September, 2006

The Macroeconomic Situation In and the Competitive Challenges Facing the Transition Economies

Robert C. Shelburne, *United Nations Economic Commission for Europe*

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by
Robert C. Shelburne[1]

I've been asked to discuss with you today the basic macroeconomic situation in the transition economies. Let me start with a quick overview of that, then I will describe the global macroeconomic situation, then explain how some possible global disturbances may impact this region. In the second part of my talk I want to focus on the longer-run competitive position of the region, and discuss some more strictly domestic problems and how they might be addressed.

The general economic story for the transition economies is one of relatively healthy growth as seen in Table 1. Growth for all the transition economies is likely to be around 6% in 2006; this is quite respectable compared to expected global growth of 5.1%. Growth this year is roughly similar to that recorded in 2005, but slightly below that of 2004. There should be a slight cooling off next year to maybe 5.5% while over the next five years, growth is forecast to be about 4.5%, with highest growth of around 6% in the CIS.

The new EU members continue to do very well, and this is especially the case for the Baltic countries where growth is slowing but still quite high. In central Europe growth is expected to be slightly above the world level. However, Hungary is expected to have growth of only 4.0% next year as tax increases are implemented in order to reduce the fiscal deficit in order to satisfy the Maastricht criteria for euro accession. In southeast Europe all of the countries except Macedonia are likely to grow by a least 5% in 2006; this is similar to or better than 2005.

CIS growth which had been predicted to be only slightly above 6 % is now forecast to be almost 7% this year, slightly up from 6.5% in 2005; growth in Ukraine has returned after a disappointing 2005 although it could decline next year as higher prices of Russian gas take hold. Note the very high growth rate of the low-income CIS. The expected growth rate of the energy exporters is greater that of the energy importers and is expected to increase further in 2007. To some degree this is due to the extraordinary growth rate of 26% in Azerbaijan, which has achieved this growth spurt after a number of years of extremely high FDI in their energy sector.

Nevertheless, despite a number of years of quite robust growth, income levels remain below or near their 1989 levels for most of the countries in the region; and inequality and poverty remain high. Figures 1 and 2 show how the level of real GDP has evolved since 1989 in the transition economies. Southeast Europe and the CIS experienced the largest declines with the Caucasus and the European CIS (Belarus, Moldova, and Ukraine) doing especially poorly.[2]

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[1] Chief Economist, United Nations Economic Commission for Europe, presented to the UNCTAD training course on Key Issues on the International Economic Agenda, Ministry of International Economic Relations, Belgrade, Serbia, September 2006.

[2] Rumen Dobrinsky, Dieter Hesse, and Rolf Traeger, *Understanding the Long-term Growth Performance of the East European and CIS Economies*, UNECE Discussion Paper, No.9, 2006.

Moving to Figure 3, EBRD has made some long-run projections of GDP per capita in the transition economies over the next ten years, and even with relatively solid growth assumptions, there is only a gradual convergence towards EU-15 levels. Even after 10 years there will still be a huge gap. This gap will mean there will remain strong incentives for workers to migrate to the richer countries, thus the migration issue is likely to remain as an important political issue in the EU-15 and remittances will remain as an important source of income for many of the transition economies.

While discussing the current growth rates of the transition economies, I would like to point out one interesting aspect of it. To a significant degree, the growth rates over the last decade and even current growth rates are positively related to the depth of their transitional recessions. Thus the implication of this is that these impressive growth rates are due to a bounce back effect from the devastating transitional recession that followed the breakdown of the planned economies beginning in 1989. By the early to mid 1990s, real GDP had fallen at least by 40 per cent for most of the FSU (states of the former Soviet Union, i.e., the CIS plus the Baltic states), 30 per cent for southeast Europe, and 20 per cent for central Europe. Currently the growth rates of the major sub-regions are positively related to the size of the declines, that being the larger the decline the larger the current growth rate. The CIS is growing the fastest followed by southeast Europe with the central European economies growing the slowest. This is true even with the sub-regions; for example in Figure 4 the average annual GDP growth rate for the New Member States of the EU for 1995 to 2006 is plotted against the maximum GDP decline that occurred during the transitional recession by either 1993 or 1994. As can be seen, a significant proportion of the current growth rate is clearly related to the depth of their transitional recession. For the EU-8, 86 per cent of the variance in their growth rates is explained by this factor alone; for the EU-8 plus the two new members (Bulgaria and Romania) to join in January, 64 per cent of the variation is explained by this factor. Clearly Bulgaria and Romania did not bounce back as fast; this difference of around 1.5 per cent in annual growth (their 2.5 per cent growth compared to the expected growth of 4 per cent for the 2004 EU members) can be considered as the EU growth dividend. The basic conclusion of the above GDP analysis is that the economies of the region are growing fast but they are largely making up for what was temporarily lost; nevertheless this bounce-back effect is not automatic but is dependent on a number of complementary factors such as EU membership as shown above. However, the bounce-back factor does explain to a significant degree the outstanding recent performance of the Baltic countries, thus raising a serious question as to whether these nations are truly new growth tigers as is often alleged. Figure 5 shows how current rates of productivity growth are also related to the size of the transition recession. The same type of bounce-back effect was present for the western advanced economies after the Second World War: those that suffered the most, western Europe compared to the U.S. and Germany compared to the European allies, had the most rapid recoveries.

Inflation throughout the region remains generally moderate, but double-digit inflation has returned to Turkey and much of the CIS, especially the oil exporters; and as a result interest rates are quite high in these economies as well. The oil exporters can expect a real currency appreciation and this can be achieved as either a nominal appreciation or through inflation. The CIS energy exporters have chosen some of each. Inflation is also picking up in Serbia and Romania. Further currency depreciation for some of the high inflation non-energy economies is likely; however even these economies may expect some real appreciation through Balassa-Samuelson effects.

A really significant macroeconomic problem plaguing not only the transition economies but much of Europe is unemployment as shown in Figure 6. Despite the recent economic growth, unemployment remains quite high in the New Member States, especially Poland, and in southeast Europe. It is particularly high in the former states of Yugoslavia where it is generally over 20%. The situation is better in Romania and Bulgaria, but as demonstrated by Poland, EU membership provides no solution to this problem given the very strict macroeconomic framework that is required for membership. Official registered unemployment is relatively low in the CIS, since many don't apply because there are often few benefits, but the internationally comparable level based upon household survey data is higher with rates around 7 to 8% in Russia and Ukraine.

I just came back from visiting the central European capitals, and the unemployment there is quite visible by the number of homeless sleeping in the parks; it's reminiscent of the situation in the big cities of the United States during the 1980s when unemployment there reached double digits.

An issue that has received considerable attention, not only in Europe, but around the world is the phenomenon of jobless growth; this is where there is favourable economic growth which, for some reason, doesn't produce employment growth. In Figure 7 the growth rate in the transition economies on the vertical axis is plotted against the change in unemployment on the horizontal axis. Given the high growth and the fact that most of the points are to the left of the axis, the situation can not really be characterized as jobless growth; a better word might be job puttering growth. With growth, most of the transition economies have experienced some decline in unemployment – thus it's not jobless growth, nevertheless there is no significant relationship between the rate of growth and the decline in unemployment – a regression through these points would be almost flat, so perhaps in that sense the situation could be described as jobless growth.

Another important macroeconomic problem facing a number of countries in the region is their current account deficits. Except for the oil-rich CIS economies, most of the transition economies are borrowing money from the rest of the world and as shown in Figure 8 they have been receiving a sizable slice of global investment in emerging markets; they are getting as much as all of Asia, and considerably more than Latin America. This seems consistent with the consumption smoothing hypothesis regarding current accounts. As described, given the large declines in income in these economies, it seems reasonable that they would borrow now to smooth out their consumption over the long run.[3]

However external borrowing can become problematic if market participants begin to wonder if the country is going to be able to pay it back. As a result a country can suffer a currency crisis where its currency depreciates rapidly and this can produce a more general financial crisis where banks, corporations and individuals are forced into bankruptcy. This is no far-fetched possibility. Based upon past trends, for an emerging market economy like those of this region, the possibility of a currency crisis in a given year is 8%, and the economic costs average 9% of GDP and appear to lower national income from its long-run trend; this means it lowers living standards permanently from what they would have been.

[3] The logic of current account deficits for the transition economies is discussed more fully in chapter 6 of the *Economic Survey of Europe*, 2005, No. 1.

Now do the current accounts in the region pose a problem? There are several reasons to be concerned about this. Historically, the bigger the deficit, the more likely there is to be a problem. When a country's current account is greater than one-half of its growth rate, it begins to become problematic. Thus a country that is growing at 6% should ideally keep its deficit to below 3%. The average projected current account is 6.5% of GDP for the New Member States and 9% for southeast Europe. These numbers are considerably bigger than the prudent standard just mentioned. The current account deficits are especially large in a number of countries including the Baltic countries, Hungary, and much of southeast Europe, including the non-transition economy of Turkey. This is not a major problem for most of the CIS.

A given current account deficit is thought to be a bigger problem when it is accompanied by a large government deficit; this is because it is obvious that the borrowed money is not being invested into something that will provide a stream of income to pay back the debt. It is for this reason Hungary's current account is being viewed as a bigger problem than the Baltic countries even through their deficits are larger. Although government deficits have increased slightly in some of the economies of the region, the general trend has been towards smaller deficits. In addition, when borrowing takes the form of FDI, it is also thought to be less problematic since the lenders only get paid back if things turn out well. This is another reason the large current accounts of the Baltics have not raised more concern.

A second reason to be concerned about the current accounts in eastern Europe is that when countries borrow they often keep a portion of it in reserve (that being their so-called international reserves) so that they have the liquid funds to pay some of it back if an emergency arises. This region is one of the few in the world that has not been accumulating large international reserves over the last five years; in addition some other areas such as Asia have also developed a regional supply of reserves which they can borrow, as under the Chiang Mai Initiative. Thus if a problem arises, the east European countries will not have the resources or financial cushion to deal with it, compared to the Asian countries.

Another significant macroeconomic vulnerability for the transition economies which is closely related to their current account deficits, concerns their financial sector's rapid growth of credit to non-financial companies and households. This has been especially the case in the Baltic countries, Hungary, Bulgaria, Romania, and Croatia. For example, banking deposits were up 25% in Russia in 2005. Compared to other world regions, eastern Europe stands out in terms of the growth of consumer credit. Much of this is due to the rapid expansion of mortgage loans to households. It is true that the stock of these loans is relatively low compared to other regions, however the concern is that when there is such a rapid growth in the amount of loans, there is likely to be some decline in asset quality. Thus this rapid credit growth has raised questions about the quality of the loans, as well the soundness of the banking institutions and the regulatory environment of the financial sector, which are both relatively new.

In addition to increasing the vulnerability of the banking system, this rapid rise of credit has fuelled a rapid rise in asset prices. Figure 9 provides some information on stock market returns. These increases are quite high compared to the advanced economies where stock returns have basically been flat over this period.

In addition, housing prices have been increasing quite rapidly as well; prices in some areas have tripled in the last 2 or 3 years. Figure 10 has data for Poland and the Baltics but these trends exist throughout the region.[4] Thus the assets that consumers hold may not be worth what they paid for them, especially if they purchased them recently and this can create all kinds of problems, especially if the assets were purchased with borrowed money as is the case with housing.

Along with the increase in credit, there is another troubling development in that much of this domestic borrowing has been in foreign currency denominated loans. Although much of this region has a long history of dollarization or euroization, a disturbing aspect of this has been that the borrowers are increasingly consumers with no access to foreign currency; this is especially noticeable for home mortgages. A depreciation of their domestic currencies would increase their domestic currency payments on their mortgages and could lead to consumers defaulting on their loans. This could then threaten the stability of the banking system.

Thus the overall story is one of increasing soundness of the public sector as governments get their deficits under control, especially in the oil-rich CIS where governments are running budget surpluses, matched to some degree by increasing vulnerabilities in the private sector. This is shown in Figure 11 where the public (and public guaranteed) debt has been relatively constant for the last several years while private sector debt has more than doubled just since 2002. This pattern mirrors the changing academic models of financial and currency crises. The early models, often referred to as first generation models, explained the crises as being due to excessive government borrowing which led to current account deficits. More recent models, the so-called third generation models, emphasize how sudden credit stops lead to depreciations which create a crisis through balance sheet effects on private borrowers. Balance sheet effects occur simply when firms' debt which is denominated in foreign currency increases in terms of domestic currency when a depreciation occurs. As firms default on these loans, the crisis spreads through the financial system.

Through experience governments have learned to avoid excessive borrowing in foreign currency, consumers and small businesses in many of the transition economies however do not appear to be taking these risks seriously. That this might be a mistake is perhaps reflected in the academic term coined for government foreign borrowing, where it is referred to as original sin. The private sector is showing that it is just as prone to sinning as the government.

By now I may have alarmed you, but I am somewhat pessimistic by nature. As economists we are paid to look for problems and perhaps I have looked too hard. However, it is quite insightful to look at the macroeconomic assessments of the Asian economies in 1997 just prior to their devastating crises. These macroeconomic analyses including those of the IMF were quite positive; thus economists then were not looking for problems as hard as they should have. I have not forgotten that lesson, but hopefully I have not over learned it either.

Perhaps the current vulnerabilities of the transition economies are really not that great, especially given the current global environment. However, that environment is likely

[4] Two papers that examine this in some detail include: Jose Palacin and Robert C. Shelburne, The Private Housing Market in Eastern Europe and the CIS, UNECE Discussion Paper No.6, December 2005; and Robert C. Shelburne and Jose Palacin, Is There an East European Housing Bubble?, *Global Economy Journal*, Vol. 6 (3), 2006.

to change, so let us look at it more closely since many of the difficult challenges that the region may have to face will be the result of changes in that environment.

The current worldwide macroeconomic situation over the last 5 years has been quite exceptional. Global growth of real GDP is expected to be around 5% in 2006, and global growth has averaged almost 5% (4.8%) over the last 4 years. This is the strongest four years since the early 1970s. In addition world growth is expected to be close to 5% (4.9%) in 2007 as well. Thus by the end of 2007 we could end up with 5 years of 5% growth for the world economy. This growth has been relatively strong throughout the world, and especially as already noted in the transition economies. Generally, economic crises do not occur during periods of solid growth and low interest rates, and that is why the last several years have been relatively uneventful.

One of the major engines of this growth has been the United States; however, it now appears that growth there is slowing down to maybe to 3% this year (2006), and there is even a possibility, at least, that there could be a recession in 2007. This is due primarily to the fact that U.S. interest rates have gone from 1% to 5.5% over the last few years. Growth in western Europe has been disappointing for some time, but seems to have picked up this year and may reach 2.5% in the eurozone this year; this is the fastest growth in six years. Unfortunately the party may be over quite soon as there are already signs that growth may have peaked with an expected slowdown coming in 2007. You may have read that Europe is now growing faster than the U.S. for the first time in many years. One should not interpret this as any real turn-around in Europe's relatively poor growth performance relative to the U.S.; it is instead simply due to the fact that these regions' macroeconomic cycles are not synchronized. Europe is approaching its peak while the U.S. is well past its peak.

Despite the large increase in oil prices over the last 2 years, inflation has been quite moderate; it's currently running about 4% in the U.S. and 2.5% in the eurozone, although this varies significantly, from 4% in Spain to 1.4% in Finland. The last two times oil prices increased significantly, in 1973 and 1979, the world experienced bad cases of stagflation, that being inflation and recession at the same time. For a number of reasons that has not occurred this time, but there is serious concern that it still may happen. Thus this is one of the problems we have to worry about, that being, that the oil price increases have not been fully absorbed and their ultimate inflationary effect is still to happen, or that even further oil price increases might occur for a number of reasons such as a conflict with Iran, or some other problem with supply due to an accident or terrorism. In such a case the monetary authorities would be unable to use monetary policy to address an approaching recession because they would be preoccupied with existing cost-push inflation. Higher interest rates in the advanced economies would lower the desire for investing in the transition economies. The fall-off in capital inflows would lead to currency depreciations for local currencies. For those countries with a currency board, there would be wage and price deflation. Thus the question is, can the region handle high interest rates, falling currencies, combined with falling exports due to a world recession? But with luck, maybe they won't have to.

There are a number of other potential risks for the global economy, including the consequences of a bird flu pandemic, or a collapse in global housing markets. A major contributor to the last recession of 2001 was caused by the global fall in stock prices, and there are good reasons for believing that a fall in housing prices would be even more disruptive.

The final global threat concerns global imbalances. This problem has been widely discussed, but I want to focus on it a little because its one of those issues that seems like it is far away, and thus somebody else's problem; more specifically the U.S. and China. However, it is in fact a problem that could have significant implications for a number of the transition economies. In addition many of the transition economies in southeast Europe and the CIS have their own imbalances problem, so although their problems are really not considered as part of the global imbalances issue, they also have essentially the same problem as the United States. Currently China, Japan, and the major oil producers including those in the Middle East, as well as Russia are selling a lot of goods to the rest of the world, and instead of taking that money and buying products from the rest of the world, they are instead saving that money and lending it to others, primarily the United States. The United States is thus borrowing this money, currently at a rate of 7% of its GDP, and spending it on goods from the rest of the world. This process is especially worrisome because the money being borrowed is not creating additional investment; if it were, that would increase U.S. national income and provide a source of funds for paying back the debt. Instead the capital inflows are being used to finance a consumption binge due to the fact that the public does not think they need to save because of house appreciation and a government deficit which has decided to fight a war and cut taxes at the same time. This is somewhat reminiscent of the Vietnam period and that situation did not turn out well. Although the U.S. budget deficit is not that great, it is significant especially given the fact that U.S. households' saving rate has basically fallen to zero. All of this spending by the United States has had a silver lining in that it has maintained the demand for goods throughout the world and that has kept global growth going for the last decade.

There is nothing wrong with this in the abstract, although it is somewhat perverse for the poorer countries of the world to be loaning money to one of the richest. The real problem, however, is that this can't go on forever; at some point either the world will decide it doesn't want to loan the U.S. any more money, or the U.S. will decide it doesn't want to go any further into debt. When this process stops, it will produce economic changes that lead to changes in prices, interest rates and exchange rates. And these changes can further produce changes in asset prices and employment levels. For those businesses and individuals that have planned their future assuming one set of prices, interest rates or exchange rates, these changes can be very damaging.

The fundamental question is whether this adjustment from the current state with its large current account imbalances can be unwound without creating havoc on the world economy. In the long-run, the only real way for this problem to be eliminated is for there to be a significant devaluation of the dollar, anywhere from 25 to 50%. When that will happen is anybody's guess. The hope is for a soft landing, that being the terminology for an optimistic gradual and relatively uneventful adjustment. If it happens very quickly, there could be some serious consequences. In this type of scenario, it is not really clear what might happen. But in terms of an international reserve currency, there are few alternatives to the dollar except for the euro; thus a dollar depreciation may result in a large euro appreciation even though Europe currently has a balanced current account. If the currencies of the transition economies depreciate relative to the euro, those (and there are a lot of them) who borrowed in euros are going to suffer. If these currencies attempt to stay linked to the euro then the competitiveness of the region will be adversely affected; the fall in exports (due to their appreciation as well as a slowdown in western Europe due to euro appreciation) could also reduce investment. With exports and investment both down, the result could very well be a recession. But it is the uncertainty about exactly what might occur that creates a real problem because people are unsure what to do now in order to protect themselves.

For the macroeconomic outlook, let me stop with that. Just to summarize, the region is doing very well, but there are a number of financial sector vulnerabilities especially in terms of debt denominated in foreign currencies, which might become problematic if the performance of the global economy should deteriorate significantly.

Finally let me say a few things about the longer-run competitive position of the region. Currently the transition economies are specialized in medium-technology and labour-intensive or semi-skilled goods. This is putting them into direct competition with many of the Asian economies, some of which have much lower wages. China is "unexpectedly" competitive in these markets as well. Although China's per capita income is only $4,000, it exports products typical of countries with per capita incomes of $16,000 –that's the income level of the New Member States. Although one can always attempt to compete with higher productivity, given the large wage differential favoring China and the fact that wages there are unlikely to rise much given the large surplus of rural workers waiting to migrate to the cities, the only alternative is to go up-market to even higher skill and technology sectors which offer higher wages.

Future growth therefore will need to be in knowledge-intensive industries. The policy focus therefore needs to be on how to develop these sectors by developing these countries' human capital and creating an environment for the assimilation of technology. Although the region stacks up reasonably well in terms of educational standards and the physical infrastructure has been rapidly improving, the region is poor in terms of its innovative capacity as demonstrated by the low volumes of business sector R&D, patents, and availability of venture capital. The transition economies, especially the CIS, are characterized by low quality products. This is demonstrated in Table 2 by the low unit values relative to world prices that exports from these countries are able to fetch.[5] This is a problem inherited from the planned economies, and although the economic systems have changed many of the problems remain the same.

Although measures of national competitiveness are probably over emphasized and over used, it is nevertheless worth looking at them to see where the transition economies fall. One thing that is obvious is that these measures are highly correlated with per capita income, with the most competitive countries being the richest. This results from the fact that the components of the index are things that basically characterize rich countries. What is perhaps insightful, however, is how countries compare after controlling for per capita income. In Figure 12, the competitive indexes as calculated by the World Economic Forum [6] (whose measures are probably the best and certainly the most comprehensive) are plotted against the per capita incomes of a large sample of countries. The positive correlation is clear. However, with only a few exceptions, the transition economies are generally to the left of the (log-linear) regression line; thus for their income levels, these economies are not generally found to be all that competitive.

[5] The trade competitiveness of southeast Europe and the CIS are examined in two recent UNECE working papers. See, Vitalija Gaucaite Wittich, *Some Aspects of Recent Trade Developments in South-east Europe*, UNECE Discussion paper 7, December 2005; and Robert C. Shelburne and Oksana Pidufala, *Evolving Trade Patterns in the CIS: The Role of Manufacturing*, UNECE Discussion Paper 10, September 2006.
[6] *Global Competitiveness Report 2006-2007*, World Economic Forum, 2006.

The problem of achieving a respectable growth in productivity, especially multifactor productivity, is not just one for these transition economies but seems to exist for the more advanced western European economies as well. Although their problem is somewhat similar, there are important differences. Western Europe was able to grow fast, including fast multi-factor productivity growth, as long as they were catching up to the technological frontier of the U.S. Their problem now, however, is not one of adopting existing technologies but of innovating at the frontier. The transition economies' main need, however, is still to promote productivity growth by absorbing existing technology. Thus their problem is more similar to that of western Europe several decades ago and that of the Asian economies (including China) now. Thus the transition economies are not faced with a new economic problem that must be addressed from scratch; there do exist roadmaps to provide a guide. These economies, however, have their own idiosyncratic situations which do require that they adopt this roadmap to their own particular situations. In addition, they may have a number of additional disadvantages which western Europe did not or Asia does not have to face.

What's needed to address this situation is a fairly complex set of policy initiatives. Let me just list a few: 1. University enrolment needs to be tilted towards engineering and the sciences. 2. Tax policy needs to encourage savings, investment and R&D. 3. Financial markets need further development with improved regulatory institutions, and the provision of finance for small and medium sized enterprises needs to be developed. 4. FDI needs further encouragement, for example by improving protections for intellectual property. 5. Public infrastructure must be improved. 6. Venture capital funds need development. 7. The research linkages between industry and the academic community need to be strengthened. 8. Collaborative research projects with advanced economies need to be encouraged including support for the migration (both ways) of scientific and technological talent.

And finally, the importance of competitive product markets should not be overlooked. A number of empirical studies of innovation in the region have emphasized the importance of this factor; the lack of competition was perhaps the key reason that innovation was so poor under central planning. The importance of this factor is supported by cross-sectoral analysis of productivity growth at the level of the firm in the transition economies. The role of competition in either promoting or discouraging productivity growth is well developed in the industrial economics literature. The lack of competing firms is a remnant of the planning phase under which there were a limited number of firms (often only one) for producing a given product because there was no emphasis on competition and one firm was thought better able to reap economies of scale. The privatization process resulted in a similar situation either because monopoly firms were privatized as a single firm, or if split up originally (or if there were several firms originally) the country often lacked the appropriate competition policy to avoid a re-concentration of the industry. Thus the current situation where there is limited competition to promote innovation seems similar to that which existed under planning. I could also throw in the importance of labor market flexibility, but that seems to be a policy prescription being over prescribed these days.

This is an exciting time to be living in the transition economies. There is tremendous potential and after many years of hardship, things are finally falling into place. Maintaining sound macroeconomic policies and implementing sensible structural policies like those just mentioned are likely to pay off handsomely in the future.

Table 1
Real GDP Growth in the Transition Economies

	2004	2005	2006e	2007e
Bulgaria	5.7	5.6	5.6	5.8
Czech Republic	4.2	6.1	5.5	4.5
Estonia	8.1	9.8	7.9	7.1
Hungary	4.9	4.2	4.4	4.2
Latvia	8.7	10.2	9.0	7.0
Lithuania	7.3	7.3	6.5	6.0
Poland	5.3	3.2	4.2	3.8
Romania	8.4	4.1	5.2	5.6
Slovak Republic	5.4	6.0	6.3	6.7
Slovenia	4.4	3.9	4.0	4.0
NMS	**5.6**	**4.5**	**4.9**	**4.6**
Albania	5.9	5.5	5.2	6.0
Bosnia and Herzegovina	5.8	5.0	6.0	6.0
Croatia	3.8	4.3	5.0	4.7
Macedonia, Former Yugoslav Republic of	4.1	4.0	3.3	4.5
Serbia	8.4	5.1	5.5	5.0
SEE	**5.6**	**4.7**	**5.2**	**5.1**
Armenia	10.1	13.9	7.5	6.0
Azerbaijan	10.2	24.3	26.2	22.9
Belarus	11.4	9.3	9.9	5.5
Georgia	6.2	7.7	6.4	5.0
Kazakhstan	9.6	9.4	8.0	8.3
Kyrgyz Republic	7.0	-0.6	5.0	5.5
Moldova	7.3	7.0	6.0	5.0
Russia	7.2	6.4	6.0	5.8
Tajikistan	10.6	6.7	8.0	6.0
Turkmenistan	17.2	9.6	6.5	6.0
Ukraine	12.1	2.6	2.3	4.3
Uzbekistan	7.4	7.0	7.2	5.0
CIS	**8.4**	**6.5**	**6.2**	**6.1**

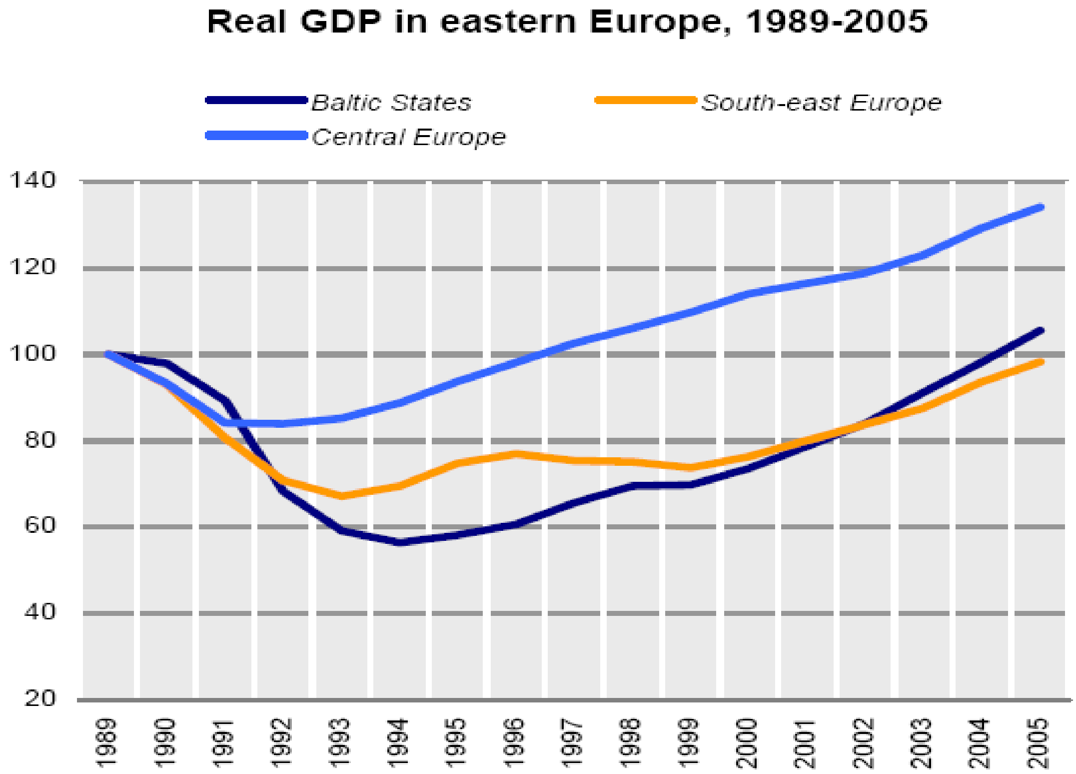
Source: IMF, UNECE, ICEG

Table 2
Quality of CIS Exports: Unit Value Calculations
Based upon the 5-digit SITC-Revision 3

	All goods	*Intermediate goods*	*Capital goods*
Armenia	0.80	0.84	0.08
Azerbaijan	1.01	0.46	0.30
Republic of Moldova	0.61	0.64	0.13
Russian Federation	0.72	0.64	0.37
Ukraine	0.70	0.71	0.25
Average	0.77	0.66	0.23
Estonia	0.62	0.65	0.57
Latvia	0.62	0.63	0.27
Lithuania	0.70	0.71	0.19

Source: *Economic Survey of Europe, 2004, No. 1*

Figure 1 and 2
Source Dobrinski, Hesse, Traeger, 2006



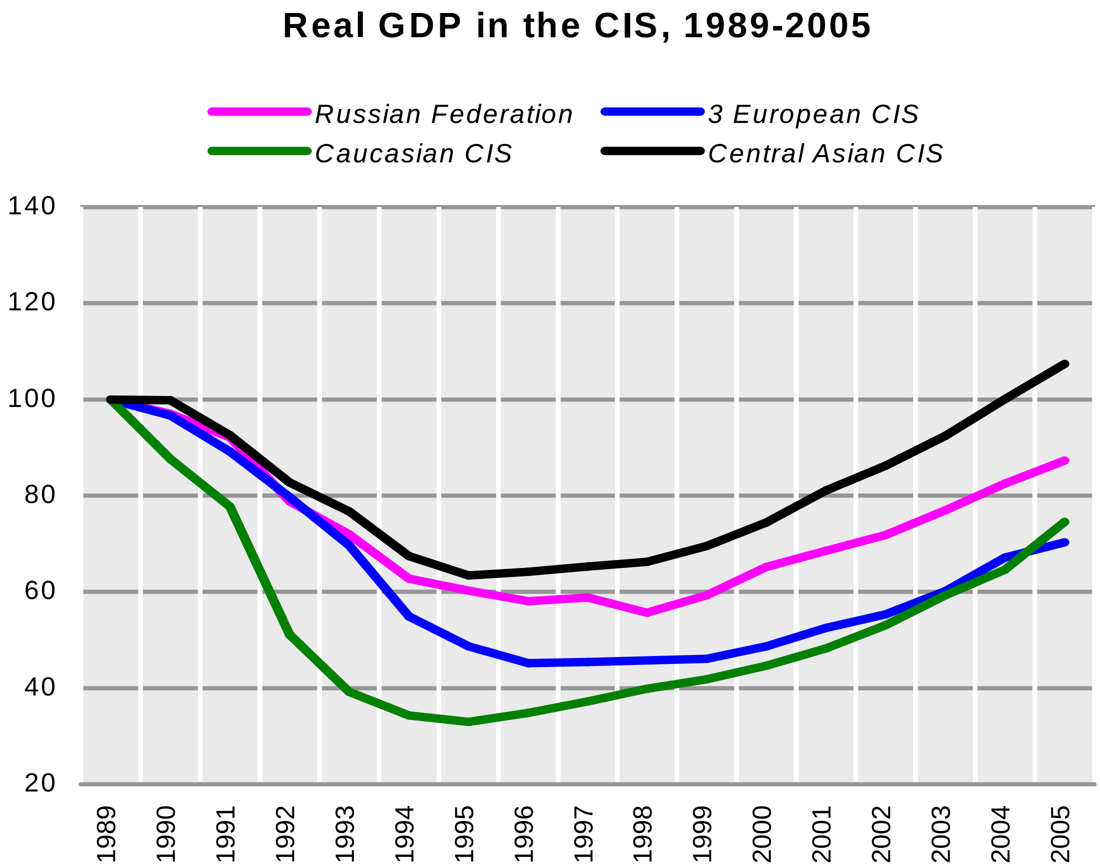
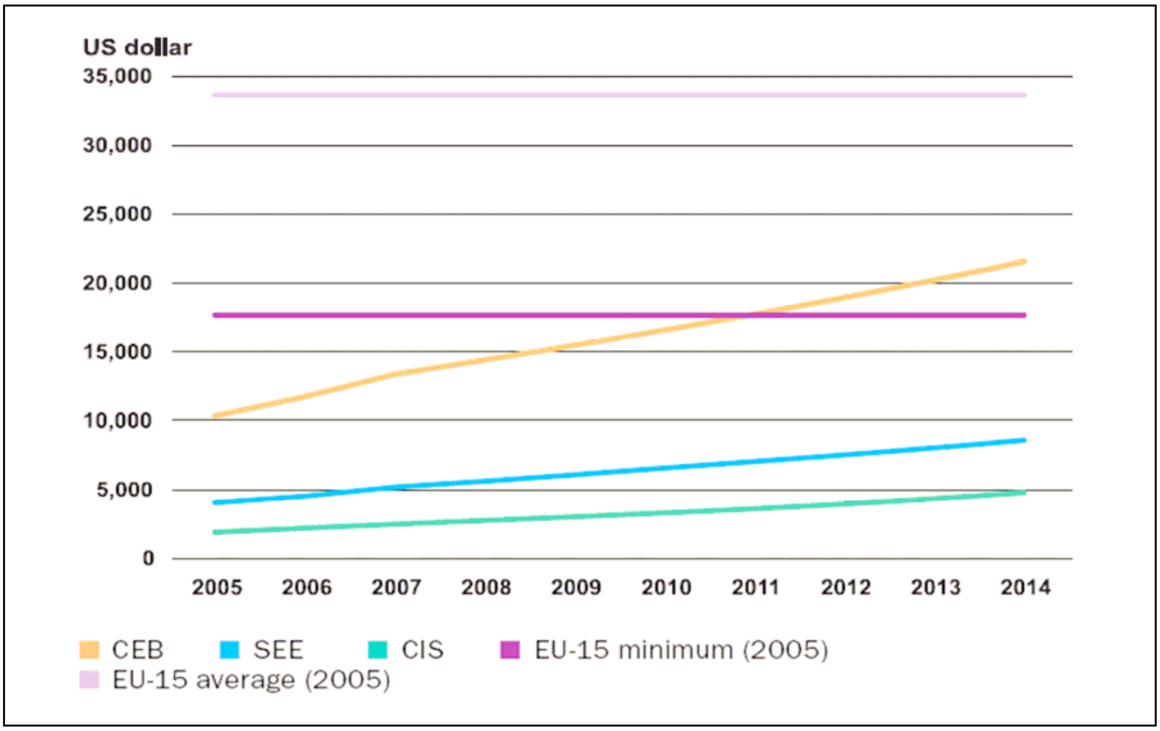
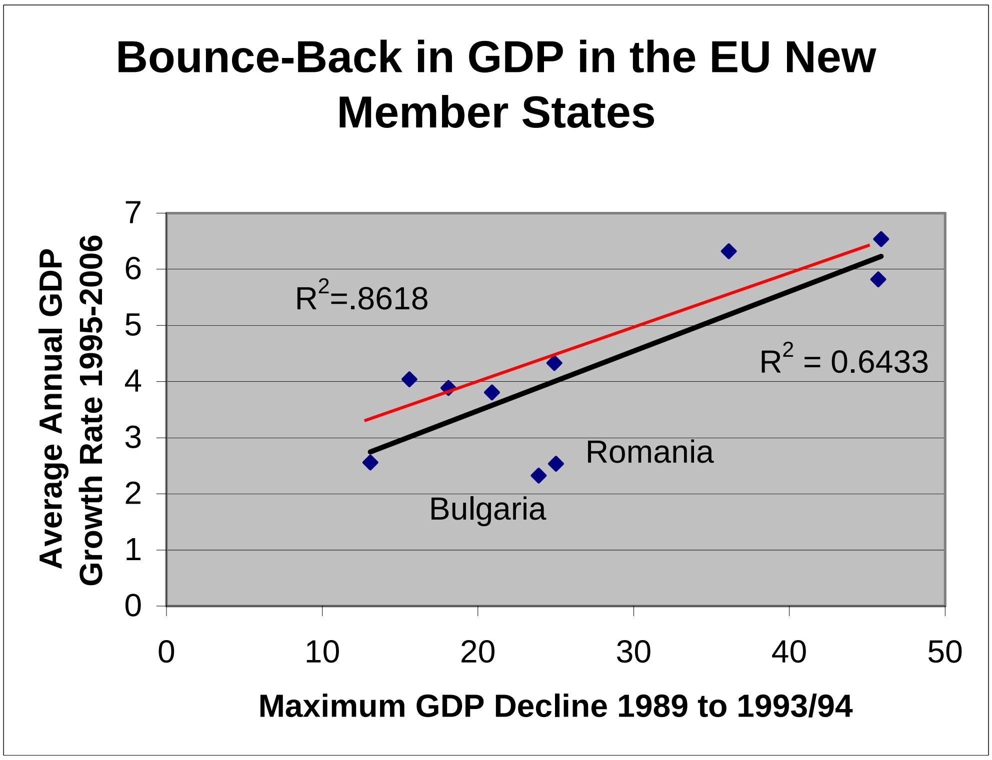


Figure 3
GDP Per Capita Long-Run Projections (by EBRD)



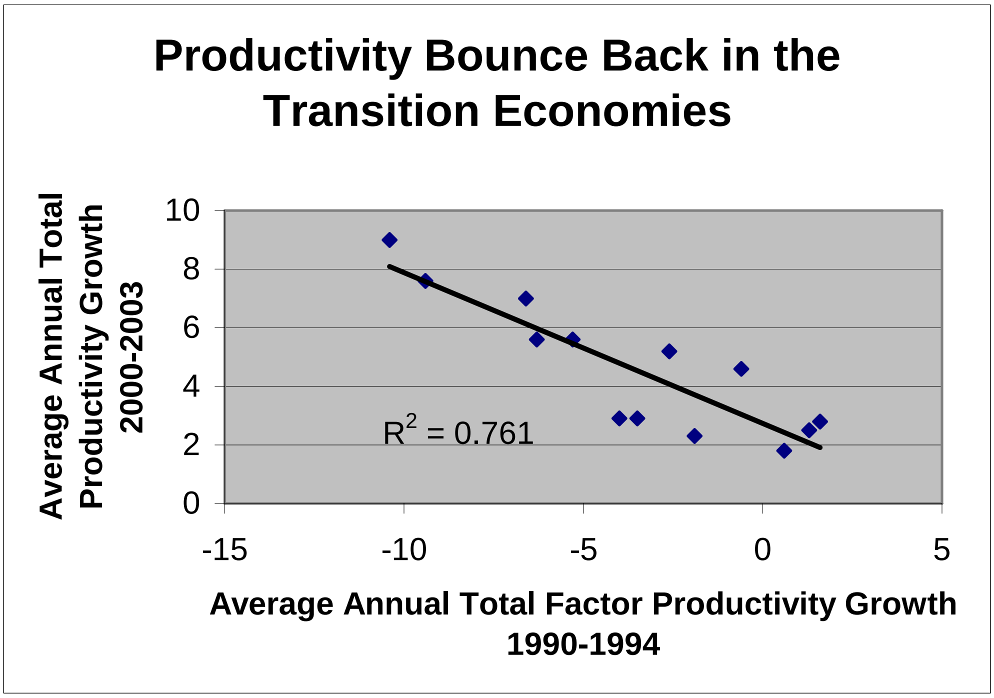
Source: EBRD, *Transition Report 2006 Update*, May 2006 (Chart 4.2).

Figure 4



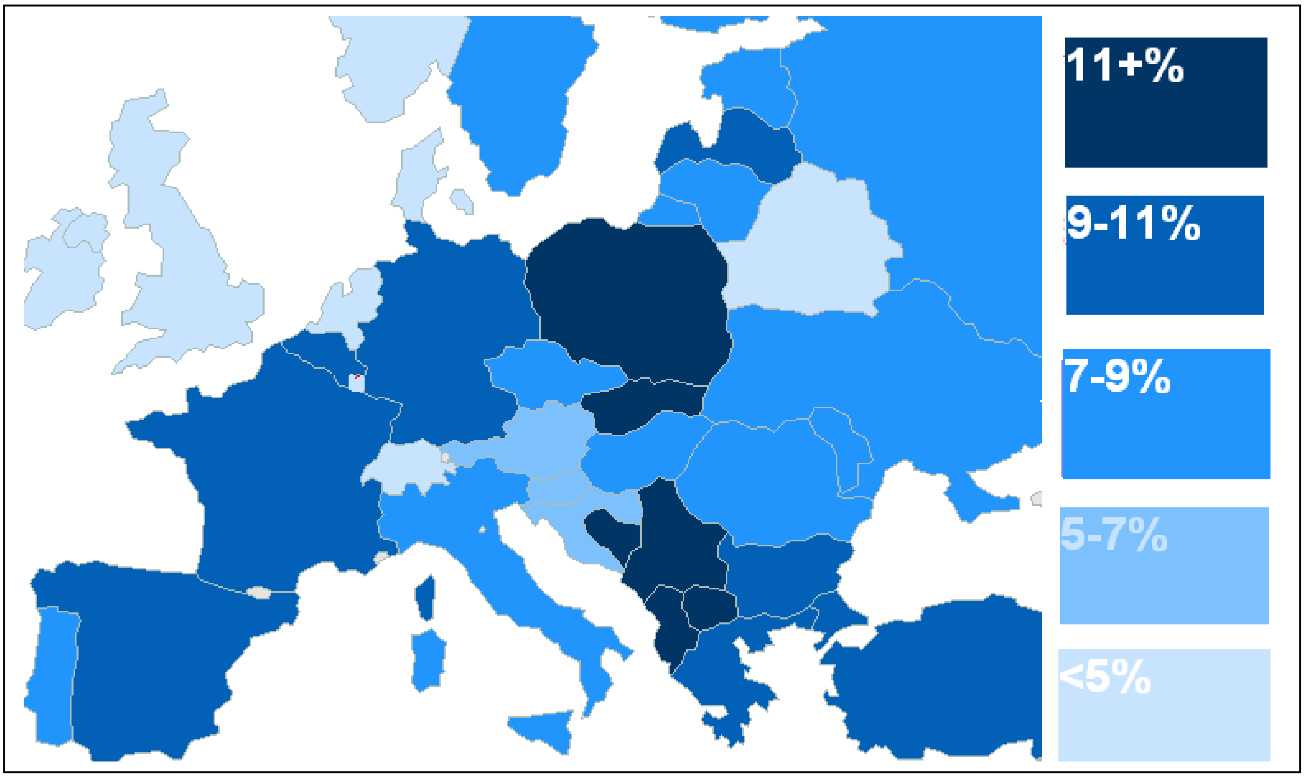
Source: Author's calculations

Figure 5



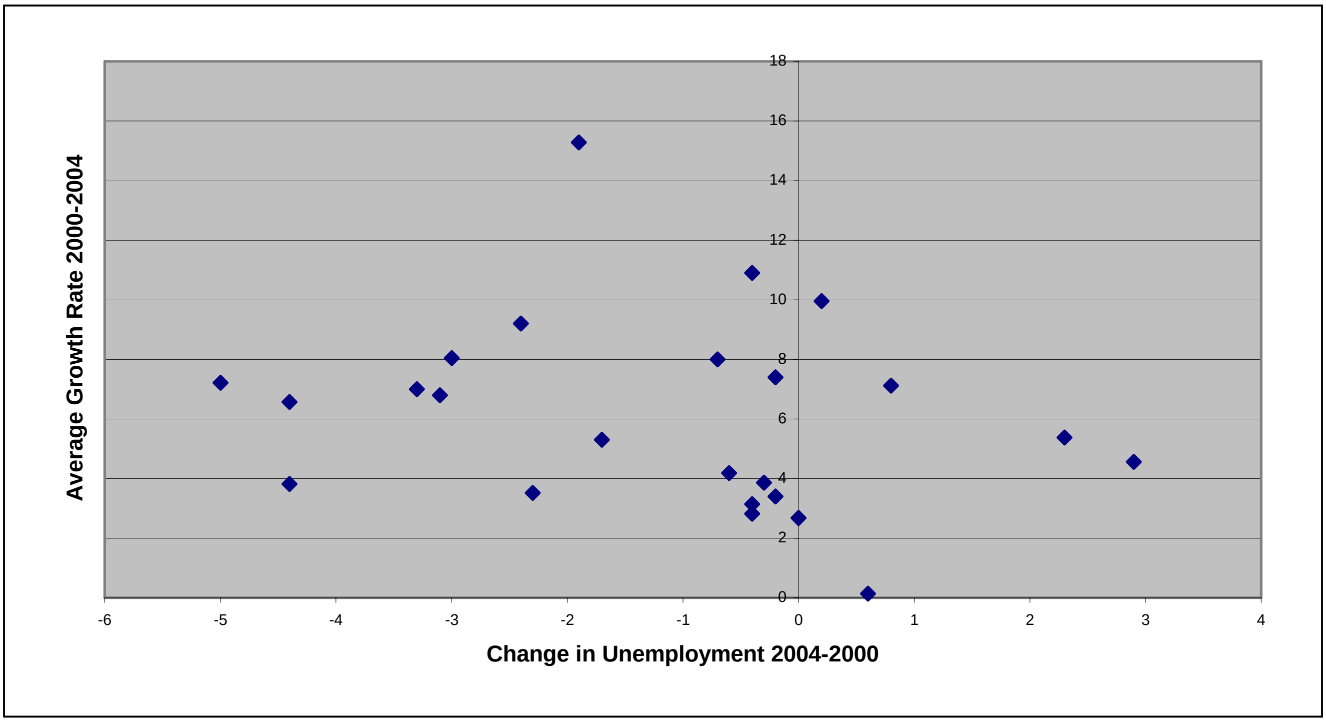
Source: Author's calculations

Figure 6
Unemployment in Europe



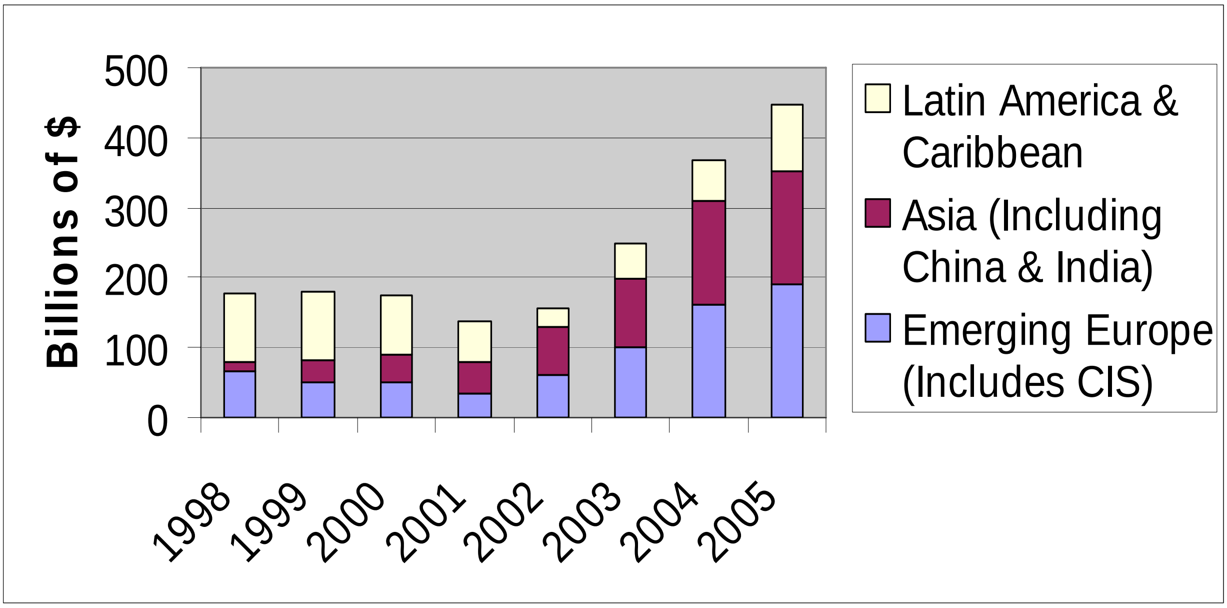
Source: Author's calculations; UNECE database

Figure 7
Growth and Unemployment in the Transition Economies 2000-2004



Source: Author's calculations

Figure 8
Private Capital Flows to Emerging Markets by Region (FDI+Debt+Portfolio)



Source: Author’s calculations

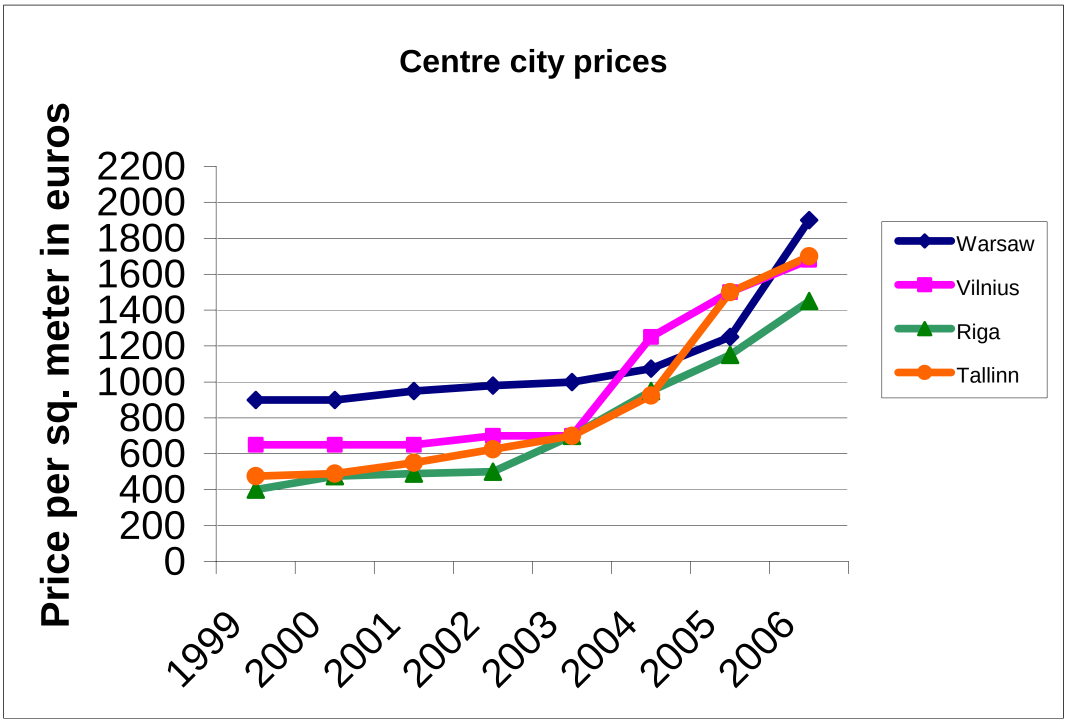
Figure 9
Stock Market Performance in Central and Eastern Europe
(Percentage Change)

	2004	2005	2006	2006
			1/1 to 5/5	5/5 to 23/5
Baltics: BALTIX	40.2	45.2	-8.0	-7.4
Bulgaria: SOFIX BS	37.6	32.0	6.4	0.0
Czech Rep.: PX-50	56.6	42.7	2.9	-9.1
Hungary: BUX	57.0	43.0	20.6	-14.7
Poland: WIG	27.9	33.6	26.6	-9.4
Romania: BET	101.0	50.9	14.7*	-12.4*
Slovakia: SAX-50	81.0	25.8	-1.5	-1.8
Slovenia: SBI-20	24.7	-6.0	9.5	-3.0
** As of 30/4/2006*				

Source: Author’s calculations

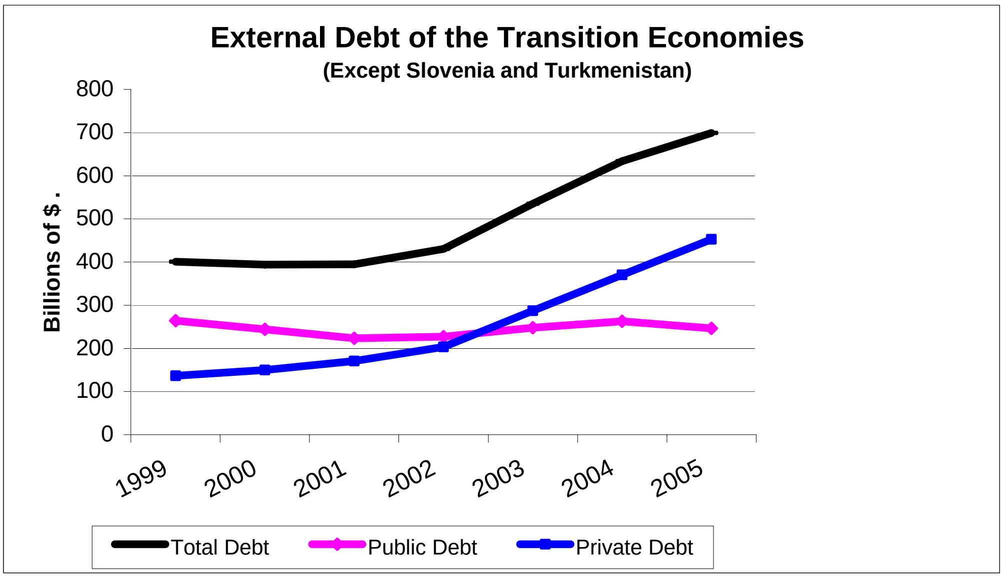
Figure 10

Prices of Residential Real Estate - Baltics, Poland



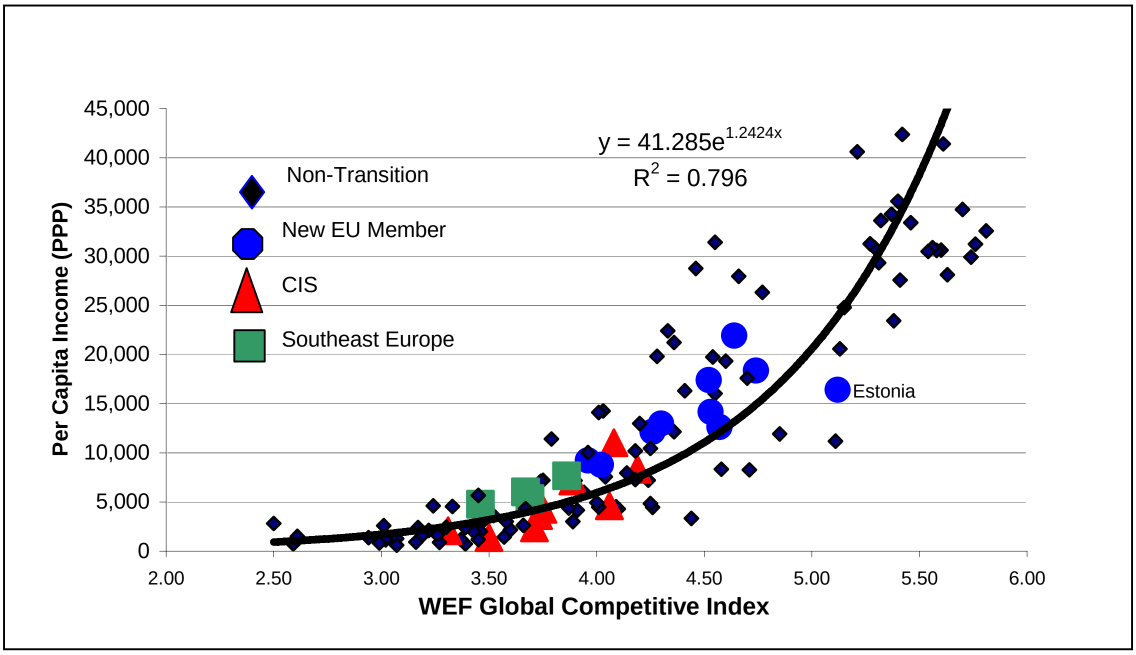
Source: Ober-Haus Real Estate Company

Figure 11



Source: Author's calculations

Figure 12
The WEF Competitiveness of the Transition Economies Controlling for Per Capita Income



Source: Author's calculations