sector are also funded from the Russian budget.

Given the likelihood of South Ossetia being inviable as an independent country and its possible annexation by Russia (and/or its *de facto* unification with Russia's North Ossetia), this could lead to further conflicts in the Russian sector of the Caucasus, in particular given the situation prevailing in Ingushetia (and possibly Chechnya and Dagestan as well).

Russia

In the medium and long term, Russia could well be the main loser in the Georgian conflict – even though the direct costs of the August war were marginal. Losses in terms of human (130 Russian soldiers) and military equipment were low. The Russian stock market only dropped a few percentage points immediately after the war;[14] its foreign exchange reserves dropped by about USD 10-15 billion (some 2%). The estimates of expected net capital inflows to Russia in 2008 have since been reduced from USD 40 billion to USD 30 billion.[15] Thanks to large windfall gains from the high energy prices on the global market, the Russian government has not only been able to repay nearly all its outstanding public external debts (although private debt increased markedly and this could heighten Russia's vulnerability), but it has also raised salaries in the public sector, as well as pensions. Moreover, it recently launched a number of national development projects (aimed at infrastructure, housing, health sector, education and agriculture). The long-discussed controversial concepts underpinning industrial policy (IP) have now received official blessing. The government-sponsored IP will offer targeted support to various public-private partnership projects in the automotive, aviation, shipbuilding and selected high-tech industries (such as nano, nuclear and space technologies).

In the medium and long term, the main challenge for the Russian economy is whether it will manage to develop other sectors and so find a replacement for energy exports as the main engine of growth. The officially endorsed long-term development programme that extends until 2020 envisages economic diversification on an ambitious scale and a gradual switch to innovation-based development supported by the IP instruments mentioned above. The programme also foresees completing a series of reforms aimed at improving the investment and business climate. The chances of the 'innovation development' scenario succeeding have now definitely diminished. The overriding concern is that the recent marked deterioration in Russia's relations with the West will bear serious repercussions for the country's future economic reforms. First, Russia's expected accession to the WTO (previously considered a possibility in 2008) will fall victim to recent developments. Even if USA and the EU abstain from sanctions, Georgia will veto Russian accession. Although the reduction in

13 See *International Herald Tribune*, 29 August 2008, p. 3.

14 The Russian stock market has been on the decline since late spring 2008 owing to the higher risks perceived in the wake of the TNK-BP and Mechel scandals.

15 See *Vedomosti Smart Money*, 18 August 2008.

import quotas envisaged by Russia will mainly hurt Western exporters (for example, poultry and pork), delaying Russia's accession to the WTO will constitute a major setback for the country's economic reforms.[16] Russia has never been too enthusiastic about joining the WTO. In fact, it transpired recently that the IP tools mentioned above might well be in conflict with WTO rules. Consequently, were the West to delay Russia's admission to the WTO, it would be playing straight into the hands of the more protectionist-minded Russian policy-makers and sectoral lobbies. From the standpoint of Western economic interests, excluding Russia from the WTO would thus be counterproductive.

As for Russia's ambitions regarding the 'innovation development' scenario mentioned above, its prospects outside the WTO are also definitely bleaker. Another repercussion of the Russian-Georgian conflict now being mooted could be the suspension of negotiations on a new EU-Russia partnership agreement (to replace the existing Partnership and Cooperation Agreement that expired at the end of 2007 and which has been automatically prolonged for one year). In all likelihood, this would also harm the EU more than Russia. This 'sanction' would only expose the lack of unity within the EU regarding Russia, since the bilateral deals that individual member states have concluded with Russia (focusing largely on energy trade) would most probably continue. Last but not least, both types of Western sanctions (delaying accession to the WTO and OECD as well as suspending talks on the new partnership agreement) would only weaken the position of liberal reformers in Russia still further.

With a stronger economy, more financial resources and a firmer consolidation of power at home, Russia's self-confidence (as well as its outward investments) will increase palpably, thus possibly leading to more conflicts with both the EU and USA.[17]

Impact on energy trade

Energy (and especially natural gas) is the dominant feature of EU-Russia economic relations. Russia is by far the largest supplier of energy to the EU, providing one third of all EU crude oil imports and more than two fifths of all gas imports. Nearly 20% of all EU energy imports come from Russia, while the new EU member states in Central and Eastern Europe (NMS-10, but Poland, Lithuania, Hungary and Slovakia, in particular) are even more dependent on Russian energy deliveries. Whereas in recent years the NMS have, to a certain degree, diversified their sources of energy imports (although more than half of their energy imports still comes from Russia), in Western Europe (EU15) the dependence on Russian energy has increased since 2000 (to 15.6% of total energy imports in 2007). Russia has refused to sign the European Energy Charter which would grant European companies access to its energy distribution networks. At the same time, it is making every attempt to enter downstream energy markets in the EU via a number of bilateral deals with German, French, Italian, Bulgarian, Hungarian and Slovak companies. The Russian state-controlled giant Gazprom is especially active in this area. Since energy is now considered the strategic sector, the Russian government has substantially increased its grip on both domestic natural gas (where Gazprom has always played a dominant role) and independent crude oil producers by reversing, or at least revising, the earlier privatization deals or production sharing agreements. Its basic argument is that those deals were unfair, having been concluded during the nineties: a time when Russia was weak.[18]

[16] WTO accession represents one of the few available institutional anchors for economic reform in transition economies that enjoy no prospects of joining the EU – see Grinberg et al. (2008).

[17] For an overview of Russian foreign policy after 2000 and an analysis of the reasons underlying the worsened relations with the West see R. Sakwa (2008). The Georgian-Russian war in August 2008 over South Ossetia and Abkhazia was the latest example of latent local tensions escalating into a broader conflict between Russia and the EU.

[18] A *de facto* re-nationalization of the largest private oil company Yukos (and gaoling its CEO Mr Khodorkovsky), as well as the disputes surrounding the Sachalin production-

While the EU depends on Russian energy deliveries, Russia is even more dependent on the EU market for her (energy-based) exports. With more than 50% of overall Russian exports going to the EU and with nearly 70% of overall Russian export revenues derived from energy-based exports, one could argue that Russia is more dependent on the EU than vice versa. This mutual interdependence is likely to persist in the future because the EU has hardly any access to alternative supply routes and supplier countries– just as Russia lacks access to alternative markets. European energy security in relation to Russia is therefore not primarily a question of whether Russia is willing to deliver (it has hardly any other alternative in the foreseeable future), but whether it will be able to meet ever-increasing EU demand (as other suppliers such as Norway, the Netherlands and the United Kingdom will ultimately go into decline).

South Ossetia and Abkhazia *per se* are unimportant in terms of global energy markets; energy considerations thus appear to have played but a minor role in the recent Russian-Georgian conflict. Of course, Georgia proper is a crucially important corridor for the transport of energy from the Caspian basin as it by-passes Russia. Its territory is transected by two major oil pipelines (both operated by British Petroleum). One runs from Baku to Supsa (the Georgian port on the Black Sea), with a capacity of 100,000 barrels per day (bpd). The other runs from Baku via Tbilisi to Ceyhan (the Turkish port on the Mediterranean Sea), with a capacity of up to 1 million bpd (the current throughput is only some 600 thousand bpd). Georgia is also crossed by a major gas pipeline running from Baku via Tbilisi to Erzurum (with a capacity of 6 billion cubic metres per year), in addition to oil being shipped by rail to the oil terminal in Batumi on the Black Sea. However, in essence Russian control over these pipelines and rail links would require control over Georgia: that appears unlikely and would in any case contradict Russia's commitments as laid out in the Medvedev-Sarkozy cease-fire agreement.

The conflict itself hardly led to disruptions in the flow of energy to the world markets. Only a minor amount of oil (some 20,000 bpd)[19] was re-routed away from the Baku-Supsa link to Novorossiysk (the Russian port on the Black Sea) for security reasons. In turn, the temporary closure of the Baku-Tbilisi-Ceyhan pipeline over much of August was not related to the Russian-Georgian conflict, but was prompted by an earlier explosion on the Turkish stretch of the pipeline attributed to Kurdish separatists.

Nevertheless, the conflict might bear negative implications for the prospects of Georgia consolidating its role as an alternative (to Russia) corridor for transporting Caspian oil and gas to Europe. This applies primarily to the planned Nabucco gas pipeline, which would draw largely on Turkmenistan's gas reserves and necessitate an upgrade of the existing Baku-Tbilisi-Erzurum gas pipeline to at least 20 billion cubic metres per year. One reason for the setback is the higher perception of risks associated (see above) with Georgia proper in particular and the whole South Caucasus region in general. With the balance of post-conflict power in the region seemingly shifting in Russia's favour and compounded by Russia's strong opposition to Nabucco, a factor of potentially greater importance is emerging: Turkmenistan may become even less willing to get involved in the project. In a similar vein, Kazakhstan may become equally unwilling to ship its oil via the Southern Caucasus, notably through the Baku-Tbilisi-Ceyhan pipeline.[20] Signs of this happening are already discernible.[21] The instantaneous expression of support for Russia's decision on Abkhazia and South Ossetia by Kazakhstan's president, N. Nazarbayev, may be yet another manifestation of this trend.

sharing agreements are the best known examples in this respect.

19 See e.g. *Izvestiya*, 12 August 2008, p. 7.

20 To accommodate the flow of additional oil from Kazakhstan, the throughput capacity of Baku-Tbilisi-Ceyhan is to be upgraded to some 1.8 million bpd – see *Neue Zürcher Zeitung*, 15 August 2008, p. 10.

21 See e.g. *Izvestiya*, 12 August 2008, p. 7.

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Annex Table 1

Black Sea region: an overview of economic fundamentals, 2006

	Armenia	Azerbaijan	Georgia	Turkey	Russia	Ukraine	Bulgaria	Romania	*NMS-10*	*EU-15*	*EU-27*
GDP at exchange rates, EUR billion	5.1	15.8	6.2	318.6	785.8	84.9	25.1	97.2	*723.9*	*10796.3*	*11539.7*
GDP at PPP, EUR billion	12.3	44.8	15.0	537.8	1574.4	242.6	66.2	197.3	*1320.3*	*10548.1*	*11907.0*
GDP at PPP, EU-27=100	0.10	0.38	0.13	4.5	13.2	2.0	0.6	1.7	*11.5*	*90.6*	*100.0*
GDP per capita at PPP, in EUR	3830	5280	3450	7370	11070	5200	8600	9140	*12700*	*26370*	*23520*
GDP per capita at PPP, EU-27=100	16	22	15	31	47	22	37	39	52	*112*	*100.0*
GDP at constant prices, 1990(1991)=100	155	150	74	186	101	73	111	120	*143*	*138*	*139*
GDP at constant prices, 2000=100	202	253	156	131	144	155	137	142	*131*	*111*	*113*
Industrial production, real, 1990(1991)=100	84	78	40	204	77	105	85	82	*145*	*.*	*127*
Industrial production, real, 2000=100	152	223	155	133.2	135	174	161	134	*144*	*.*	*110*
Population - thousands, annual average	3220	8480	4350	72974	142221	46646	7699	21584	*102171*	*390196*	*493499*
Employed persons - LFS, thousands, annual average	1112	3973	1700	22330	68693	20730	3110	9313	*42270*	*171010*	*213768*
Employed persons, in % of population	34.5	46.9	39.1	30.6	48.3	44.4	40.4	43.1	*41.4*	*43.8*	*43.3*
Unemployment rate - LFS, in %	7.2	.	13.6	9.9	6.8	6.8	9.0	7.2	*10.0*	*7.9*	*8.7*
General government expenditures, in % of GDP	19	19	32.4	26.7	31.3	32.6	37.2	32.9	*41.8*	*47.4*	*47.2*
General government revenues, in % of GDP	18	21	30.7	27.1	39.7	32.0	40.8	31.2	*38.4*	*45.1*	*44.8*
Price level, EU-27=100 (PPP/exchange rate)	35	29	41	63	56	26	37	50	*54*	*102*	*97*
Average gross monthly wages, in EUR	123	126	110	651	315	164	181	326	*765*	*3211*	*2755*
Average gross monthly wages, EU-27=100	4.5	4.6	4.0	23.3	11.2	5.9	6.5	11.6	*27.3*	*116.6*	*100.0*
Exports of goods, in % of GDP	15.7	32.2	12.6	22.7	31.0	36.5	47.7	26.6	*46.9*	*29.6*	*30.6*
Imports of goods, in % of GDP	34.3	26.6	46.9	32.9	16.8	41.5	69.2	38.7	*51.3*	*29.9*	*31.3*
Exports of services, in % of GDP				6.0	3.2	10.6	15.9	5.7	*8.7*	*8.9*	*8.9*
Imports of services, in % of GDP				2.8	4.6	8.6	13.0	5.7	*7.5*	*8.0*	*8.0*
Current account, in % of GDP	-4.5	15.6	-14.9	-7.9	9.8	-1.5	-15.8	-10.3	*-5.7*	*-0.2*	*-0.5*
FDI stock per capita, in EUR	423	1250	620	822	1160	370	2047	1432	*3019*	*.*	*.*

Note: NMS-10: Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia. PPP: Purchasing power parity - wiiw estimates.

Source: wiiw, AMECO, UNCTAD, EBRD, Eurostat and CISSTAT; own estimates.

Annex Table 2

Georgian Exports by Countries in January-December 2007

(Thsd. USD)

Countries	Q1	Q2	Q3	Q4	Year (USD million)
Total Exports	223,661.4	320,302.4	330,505.0	365,715.7	1,240.2
of which:					
CIS counrties	86,996.3	125,370.2	122,067.1	135,004.0	469.4
Armenia	21,486.5	21,848.5	34,094.2	33,415.0	110.8
Azerbaijan	21,914.0	41,306.3	35,053.8	39,047.1	137.3
Belarus	410.2	1,274.9	996.9	2,056.7	4.7
Kazakhstan	11,177.2	6,924.8	6,846.2	9,343.3	34.3
Kyrgyzstan	66.4	48.3	107.0	657.7	0.9
Moldova, Republic of	26.9	524.7	117.9	171.9	0.8
Russian Federation	13,267.0	10,582.6	19,393.1	9,771.3	53.0
Tajikistan	110.2	1,293.0	1,218.7	1,641.8	4.3
Turkmenistan	1,212.1	20,104.8	4,096.9	924.6	26.3
Ukraine	16,986.3	20,938.5	19,436.9	36,807.6	94.2
Uzbekistan	339.4	523.8	705.5	1,166.9	2.7
EU countries	62,618.6	57,949.0	78,341.8	69,621.0	268.5
Austria	44.0	171.3	1,473.8	3,230.2	4.9
Belgium	3,957.2	5,267.5	5,898.8	2,614.2	17.7
Bulgaria	7,924.6	22,338.1	20,948.7	8,145.9	59.4
Cyprus	78.9	62.6	58.6	34.3	0.2
Czech Republic	849.2	484.4	1,697.8	3,079.8	6.1
Denmark	280.9	23.0	23.0	481.8	0.8
Estonia	332.4	132.7	210.8	766.8	1.4
Finland	44.8	3.1	6,843.9	-	6.9
France	4,654.6	868.4	3,855.1	2,235.6	11.6
Germany	11,308.3	9,445.3	13,760.8	21,641.5	56.2
Greece	3,548.9	655.9	902.9	1,898.8	7.0
Hungary	37.3	0.4	0.0	0.2	0.0
Ireland	25.7	81.2	176.2	73.7	0.4
Italy	7,331.5	2,484.4	3,598.5	4,378.2	17.8
Latvia	1,399.6	776.5	1,278.2	1,047.7	4.5
Lithuania	1,447.6	1,434.1	1,490.0	1,668.6	6.0
Netherlands	1,987.5	3,449.0	3,921.7	2,753.2	12.1
Poland	812.2	336.5	1,163.7	3,962.9	6.3
Portugal	448.1	568.3	844.5	450.7	2.3
Romania	314.2	1,101.0	1,151.1	4,968.4	7.5
Slovakia	297.8	443.1	506.9	313.7	1.6
Spain	9,225.3	1,239.5	2,734.4	1,215.7	14.4
Sweden	64.1	0.3	8.7	17.2	0.1
United Kingdom	6,203.9	6,582.2	5,780.1	4,606.2	23.2
Other countries	74,046.5	136,983.2	130,096.1	161,090.7	502.2
Afghanistan	-	270.6	155.2	655.7	1.1
Algeria	-	1,588.0	-	-	1.6
Belize	291.8	766.3	37.1	309.6	1.4
Brazil	-	9,299.8	-	-	9.3
Canada	9,543.1	14,541.0	19,685.3	26,834.1	70.6
China	1,171.9	2,089.0	2,331.4	2,680.3	8.3
Egypt	2,791.1	-	-	-	2.8
Gibraltar	1,925.4	3,311.6	1,093.4	2,486.0	8.8
India	2,351.1	2,381.8	1,626.9	1,781.0	8.1
Iran, Islamic Republic of	1,266.3	866.9	1,774.3	2,142.5	6.1
Iraq	342.8	207.2	192.3	640.5	1.4
Israel	1,860.1	6,175.2	4,074.5	1,605.2	13.7
Japan	1.3	77.7	232.1	81.8	0.4
Korea, Democratic People's Republic of	326.1	379.0	143.9	-	0.8
Korea, Republic of	215.9	998.2	1,279.9	694.8	3.2
Mexico	-	9,550.0	21.4	3,110.0	12.7
Mongolia	87.8	191.2	52.8	110.7	0.4
Peru	145.9	423.1	210.2	522.1	1.3
Singapore	22.8	216.2	295.9	431.6	1.0
Switzerland	155.8	315.2	84.4	811.9	1.4
Turkey	35,495.7	48,297.2	48,006.3	39,971.5	171.8
United Arab Emirates	1,801.8	10,960.0	3,264.2	2,612.2	18.6
United States	10,569.8	23,606.6	43,176.0	72,209.0	149.6
Yemen	2,073.2	0.3	-	-	2.1

(Annex Table 2 continued)

Annex Table 2 (continued)

Countries	Q1	Q2	Q3	Q4	Year (USD million)
Total Imports	1,045,098.7	1,179,299.8	1,317,693.9	1,674,609.6	5,216.7
of which:					
CIS counrties	395,317.6	418,260.6	444,582.3	595,752.0	1,853.9
Armenia	10,996.7	15,902.2	17,704.7	14,953.9	59.6
Azerbaijan	76,283.6	85,461.4	86,801.8	133,405.2	382.0
Belarus	2,422.0	5,124.4	6,253.0	15,073.6	28.9
Kazakhstan	18,478.6	11,753.3	10,739.1	22,848.1	63.8
Kyrgyzstan	797.9	77.0	31.0	261.9	1.2
Moldova, Republic of	719.1	911.5	901.5	1,278.0	3.8
Russian Federation	168,500.0	129,596.8	125,437.5	155,304.0	578.8
Tajikistan	29.5	-	-	1.1	0.0
Turkmenistan	21,207.9	33,528.4	41,469.2	53,696.3	149.9
Ukraine	92,418.9	133,119.7	152,748.3	196,619.1	574.9
Uzbekistan	3,463.5	2,786.0	2,496.2	2,310.7	11.1
EU countries	310,844.0	365,204.1	379,717.1	483,140.2	1,538.9
Austria	9,835.0	9,598.0	13,488.8	21,745.1	54.7
Belgium	9,798.4	11,057.2	12,088.2	12,546.6	45.5
Bulgaria	38,531.2	35,548.7	46,303.4	63,666.3	184.0
Cyprus	1,170.8	1,164.6	321.7	194.7	2.9
Czech Republic	8,902.5	6,745.4	15,389.4	22,178.5	53.2
Denmark	3,994.8	4,183.5	2,791.9	2,841.5	13.8
Estonia	156.9	1,216.4	615.3	1,935.7	3.9
Finland	8,172.7	8,127.8	12,188.8	9,199.8	37.7
France	19,996.2	29,396.1	27,763.9	23,871.1	101.0
Germany	86,313.5	92,607.7	99,200.4	109,205.0	387.3
Greece	8,013.2	17,780.1	16,341.5	10,726.3	52.9
Hungary	5,208.6	6,730.7	5,754.6	9,394.1	27.1
Ireland	984.2	1,477.0	1,357.5	1,225.1	5.0
Italy	25,274.0	37,038.4	34,786.3	46,950.1	144.0
Latvia	1,766.3	2,140.4	2,594.1	1,840.8	8.3
Lithuania	2,791.7	3,671.6	2,424.8	6,963.1	15.9
Luxembourg	449.1	1,942.4	212.6	351.7	3.0
Malta	1,520.2	0.5	709.9	0.1	2.2
Netherlands	22,303.8	24,640.2	23,600.3	31,194.4	101.7
Poland	8,356.3	8,417.0	8,752.1	35,098.6	60.6
Portugal	1,008.6	969.8	1,651.7	1,259.5	4.9
Romania	20,506.0	16,286.2	18,170.1	35,244.0	90.2
Slovakia	702.6	1,293.3	589.2	1,207.7	3.8
Slovenia	1,559.7	1,751.4	1,867.2	2,542.6	7.7
Spain	4,996.6	5,752.1	6,276.6	6,238.9	23.3
Sweden	2,917.1	19,450.7	6,261.8	3,810.2	32.4
United Kingdom	15,613.7	16,217.1	18,214.8	21,708.7	71.8
Other countries	338,937.1	395,835.0	493,394.6	595,717.4	1,823.9
Albania	1,537.0	-	-	12.1	1.5
Argentina	472.8	301.8	998.2	938.4	2.7
Australia	106.4	222.4	626.0	158.7	1.1
Brazil	16,450.7	12,149.8	17,390.3	36,127.9	82.1
Canada	3,334.0	2,763.6	1,257.8	4,906.5	12.3
Chile	98.6	83.9	62.6	43.3	0.3
China	41,468.0	45,170.5	56,947.9	63,123.0	206.7
Croatia	947.5	5,032.0	180.3	1,240.6	7.4
Ecuador	976.6	1,017.4	324.8	259.9	2.6
Egypt	1,712.2	3,283.7	2,481.4	2,329.9	9.8
India	3,644.0	4,508.7	5,309.9	18,671.5	32.1
Indonesia	834.8	1,195.0	631.7	1,226.7	3.9
Iran, Islamic Republic of	10,339.7	10,749.8	13,409.2	17,234.2	51.7
Israel	2,700.7	10,507.9	8,851.9	15,719.8	37.8
Japan	10,189.0	14,836.8	14,702.1	16,022.1	55.7
Korea, Republic of	3,697.2	4,297.8	7,525.5	7,638.9	23.2
New Zealand	2,195.8	2,794.5	1,398.0	1,834.3	8.2
Norway	894.3	993.4	103.7	601.2	2.6
Switzerland	8,094.1	8,075.4	35,341.7	12,667.4	64.2
Syrian Arab Republic	356.7	984.4	618.2	787.1	2.7
Taiwan, Province of China	1,674.4	1,486.2	1,932.1	2,315.8	7.4
Turkey	136,203.9	167,449.4	184,040.6	240,212.1	727.9
United Arab Emirates	42,353.3	45,531.6	53,154.1	73,682.3	214.7
United States	35,484.6	39,712.9	71,168.7	57,525.1	203.9
Viet Nam	325.8	1,057.0	933.9	792.7	3.1

Source: Revenue Service, Ministry of Finance of Georgia; Georgian State Electric System, LTD; Georgian Gas Transportation Company, LTD

Annex Table 3

Georgia: Structure of exports (percent)

	To CIS countries			To other countries of the world		
	2000	2005	2006	2000	2005	2006
Total	100	100	100	100	100	100
Live animals; vegetable Products	10,5	9,0	7,7	11,1	13,7	8,8
Animal or vegetable Fats	0,0	0,0	0,0	0,0	0,0	0,0
Prepared foodstuffs; alcoholic and non-alcoholic beverages and tobacco	38,1	41,8	28,6	4,4	7,5	6,4
Mineral products	9,6	5,2	8,5	23,2	13,9	17,9
Products of the chemical industry; plastics; rubber and articles thereof	11,9	5,7	8,3	9,4	7,9	7,9
Wood and articles of wood; pulp of wood	0,6	0,7	1,5	3,8	3,1	2,5
Textiles and textile Articles	0,4	0,1	0,2	0,5	1,9	1,9
Non-precious metals and articles from non-precious metal	6,8	7,0	10,9	37,3	36,6	29,5
Machinery and mechanical Appliances	11,3	1,8	4,8	4,5	6,0	8,6
Means of transportation	7,4	27,2	27,5	3,0	0,3	5,3
Instruments and apparatus; clocks and watches; musical Instruments	0,1	0,2	0,9	0,1	0,1	1,2
Other	3,3	1,4	1,0	2,8	9,0	9,9

Georgia: Structure of imports (percent)

	From CIS countries			From other countries of the world		
	2000	2005	2006	2000	2005	2006
Total	100	100	100	100	100	100
Live animals; vegetable Products	8,3	10,5	11,1	13,5	5,2	5,7
Animal or vegetable Fats	0,2	2,0	1,8	1,2	0,8	0,5
Prepared foodstuffs; alcoholic and non-alcoholic beverages and tobacco	4,2	8,2	10,4	14,3	9,4	6,0
Mineral products	54,2	41,8	43,9	3,8	6,7	5,8
Products of the chemical industry; plastics; rubber and articles thereof	6,9	7,0	6,0	14,8	15,1	14,4
Wood and articles of wood; pulp of wood	1,6	2,0	1,7	3,3	3,6	3,4
Textiles and textile Articles	0,3	1,0	1,4	3,8	3,8	5,0
Non-precious metals and articles from non-precious metal	5,3	6,3	7,6	3,6	4,7	5,1
Machinery and mechanical Appliances	5,3	5,3	6,3	24,2	23,9	23,4
Means of transportation	10,8	10,8	5,7	5,0	14,6	16,6
Instruments and apparatus; clocks and watches; musical Instruments	0,6	1,1	0,7	4,5	3,7	2,6
Other	2,3	3,8	3,4	8,0	8,4	11,3

Source: CISTAT.

EU Structural Funds in Central and East European countries

BY ROMAN RÖMISCH

The accession of eight Central and East European countries to the European Union in 2004, followed by Bulgaria's and Romania's accession in 2007, was and still is in many respects a major challenge to the European project. One of the many challenges is the drastic increase in regional (and national) disparities as concerns income levels and living standards. The present article focuses on the main tool of the European Union to address these regional disparities, i.e. the EU Structural Funds in the framework of the EU Cohesion Policy.

Cohesion Policy 1957-2007

Although the origins of European Community policies to tackle regional and social imbalances can be traced back to the Treaty of Rome in 1957, it was not until 1975 that the European Regional Development Fund (ERDF) was created, and until 1986 the ERDF supported exclusively national projects. In 1986, with the signing of the Single European Act (the intention to form a single market, that was to be established in 1993) as well as with the accession of Greece, Portugal and Spain to the EU, a much more genuine 'European' Cohesion Policy was created. Besides a doubling of funds available for regional policy, the formerly relatively loosely coexisting Structural Funds[1] were now integrated under the umbrella of Cohesion Policy. Simultaneously, policy started to focus on the least developed, most backward regions. In 1992/93 the revised Treaty on the European Communities (TEC) introduced the Cohesion Fund as an additional instrument of Regional Policy. Furthermore, for the financial perspective of the period 1994-1999, the available funds for Cohesion Policy were again doubled, and represented by then around one third of the total EU budget. During that period the Structural Funds were allocated to a highly dispersed number of programmes, i.e. 6 Objectives and 14 Community Initiatives[2] (basically taking over the structure of the previous financial period).

With the biggest enlargement of the European Union set for the year 2004, the financial period 2000-2006 was marked by a significant reform of EU Cohesion Policy. Following the Agenda 2000, a package comprising a reform of the Common Agricultural Policy as well as of the Cohesion Policy, and covering furthermore the pre-accession instruments and the new financial framework, was introduced in 1997. The main outcome of this package was the adoption of a new general regulation for Cohesion Policy as well as of five new regulations on the ERDF, the ESF, the EAGGF, the FIFG and the Cohesion Fund (in the year 1999). As a consequence of this reform, the structure of Cohesion Policy was simplified, as the number of Objectives was reduced from six to three[3], and the number of Community Initiatives was reduced from thirteen to four (European Commission DG Regio, 2008). Around one third of the total EU budget was spent on these Objectives and Initiatives.

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1 By that time consisting of the ERDF, the European Social Fund (ESF), the European Agricultural Guidance and Guarantee Fund (EAGGF) and the Financial Instrument for Fisheries Guidance (FIFG).

2 The six priority Objectives were: *Objective 1:* promoting the development and structural adjustment of regions whose development is lagging behind; *Objective 2:* converting regions or parts of regions seriously affected by industrial decline; *Objective 3:* combating long-term unemployment and facilitating the integration into working life of young people and of persons exposed to exclusion from the labour market, promotion of equal employment opportunities for men and women; *Objective 4:* facilitating workers' adaptation to industrial changes and to changes in production systems; *Objective 5:* promoting rural development by (a) speeding up the adjustment of agricultural structures in the framework of the reform of the Common Agricultural Policy and promoting the modernization and structural adjustment of the fisheries sector, (b) facilitating the development and structural adjustment of rural areas; and *Objective 6:* development and structural adjustment of regions with an extremely low population density (introduced for Sweden and Finland in 1995). (European Commission DG Regio, 2008.)

3 The Objectives were: *Objective 1:* promoting the development and structural adjustment of regions whose development is lagging behind; *Objective 2:* supporting the economic and social conversion of areas facing structural difficulties; and *Objective 3:* supporting the adaptation and modernization of policies and systems of education, training and employment.

Cohesion Policy 2007-2013

For the current financial period 2007-2013 the architecture of Cohesion Policy was reformed once more. A key concern of the reform was to increase the effectiveness of the Structural Funds, in particular with respect to the economic development of the least prosperous countries and regions in the new EU member states in Central and Eastern Europe. At the same time the latest reform is also expected to raise the potential of the entire EU to successfully address the challenges of technological change, an aging population, as well as globalization and an increase in trade liberalization, and furthermore the economic restructuring connected with the latter.

Based on a set of new regulations, the key aspects of the latest reform were:

- a more strategic approach of European Cohesion Policy, linking it to the Lisbon strategy for growth and employment. The most important measures here were the publication of Community strategic guidelines by the EU Commission that in one way or another were followed by each member state in the design of their National Strategic Reference Framework and their respective Structural Funds priorities and operational programs. Its major priorities are: research and technological development, innovation and the spirit of enterprise, a knowledge-based society, transport, energy, the protection of the environment, as well as investment in human capital, employment market policy and improving worker and business adaptability (EU Commission DG Regio, 2007a);
- a redirection of responsibilities away from the Commission to the individual member states, particularly with respect to monitoring and control rules. The basic aim here was to facilitate the use of the funds allocated to the operational programmes and priorities, especially with respect to the new member states (NMS) in Central and Eastern Europe, where the lack of administrative capacity and, respectively, the complex funding system of the previous financial period led to an unsatisfactory absorption of funds[4];
- a simplification of the architecture of Structural Funds to accommodate the new strategic approach to Cohesion Policy as well as facilitating the use of funds. In addition, the rules for the Structural Funds and the Cohesion Fund were harmonized and – in contrast to earlier periods – each region of the EU is now eligible for (some amount of) funding.

The most fundamental changes in the architecture of Cohesion Policy were the reduction of the number of Objectives or Initiatives to three and a restructuring of the Cohesion Fund.

The changes from the period 2000-2006 to the financial perspective 2007-2013 are presented in Table 1.

In detail, the new Objectives are:

- **Convergence**: This Objective covers the previous Objective 1 as well as the Cohesion Fund, which no longer acts independently. Moreover, the programming and management rules of the ERDF, ESF and Cohesion Fund have been harmonized for the period 2007-2013. Eligible for funding under the Convergence Objective are:
  - regions whose per capita gross domestic product (GDP) is less than 75% of the Community average;
  - member states whose per capita gross national income (GNI) is below 90% of the Community average.[5]

[4] As data show, the absorption capacity of most new member was relatively low up to 2006. Thus, for instance, the Czech Republic, Latvia and Lithuania only used 30% of the funds allocated for 2004-2006, and even in the best performing country, Slovenia, this rate was only at 50%, which is lower than the rate of the worst performing country among the old members states, Greece, which in 2006 was 55%. However, given the n+2 rule, i.e. funds can be drawn up to 2008, a final conclusion about the new member states' absorption capacity in their first years of EU membership cannot yet be drawn.

[5] There is a transitional (reduced) support for Member States who would have been eligible for the Cohesion Fund objective if the threshold had remained 90% of the average GNI of EU-15 and not EU-25. Basically this applies to Spain.

Table 1

2000-2006			2007-2013	
Objectives, Community initiatives, Cohesion Fund	**Financial Instruments**		**Objectives**	**Financial Instruments**
Objective 1 – Regions lagging behind in development terms	ERDF, ESF EAGGF, FIFG	→	Convergence	ERDF, ESF Cohesion Fund
Cohesion Fund	Cohesion Fund			
Objective 2 – Economic and social conversion zones	ERDF ESF	→	Regional competitiveness and employment	ERDF ESF
Objective 3 – Training systems and employment policies	ESF			
Interreg III	ERDF	→	European territorial cooperation	ERDF
URBAN II	ERDF			
EQUAL	ESF			
LEADER +	EAGGF			
Rural development and restructuring of the fishing sector beyond Objective 1	EAGGF, FIFG			

Source: EU Commission DG Regio (2007a).

- **Regional Competitiveness and Employment**: This Objective covers the previous Objectives 2 and 3 and covers all regions that are not supported through the Convergence Objective. Furthermore there is a higher transitional support ('phasing in') for NUTS 2 regions which were earlier covered by Objective 1 but whose GDP exceeds 75% of the EU-15 GDP average. For instance, this applies to the Hungarian capital city region Közép-Magyarország.
- **European Territorial Cooperation:** As compared to the period 2000-2006, the Interreg III Initiative has been promoted to Objective status, in order to raise its visibility. It aims at promoting the cooperation at cross-border, transnational and interregional level.

The Leader+ programme and the European Agricultural Guidance and Guarantee Fund (EAGGF) have been replaced by the European Agricultural Fund for Rural Development (EAFRD); the Financial Instrument for Fisheries Guidance (FIFG) has become the European Fisheries Fund (EFF). The EAFRD and the EFF now have their own legal basis and are no longer involved in the Cohesion Policy (EU Commission DG Regio, 2007b).

The available resources for Cohesion Policy amount to a total of EUR 308 billion (in 2004 prices) and are split between the three Objectives as follows:

- 81.5% for the Convergence Objective;
- 16% for the Regional Competitiveness and Employment Objective;
- 2.5% for European Territorial Cooperation Objective.

Given the strong focus on the Convergence Objective, the distribution of Structural Funds across countries is heavily skewed towards the new member states in Central and Eastern Europe.

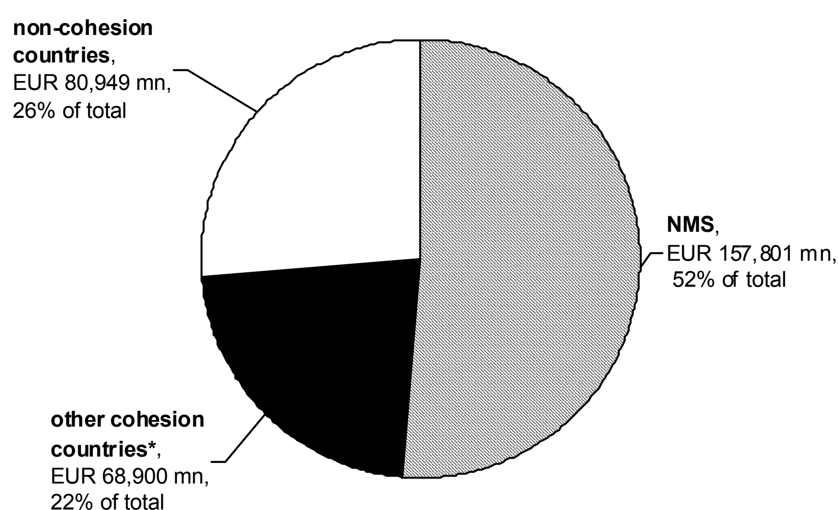
Thus, over the period 2007-2013, the CEE new member state regions receive more than half of the totally available funds, while about slightly more than 20% of funds flow into the remaining three cohesion countries in the EU-15 (Greece, Portugal, Spain). The rest, i.e. about one quarter of total funds, goes to the least developed in the remaining EU member states (see Figure 1).

Within in the group of NMS countries, Poland (by far the biggest country in this group) receives, in absolute terms, the highest amount of funds (about EUR 60 billion, in prices 2004). This is approximately three times as much as allocated to the second most important receiving countries, the Czech Republic and Hungary. Romania, the second largest country among the NMS in terms of population, receives less than the former two, less populated countries (about EUR 17 billion), because it joined the EU, just as Bulgaria, only in 2007 and still has to undergo a three-year phasing-in period. During this period funds are kept at a relatively low level, taking account of the fact that the newly acceded countries require some time to get acquainted with the administration and management of EU Structural Funds.

While the distribution of total funds is dominated by countries with a higher number of population, the distribution of Structural Funds per head of population is different. In principle there is a clear-cut rule of how funds are to be distributed across regions and countries, set by the EU Council regulation laying down the provisions for the Structural Funds (European Union, 2006, Annex II). According to this rule, funds are allocated according to the level of GDP per head, population and the unemployment situation in the respective regions. This implies that, in per capita terms, regions with low levels of GDP and relatively high unemployment levels should receive more funds than more prosperous regions. However, the

Figure 1

Allocation of Structural Funds total, by country groups
2007-2013, EUR million, in prices 2004

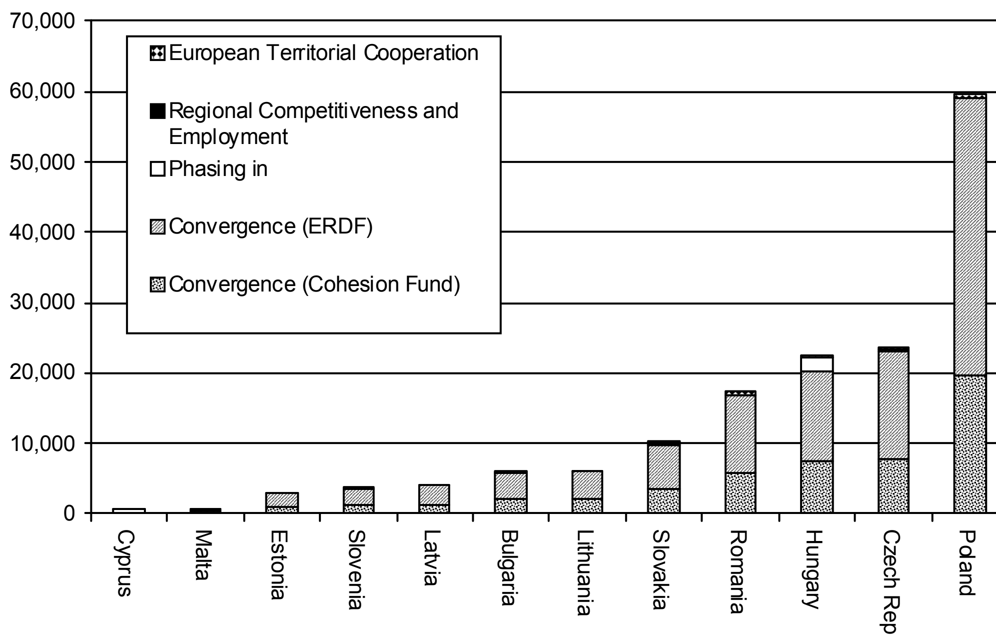


* Greece, Portugal, Spain.

Source: European Commission.

Figure 2

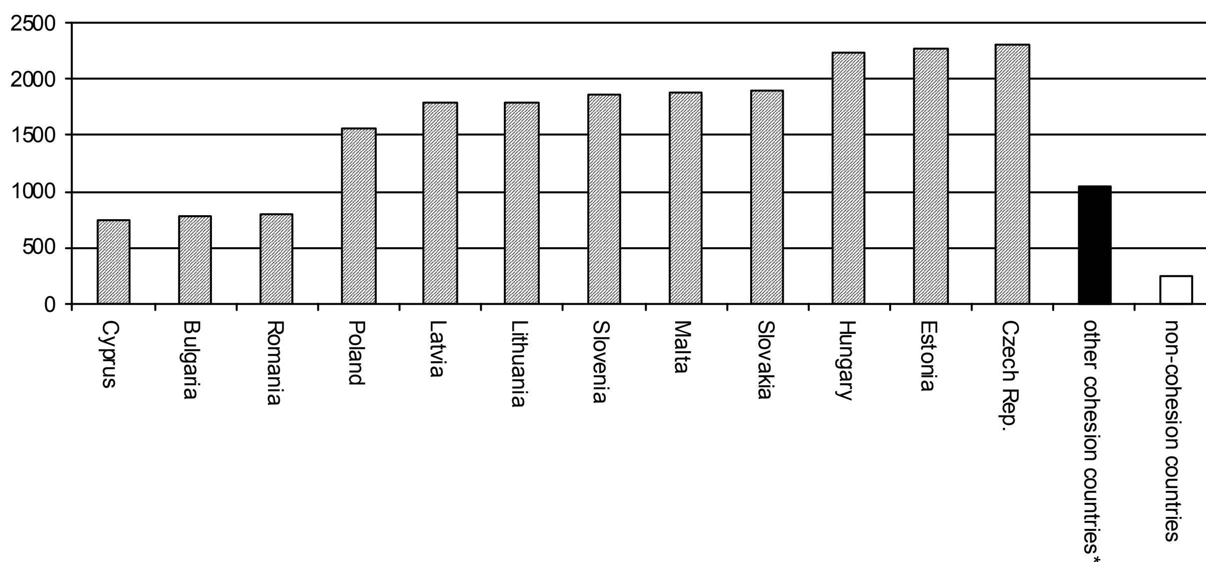
Allocation of Structural Funds, 2007-2013, total and by Objectives, NMS countries, EUR million



Source: European Commission.

Figure 3

Allocation of Structural Funds per head, 2007-2013, EUR per head, in prices 2004



* Greece, Portugal, Spain.

Source: European Commission.

numbers in Figure 3 suggest that in practice the distribution of funds is much more the outcome of a political bargaining process (which in the case of the negotiations on the current financial perspective was quite intense) rather than a rule-based decision process.[6] Thus, the more advanced countries among the NMS may receive, in per capita terms, the highest amount of funding, such as Hungary and the Czech Republic, while in this ranking Poland is at the lower end, followed only by Romania, Bulgaria and Cyprus (with the former two countries receiving lower per capita funds because they still have to pass a three-year phasing-in period as mentioned above).

Effects of Funds

The bare figures of the Structural Funds may or may not seem impressive. On the one hand, EUR 308 billion (distributed over six years) is a considerable amount of money, yet it only represents about 35% of the total EU budget, or 0.35% of total EU GNI. This may cast some doubts on the re-distributive and growth-enhancing effects of Cohesion Policy.

Nevertheless, on the other hand, those funds are distributed in favour of the least developed countries and regions. For the NMS in Central and Eastern Europe, this means that the Structural Funds assistance (ERDF, ESF and Cohesion Fund) amounts to 3.2-3.8% of GNI from 2007 onwards. Furthermore, considering that there will be additional assistance for agriculture, which – depending on the country – will make up about 0.3-1.0% of GNI, and adding some minor transfers and subtracting the NMS contributions to the EU budget (around 1% of GNI p.a.) results in net transfers from the EU to the NMS of +2.5% to +4.0% of GNI per year.

Thus, in total, the size of the yearly inflows of EU funds is approximately the same as the amount of yearly FDI inflows to the NMS, which undoubtedly contributed much to the structural change and economic growth in these countries. Notably, the amount of Structural Funds is also higher than Western Europe received through the European Recovery Programme (ERP, Marshall Plan, 1948-1952) after WWII: Funds from the ERP amounted to about 2.1% of GDP on average.

As a consequence, Structural Funds can be assumed to exert a (significant) impact on the economic development in the NMS in Central and Eastern Europe. The exact size of the effects of Cohesion Policy, however, is hard to assess. One way to measure the economic impact of Structural Funds is through the use of macroeconomic models.

For illustration, the HERMIN macroeconomic model predicts quite significant gains in both income per head and employment due to Cohesion Policy over the next several years. Thus, with the exception of Slovenia, Structural Funds are estimated to induce around 5-10% of additional income growth in the NMS of Central and Eastern Europe ('additional' meaning in addition to the growth without interventions; see Figure 4). The effects are estimated to be highest in the three Baltic States, in the Czech Republic and in Romania, and somewhat weaker in the other NMS.

As far as employment is concerned, the results are equally positive: until 2013 employment growth is expected to be three to six percentage points higher than in the absence of Cohesion Policy. Again, the effects are estimated to be highest in the Baltic States but especially in the Czech Republic, while in the case of Romania employment gains are estimated to be weaker, mainly because the expected gains in GDP are supposed to be triggered by gains in productivity instead of employment (see Figure 5).

It has to be noted that other models, such as the EcoMod or the Quest model, come to slightly different conclusions, in particular with respect to whether the effects are demand- or supply-side driven, which has some impact on the time horizon of the potential impact of Cohesion Policy. Thus, as

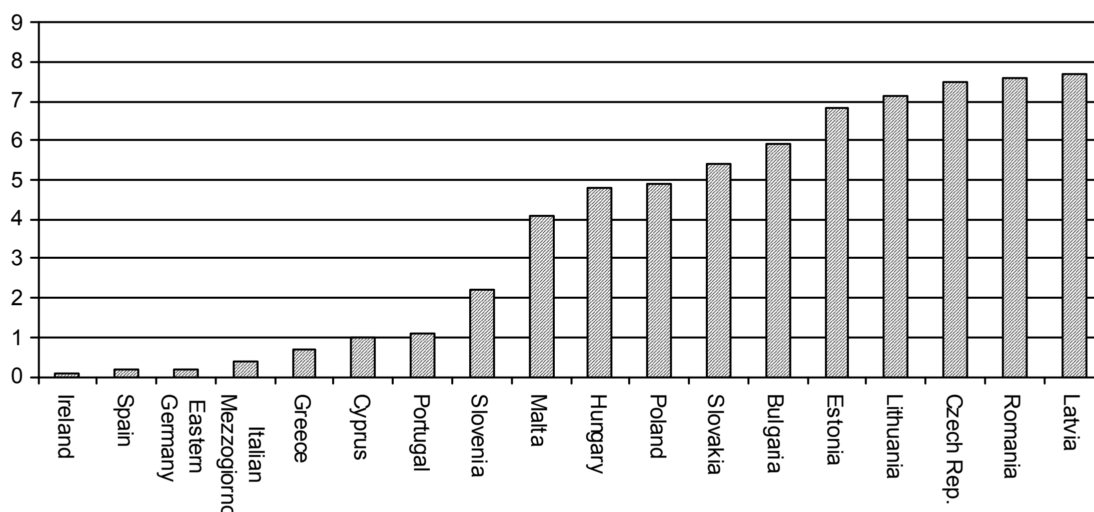
[6] Quite realistically the Council regulation accounts for such bargaining processes in stating that the rule-based allocation of funds is 'indicative' (EU, 2006, Article 18, paragraph 2, and Article 19).

compared to the HERMIN model, in the Quest model demand-side effects are weaker while supply-side effects are approximately similar, so that in the HERMIN model much of the positive effects may be rather short-lived, while the Quest model assumes Cohesion Policy to have positive effects over the longer run that may potentially only become visible after the current financial period has ended (European Commission DG Regio, 2007).

Thus, though the individual models differ in the time horizon of effects, just as they differ in their predictions concerning which countries benefit the most (the Quest model predicts a much weaker impact of Cohesion Policy in the Baltics than the HERMIN model), the common ground of all models is that Cohesion Policy and Structural Funds do have a significant positive impact on the economic development of the least prosperous countries and regions, irrespective of how these gains materialize.

Figure 4

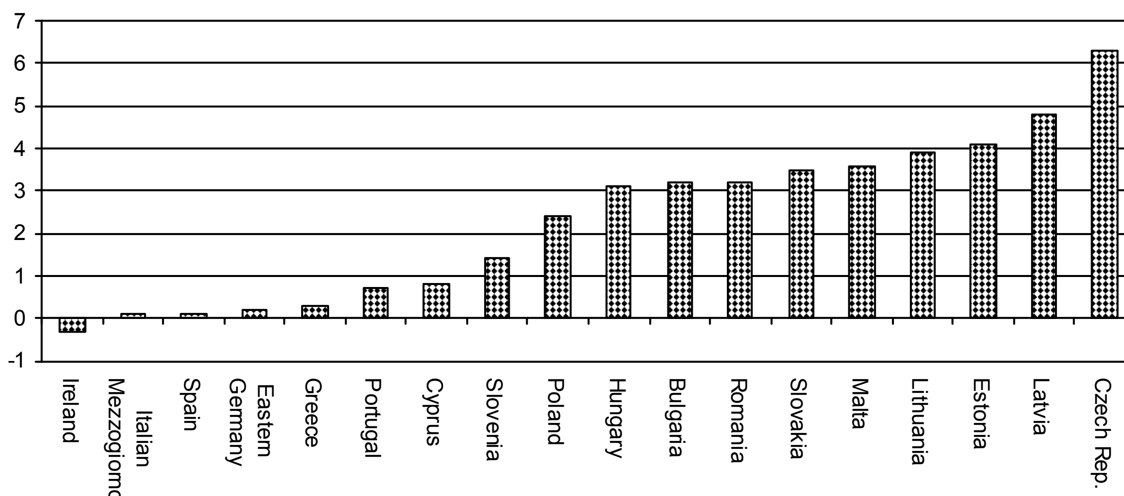
Effects of EU regional policy on growth – Model estimates (HERMIN) – GDP gain 2007-2013 (% above baseline)



Source: European Commission.

Figure 5

Effects of EU regional policy on employment – Model estimates (HERMIN) – employment gain 2007-2013 (% above baseline)



Source: European Commission.

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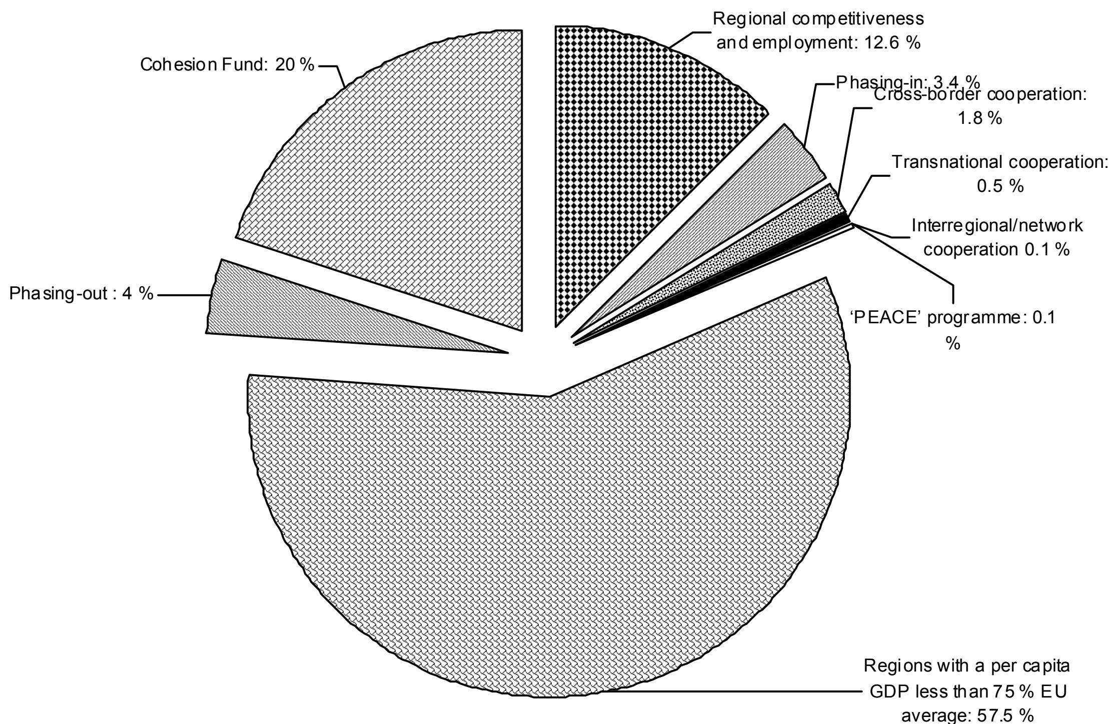
ANNEX

Share of Objectives and programmes in the Structural Funds for the period 2007-2013, in %



Source: EU Commission.

Czechoslovak economic reforms of the 1960s*

BY OTAKAR TUREK AND MILOŠ PICK

We reject the post-1989 interpretation that the Czechoslovak economic reforms of the 1960s were part and parcel of a homogeneous forty-year period of totalitarian Communist rule and that the 1968 Prague Spring was a year when there was just a pointless exchange of one Communist establishment with another. Such an interpretation after the November 1989 'Velvet Revolution' was a smart and politically effective move by Václav Klaus (and his Civic Democrats), conveying to the public the opinion that any inspiration from 1968 was misguided and that the only true way to make the transition to democracy and a market economy was his invention. As a result, the people behind the fundamental criticism of the Communist political and economic system, who had inspired the changes in the 1960s, were politically discredited and sidelined. Even the left wing initially took only a defensive stance against this position; the only real alternative to be put forward came from the team headed by the deputy prime minister of the Czech government, František Vlasák. The success of a similar path pursued by Slovenia underscored how promising this alternative was.

The basic concept of the 1960s economic reforms

In the 1960s, critical ideas started emerging that ultimately became the core of Ota Šik's reform package. The key reform ideas were the following:

– An external point of view, free of all ideological illusions, was applied to the central planning system. The latter was understood to be fundamentally flawed, which meant that no amount of tweaking could remedy the situation. This was confirmed by comparisons with western market economies, which were evidently functionally superior and reported better qualitative results, particularly in the application of new scientific innovations.

– A comparison of the theoretical background of the two systems gave even more reasons to be doleful. In one corner, there was the knowledge of economic science accumulated over two hundred years and verified by economic development, albeit interspersed with crises. In the other corner, there was the poorly substantiated claim that even Marx had tied future socialism to the concept of planning, plus a plethora of empty ideological phrases not joined up into any coherent theory, in the vein of 'in socialism people will work better because they are working for themselves, not for the profits of capitalists', which relied only on moral motivation and concealed the absence of the chief motivating mechanism – the market.

In the conceptual notion of reform a crucial factor was the idea of nurturing an environment that would profoundly change the behaviour of enterprises. In the command system, the superior bureaucratic bodies were the key for the enterprise: with them it could negotiate anything for itself and its employees. In this respect, the enterprise played the role of a trade union of sorts, perhaps even a social institution. The customer was a nuisance rather than someone to bow down to. The enterprise was not dependent on the customer; it produced and supplied to customers only in accordance with the plan, and anything else was a matter of goodwill.

In the reformed system, enterprises should have a new lord – the consumer, the customer. The enterprise's revenue position should fully depend on the sales generated. Therefore, in this interrelationship the economic balance was meant to shift in favour of the customer. The customer would have the opportunity to choose between alternatives, while the supplying enterprise had no alternative – it needed the customer's money. This would generate natural interest on the part of the enterprise in the best possible customer service and in maximum efficiency and innovation as a way to produce relatively higher value added and profit.

* The present article is a shortened version (as revised by wiiw editors) of a text originally published in the Czech journal *Perspektivy*, 6/2008.

If an enterprise's revenue position was to hinge solely on income from customers, further paradigm shifts were required. The plan should not impose binding indicators. The prices, set freely in a competitive market, should be a parameter for the enterprise to which it must adapt its costs and, by extension, efficiency. Relations vis-à-vis the national budget could no longer be individualized based on the enterprise's financial situation, but stipulated by the law which should be equal for everyone. The recoverability of loans should be strictly enforced. All this would place an enterprise in a competitive environment where financial performance would depend exclusively on its efficiency and the quality of customer services.

In line with the new concept of the relationship between enterprises and the national budget, investments were reassessed as well. The only sources of investment funding should be resources accumulated by the enterprise from its profits or returnable loans. The idea of creating a capital market did not surface until a later stage of reforms, and raised doubts about the compatibility of speculative operations typical of such a market with the ethos of the reform ideas.

This environment was designed to give companies freedom of choice and liability for economic results while guiding their behaviour accordingly. From the legal perspective, the personality of large enterprises was similar to that of a state enterprise headed by a self-governing body in which one third of members were employees, another third external experts, and the remaining third delegated representatives of the national property fund. The basic powers of this autonomous governing body were the appointment and removal of managers and the approval of the long-term enterprise development concept. Cooperatives or private ownership forms were envisaged for other enterprises.

The Šik reform and the social-policy 'miracle of 1968'

The 'miracle of 1968' departed from the development trajectory of Stalinist socialism, which simply bulldozed its way through time, flooring any attempts or even ideas geared towards recovery. This miracle had been maturing for years, at least since the start of the 1960s. Šik's reform was just one of a number of factors gradually mobilizing society until this movement peaked in 1968.

There were attempts at political reforms as well. It is worth recalling, at the very least, the conference of writers in 1967, the openness with which the media started giving voice to experts and, in particular, to those who expressed dissatisfaction with the current situation, and, last but not least, to the new wave of Czechoslovak films, Suchý's Semafor Theatre and Havel's *Garden Party* play. A number of reform-minded Czechoslovak politicians such as František Kriegel and others, who in the past had already wielded informal clout within the Communist Party, opened up the path to the reform process.

The initiator of economic reforms was Ota Šik, appointed as the director of the Economics Institute of the Czechoslovak Academy of Sciences in 1962. In his academic work he focused on the critical analysis of the existing system of the centrally planned economy and looked for ways of tackling its defects. This activity culminated in his book *Economics, Interests, Politics* ('Ekonomika, zájmy, politika'). He surrounded himself with economists who had the same mindset and published work in the same spirit.

The third Czechoslovak five-year plan collapsed in 1963, and national income declined for the first time in the era of central planning. The country's political leadership needed to demonstrate to the public that it stood ready to do something about this. This was the background to the decision to draw up a comprehensive reform proposal. At the governmental level, the State Commission for Management and Organization was delegated to submit the proposal; a working (or 'theoretical') group headed by Ota Šik was set up to prepare the relevant material. One of the people linked to the group was František Vlasák, already a member of the government and the president of the State Planning Commission, whose role was

indispensable because of his contributions to debates, drawing on his long-standing experience of the way governmental bodies function, and – perhaps more importantly – because of his ability to identify the relevance of principles of 'economic theory' as the basis for problems encountered by the economy.

The theoretical material was submitted for discussion, and assessed by the presidium of the Czechoslovak Communist Party. It followed from the logic of efforts to maintain the status of individual bodies that the originally more radical proposals became less emphatic as they passed through the various stages of discussion.

For Šik, Vlasák and the theoretical group, it was clear that, besides the fate of their material in the formal authorization procedures, it was of greater importance that the original, non-reducible pivotal ideas of reform must resonate in society. Fortunately, it was possible to publish very open, critical articles as censorship had gradually weakened. The members of the theoretical group and a growing number of other of economists sharing the same mindset published texts which were lapped up by the public. Šik himself delivered dozens of speeches in companies, and his voice could even be heard on the government-controlled television. The reform attracted mass sympathy, broad support and even impatience with regard to its launch into the real world because the public found it so plausible.

This social mood infiltrated the power structures and logically split the political leadership into two camps – reformers and conservatives. The Communist Party Central Committee, thus 'prepared', replaced the party leadership by Alexander Dubček at the turn of 1967-1968. When, after a few weeks, the people found out that the changes were not of the 'cosmetic' nature they were used to, they realized that the very barriers of the Stalinist pattern had been shaken. This gave rise to the hope that the anomalies that had embittered people's lives over the years could now be ventilated in public and solutions found. A remarkable initiative emerged, cells of civil society were formed, new policy suggestions surfaced from meetings that frequently transgressed the absorption capacity of the bodies that were meant to give them life. The 'holy' principle of the leading role of the Communist Party was somehow turned upside down, resulting in a situation where the people were leading the Party towards deep regenerative reform in all spheres of social life.

Lessons of a more general nature

In the conditions of Stalinist socialism, the cohesion of economy and politics was so strong that reforms were either superficial and did not affect the political system (regardless of the fact that they did nothing to help the economy), or were so profound that, while they pave the way for the improved functioning of the economic system, they would destroy the very foundations of the political system. That is why the regime representatives tried to suffocate the reform process at birth and imposed exemplary punishments on the originators of reforms. Yet the Šik reform was an exception – it was not stifled at birth, but influenced public opinion over a number of years, and its first steps on the way to practical implementation brought positive results. Dubček's leadership gave green light to the reform, appointing Šik as the deputy prime minister, and was accommodating to popular pressure for the democratization of the political system, so further developments were steered towards democracy and a socialist market economy. However, Moscow intruded in the run of events in August 1968. The military intervention in itself was not enough to break the spontaneous nationwide reform movement, but laid the foundations that would convert domestic politics to the new, 'normalized', Husák administration, which would restore Stalinist socialism. Only then was Šik's reform suppressed.

With the benefit of hindsight, however, we can see that the reform ideas were not defeated – the seeds of knowledge and hope were cultivated in the people for another two decades. In November 1989, the public not only welcomed the end of the

normalization caricature of socialism; according to surveys conducted at the start of the 1990s, 90% of people also rejected capitalism. Only post-November 1989 developments put an end to that hope.

To what extent can Šik's reform be compared to Klaus' transformation, considering that the historical missions of the two were diametrically opposed? The latter took root after the political fall of Stalinist socialism, the former accomplished the mission required to trigger that fall. A major factor contributing to this outcome was the year 1968 in Czechoslovakia. Illusions about the system's ability to function rationally and return results that would help it keep pace with the developed world evaporated. Two decades of normalization after August 1968 were agony for the system. While the command system had been an adequate means of reinforcing heavy industry in the 1950s, in the 1980s, when the world entered a post-industrial phase stressing the knowledge society, the command system became absolutely ineffective, and as a result the economy lost a lot more ground.

To what extent could the intellectual legacy of Šik's reform be regarded as the inspiration (at least) for the formation of a target modern left-wing, non-capitalist economic system? Although the documents adopted within the scope of Šik's reform did not specify in full the procedure to be applied in attaining a market economy, initially they did selectively concentrate on market exploitation primarily as a mechanism for the coordination of economic activities and the application of motivation, based on the equivalence principle, where each entity receives income corresponding to its societal benefit. This is a sphere where, for centuries, the market has revealed itself to be a good servant and where the link between a certain reform step and the exorcism of universal abuses was abundantly clear to everyone.

However, as has been mentioned above, the reform processes developed to a level well beyond the framework of the adopted documents in the minds and support of the public and in the behaviour of enterprises. In the words of theorists, the changes to formal institutions were outstripped by changes to informal institutions. This is a globally unique phenomenon and is in contrast to the post-November 1989 developments. This process primarily sought an answer to a fateful question highlighted even in the speeches of Ota Šik: to the symbiosis of the roles of the plan and the market. This was not an original Czechoslovak concept. In the bipolar world, the Cold War threatened catastrophic consequences, but was also a platform for competition and the tendency to approximate social and economic systems from both sides of the Iron Curtain. The Czechoslovak reform of the 1960s approached the symbiosis of the roles of the state and the market by 'adding' the role of the market to the previous role of the 'pure' state, whereas the West European welfare state approached this objective from the other end, 'adding' the role of the state (in macro- and microeconomic policy, the plurality of ownership, the redistribution of income, moral motivation) to the 'pure' market. The economic miracle of the time – economic growth, improved productivity, competitiveness and living standards – verified the substance of the reform approach on both sides.

That symbiosis is thus more relevant in the era of the 21st-century knowledge-based society than the current incursions by neo-liberals designed to curtail the welfare state in EU countries or than Klaus' restoration of the 'pure' market economy in the Czech Republic. (What is more, Klaus' strategy was a shock strategy that did not allow enough time for the construction and maturing of legal and ethical institutions, or for gradual privatization which, instead of enriching individuals by means of manoeuvres bordering on illegality, would have been of major benefit to society. There is also a lack of effort to ensure that the market does not make inroads into spheres where it would be a bad taskmaster, such as the health services, the education system and culture.)

At an even higher level of abstraction, a dual cardinal issue looms large – a matter of contention even then between the Czech writers Milan

Kundera and Václav Havel – that of whether Czechoslovakia was the 'navel of the world' or just a part of global evolution, and whether this included the replacement of the Stalinist system, albeit only with the restoration of capitalism, or even with the renaissance of the untapped potential of a project of free and market socialism. Today, we know that the 'Czech lot' was and is part of the world's (and especially Europe's) lot, where a battle is being waged to overcome the capitalist model with a freer, more socially just model.

This contest takes place in the ebb and flow of reformist and anti-reformist waves. The 'Prague Spring' flourished side by side with the 'European Spring' in 1968. The restoration of Stalinist socialism in Czechoslovakia by virtue of 'Brezhnev's Doctrine' of restricted sovereignty was accompanied by the shock restoration of capitalism by virtue of the 'Washington Consensus' (the shock liberalization, the total privatization and the macroeconomic restrictions demand), which was imposed on Latin American countries in the 1970s and on the post-Communist countries of Central and Eastern Europe in the 1990s, and is crowned by the current neo-liberal incursion intended to abridge the European welfare state. However, reverse trends are now surfacing in the world.

STATISTICAL ANNEX

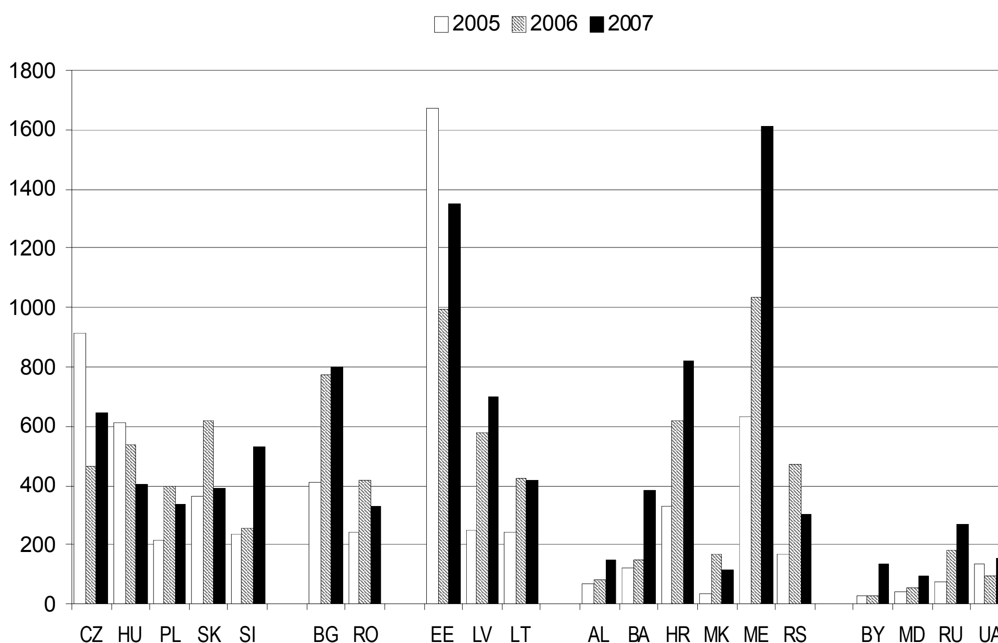
wiiw Database on Foreign Direct Investment in Central, East and Southeast Europe, 2000-2007

The annual wiiw presentation and analysis of FDI flows and stocks in the former transition countries has come in its fourth edition. The publication contains methodological guidelines and an analysis of recent FDI trends. The database contains 3700 time series. Data availability has improved or major revisions were made for Slovakia and Ukraine. The *wiiw Database on FDI* is available in printed format and PDF as well as on CD-ROM. The latter version contains longer time series and provides tables in HTML, CSV and MS Excel format.

The publication and the CD-ROM can be ordered from the wiiw homepage – www.wiiw.ac.at.

Figure 1

FDI inflow per capita, EUR, 2005-2007



Source: wiiw FDI Database.

Table 1

FDI inflow, EUR million

	2000	2001	2002	2003	2004	2005	2006	2007
Czech Republic	5404	6296	9012	1863	4007	9374	4797	6674
Hungary	2998	4391	3185	1888	3633	6172	5428	4049
Poland	10334	6372	4371	4067	10453	8317	15198	12834
Slovakia	2089	1768	4397	1914	2441	1952	3324	2093
Slovenia	149	412	1722	271	665	473	512	1073
New Member States-5	**20974**	**19240**	**22687**	**10002**	**21200**	**26287**	**29258**	**26722**
Bulgaria	1103	903	980	1851	2736	3152	5961	6109
Romania	1147	1294	1212	1946	5183	5213	9060	7141
Estonia	425	603	307	822	775	2255	1341	1815
Latvia	447	147	269	270	512	568	1326	1589
Lithuania	412	499	772	160	623	826	1448	1412
New Member States-10	**24508**	**22685**	**26226**	**15051**	**31029**	**38301**	**48394**	**44789**
Albania	155	232	143	158	278	224	259	463
Bosnia and Herzegovina	159	133	282	338	567	478	564	1478
Croatia	1141	1468	1138	1762	950	1468	2738	3626
Macedonia	233	499	112	100	261	77	345	239
Montenegro	.	5	76	44	53	393	644	1008
Serbia	55	184	504	1204	777	1265	3504	2258
Southeast Europe	**1743**	**2520**	**2255**	**3606**	**2885**	**3906**	**8054**	**9072**
Belarus	129	107	262	152	132	245	282	1293
Moldova	138	116	89	65	121	159	193	335
Russia	2933	3069	3660	7041	12422	10354	25979	38344
Ukraine	644	884	734	1260	1380	6263	4467	7220
European CIS	**3844**	**4175**	**4744**	**8518**	**14055**	**17021**	**30921**	**47192**
Total region	**30094**	**29380**	**33226**	**27175**	**47970**	**59227**	**87369**	**101052**

Note: Country groups refer to sum over available data.

Remarks:

Czech Republic: equity capital + reinvested earnings from 1998 + loans from 1998.
Hungary: equity capital + reinvested earnings from 1995 + loans from 1995.
Poland: equity capital + reinvested earnings + loans from 1991.
Slovak Republic: equity capital + reinvested earnings from 1995 + loans from 1995.
Slovenia: equity capital + reinvested earnings from 1994 + loans from 2001.

Bulgaria: equity capital + reinvested earnings from 1997 + loans from 1996.
Romania: equity capital + reinvested earnings from 2003 + loans from 1998.
Estonia: equity capital + reinvested earnings + loans.
Latvia: equity capital + reinvested earnings from 1996 + loans from 1996.
Lithuania: equity capital + reinvested earnings from 1995 + loans from 1997.

Albania: equity capital + loans from 1999.
Bosnia and Herzegovina: equity capital + reinvested earnings from 2004 + loans from 2004.
Croatia: equity capital + reinvested earnings from 1997 + loans from 1997.
Macedonia: equity capital + reinvested earnings from 2003 + loans from 2003.
Montenegro: equity capital cash.
Serbia: equity capital cash + in kind. Until 2004 FDI net (inflow minus outflow). Excluding Kosovo.

Belarus: equity capital + reinvested earnings from 1997 + loans from 2000.
Moldova: equity capital + reinvested earnings from 1997 + loans from 1995.
Russia: equity capital + reinvested earnings from 1998 + loans from 1997.
Ukraine: equity capital + reinvested earnings from 2002 + loans from 2003.

Source: Respective National Banks according to balance of payments statistics.

Table 2

Inward FDI stock, EUR million

	2000	2001	2002	2003	2004	2005	2006	2007
Czech Republic	23323	30717	36884	35852	42035	51424	60621	68641
Hungary	24578	31045	34575	38329	45881	52370	61964	66357
Poland	36792	46686	46139	45896	63505	76645	94603	110000 1)
Slovakia	5129	6495	8563	12617	16068	19968	29102	32000 1)
Slovenia	3110	2940	3948	5047	5580	6134	6775	8000 1)
New Member States-5	**92932**	**117884**	**130109**	**137741**	**173069**	**206542**	**253064**	**284998**
Bulgaria	2906	3342	3927	5045	7421	11741	17363	24848
Romania	6966	8656	7482	9662	15040	21884	34512	41260
Estonia	2843	3573	4035	5553	7378	9539	9617	11282
Latvia	2241	2648	2679	2630	3324	4159	5702	7226
Lithuania	2509	3023	3818	3968	4690	6921	8377	10021
New Member States-10	**110397**	**139126**	**152049**	**164598**	**210922**	**260786**	**328635**	**379636**
Albania	519	751	894	1051	1330	1554	1812	2276
Bosnia and Herzegovina	384	517	799	1463	2031	2463	3013	4500 1)
Croatia	2992	4414	5791	6809	9114	12332	20782	30375
Macedonia	580	1039	1161	1292	1610	1769	2099	2400 1)
Montenegro	.	5	81	125	178	570	1215	2222
Serbia	914	1098	1602	2806	3583	4830	8317	9912
Southeast Europe	**5389**	**7823**	**10327**	**13546**	**17846**	**23519**	**37238**	**51685**
Belarus	1403	1585	1570	1503	1510	2020	2076	3090
Moldova	482	623	610	567	638	896	987	1231
Russia	34693	60211	68046	77371	89753	151817	224380	280000 1)
Ukraine	4164	5448	5709	6055	7061	15067	18044	26182
European CIS	**40742**	**67868**	**75934**	**85497**	**98962**	**169799**	**245487**	**310503**
Total region	**156528**	**214816**	**238310**	**263640**	**327730**	**454104**	**611359**	**741824**

Note: Country groups refer to sum over available data.
1) wiiw estimate.

Remarks:

Czech Republic: equity capital + reinvested earnings from 1997 + loans from 1997.
Hungary: equity capital + reinvested earnings from 1995 + loans from 1995.
Poland: equity capital + reinvested earnings + loans from 1992.
Slovak Republic: equity capital + reinvested earnings + loans. From 2003 new methodology according to annual survey.
Slovenia: equity capital + reinvested earnings + loans.

Bulgaria: equity capital + reinvested earnings from 1997 + loans from 1996; cumulated inflows until 1997.
Romania: equity capital + reinvested earnings from 2003 + loans from 1994.
Estonia: equity capital + reinvested earnings + loans.
Latvia: equity capital + reinvested earnings + loans.
Lithuania: equity capital + reinvested earnings + loans from 1996. From 2005 joint stock companies valued at market value (book value before).

Albania: equity capital + loans from 1999; cumulated inflows from 1992.
Bosnia and Herzegovina: equity capital + loans; cumulated inflows until 2002.
Croatia: equity capital + reinvested earnings from 1997 + loans form 1997; cumulated inflows until 1997.
Macedonia: equity capital + reinvested earnings + loans.
Montenegro: equity capital cash; cumulated inflows from 2001.
Serbia: FDI net of equity capital cash + in kind; cumulated from 1997. Up to 1999 Serbia and Montenegro. Excluding Kosovo.

Belarus: equity capital + reinvested earnings + loans from 2002.
Moldova: equity capital + reinvested earnings from 1997 + loans from 1994.
Russia: equity capital + reinvested earnings from 1998 + loans from 1997; cumulated inflows until 1999.
Ukraine: equity capital + reinvested earnings + loans from 2002; cumulated inflows until 1999.

Sources: Respective National Banks according to international investment position (IIP).
Cumulated inflow for some countries as mentioned in the remarks.

Table 3

FDI outflow, EUR million

	2000	2001	2002	2003	2004	2005	2006	2007
Czech Republic	46	185	219	183	817	-15	1170	976
Hungary	664	399	296	1463	892	1777	2993	3004
Poland	18	-97	228	269	668	2756	7134	2395
Slovakia	31	72	12	219	-17	120	294	149
Slovenia	72	161	166	421	441	516	719	1154
New Member States-5	**832**	**719**	**921**	**2555**	**2801**	**5154**	**12309**	**7678**
Bulgaria	4	11	29	23	-166	249	137	191
Romania	-14	-18	18	36	56	-24	337	-45
Estonia	67	226	140	137	217	507	876	1123
Latvia	13	20	3	44	88	103	136	166
Lithuania	4	8	18	34	212	278	232	431
New Member States-10	**905**	**965**	**1129**	**2829**	**3208**	**6267**	**14027**	**9543**
Albania	.	.	.	.	9	2	8	11
Bosnia and Herzegovina	.	.	.	.	1	1	2	7
Croatia	5	210	607	106	279	192	177	206
Macedonia	-1	1	0	0	1	2	0	-1
Montenegro	.	0	0	5	2	12	178	483
Serbia	.	.	.	.	.	18	17	664
Southeast Europe	**4**	**211**	**607**	**111**	**292**	**227**	**381**	**1370**
Belarus	0	0	-218	1	1	2	2	2
Moldova	0	0	0	0	3	0	-1	-9
Russia	3433	2827	3736	8606	11085	10258	18570	33358
Ukraine	1	26	-5	12	3	221	-106	491
European CIS	**3435**	**2854**	**3513**	**8620**	**11092**	**10481**	**18466**	**33843**
Total region	**4344**	**4030**	**5249**	**11560**	**14592**	**16975**	**32875**	**44756**

Note: Country groups refer to sum over available data.

Remarks:

Czech Republic: equity capital + reinvested earnings from 1998 + loans from 1998.
Hungary: equity capital + reinvested earnings from 1995 + loans from 1995.
Poland: equity capital + reinvested earnings + loans from 1996.
Slovak Republic: equity capital + reinvested earnings from 1995 + loans from 1995.
Slovenia: equity capital + reinvested earnings from 1994 + loans from 2001.

Bulgaria: equity capital + reinvested earnings from 1999 + loans from 1997.
Romania: equity capital + reinvested earnings from 2005 + loans from 2005.
Estonia: equity capital + reinvested earnings from 1996 + loans from 1993.
Latvia: equity capital + reinvested earnings from 1996 + loans.
Lithuania: equity capital + reinvested earnings from 1997 + loans from 1997.

Albania: equity capital + loans from 2006.
Bosnia and Herzegovina: equity capital + loans.
Croatia: equity capital + reinvested earnings from 1997 + loans from 1997.
Macedonia: equity capital.
Montenegro: equity capital cash.
Serbia: equity capital cash + in kind. Excluding Kosovo.

Belarus: equity capital + loans from 2002.
Moldova: equity capital from 1997 + loans.
Russia: equity capital + reinvested earnings from 1997 + loans from 1997.
Ukraine: equity capital + loans from 2005.

Source: Respective National Banks according to balance of payments statistics.

Table 4

Outward FDI stock, EUR million

	2000	2001	2002	2003	2004	2005	2006	2007
Czech Republic	795	1288	1405	1808	2760	3061	3810	4734
Hungary	1376	1763	2068	2782	4412	6622	9248	12456
Poland	1095	1309	1390	1700	2401	5305	12375	15000 [1]
Slovakia [2]	402	574	522	663	618	504	876	1000 [1]
Slovenia	825	1120	1445	1880	2224	2789	3457	4600 [1]
New Member States-5	**4493**	**6054**	**6830**	**8833**	**12415**	**18281**	**29766**	**37790**
Bulgaria	72	39	38	41	-129	105	219	408
Romania	146	132	138	165	200	181	668	675
Estonia	279	500	645	816	1040	1639	2744	3993
Latvia	25	45	58	92	175	238	363	534
Lithuania	32	54	57	96	310	608	793	1068
New Member States-10	**5046**	**6823**	**7767**	**10043**	**14012**	**21051**	**34552**	**44469**
Albania	.	.	.	.	9	11	19	30
Bosnia and Herzegovina	.	.	.	.	1	2	4	10 [1]
Croatia	886	1008	1607	1627	1563	1730	1834	2379
Macedonia	.	.	.	34	40	53	30	30 [1]
Montenegro	.	0	0	5	7	19	196	679
Serbia	.	.	.	.	.	.	.	.
Southeast Europe	**886**	**1008**	**1607**	**1665**	**1621**	**1814**	**2083**	**3128**
Belarus	26	23	4	5	6	12	14	19
Moldova	25	26	22	19	21	25	22	28
Russia	21697	50312	59854	72687	78742	123498	173132	210000 [1]
Ukraine	183	177	139	133	146	396	278	4301
European CIS	**21930**	**50538**	**60019**	**72844**	**78915**	**123931**	**173447**	**214348**
Total region	**27863**	**58369**	**69392**	**84552**	**94548**	**146796**	**210082**	**261944**

Note: Country groups refer to sum over available data.
1) wiiw estimate.

Remarks:

Czech Republic: equity capital + reinvested earnings from 1997 + loans from 1997.
Hungary: equity capital + reinvested earnings from 1995 + loans from 1995.
Poland: equity capital + reinvested earnings + loans from 1996.
Slovak Republic: equity capital + reinvested earnings + loans. From 2003 new methodology according to annual survey.
Slovenia: equity capital + reinvested earnings + loans.

Bulgaria: equity capital + reinvested earnings + loans.
Romania: equity capital + reinvested earnings + loans from 2004.
Estonia: equity capital + reinvested earnings + loans.
Latvia: equity capital + reinvested earnings + loans. From 2001 change in methodology and range of entities regarded as residents.
Lithuania: equity capital + reinvested earnings + loans from 1996. From 2005 joint stock companies valued at market value (book value before).

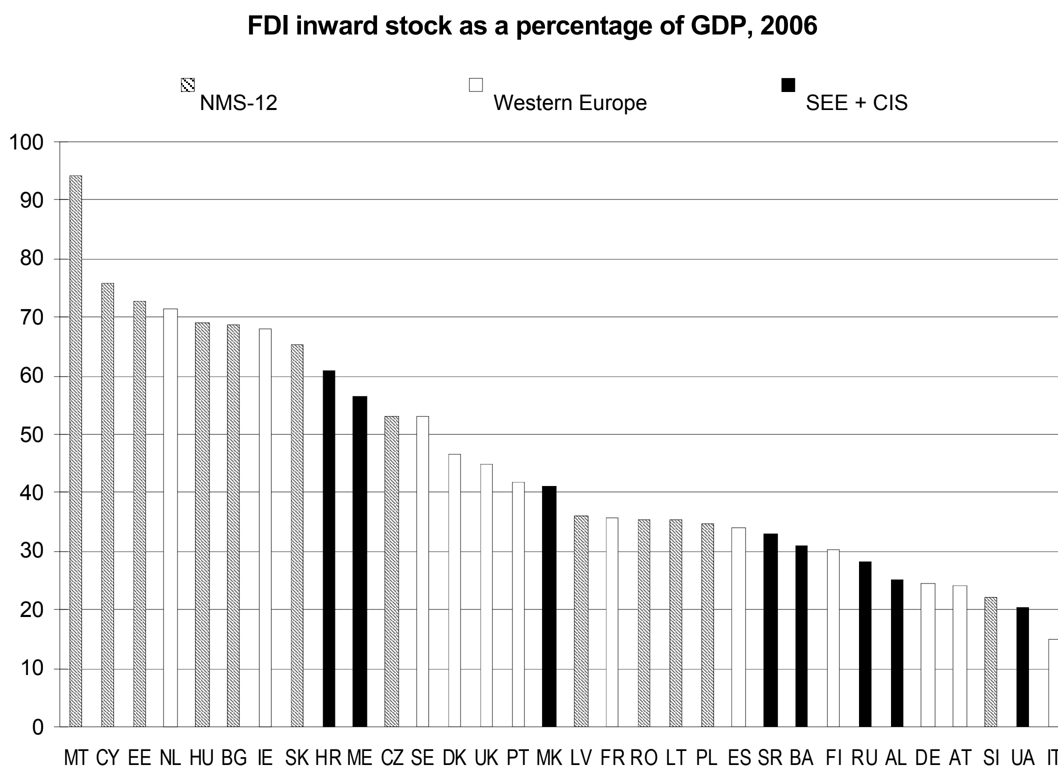
Albania: equity capital + loans from 2006; cumulated outflows from 2004.
Bosnia and Herzegovina: equity capital + reinvested earnings + loans.
Croatia: equity capital + reinvested earnings + loans.
Macedonia: equity capital + reinvested earnings + loans.
Montenegro: equity capital cash; cumulated outflows from 2001.
Serbia: not available.

Belarus: equity capital + reinvested earnings + loans from 2001.
Moldova: equity capital + loans from 1995.
Russia: equity capital + reinvested earnings from 1997 + loans from 1997; cumulated outflows until 1999.
Ukraine: equity capital + reinvested earnings + loans from 2005; cumulated outflows until 1999.

Sources: Respective National Banks according to international investment position (IIP).
Cumulated outflow for some countries as mentioned in the remarks.

Figure 2

FDI inward stock as a percentage of GDP, 2006



Source: wiiw FDI Database.

Table 5

FDI-related income outflow relative to inward FDI stock, selected countries, %

	2000	2001	2002	2003	2004	2005	2006	2007
Czech Republic	6.4	7.7	9.1	10.3	11.7	10.4	12.0	13.0
Hungary	8.9	8.4	9.7	8.3	9.6	9.1	9.2	10.7
Poland	2.1	1.7	1.7	4.0	12.1	9.7	11.0	10.3
Slovakia	0.9	1.5	2.0	13.3	12.6	11.0	8.7	10.4
Slovenia	3.1	-0.3	5.1	5.3	6.8	6.3	8.3	7.6
Bulgaria	4.0	5.0	6.0	9.8	8.2	6.3	7.7	5.0
Romania	1.1	1.5	2.8	8.2	13.9	10.8	9.6	11.3
Estonia	7.9	9.7	10.4	10.0	9.3	8.0	11.9	13.6
Latvia	4.4	4.2	4.2	7.1	12.8	11.9	13.7	13.2
Lithuania	5.3	5.3	3.4	9.0	11.2	8.2	8.3	10.4
Croatia	5.9	8.5	6.5	13.1	6.8	6.9	5.1	3.6
Russia	2.8	2.8	4.6	14.3	9.2	10.3	12.4	11.0
Ukraine	1.1	1.6	1.9	1.3	2.1	1.5	4.5	3.3

Source: wiiw FDI Database.

Table 6

Share of repatriated income in FDI income outflow, %

	2000	2001	2002	2003	2004	2005	2006	2007
Czech Republic	31	29	38	48	52	51	52	47
Hungary	48	43	43	44	50	60	74	62
Poland	156	244	263	104	34	63	57	53
Slovakia	99	99	93	20	36	68	73	78
Slovenia	46	-674	33	26	27	35	65	91
Bulgaria	46	96	63	55	27	45	38	69
Romania	.	.	.	28	30	51	19	49
Estonia	48	28	49	26	26	31	20	21
Latvia	36	64	72	55	43	45	25	43
Lithuania	27	41	42	45	37	57	23	26
Croatia	51	50	57	34	53	33	34	55
Russia	89	71	78	44	48	52	57	44
Ukraine	.	.	98	86	97	99	96	99

Source: wiiw FDI Database.

Table 7

FDI and current account position

	Current account % of GDP			FDI income balance % of CA			FDI net % of CA deficit		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Czech Republic	-2	-3	-3	303	188	261	572	102	178
Hungary	-7	-6	-5	70	85	113	73	46	21
Poland	-1	-3	-4	245	134	97	185	111	91
Slovakia	-8	-7	-5	67	78	111	56	97	67
Slovenia	-2	-3	-5	70	85	113	-8	-24	-5
Bulgaria	-12	-18	-22	27	30	20	119	130	95
Romania	-9	-10	-14	35	33	27	76	86	42
Estonia	-10	-16	-17	50	38	41	156	23	26
Latvia	-12	-22	-23	29	21	20	29	33	31
Lithuania	-7	-11	-14	38	26	27	37	48	26

Note: CA means current account balance. FDI income balance is defined as income on inward FDI minus income on outward FDI. FDI net is defined as inflow minus outflow.

Source: wiiw annual Database incorporating national bank statistics.

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