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**TRADE DEVELOPMENT AND TRADE
PERSPECTIVES OF VISEGRAD GROUP**

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Declaration:

I hereby declare that I am the sole author of the thesis entitled “TRADE DEVELOPMENT AND TRADE PERSPECTIVES OF VISEGRAD GROUP“. I duly marked out all quotations. The used literature and sources are stated in the attached list of references.

In Prague on

Signature.....

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Introduction

Central and Eastern European countries Czech Republic, Slovakia, Poland and Hungary, who had common fate in the past found their way from the Soviet planned economy to transformation through the regional cooperation. They formed the Visegrad Group (V4) in 1991 at a meeting with the President of the Czechoslovak Republic Vaclav Havel, the President of the Republic of Poland, Lech Walesa, and the Prime Minister of the Republic of Hungary, Jozsef Antall. Czechoslovakia split in 1993 into Czech Republic and Slovak Republic for which Visegrad Group currently includes four countries. They wanted to intensify mutual cooperation with their common goals such as to eliminate traces of communism, inherent conflict among Central European countries and accomplish economic and social transformation in order to join the European Union. Also, they believed that they can achieve their set of goals faster and easier through this cooperation.

This thesis will analyze the trade development and trade perspectives of these countries. It is worth to study these countries trade as they are growing economies with the active participation in the globalization process and also their markets are not yet saturated in many sectors. This grants a great opportunity for international companies to find market niches and start up new businesses. These countries are better integrated into the global economy today than at any time during the communist regime. Their trade has been growing at a faster pace than anywhere else in the post Soviet bloc. It is especially due to their close ties with the Western Europe and the trade reforms on the international and national levels. This is a strong drive for the general development in the countries. The aim of the thesis is not to focus on the Visegrad Group as such in the meaning of their organization. The name is used to refer to these four countries and focus on their trade development during the communism and after the fall of the communist regime and to evaluate their future perspectives, including the countries comparison as for their competitiveness at foreign markets and in attracting FDI.

In the first chapter of this thesis I will discuss the trade development of the V4 countries during the communist regime with main macroeconomic indicators. Development of value of GDP, its growth rate and GDP per capita will be discussed to analyze the basic macroeconomic environment for the period of the socialist system. Currency and exchange rate system was regulated artificially in all V4 countries and the inflation rate was higher in Poland and Hungary than in Czechoslovakia. The analyses of economic indicators are

illustrated with statistical data for several time periods and we can see the influence of the inadequate economic system and also the world recessions on the development of their economies and trade. Trade of these countries will be discussed based on territorial and commodity structures presented with detailed statistics. Their foreign trade was limited mostly to the Soviet bloc and was heavily controlled by the communist system to make sure that world economic trends would not influence them. FDI was almost non-existent except for few joint ventures that were created in late 80s in Hungary and Poland. The economies of these countries were heavily dependent on USSR with a small surplus in their trade balance and a low growth in export volume which had resulted in decline of their share in the global market. This historical development is important in order to allow comparing the development after the fall of Soviet regime to see how these countries came to their current prosperous standing and that the period of communism in their history served as an obstacle in their successful growth.

The second chapter will be dedicated to the analyses of the trade development of the V4 countries after the fall of the communism and to the discussion of the statistical data concerning their GDP, currency, inflation and import and export flows based on the geographical and commodity structures. Their transition to market economy is a success story although they have had some critical turns as well. Overall, it is demonstrated how much their economies have improved and reached such high level development. In the second chapter, Czech and Slovak Republics will be discussed separately as Czechoslovakia split in the 1993 and both new countries became the independent subjects of international trade. The analyses will also demonstrate the redirection of their trade from the post Soviet bloc of countries to the EU countries which ultimately led to their full integration with the EU. I will also compare these four countries from several perspectives particularly their domestic production, foreign trade and FDI.

In the third chapter, after analyzing the recent historical economic and trade development of the V4 countries in previous chapters, I will discuss their perspectives, in terms of how the V4 countries are handling the last global economic crisis and the external trends that have impact on their recovery process. Future projections for each of them in respect of economic growth, foreign trade, industry, inflation and other important indicators are presented. Moreover, chapter three will evaluate the fulfillment of the Maastricht criteria by the Czech Republic, Poland and Hungary to join the Eurozone. This part excludes Slovak

Republic as it is already a member of the Eurozone. Lastly, I will discuss the importance to increase the competitiveness of the V4 in attracting FDI and if they could cooperate in this field as their synergetic effort would bring much better results.

1 Trade Development of the V4 countries during communism

1.1 Czechoslovakia

Czechs and Slovaks merged together and founded Czechoslovakia in the year 1918, once they gained their independence from the Austria-Hungarian Empire. The distinction was that Slovakia was basically agricultural region and Bohemia and Moravia were the most industrially developed parts of the former Empire, specializing in coal mining, metal processing, textile, building and also in manufacturing of glass, cars, leather goods and armaments.

Czechoslovakia became part of the Soviet Union bloc of countries in 1948 after the Communist putsch and nationalization began in all sectors including even small businesses and self employed craftsmen. The socialist central planned economy severely limited foreign currency transactions. The country highly concentrated on heavy industries, such as armaments, at the expense of consumer goods, services and agriculture.¹ The communist regime held power until November 17th 1989, when the peaceful Velvet Revolution took place in the country. From this time Czechoslovakia moved from centrally planned economy to the free market economy with various liberal trade reforms.

In 1993 Czechoslovakia split into two independent countries: the Czech Republic and the Slovak Republic. Relative to other V4 countries Czechoslovakia had maintained better macroeconomic results in the end of the communist regime. For example, it was never heavily in debt due to its very cautious debt policy and its gross debt was 5.6 bn USD in 1988 which was less than its exports in convertible currencies and much less than foreign debts of Poland and Hungary.² Also, inflation rate was kept low and it was not an obstacle to the health of the economy.

1.1.1 GDP

Centrally planned economies as a whole had significant share of world's production and income. However, the World Bank does not provide figures for Czechoslovakia's GDP on its website for the years before 1989.

Angus Maddison in his "The World Economy Historical Statistics" provides Czechoslovak GDP values in dollar. Figures show that Czechoslovak GDP was growing low

¹ Stephen White, Political and Economic Encyclopedia of the Soviet Union and Eastern Europe, 1990, p. 76

² Michael Friedlander, "Foreign Trade in Eastern and the Soviet Union", 1990, The Vienna Institute for Comparative Economic Studies, p. 206

in value but steadily for the period of 1970-89 except for 1981 that suffered a slight drop from 12.2 bn in 1980 to 12.1 bn dollars. Czechoslovakia experienced economic growth after 1982 at annual average output growth of more than 3% for the period of 1983-85.³ Moreover, the population remained less than 16 mil. people with a very modest growth throughout the period from 1970 till the collapse of the communism. The 1989 population figures show 15.5 mil. people for Czechoslovakia.⁴ Because of the unreported inflation rate in the 80s the real growth of GDP was close to zero.⁵

According to the Czechoslovak authorities, the GDP of the country in 1980 equaled 586.8 mil. Czechoslovak crowns (Československá koruna) and then no figures are provided until the year 1985. GDP figures in million Czechoslovak crowns were as follows: 677.0 in 1985; 694.7 in 1986; 711.1 in 1987; 740.0 in 1988; and 758.7 in 1989. Industry and water works constituted the biggest share of the GDP for example it was 379.1 bn in 1988 whereas in the second place trade and transport made up 123.6 bn, in the third place services 116.9 bn, in the fourth place construction 63.7 bn and the fifth place agriculture and forestry 48.0bn in Czechoslovak crowns.⁶

1.1.2 Currency and inflation

In 1919 Czechoslovakia's new national currency "koruna" (crown) was introduced with the initiative of the first Czechoslovak Finance Minister Mr. Alois Rasin, to replace the Austrian crown that was previously in use. Czechoslovak crown underwent changes in 1939, in 1945 and in 1953 with new banknotes and was valid until the dissolution of federation in 1993. The reason for the introduction of the new currency in 1919 was that Austrian crown had high rate of inflation at that time. Also having national currency was one of the most important state symbols for the newly established Czechoslovakia. First, circulation of the Austrian crowns was limited within the country by stamping them and gradually new Czechoslovak crown was issued.⁷ Czechoslovak crown was abbreviated as CSK (Československá koruna) and its sign was Kcs.

Czechoslovakia's exchange rate system for crown was based in 1953 on gold parity (in terms of 123 milligrams of gold) and set the dollar exchange rate on that basis. The gold

³ Travel Document Systems, Czech Republic, Europe, Economy - <http://www.traveldocs.com/cz/economy.htm>

⁴ Maddison A., (2003) "The World Economy: Historical Statistics", p.97

⁵ Svejnar J., (1989) "A Framework for the Economic Transformation of Czechoslovakia" p. 4

⁶ Federální Statistický Úřad, Český Statistický Úřad, Slovenský Statistický Úřad (1992): Statistická ročenka České a Slovenské Federativní Republiky, p. 31

⁷ Radovan Novotny, Jak se z rakouské koruny stala koruna československá - <http://trhy.mesec.cz/clanky/jak-se-z-rakouske-koruny-stala-koruna-ceskoslovenska/>

parity was supposed to help the exchange rate achieve equilibrium in external payments and also currency's purchasing power. Exchange rate was based on a fixed system and was strictly controlled by the government.⁸ Crown was used only within the country and was not used in foreign trade. There was no currency convertibility for crown until 1991 when internal convertibility was introduced and full convertability was implemented only in 1995.⁹

Under the strict system of controls crown was largely overvalued at official rate until the late 1980s, prior to the subsequent devaluations. The black market premium exceeded 100%. Therefore, the official exchange rates were not realistic and priced not by the standards of evaluation in the exchange rates of market economies. The official crown exchange rate against dollar, provided by the State Bank of Czechoslovakia, dropped from 27.0 in 1970 to 20.9 in 1975. It further went down to 14.2 in 1980 as reported by the World Bank. However, the black market price of dollar differed notably as it was 40.9 in 1970, 23.5 in 1975 and 26.2 in 1980. Appreciation of crown against dollar was observed until 1980. But then crown had a depreciating trend as the official rate went up from 14.2 in 1980 to 17.2 in 1985. In the next years crown again appreciated against dollar at 15.0 in 1986 and at 13.7 in 1987. The black market price differed tremendously in 1989 as it was about 42.4 compare to the official rate of 15.0¹⁰

Since the official commercial exchange rates were artificial they did not have a direct relation to purchasing power in other currencies. Official rates overvalued crown against dollar and transferable ruble; as a result, the dollar and ruble were undervalued. However, the Czechoslovak government carried out serious of currency devaluations between 1989 and 1991, which generated more reasonable crown exchange rates.¹¹ Together with the introduction of internal convertability these massive devaluations substantially narrowed the gap between official and black market rates.¹²

Prices were centrally set and changed independently of world price movements and it caused inflation pressures in the areas such as commodity shortages and increased savings by the population. In the 80s the inflation rate was significantly lower in Czechoslovakia than in Poland and Hungary due to the tight monetary discipline and financial policy. The growth of money supply was regulated to minimize inflationary impacts. Also, strict wage control

8 Jozef M. van Brabant, Exchange Rates in Eastern Europe Types, Derivation, and Application, 1985, World Bank

9 Milan Sojka, (1994) The Transformation of the Czech Economy – Present and Future Developments

10 World Bank country report 8, Czechoslovakia Integrating into the Global Economy: A Transition Strategy, 1992, p.79

11 Zdenek Drabek, Josef Brada, Exchange Rate Regimes and the Sustainability of Trade Policy in Transition Economies, 1998, WTO

12 World Bank country report 8, Czechoslovakia Integrating into the Global Economy: A Transition Strategy, 1992, p. 77

succeeded to keep the growth rate of wages below that of labor productivity. For example, the ratio of growth of wages to growth of productivity was only 0.51 which means for every increase of labor productivity by 1% wages increased by 0.51%. Moreover, long-term policy of equilibrium in balance of payments kept the Czechoslovak economy safe from the inflationary pressures as it is known that disequilibrium in balance of payments can be a major source of inflation.¹³

The official data provided by the Federal Statistical Office on consumer price index for goods and services show a slight gradual increase of 3.2% for 1986, 3.3% for 1987, 3.5% for 1988 and 4.9% for 1989.¹⁴ During the period of 1985-89 inflationary pressures arose mainly in the investment sector although this sector was strictly controlled. This happened due to the systematic factors such as “high priority given to investments and social consumption, poor investment planning and accommodating government finance”.¹⁵ Moreover, type of economic policy and rising import prices caused the inflation. There is almost no reported inflation for the period of 1985-89 according to the official price indices when there were long waiting lists for cars and state and cooperative flats. The official price indices did not take into account the economic disequilibrium in full scope during that period. The World Bank statistics do not give inflation rates for the communist period of Czechoslovakia until 1985 and after it is only given for Slovak Republic as 1.7% in 1985, 0% in 1986 and 1987. The highest rate reported is for 1989 at 2.8% before the collapse of the communism. Considering these figures the situation still appears to be relatively stable in the late 80s.

Dr. Svejnar from University of Pittsburgh says that domestic as well as foreign observers were skeptical about the official 1989 inflation rate of 1.5%, but their own estimates of open inflation are only about 4.0%, therefore there is no major sign of a macroeconomic disequilibrium though certain commodity categories experienced shortages. Many other sources state 1.4% inflation in 1989, the last year of communism. However, this perceived macro stability may be misleading because of the monetary overhang or forced savings as a result of the commodity shortages. Between 1979 and 1989 cash holdings and household savings increased by 55%, whereas official retail price index went up by 21% according to the official data reported by PlanEcon. The PlanEcon own estimates provide actual retail price increase of 44% for this period. Both estimates of the inflation rate shows

¹³ Drabec Z., Janacek K., Tuma Z., (1993): Inflation in Czechoslovakia 1985-1991; World Bank, p. 5

¹⁴ Statistická ročenka České a Slovenské Federativní Republiky, 1992, p..260

¹⁵ Drabec Z., Janacek K., Tuma Z., (1993): Inflation in Czechoslovakia 1985-1991; World Bank

to be much less than the cash holdings and savings. The velocity of circulation of money went down perhaps because people could not buy certain commodities when they wished and spend their money during this period of the economic stagnation.

In addition, this can be confirmed by the fact that cash holdings and savings deposits have gone up from 74% in 1979 to 100% in 1989 as a proportion of retail sales. Therefore, this resulted in the gradual forced savings which could eventually lead to high inflation although the government policy would determine how demand would match the supply side.

Majority of the money accumulated was held by a small group of people. The data on the government budget deficit was not made available to public in that period so it was not possible for external observers to evaluate its extent of importance in the present and future inflation trends. It is worth to mention that in centrally planned economies it was a tendency to finance the government deficits by borrowing against household savings and a mixture of non-convertible enterprise funds.¹⁶

1.1.3 Foreign Trade

Importance of the foreign trade for Czechoslovakia's small domestic economy has been increasing more rapidly since 70s. The Czechoslovak economy was dependent on the USSR more heavily than other Eastern Bloc countries for the guaranteed export markets and also imports of low-cost raw materials. Over 97% of the net material product was originated in the socialist sector in the 80s. Private sector was much smaller than in other Eastern bloc countries¹⁷ and all this slowed down the development of the economy and the country lacked behind with the competitive commodity specialization and higher quality production. Also, marketing and management knowledge could not develop in such restricted environment and the private entrepreneurship attempts were blocked by the strict political obstacles. Czechoslovak's small domestic market needed well functioning foreign trade, which was limited to small scope, compare to the Western markets, as an instrument for linking the economy to global financial and technological advances. However, Czechoslovakia's economy was comparatively open among other Eastern bloc countries and as an indicator of the open economy we can look at the statistics from Collin & Rodrik (1991) in regard to the

¹⁶ Svejnar J., (1989) "A Framework for the Economic Transformation of Czechoslovakia" p. 4

¹⁷ Eastern Bloc – refers to the countries that were under strong influence of Soviet Union and had communist regime such as Bulgaria, Poland, Hungary etc.

ratio of trade flows to GDP which progressively was going up from 57.9% in 1980 to 69.8% in 1985 and 70% in 1989.¹⁸

During 1980-87 the growth of imports and exports was virtually the same. Exports increased by 32.4% (4.1% p.a.) in real terms and imports rose only by 9.7% (1.3% p.a.). The country's terms of trade faced deterioration. Prices of imports were much higher than export prices because of the CMEA pricing system. Thus price of fuels and raw materials, which were the primary Czechoslovak imports, were much higher than the price of manufactured goods, which were its main exports.¹⁹

Territorial Structure

Majority of the Czechoslovakia's trade was with the USSR and other communist Eastern European countries. Top trading partners were USSR, East Germany, Poland, Hungary and West Germany.²⁰ Czechoslovak trade predominantly was done through the Council for Mutual Economic Assistance (CMEA) that was created in 1949 and the Warsaw Pact military alliance of 1955. Czechoslovak government remained loyal and believed that alliance with USSR was essential for the interests of the population and the security of the state.²¹

Introduction of the so-called Brezhnev Doctrine of limited sovereignty, which gave the USSR right to use military force to prevent any socialist country from becoming a capitalist one, further increased the Soviet influence.²² This can be seen in the substantial share of trade with the Soviet bloc as for example in 1986 it represented almost 50% of the total trade. Official statistics provide that socialist countries, i.e. CMEA member countries, Yugoslavia, China and other non-European socialist countries made up 79.1% of Czechoslovakia's foreign trade turnover in 1987 of which 75.4% belonged to CMEA countries. USSR accounted for 43.5% and East Germany's and Poland's shares were 10% each. Western industrialized countries amounted only to 16.6% in total turnover of Czechoslovak foreign trade of which Federal Republic of Germany's share was 4.7%, Austria 2.3%, Switzerland

¹⁸ World Bank country report 8, Czechoslovakia Integrating into the Global Economy: A Transition Strategy, 1992

¹⁹ Michael Friedlander, "Foreign Trade in Eastern and the Soviet Union", 1990, The Vienna Institute for Comparative Economic Studies p. 27

²⁰ Stephen White, Political and Economic Encyclopedia of the Soviet Union and Eastern Europe, 1990, p. 71

²¹ Czechoslovakia, Relations with Communist Nations - <http://www.country-data.com/cgi-bin/query/r-3737.html>

²² Modern History Sourcebook, the Brezhnev Doctrine 1968 - <http://modernhistorian.blogspot.com/2008/11/on-this-day-in-history-brezhnev.html>

and Great Britain 1% each, making them the most important western trade partners. Only 4.3% of the Czechoslovak trade was done with developing countries.²³

Czechoslovak exports to CMEA countries increased from 55.4% in 1980 to 58.6% in 1985 reaching high level of 63.4% in 1987 and then declining to 54.9% in 1989. USSR's share in exports demonstrates upward tendency till 1985 and after downward recording 30.5% in 1989, just before the collapse of the centrally planned economy.

Imports from the CMEA countries raised from 56.4% in 1980 to 64.2% in 1985, but then showed declining trend. This trend is explained by the currency devaluations, changes in the cross exchange rates between dollar and transferable ruble and also a big decline in trade relations with the CMEA countries during this period. Decline was observed in imports from the USSR going down to 29.7% in 1989.

Other socialist countries and developing countries have fairly small share in trade in comparison to OECD countries' share which had climbed up from 23% in 1985 to 31% in 1989 in both exports and imports (see Appendix 1.3).

The demand for Soviet energy and Czechoslovak domestic economic problems such as decreasing productivity, corruption and low investment contributed to its dependence on USSR. Therefore, the country responded by strongly supporting the integration of the Soviet and Czechoslovak economies.

The relations with other communist countries in the Eastern Europe were only a reflex of the relations with the Soviet Union. East Germany was Czechoslovakia's closest ally in the region and was in opposition to reform the communist regime. Czechoslovakia had good relations with Poland as well before the 80s as it was depended on Polish port Szczecin as the main sea outlet. However, the relations became stiff as Czechoslovakia had fear of spreading of the Polish labor strikes during the early 80s in its territory close to the Polish border, for example, in Ostrava mines and the disruption of the imports and exports. Czechoslovak authorities criticized the creation of independent trade unions in Poland and named it as anti-socialist. After the imposition of the martial law in Poland in 1981 bilateral trade relations were rebuilt.

Trade with Romania, Yugoslavia, Albania and China was also important in value but they were not supporters of the Warsaw Pact unlike Czechoslovakia. During 1970-80 substantial amounts of grain and in 1985 raw materials, specialized industrial machinery and

²³ Michael Friedlander, "Foreign Trade in Eastern and the Soviet Union" (1990), The Vienna Institute for Comparative Economic Studies

printed materials were imported from the USA; Czechoslovakia exported footwear, jewelry, glassware, steel bars, wire and meat in exchange.²⁴

Commodity Structure

Considering the commodity structure of Czechoslovakia's foreign trade in general it can be said that during the 80s exports were dominated by machinery and transport equipment despite its falling share later in the decade. It reached 60.3% of total exports in 1985 and half of total exports in 1986 and 1987 and fell to 44.39% in 1989. Czechoslovakia had the strongest tradition in automobile production thanks to Škoda, the oldest and the largest automobile manufacturer in the region which was the first in specializing in design of cars. Before 1989 Škoda produced 193.000 units of vehicles per year and it exported 45.500 units of cars to the Western Europe in 1989. Besides, Czechoslovakia had other smaller manufacturers of motor vehicles such as Tatra, TAZ, and BAZ.²⁵ Exports of manufactured goods represented 15.4% of total exports in 1980 but were up at 22.44% in 1989. Also, share of miscellaneous manufactures in exports was between 9-11% during the 1980-1989. Export of food and livestock constituted very small portion of total exports; for example in 1985 it was 1.03%.

Regarding imports, share of machinery and transport equipment had increased from 26% in 1980 to 36.95% in 1989, together with mineral and fuels which significantly rose from merely 2.2% in 1980 to 17.31% in 1989. Import volume of crude materials and chemicals had been stable till 1989 at around 16% when both commodity shares fell by half. Imports in food and livestock were as high as 13.4% of total imports in 1985 but declined by half in 1989²⁶ (see Appendix 1.2).

Due to the centrally planned trade volumes Czechoslovakia's competitiveness had declining trend in comparison with other CMEA countries that decreased their dependence on USSR earlier. On the one hand it can be seen from the statistics regarding Czechoslovakia's share in CMEA exports to OECD countries during 1975-87 provided by the World Bank that Czechoslovakia's competitiveness in raw material and energy markets, in which it would not possibly have a comparative advantage in the future, had positive change. It gained more market share in food and beverages as well. Hence, from 33 product groups in its exports

²⁴ Library of Congress, Czechoslovakia Foreign Trade - <http://www.country-data.com>

²⁵ Malgorzata Jakubiak, Peter Kolesar, The Automotive Industry in Slovakia: Recent developments and Impact on Growth, 2008, page 10 - <http://www.growthcommission.org/storage/cgdev/documents/gcwp029web.pdf>

²⁶ World Bank country report 8, (1992) Czechoslovakia integrating into the Global Economy: a Transition Strategy, pp. 3,4

Czechoslovakia improved its market position only in 6 of them: meat, crude rubber, pulp and paper, crude fertilizer, plastic materials, and cork and wood manufactures. On the other hand Czechoslovakia suffered a loss in its share in total CMEA machinery exports to the OECD dropped from 19% in 1975 to 14.8% in 1987. This demonstrates that Czechoslovakia's competitiveness became even weaker as an industrial economy during this period and exporters such as Yugoslavia, Spain, Hungary, Poland, Austria and other countries gained more and more market share at Czechoslovakia's expense.

1.2. Poland

Poland is the largest by the area and number of population among the Visegrad group countries. Poland fell under the Soviet influence in 1947 via elections that were far from being free and democratic. It suffered highest number of deaths among all countries involved in the WW II and also great devastation of property and extensive loss of productive capacity. The Poles resisted to the occupation more than their neighbors. The country experienced economic hardships many times in the last century especially in the last decades of the 20th century due to the governmental policy of raising prices to attempt to stabilize the high inflation rate and also huge amount of foreign debt. The establishment of communist control immediately led to the central planning, accelerated industrialization, agricultural collectivization, imposition of one-party system and state ownership. However, it should be mentioned that private sector in Polish agriculture was larger than in Czechoslovakia, for example, and collectivization was not very successful.

In 1970, just before the Christmas, price rise was introduced which followed by the strikes and demonstrations that turned into massacre. Party Leader, Edward Gierek used a disastrous strategy of borrowing large amounts of loans from foreign institutions to accelerate the development of the Polish economy. It partly increased the consumption and new investments in Western technology but took Poland to the economic crisis followed by the drastic cuts in imports.²⁷ The Polish foreign debt was 6.4 bn USD in 1975 and reached as high as 39.2 bn USD in 1987. Repaying the debt by producing large quantities of exportable goods was impossible. After long national struggle Poland became independent and democratic state in September 1989 and transited to the market economy.²⁸

²⁷ Leszek Balcerowicz, (1995), *Socialism, Capitalism, Transformation*, pp. 291-293

²⁸ Stephen White, *Political and Economic Encyclopedia of the Soviet Union and Eastern Europe*, 1990, pp. 190-199

1.2.1 GDP

Using the 1977 constant prices Polish GDP for 1970 was estimated at about 1.3 bn zlotys, the Polish currency, and 1.9 bn zlotys for 1975. In 1980 GDP reached 2.1 bn zlotys. As for the GDP growth rates it is estimated at 8.4% for 1970-75 and at 1.8% for 1975-80. The average rate of growth for the period of 1970-80 was 5.1%.²⁹ The World Bank website provides dollar GDP statistics for Poland only from 1985. Poland's GDP in dollar increased from 71 bn in 1985 to more than 82 bn in 1989.

Poland's gradually growing population was more than 37 mil. during the 1980s with the growth rate of 0.9% during 1981-85. The population growth slowed down from 1985 going down 0.1% each year. GDP per capita was with insignificant growth in the value of 1.909 USD in 1985 and 1.973 USD in 1986. It declined in 1987 to 1.696 USD then again climbed up to 1.818 USD in 1988 and to 2.166 USD in 1989.

United Nations statistics show that Polish economy experienced a serious crisis from 1979 to 1983. It was due to the intrinsic weakness of the central planning and rapidly declining competitiveness. Moreover, growing political unrest, dependence on foreign inputs, combined with a loss of creditworthiness, increasing inflation and shortages in supply of food and other goods were the reasons behind the crisis. These causes are all interconnected with each other. Also, harsh weather was a brake on the agriculture which also contributed to the economic halt. In 1981 the imposition of martial law had left the Poles in even deeper agony. GDP growth rate went down to 3.8% in 1979 from 5.4% in 1978. The further trend was even worse the growth rate declining to -6% in 1980 and -10% in 1981. In 1982 the growth rate was still negative at -4.8% but lower than the previous year. The situation was a bit stabilized in 1983 with a positive growth of 5.6% (see Appendix 4.2). In 1987 and in 1989 the Polish economy showed to be in a decline again, with further escalation of the crisis caused by dropping production and speedy inflation due to the failure to apply some successful solution. High foreign debt and inability to make interest payments, consumer shortages, and underinvestment in transport, energy, water, housing, and health sectors were the roots of the economic and social downturn.

1.2.2 Currency and inflation

“Zloty” has been the national currency of Poland for centuries but was reintroduced several times in the history as a solution to high inflation. So called third zloty was in use

²⁹ Zbigniew M. Fallenbuchl, (1985) National Income Statistics for Poland, 1970-1980, World Bank, p. 66

during 1950-95. 100 groszy (coins) were equal to one zloty. It was abbreviated as PLZ. First banknotes were printed already from 1948 and due to the growing inflation in 1962 new bigger value banknotes in denomination of 1.000 and later 2.000 and 5.000 were added. The hyperinflation in the late 80s led to issuing of more new banknotes in the denomination from 10.000 to 2.000.000. There was a need to issue such big notes as the 20-30 USD salary was in millions of zlotys during the hyperinflation.³⁰

The full convertibility of zloty was not achieved until January 1990. The exchange rate was centrally set and there were two different rates: official and black market rates. The black market rate was much higher than the official rate. The authorities used devaluation of zloty to reduce the gap between official and black market price of zloty in 1989 when the black market premium was 83%.³¹ High valuation of dollar on the black market worsened the lack of confidence in zloty and lowered the domestic demand for it. It proved that the monetary and exchange rate policies were very weak. Such situation also increased the already excess demand for goods.³² As the World Bank reports the exchange rate of zlotys against dollar was at 175 in 1986 and at 265 in 1987. 1988 average rate was at 431 zlotys but in December the same year it was 503 zlotys. The depreciation of zloty accelerated in 1989 very significantly the rate being 6500 zlotys.³³

Prices remained relatively stable until 1974 and first high increase in prices was in 1975-76 when both imported and domestically generated inflationary pressure appeared in the Polish economy. Such price rises followed by protests which caused the changes in the state leadership in 1970 and 1980. Some compensation had to be given to the workers and savers.

The World Bank statistics demonstrate that the inflation rate was at 19.1% in 1981 and it reached the three digit level of 103.6% in 1982. Many external and internal factors caused the steeply rising inflation and the overall economic crisis in the early 80s. World inflation, rise in interest rates, growth of trade barriers and unexpected contraction of international trade were considered to be the external factors that triggered and worsened the early 80s Polish economy. Due to the bad weather there was a bad harvest in agriculture including the neglect of the agriculture in general. The policy of the communist government in general and excessive reliance on the technology transfer and imported capital goods in the

³⁰ The Polish Genealogy Project, Zloty, <http://polishgeno.com/?p=70>

³¹ Liam P. Enrill, (1998), Poland: Path to the Market Economy, p. 45

³² The World Bank (1987) Poland: Reform, Adjustment and Growth, pp. 33, 34

³³ The World Bank (1990) Poland Economic Management for a New Era

development of Polish exports were also internal factors. Also overdevelopment of the steel, shipbuilding and the chemicals sector were the policy mistakes that led to the hardship.³⁴

Some stabilization was observed during 1983-86 with the inflation rate going down to 11.5% in 1986, but it was not preserved for long-term. Already in 1986 the prices rose by 16.5%, in 1987 by 26.4%, in 1988 by 58.7% and again it reached three-digit level of 244.6% in 1989. During the month of August in 1989 prices of consumer goods and services rose by 44% and prices of food products rose by 78% whereas wages went up by 67%.³⁵ This hyperinflation continued in the early stage of the transformation of the Polish economy from communist central planning to the market economy which will be discussed in the next chapter.

1.2.3 Foreign Trade

Due to the critical economic situation of the early 80s in Poland the total exports fell from 14.2 bn USD in 1980 to 11.5 bn USD in 1983 and climbed up only in 1986 to 12 bn USD. Total imports grew from 11.1 bn USD in 1975 to 16.6 bn USD in 1980, but had also declining trend till 1984. Value of total imports was recorded as 11.5 bn USD in 1986, which was still not even close to the 1980 figure according to the World Bank.

Polish foreign trade was highly under state monopoly and was strongly restricted until 1982. The objective of high degree of self-sufficiency of the CMEA limited the trade with the West and deprived the economy from technological advancements and healthy competition. Export and import licenses were given only to specialized entities such as Foreign Trade Organizations (FTOs). Domestic exporters could not have direct contacts and trade relations with foreign counterparts and were cut off from the valuable sources of information and isolated from the world market. After 1982 some reforms had been made and state and private enterprises and individuals could be issued trading permits that allowed them to directly market their outputs and buy their own inputs. However, such permit was subject to certain requirements such as that their export volume must be at least 1 mil. zlotys (4,000 USD) and that their staff had to be qualified in foreign trade operations.³⁶ Such permit holders accounted for 3.5% in 1984 and 10% of total exports in 1986. Ministry of Foreign Trade still had to issue separate authorization to import or export a given quantity of a specific good to be in the line with the central plans and trade agreements.

³⁴ The World Bank, (1987) Poland: Reform, Adjustment and Growth, p. 3

³⁵ Stephen White, (1990) Political and Economic Encyclopedia of the Soviet Union and Eastern Europe, page 199

³⁶ Anna Kubiak, (1998) Market Structure and Foreign Trade Performance in Poland, pp. 7,8

The state subsidies, state allocation of profits and the guaranteed bilateral barter agreements with the CMEA did not do anything else than halting the enterprises from competition and acquiring high quality standards. Further to reform Polish foreign trade in the 80s new Foreign Trade Companies (FTCs) were created as joint stock companies. Their majority shares were held by the Ministry of Foreign Trade and other state enterprises were the minority shareholders. They were subject to 75% tax on profits instead of usual rate of 65%. It was because they had higher profitability due to commissions and trade margins. In 1987 65% of the Polish foreign trade was carried out by the new FTCs that imported and exported primary goods. The old FTOs losing their monopoly tried to influence the foreign trade by introducing extended investment credits and services such as contracting and organizing export financing.

Moreover, the Equalization Payment System was set to eliminate the differences between domestic and international pricing during 1987-88. Yet, for example, price of coal was raised by 60% and still was not in line with international pricing. This mechanism covered a big portion of foreign trade in Poland. For example in 1984 15% exports to and 45% imports from CMEA and 40% exports to and 30% of imports from convertible currency area were subject to price equalization.³⁷ In 1989 the communist system of central planning was brought down and since then the system of foreign trade gives equal rights to the participants.

Territorial Structure

Top trading partners for communist Poland were USSR, West Germany, Czechoslovakia, East Germany and the UK.³⁸ Poland had extensive commercial relations with Western European countries before the WW II but this was significantly reduced after the establishment of communism. Poland lost some of its important markets for trade and had to expand its trade relations with the Soviet Union very rapidly. The trade with the Soviet Union was mostly based on the export of coal and manufactured goods from rapidly growing heavy industries. Poland became dependent on Soviet imports of oil, natural gas, iron ore and many other raw materials that its production needed. In fact it meant that Poland had to adjust its industrial structure according to the needs and specifications of the Soviet Union and many of its export products could be sold only to the Soviet Union and other CMEA

³⁷ The World Bank (1987), *Poland: Reform, Adjustment and Growth*, pp. 28,29,30

³⁸ Stephen White, (1990), *Political and Economic Encyclopaedia of the Soviet Union and Eastern Europe*, pp.190

countries. This led Poland to the heavy dependency on the markets of CMEA for its exports.³⁹

Due to the bad economic policy of the 70s Poland's foreign debt was too high to pay it off with its annual export earnings which it had to pay for its imports of raw materials and semi-finished products that its industry badly needed.⁴⁰

According to the 1985 statistics of the World Bank, Poland's foreign trade relations were somehow balanced as the trade volume for convertible currency area and the CMEA countries represented 50/50 of Poland's imports plus exports. (see Appendix 4.3).

The Polish import share from the USSR in 1970 accounted for 37.7%, which made the USSR Poland's number one trading partner, followed by the East Germany with 11.1% and Czechoslovakia with 8.6% share. In 1980 the imports from the USSR were 33.1% of the total imports. Still in 1985 the USSR was the most important trade partner for Poland with the 34.4% share in imports. The position of the USSR was strong until the break down of the communism, after it changed drastically. West Germany replaced in the 80s the East Germany in Poland's number two trade partner position. Its import share was 6.7% for 1980 and 9% in 1985. East Germany's import share accounted for 6.6% and 6.1% for the same period.

In Polish exports for 1970 the USSR represented 35.3%, East Germany 9.3% and Czechoslovakia 7.5%, which was actually less than their shares in imports as mentioned above. Therefore, Poland had negative trade balance of – 59.9 mil. USD. In 1980 the USSR made up 31.2% of total exports but its share was reduced to 28.4% in 1985. Export share of the West Germany was 8.1% in 1980, which slightly went up to 8.7% in 1985. Czechoslovakia's share of exports was 6.9% and 6.2% for the analyzed period. Trade balance in 1980 suffered huge deficit of – 2.0 bn USD though reaching surplus of 653 mil. USD already in 1985.⁴¹

Commodity Structure

Concentration on achieving high growth rate in heavy industry, especially in steel industry, disregarded the other important sectors for the development of the Polish economy such as agriculture, infrastructure, housing, services, and consumer goods. All heavy industries were capital, fuel and material-intensive and shortages of materials had developed

³⁹ Library of Congress, Economy Under Communism - <http://countrystudies.us/poland/49.htm>

⁴⁰ John Tagliabue, (1983) Eastern Bloc Losing Markets, The New York Times

⁴¹ Central Statistical Office, (2010) Yearbook of Foreign Trade Statistics of Poland, pp. 36,37

already from the 60s. As a consequence, Poland had to expand its extraction of coal, copper, and sulfur, and also its production of steel and other primary industrial materials without considering the costs.⁴²

Rejection by the Soviet buyers due to the low quality of the Polish machinery on the technological and engineering grounds lowered the planned CMEA exports for Poland in this category in 1986. The positive point here was that it actually increased the competition between the convertible and non-convertible markets for export. Polish exports by commodity category for 1985 according to SITC (Standard International Trade Classifications) nomenclature as reported by the World Bank were mainly machinery and transport equipment (39.4%), manufactured goods classified chiefly by material (15%), mineral fuels, lubricants and related materials (15.7%), food and live animals (7.5%), miscellaneous manufactured articles (6.8%) and others constituted a small share of the total exports. Machinery and transport equipment were leading commodities as they constituted the biggest portion of the total exports throughout the period of 1975-86 (see Appendix 4.4) It should be pointed out that in the progress of this commodity group establishment of the two car manufacturers, FSO and FSM, producing vehicles using Fiat licenses in the late 80s was very important.⁴³ Commodities such as crude materials (7.2%), chemicals (6.1%), commodities and transactions not classified elsewhere in SITC (1.4%), beverages and tobacco (0.7%) and animal and vegetable oils, fats and waxes (0.2%) represented smaller shares of the total Polish exports.⁴⁴

Polish economy as other communist countries, suffered chronic shortages, which led the people to revolt several times in Polish communist history. Also, the Soviet Union, as a source of energy and raw materials for Poland, reduced its shipments in 1982, for example it reduced crude oil by million tons.⁴⁵

Machinery and transport equipment were significant part of Polish imports as well as of its exports. The domestic producers needed the machinery from abroad for their production processes so they could produce the goods for export and internal trade. Import value in this commodity category in 1980 was 4.2 bn. USD which went down to 2.5 bn USD in 1982. As Polish economic situation was more or less stabilized its trend was again going slowly up at 2.9 bn already in 1984. This category commodity import was estimated at 3.6 bn USD in

⁴² Library of Congress, Economy Under Communism - <http://countrystudies.us/poland/49.htm>

⁴³ Malgorzata Jakubiak, Peter Kolesar, The Automotive Industry in Slovakia: Recent developments and Impact on Growth, 2008, p. 10 - <http://www.growthcommission.org/storage/cgdev/documents/gcwp029web.pdf>

⁴⁴ Central Statistical Office, (2010), Yearbook of Foreign Trade Statistics of Poland, p. 50

⁴⁵ Henry Kamm, (1982), Czech Leaders Are Nervous About Crisis In Poland, The New York Times

1986, which was 32% of total imports. Mineral fuels, lubricants and related materials represented 22.2%, manufactured goods classified chiefly by material 13.6%, chemicals 8.9% and food and live animals 8.3% of total imports in 1985. Crude materials (9.3%), miscellaneous manufactured articles (5.1%), beverages and tobacco (0.9%) and others constituted very small portion of the Polish imports (see Appendix 4.5). Total imports volume increased by 4.5% in 1987 and by 9.4% in 1988 but was by as little as 1.5% in 1989 at constant prices compared to the previous year according to the Polish Central Statistical Office.⁴⁶

1.3 Hungary

Hungary fell under communist influence after the WW II, too. It lost nearly 10% of its population in the war and was obliged to pay reparations to the Allies by the peace agreement. The years of socialist system in Hungary are indicated as 1947-89. Throughout the socialist period Hungarians resisted the system of central planning and the economic experts attempted to make some economic reforms but such reforms required structural change in politics as well. At that time political reforms seemed impossible and met harsh suppression by the government.

Nationalization of industrial sectors, transport, banking and wholesaling began already in the end of 40s and continued in even small businesses. Land owners were forced to join the collective farms and National Planning Office was put in operation to control organization of production and distribution of resources in line with the Soviet model.

As a result of excessive rates of growth of industrial production through high levels of investments mainly in heavy industry at the expense of agriculture, light and consumer goods industry and populations' living standard Hungary faced extreme disequilibrium in its economic performance during the Stalin era. Massive investments in steel industry did not make much sense as Hungary had only few valuable natural resources and consequently became dependent on the imports of raw materials such as iron ore and coking coal. Wrong economic policies and strict central control led Hungary to serious crisis followed in 1956 by a national unrest. The unrest was crushed by the Soviet troops.

In 1968 introduction of some economic reforms resulted in some improvements. The growth was higher at the 6-7% for couple of years, supply better matched demand, stocks declined and exports to capitalist economies grew in importance. Moreover, as export-import

⁴⁶ Central Statistical Office, (2010) Yearbook of Foreign Trade Statistics of Poland, p. 43

transactions with market economies grew, managers of independent trading companies gained personal contacts in the West. Voluntary cooperation of large co-operative firms and small private farms was the basis in agricultural production. Supply of farm products became large on domestic market as well as in exports. Consumption increased by 4-4.5% among urban population. However, the Hungarian economic reforms were attacked by the communist media in other socialist countries and the reforms had to be stopped already in 1972.

The government trying to avoid another public unrest issued temporary measures to the large key firms and they were able to negotiate with the sector ministries on subsidies on prices, wages and investments. This though did not help to avoid another economic recession in 1979, followed by the world oil price shock. It was then realized that halting the economic reform was a mistake and the government again applied several economic reforms in the early 80s. Competitive wholesale pricing and regular consumer price rises were allowed and subsidies on food, energy, rents and public transport were reduced. State managed restaurants and shops were privatized with the possibility of leasing arrangements. Sector ministries merged in one Ministry of Industry which did not have direct influence over the firms. Some of the giant enterprises were broken down into smaller units which had more flexible management system and worker's councils that further assured the autonomy of the enterprises. Banking system was reformed as well and the Hungarian National Bank was separated from the commercial credit banks in 1985.

All the above positive economic reforms could not halt the coming recession because they were not implemented fully and consistently. Hungary had high foreign debt and faced a serious problem with the hard currency liquidity in 1982, when foreign depositors withdrew 1.3 bn USD. This withdrawal cut the Hungary's hard currency reserves to less than 500 mil. USD. Hungary joined IMF and World Bank the same year, thus it was able to receive their financial aid. This helped Hungary to stand against the crisis and regain the Western confidence to some extent.

The foreign debt was reduced from 9.1 bn USD to 8.3 bn USD during 1980-83. The government took up the policy of accelerating the economic growth which did not prove to be successful and it faced tension in the trade balance with the West. It was due to the fact that the policy was implemented without the needed restructure of the economy. Because of the easy access to the Western credits Hungary's foreign debt moved up from 8.8 bn USD to 17.7 bn USD during 1984-87, which was the highest per capita foreign debt among the

communist countries at that time. IMF insisted on austerity terms in return to the further financial aid, which had negative effect on the peoples' living standard and standby credit agreement was concluded in 1988. Privatization of the state assets was put in progress particularly by selling them to the foreign investors and also joint ventures were encouraged so the state debts could be paid off.⁴⁷

Hungary was the first one among the Soviet bloc to make a shift to democracy and market economy, some essential changes taking place already by 1987. The country was completely out of the Soviet control by June 1991.

1.3.1 GDP

With the transition from agricultural economy to an industrial one Hungarian GDP saw some improvements in the first decades of the Soviet control. Between 1968 and 1978 GDP grew at 5% p.a., but the economic growth rate decreased to one-half of this level in 1979-81 due to the implementation of demand management policies. The investment reached as high as 41% of GDP in 1978, but was reduced to 30% by 1981 as a part of the stabilization requirements.

According to the Hungarian Central Statistical Office, the value of GDP in million USD at the 1981 constant prices was 20.598 in 1977, 21.886 in 1980 and 23.830 in 1985, of which consumption was the biggest part. As for 1985 the consumption accounted for about 17 bn. USD. These figures show that the GDP was stable but grew very slowly and insignificantly in value.

The aggregate real growth rate fell in 1979 to 2.7% from 4.4% of the previous year. It then went down further in 1980 to 0.2% and only started its upward trend in 1981 and reached 2.6% growth in 1984. The World Bank statistics show that since 1980 till the end of communism Hungarian GDP growth rate was under 3%, at 2.9% for 1981 and 0.7% for 1983 when the economy experienced a drought in agriculture. 1984 was a relatively successful year in terms of GDP growth (2.6%) and current account, which was in surplus. The year 1985 suffered an economic slowdown due to the decline in the exports to the convertible currency area, with a negative GDP growth of -0.3%. This downturn partially resulted from the unusual cold and long winter, which caused a shortage in energy supply. Further it was a consequence of weak external demand for the Hungarian export goods that were not

⁴⁷ Stephen White, (1990) Political and Economic Encyclopedia of the Soviet Union and Eastern Europe, pp. 132, 133, 134

competitive enough on the international markets.⁴⁸ Some stabilization was observed with the GDP moving up to 4.1% in 1987. Yet, next year it again went down to negative (- 0.1%).⁴⁹

The country has limited natural resources and the economy was highly dependent on foreign trade with over 40% of GDP being internationally traded on CMEA markets and non-socialist countries' markets during the 80s. The industrial sector became fundamental for the economy. According to the World Bank data on Hungarian GDP classified by source of production, the share of industry and mining accounted for the 37% of GDP in 1979 and 40% in 1980, 40% of employment and 75% of the exports. In the agricultural sector the country was self-sufficient and has experienced a surplus in exports but it declined from 22% in 1970 to 18% in 1980.

Private sector made up approximately 10% of GDP in the 80s including so called "second economy" that consisted of the small scale private farms and also some businesses in trade, construction and services but there is no data available as to the extent of its presence. Government in fact encouraged such activities attempting to fill the gap in the productive structure.

The population of Hungary was 10.6 mil. at the end of 70s. Consumption increased by 4.8% during 1968-78, while the standard of living notably grew as the population growth was merely 0.35% a year. GDP per capita fell from 2.124 USD in 1981 to 1.949 USD in 1985 but then had an increased value of 2.805 USD in 1989. GDP per capita was more or less stable but with very low or negative growth in some years until 1989.⁵⁰

In the downturns of the economy the divergence in the political leadership and population unrest had their impact. As mentioned above, reforms were carried out but in a limited way and without removing main factors in the system that caused repetitions of hardships.

1.3.2. Currency and inflation

Hungarian national currency "forint" was introduced in 1946 and is abbreviated as HUF and it is presented with the symbol of "Ft". It replaced the currency "pengo" which underwent hyperinflation in 1945. Forint got its name from the gold coins that were minted

⁴⁸ Hungary Country Economic Memorandum (1986), World Bank

⁴⁹ United Nations Statistics Division, Hungary, GDP, <http://unstats.un.org/>

⁵⁰ Economic Developments and Reforms in Hungary (1983), World Bank, pp. 1, 38

during the middle ages in the city of Florence. Forint is comprised of 100 filler and remained as an official currency of Hungary even after the break down of the communist system.⁵¹

The currency stability was maintained for several years however as the socialist state lost its competitiveness forint's purchasing power declined during 70s and 80s.⁵² Until 1981 forint had commercial and non-commercial exchange rate which then was unified and the limited convertibility was allowed.⁵³ The exchange rate of forint against dollar was 35.9 in 1981, 39.6 in 1982 and 50.0 in 1985⁵⁴ and 62.2 in 1989⁵⁵. This depreciation trend of the currency accelerated particularly after 1987. The stability of forint during and after the political changes of 1989-90 will be discussed in the second chapter.

Since 1968 the exchange rate policy of the Hungary was based on the limitation of the effects of the international inflation to keep the consumer prices relatively stable and low price elasticity for Hungarian exports to convertible currency area.

Government's extensive consumer subsidies for energy, transport and rent, which constituted 8% of the GDP still in 1981 and also tax exemptions led to distortion of the price structure by 1977 that producer prices were 4% higher than consumer prices. In 1979-80 a large-scale increase (9%) in consumer prices was introduced including some tax changes so that consumer prices were above producer prices. Another source provides that consumer prices raised by 20% in 1979 and meat prices rose even by 40%. During 1979-90 consumer prices increased by 150%, which was almost 10% raise per year.⁵⁶

Furthermore, producer prices were then linked with actual world export and import prices under competitive price system of 1980. Consumer prices were also let be influenced by market forces. 67% of producer and 55% of consumer prices were established freely in 1980. In 1982 the forint devaluation policy shows a change in the exchange rate policy.⁵⁷ According to the World Bank statistics, overall inflation rate was 4.5% in 1981, which increased to 8.7% in 1984. The trend was mainly upward but came down to 5.3% in 1986. The upward tendency continued in a rapid pace from 1987 as 8.7%. Further two-digit level of inflation of 15.8% in 1988 and 16.9% in 1989 was observed.

⁵¹ What is the Hungarian Forint (HUF) - <http://www.gocurrency.com/countries/hungary.htm>

⁵² Central Bank of Hungary Banknotes and Coins, - http://english.mnb.hu/Bankjegy_es_erme

⁵³ Hewet A., The Gross National Product of Hungary (1985), World Bank, p. 6

⁵⁴ Hungary Country Economic Memorandum (1986), World Bank

⁵⁵ Library of Congress, Glossary -- Hungary – <http://www.country-date.com>

⁵⁶ Ehrlich E., Revesz G (2000) Coming In From The Cold The Hungarian Economy in the 20th Century, p. 13

⁵⁷ Economic Developments and Reforms in Hungary (1983), World Bank

1.3.3. Foreign Trade

Hungary's small and open economy has been highly dependent on foreign trade. Domestic demand though should be in equilibrium. High trade dependence of the Hungarian economy made it vulnerable to the world economic downturns. It was proven during the world oil shock in 1974-75 and 1979-80 that the external demand was essential.

In the late 70s expansion of investment and consumption with the worsening in the trade terms led to the big deficit in the external accounts. Increase in investment led to immediate increased demand for imports as Hungary needed raw materials for the production. It signed the General Agreement on Tariffs and Trade in 1973, when its balance of payments was not in a good shape. By this Hungary wanted to insure the trade relations with the West. After 1979 Hungary increased enterprise autonomy and the enterprises could rely on international market signals to strengthen their international competitiveness.⁵⁸

Hungarian total trade turnover increased from 13.4 bn USD to 18.8 bn USD during 1981-86. Exports rose from 6.5 bn USD to 9.2 bn USD in the same period whereas imports went up to 9.6 bn USD from 6.9 bn USD at 1986 prices.⁵⁹

The year 1984 ended with the trade surplus of 1.2 bn USD.⁶⁰ Hungary underwent serious foreign-trade imbalances after 1987 due to the deterioration of terms of trade with increasing protectionism of the West. Access to foreign credit was reduced and interest rate went up. The domestic enterprises could not respond fast to the changing market conditions in general. Further Hungary had to spend 65-70% of its convertible currency earnings on its debt payments.⁶¹

It has to be pointed out that tourist visits brought 371 mil. USD in 1986 to Hungary's economy and the number of foreign tourists rose from 4 mil. in 1984 to 10.6 mil. in 1986. Tourists were mostly from Czechoslovakia, Poland, Austria, Yugoslavia and the USA.⁶²

Territorial Structure

USSR, West Germany, East Germany, Czechoslovakia and Poland were top trading partners of Hungary during communist regime.⁶³ During 1968-73 exports to convertible currency area expanded by 20% per year but slowed down during 1980-81.⁶⁴

⁵⁸ Economic Developments and Reforms In Hungary (1983), World Bank

⁵⁹ Library of Congress, (1989) Hungary Trade Volume and Structure

⁶⁰ Hungary Country Economic Memorandum (1986), World Bank

⁶¹ Library of Congress, (1989) Hungary Foreign Trade

⁶² Library of Congress, (1989) Trade Volume and Structure,

⁶³ Stephen White, (1990), Political and Economic Encyclopedia of the Soviet Union and Eastern Europe, p. 128

Foreign trade was divided evenly between the CMEA and the West. In 1986 the CMEA trade share stood for 53.1% which was an increase from 49.3% in 1980. The trade turnover with CMEA made up 10 bn USD in 1986 which was again a raise from 1981 turnover of 6.8 bn USD. In 1986 trade turnover with the West amounted to 7.9 bn USD. This made up approximately 50% of Hungary's overall trade.⁶⁵

USSR made up 60% of Hungary's trade with CMEA and 30% of its overall trade in the late 80s. Hungary's other major trade partners East Germany, Czechoslovakia and Poland accounted for 16.5% of overall Hungary's trade and 31.1% of its CMEA trade.

West Germany was the first biggest Western trade partner and second biggest overall trade partner for Hungary. It should be noted that in 1987 about 330 cooperation agreements were signed between West German and Hungarian companies especially in engineering and machine industries. West German companies such as Siemens, Volkswagen, Telefunken and Krupp had joint ventures with the Hungarian companies. Besides, West Germany was the first government creditor for Hungary and Hungary in return agreed on an investment protection agreement in 1986 that assured that the assets of West German firms with investments in Hungary would not be nationalized by the Hungarian government.⁶⁶

Austria was one of the top trading partners for Hungary. There were 14 Austrian-Hungarian joint ventures and 120 cooperative agreements.

Hungary was the first CMEA country to sign a trade agreement with the European Economic Community (EEC) in 1988 with the aim to gradually reduce quotas on about 2000 articles. Hungary's trade deficit with the EEC countries was 5 bn USD during 1979-86.

Hungary enjoyed most favored nation status in the trade with the USA after their trade agreement in 1978. The USA capital investments amounted only to 58 mil. USD and had 10 joint ventures in 1988. The bilateral trade turnover between Hungary and the USA reached 500 mil. USD in 1987.⁶⁷

Among Asian countries Japan was very important for Hungary for its capital and technology. Trade with China accounted for about 2% of Hungary's trade but the value grew significantly from 112.7 mil. USD in 1984 to 343.9 mil. USD in 1986.

From the perspectives of imports 32.5% came from industrial countries, 14.9% from developing countries and 4.3% from high income oil exporter countries in 1983. Hungary

⁶⁴ Economic Developments and Reforms in Hungary (1983), World Bank

⁶⁵ Library of Congress, (1989) Hungary Trade Partners

⁶⁶ Library of Congress, (1989) Hungary Trade Partners

⁶⁷ Library of Congress, (1989) Hungary Trade Partners

imported tropical foods and other agricultural products, petroleum oil, clothing, carpets, steel products and electrical appliances from developing countries. Imports from the Eastern Europe accounted for largest share, 49%, in 1982, which slightly decreased to 48.3% next year. Imports from the CMEA during 1981-86 went up from 3.3 bn USD to 4.9 bn USD. More than 90% of energy imports, 42.5% of raw and basic material imports and more than 60% of capital goods imports were from CMEA in 1986. Imports alone from the USSR represented 25% of the total imports in 1988.

In 1986 4.7 bn USD was paid for the imports from the West. Raw materials and semi-finished goods import from the West Germany alone reached 65% and machinery and equipment 20% of the 1.2 bn USD, their total imports in 1986. Hungary's imports from Austria were worth 574 mil. USD in 1987. The EEC countries represented about 25% of total Hungary's imports in the late 80s. Imports from the USA were a bit more than 2% of the total Hungarian imports in 1986. Hungary imported goods from Japan worth 142 mil. USD in 1986. More than 50% of the imports were basic materials and semi-finished goods.

On the side of exports, industrial countries accounted for 25.3%, developing countries 23.2% and high income oil exporter countries 2.1%.⁶⁸ Hungary exported machinery, vehicles, industrial consumer goods and agricultural goods to the developing countries which totaled to 1.4 bn USD in 1986.

Eastern Europe composed the biggest share of exports as 52.3% in 1982, which then reduced to 49.4% in the next year. During 1981-86 value of exports to CMEA increased from 3.6 bn USD to 5.1 bn USD. About 48% raw materials and semi-finished goods exports, 84.3% machinery and capital goods exports and more than 50% of the industrial consumer and agricultural goods exports went to the CMEA countries.⁶⁹ Exports to the USSR constituted 27.6% of total exports in 1988.⁷⁰

In 1986 value of exports to the West made up 3.7 bn USD. Due to the supply shortages of energy and raw materials from the USSR Hungary had to raise its exports to the West to pay for additional imports of raw materials.⁷¹ Exports to West Germany made up 771 mil. USD in foodstuffs, live animals, machinery, chemical products, textiles, clothing, pharmaceuticals and aluminum products. The value of exports to Austria amounted to 594 mil. USD in 1987. 19.9% of total Hungarian exports went to the EEC countries in the late

⁶⁸ Hungary Country Economic Memorandum (1986), World Bank, pp. 14,15

⁶⁹ Library of Congress, (1989) Hungary Trade Partner,

⁷⁰ Socialist Economies in Transition (1990), World Bank, pp. 4

⁷¹ Economic Developments and Reforms in Hungary (1983), World Bank

80s. Exports to the USA accounted only for 2.3% in 1986. Hungary did not export in large-scale to Japan, only worth 42.4 mil. USD in 1986. Exports were mainly in basic materials, semi-finished products, pharmaceuticals, aluminum and chemical products that made up more than 65% of the exports to Japan.

Commodity Structure

Hungary's export commodities were composed of agricultural goods, pharmaceuticals, bauxite, machine tools, buses, telecommunications, electronic equipment, rubber goods, steel, aluminum, clothing and footwear. Hungary was specialized in producing buses and the production of car components. Its bus company Ikarus was one of the largest bus producing companies in Europe.⁷² During 1970-78 exports of manufactures grew by 9.6%, primaries by 6.8%, fuels by 9.4% and non-fuels by 6.4%. Exports in fuels increased significantly by 16.2% and the growth of primaries export was 7.9% for the period of 1978-83. In addition, export growth rate for manufactures was 5.2% and for non-fuels was 6.2% for the same period. According to 1983 statistics manufactures made up 62.4% of the total exports of which machinery and transport equipment were 30.4% and textiles and clothing were 5.7%. Primaries accounted for 37.6% of exports in 1983.⁷³

Export share of raw materials, semi-finished goods and spare parts represented 30.2% of exports in 1985. Machinery and transport equipment and capital goods export rose from 16.7% in 1970 to 30% in 1986. During the same period agricultural goods export grew from 7.4% to 20.1%. Manufactured consumer goods export declined from 20% of total exports in 1970 to 15.1% in 1985 (see Appendix 5.1).

Major imported goods contained crude oil, coal, iron ore, copper, raw materials for the production of plastics, chemical fibers, artificial fertilizers, paper, cotton, animal feed, capital and consumer goods. Total merchandise imports grew by 7.8% during 1970-78 however negative decline of -0.3% was observed during 1978-83. The decline occurred due to the world oil crisis of 1979 and its consequential impacts on the foreign trade. Imports from Eastern Europe, industrial countries and also developing countries went down even to negative rates whereas imports from the high income oil exporter countries increased significantly due to the overconsumption of the energy in the households and in production

⁷² Malgorzata Jakubiak, Peter Kolesar, The Automotive Industry in Slovakia: Recent developments and Impact on Growth, 2008, p. 10 - <http://www.growthcommission.org/storage/cgdev/documents/gcwp029web.pdf>

⁷³ Hungary Country Economic Memorandum (1986), World Bank, p. 14

during the unusual harsh winters. The raise in fuel imports was 390% in 1983 but such very high growth rates were also due to the low base year values (see Appendix 5.2).

Moreover, the imports of fuels and electric energy saw a significant raise from 6.8% in 1970 to 20.9% in 1985. Raw materials, semi-finished goods, and spare parts accounted for 44.8% of imports in 1985. Capital goods and transport equipment represented 16.8% of the imports and the share of manufactured consumer goods was 10.4%. Raw and processed foods were equal to 7.1%. Energy imports expanded from 6% of total imports in 1970 to 19.4% in 1986.

Hungary's severe balance of payments situation in the early 80s led to increased controls over imports and list of temporary quotas for non-ruble imports was issued in 1982 which included industrial and agricultural raw materials. Surcharge for the imports of components and spare parts was 20% and consumer goods were also subject to such surcharge. Such restrictions showed importance of the reduction of energy and raw material utilization.⁷⁴

⁷⁴ Economic Developments and Reforms in Hungary, Statistical Appendix (1983), World Bank

2 Trade Development of the V4 countries after collapse of the communism

2.1 Czech Republic

The whole period of centrally planned economy caused the country to lose market shares in the world market. The Velvet Revolution of 1989 opened the way to a profound economic reform that led to elimination of price controls, large inflows of Foreign Direct Investment (FDI), increasing industrial production and domestic consumption and a stable exchange rate. This economic management was labeled as “big bang” of 1991 by the IMF. Czech Republic implemented market-oriented reforms with prudent macroeconomic management that included the opening the economy to foreign investment, privatization of state enterprises, liberalization of price system and foreign exchange regime, and the relaxation or elimination of foreign trade restrictions. Exports shifted to Western Europe and lowered the share of the former USSR and its allies. Government’s domestic and foreign indebtedness remained relatively low despite the upward trend of the budget deficit in the late 80s.⁷⁵

Czech economic transformation was a very successful one creating functional market economy. The country inherited growth in GDP, relatively stable political environment and low inflation rate. Relatively low level of wages and well educated and highly skilled workers attracted foreign investment. Two economic transitions can be pointed out as first country’s shift to democracy and market economy and the second was the EU accession process. The country joined the Visegrad Group in 1991 on the road to European integration. Entry to the EU was the priority of the all V4 nations. The members often had held meetings to discuss their cooperation to achieve this end. The Czech Republic together with the other Visegrad members joined the EU in 2004. It remained stable in its economic and political environments and coped relatively well with the last world financial crisis. The country is founding member of the WTO and joined the OECD in 1995 and NATO in 1999.

2.1.1. GDP

Czech Republic faced economic and social turmoil in early post-communist years as an immediate result of a collapse of export demand from CMEA key partners and decline in domestic demand. This can be seen in the drastic drops in the GDP growth. 1989 GDP growth of 4.5% fell to -1.2% in 1990 and -14.2% in 1991 and additional -6.6% in 1992,

⁷⁵ US Department of State, Czech Republic (2011) - <http://www.state.gov/r/pa/ei/bgn/3237.htm>

before improving in 1993 with a drop of only -0.3%. Recovery began in 1994 with positive GDP growth rate of 4.5%.⁷⁶ Czech Republic was an advanced reformer during the transition period. Its private sector was only 4% of GDP before the reforms and reached 50% already in 1994 and 75% in 1996.⁷⁷ Services accounted for about 53% of GDP in 1994, industry together with construction made up 41% and agriculture and forestry only 6% according to the WTO.

The year 1995 saw vast foreign capital inflows, which made up 18% of the GDP or 223 bn CZK capital account surplus, although this was accompanied by increasingly imbalanced tendencies in next years. The GDP growth went down to negative -0.7% in 1997 and -0.8% in 1998. The year 1997 was the most difficult year since the beginning of transformation process. Current account was in a very unhealthy shape with high deficit. The external funds inflows were peak in 1995 but majority was short-term speculative investments. In 1997 the inflows decreased substantially and were not sufficient to cover the current account deficit (- 100.1 bn CZK). FDI for 1995 made up 68 bn CZK, which went down to 40.6 bn CZK in 1997 according to the Czech National Bank.

Foreign exchange reserves experienced decrease, further deterioration of the balance of trade and high state budget deficit were the impacts of the economic slump. Followed by the measures taken in stabilization and recovery program the economic situation improved with a positive GDP growth of 1.3%. Overall still in 1999 economy was stagnating and the growth rate of GDP was slowed because imports surpassed exports. However, GDP growth declined from 2.5% in 2001 to 1.9% in 2002 as an impact of the slow down of the world economic growth in general. Especially Germany, Czech Republic's most important trading partner was hard hit by the economic stagnation. The growth rate was 4.5% in 2004 when Czech Republic joined the EU. Until 2007 growth remained as high as 6%.

The Czech economy grew faster than the EU economy as a whole. The growth was mainly due to gross fixed capital formation, household consumption and net exports. 2008 was a year of global economic and financial crisis, which also affected Czech domestic economy. The growth rate fell to 2.5% and it is mainly due to the decrease in external demand. Economic growth further went down to -4.1% in 2009 and recovery started in 2010 with the positive growth rate of 2.3%.⁷⁸

⁷⁶ Joint Economic Committee, Congress of the United States, East Central Economies in Transition (1995) p. 510

⁷⁷ Cevdet Denizer, Stabilization, Adjustment and Growth Perspectives in Transition Economies (1997), p. 11

⁷⁸ Czech Statistical Office, Macroeconomic indicators – www.czso.cz

GDP value grew from 34.9 bn USD in 1990 to 190.3 bn USD in 2009 according to the World Bank statistics. In terms of national currency GDP value went up from about 1500 bn CZK in 1995 to about 3700 bn CZK in 2010.

Population of the Czech Republic remained stable at about 10.3 mil. With such a dynamic economy Czech GDP per capita recorded very positive results growing from 142.000 CZK in 1995 to 349.000 CZK in 2010 (see Appendix 2.1). Czech Statistical Office reports that during 2008-2009, GDP per capita decreased from 354.000 CZK to 346.000 CZK as an impact of the world economic crisis. In dollar terms GDP per capita grew from its 1990 value of about 3.600 to a bit more than 18.000 in 2009 according to the UN statistics.

2.1.2. Currency and inflation

The new Czech national currency, “koruna”, was introduced in 1993 after the separation of the Czechoslovakia. Its international acronym is CZK and it is abbreviated as Kč. Logistics of the process of introduction of the new currency was smooth due to the fact that excess cash of the most people was deposited in banks. One Czech crown equals hundred hellers, but heller coins are not in use since September 2008. Nevertheless, hellers are still added to prices of goods and services and only then the final price is rounded up to the nearest crown amount. Currently the Czech crown in circulation is in the form of coins (1, 2, 5, 10, 20 and 50) and banknotes (50, 100, 200, 500, 1000, 2000 and 5000). The latest Czech banknotes have modern anti-copying precautions and were designed by a famous Czech designer Oldrich Kulhanek.⁷⁹

In the early 90s the exchange rate regime was fixed and pegged to a currency basket of German mark (65% DEM) and US dollar (35% USD) with a fluctuation band of +/-7% until 1997. However, crown experienced speculative attacks in 1997 as contagious effect of speculative attacks in Southeast Asian countries. Crown exchange rate moved within appreciation band, due to the short-term capital inflow, reaching its maximum deviation of 5.5% from the central parity in February. Moreover, this was associated with significantly rising interest rates. In mid-May currency crisis accelerated under the pressure of investors, which resulted in heavy sale of crown and purchase of foreign exchange assets. At this point the Czech National Bank (CNB) intervened the foreign exchange market and adopted necessary measures including the restriction of the foreign entities to the domestic money market. When the speculative attacks calmed a bit the CNB cancelled the existing fixed

⁷⁹ Czech Currency – crown (koruna) - <http://www.prague.net/blog/article/60/money-money-money-czech-crown>

exchange regime and introduced managed floating exchange rate system linking the crown to the German mark.⁸⁰ Overall the CNB successfully managed to fade the currency crisis and the crown exchange rate and interest rates were stabilized. Since then Czech crown has been a very strong and stable currency and owing to that Czech Republic went through the last global crisis more smoothly than others.

The crown exchange rate against dollar was 28.2 in 1992 and 27.1 in 1996. Despite the strong appreciation of crown in the beginning of 1997 it depreciated to 31.7 on average for this year in comparison to the preceding year. Further strong appreciation of crown was observed against dollar at 25 in 2004 and at 17 in 2008.⁸¹

When the Czech Republic joined the EU together with other V4 countries, it agreed to enter the European Monetary Union, the so called Eurozone and adopt euro as soon as it fulfills Maastricht criteria regarding inflation rate, national budget deficit, national public debt, long term interest rates and the Exchange Rate Mechanism. The country has been steadily moving towards the Euro zone since its accession to the EU. The date of the euro adoption has not set for sure yet however it was forecasted before that it would be 2006 which was then postponed. Nowadays Czech politicians say it may be possible to enter the euro zone in 2013-14. This is rather a political decision than a monetary one as many of the Czech ruling political leaders are skeptical about it. Moreover, the economic crisis also has played its role in delaying the process.

In 1998 monetary strategy of the CNB was switched from the money supply targeting to direct inflation targeting of 4.5% with a tolerance band of +/-1% which has then been often changed. Since 2010 the inflation target is at 2% for the period ahead until the Eurozone accession.⁸² By this CNB attempts to achieve price stability and keep inflation close to the declared target.

Czech economy had experienced high inflation during 1990s reaching 9.1% in 1995 and 10.7% in 1998, owing to rapid growth in regulated prices, depreciation of crown to some extent and rise in indirect taxes. In 1999 the rate dramatically dropped to 2.1% but was a bit higher in 2000 and 2001 again. The lowest inflation rate observed was in 2003 at the rate of 0.3%. Owing to the last global financial crisis the inflation was triggered once more and went up to 6.3% in 2008 which then dropped to 1% in 2009 (see Appendix 2.2). Overall it can be

⁸⁰ Czech National Bank, Annual Report 1997, p. 68

⁸¹ Czech National Bank, exchange rate statistics - <http://www.cnb.cz>

⁸² Czech National Bank, Annual Report 2004, p. 19

said that the Czech Republic has managed to keep the inflation rate relatively low and the value of the Czech koruna high.

2.1.3. Foreign Trade

Trade is extremely important for the healthy functioning of the Czech economy and realizing that Czech Republic has built relatively open trading system in the transition to market economy. In 1990 exports of goods and services made up 45% and the imports 43% of GDP. This has grown quite fast in the next years and in 1994 value of foreign trade in goods and services exceeded the GDP. However, due to the rapid increase in consumption and investment the import growth increased more quickly than exports. Domestic supply could not respond very much to the increased demand for high quality goods. Obstacles in export growth came from the breakdown of CMEA markets and still low competitiveness of Czech goods. Particularly during 1993-96 trade balance experienced high deficit. In 1996 it was as high as about – 158 bn CZK or 10.3% of the GDP, which fell to 8.5% in the next year. Merchandise imports grew by 8.7% for this year, which was 3% less than the previous year. It was due to the slowdown of the domestic demand and rise in prices of imported goods. Reflecting European import demand, Czech exports increased by 20% with 40% expansion just in sales of machinery and transport equipment. Furthermore, Czech export prices grew faster by 2-3% than international prices. Demand was sufficient for Czech exporters to allow them raise prices and at the same time increasing competitiveness for the quality of Czech goods.⁸³

In terms of value, Czech imports increased from 915 bn CZK in 1998 to 1989 bn CZK in 2009. Exports value for the same period grew from 834 bn CZK to 2139 bn CZK according to the Czech Statistical Office. In 2009 exports constituted 70% of GDP and imports 64% according to the World Bank. It was in most cases already possible in transition period to buy inputs from abroad without substantial taxes or restrictions.

Czech trade regime has been based on the WTO principles such as “Most Favored Nation”. Tariffs were applied at moderate levels on an ad valorem basis and non-tariff barriers were used in very exceptional cases. The openness of the trade resulted in the economic growth and stability. Joining the EU and accepting the common market principles including the EU Common Commercial Policy also ensured the continuation of the positive

⁸³ OECD Economic Surveys, Czech Republic 1998, p. 21

trade development. Since 2004 Czech Republic has had positive trade balance, trade with the EU constituting the highest value.

Territorial Structure

External factors such as the unification of Germany in 1990, disintegration of CMEA, the move towards world prices in trade with the former Soviet bloc and the depression of their economies have had a major effect on Czech foreign trade. Czech Republic had to reorient its trade from former Soviet bloc of countries towards advanced market economies, particularly European Union countries. Most of the foreign trade was exchanged with the EU already in the beginning of the transition period. Trade liberalization particularly via the Europe Agreement with the EU and Central European Free Trade Association (CEFTA) is considered to have had a strong influence. 1995 experienced first increase in trade among former CMEA countries since the collapse of the communist regime.⁸⁴

Germany has replaced USSR as the number one trading partner with the highest trade turnover. Slovakia remained as the second most important trade partner. Trade with Poland (2.7%) and Hungary (1.7%) was quite low as of 1994 stated by the Joint Economic Committee of Congress of the USA. But Poland later became a number three trade partner. Trade with Hungary remained less intense.

Since 2007 the importance of the trade with China grew fast and China went up from the 10th place to the 4th place in 2009 as a trade partner according to turnover as Czech Statistical Office reports. Trade between the Czech Republic and the USA became less intense due to the EU and USA disputes over WTO trade rules.

Czech Republic's share in intra EU-27 exports is 3.1% and imports 2.8% for 2008 and 2009. Export share extra-EU 27 was 1.1% and import share 1.4% according to Eurostat.

In terms of imports the EU contributed 62.1% of imports in 1997. Imports from the EU remained high accounting for 72% of total imports in 2004, 71% in 2006 and 67% in 2009 according to the CNB figures. Germany, being the number one trading partner for the Czech Republic, provided 25.1% of total imports in 1993. Imports received from Germany accounted for 32% of total imports in 2004, 30% in 2006, which then reduced to 26.5% in 2009. Slovakia's share in imports for the same period was 5.4% and 5.5%.

⁸⁴ OECD Economic Surveys, Czech Republic 1996, pp. 20-21

Transition and state economies represented 24.3% of imports. Imports to developing countries were as low as 5% (see Appendix 2.3). Imports from CIS countries fell from 8.2% in 2006 to 6.8% in 2009 (see Appendix 2.4).

Imports from Russia accounted for 13.8% in 1994. Imports value with the USA was 275 mil. USD for the same year.⁸⁵ Strong decreasing trend can be observed for the imports from the USA during 2000-09 from 16.4% to 5.2%.⁸⁶

EFTA represented 2% of imports during 2005-2009. Imports from developing countries went up from 5.7% to 6.8% for this period. Imports from China remained at around 5-6% for sometime and increased to 10% in 2009 (see Appendix 2.4).

From the exports perspective the EU's share was as high as 60.2% in 1997, making it the biggest market for the Czech goods. Exports to the EU countries grew the fastest, by 24.3%, followed by the transition European economies of that time especially Russia (by 25%) and Poland (by 25.8%). The EU members were stable at 85% in exports during 2005-09. Germany received 26.9% of Czech exports in 1993. Exports to Germany grew from 38% in 1998 to 42% in 1999. But 2009 statistics of the CNB show that it declined to 33%. Exports to Austria accounted for 9.8% followed by the UK and Russia with 3.2% each in 1994. Exports to Slovakia made up about 8.5% of total exports for 2004-06. Value of exports to the USA amounted to 266 mil. USD in 1993. Exports to the USA fell from 20% in 2000 to 10.5% in 2009.

The Czech Republic exported to CIS countries as little as about 3.5% of its total exports during 2006-09. Exports to developing countries stagnated for sometime with their share close to 5% in 90s. But their share had slightly decreasing trend and then experienced a modest increase from 3.2% to 4.3% during 2006-09. Share of transition and state economies was 29.7% of total exports. Exports to China did not make even 1%. EFTA countries accounted for merely below 2.1% in exports during 2006-09 (see Appendix 2.4).

Commodity Structure

In the commodity structure of Czech trade there has not been any major change except for the increasing trend in the trade of machinery and transport equipment and shrinking trend of the other commodity groups.

⁸⁵ Joint Economic Committee, Congress of the United States, East Central Economies in Transition 1995 pp. 514-515

⁸⁶ Eurostat, External and Intra-EU Trade Statistical Yearbook, 2010, pp. 132-133

The leading commodity group in exports was machinery and transport equipment constituting 38% of total Czech exports in 1997 according to the Czech Central Statistical Office.⁸⁷ Exports in this category of goods then increased from 50.8% in 2005 to 53.3% in 2009. Manufactured goods classified chiefly by material fell from 21.7% to 17.8% of total exports for the same period. Export share of miscellaneous manufactured articles category and commodities and transactions not classified together floated between 10.8% and 11.8% during 2005-09. Next, chemicals had the export share of 8.8% in 1997 which then stagnated at 5-6% after 2005. Raw materials and fuels in exports had insignificant share of 5.6% in 2005 which slightly floated downward and then upward reaching only 6% in 2009. Exports in live animals, food, beverages, tobacco, oils and fats constituted as low as 3.9% and 4.5% respectively.

Machinery and transport equipment were leading commodities also in imports, which accounted for 38.2% in 1997. Imports in this commodity category remained 40-43% during 2005-09. Imports of manufactured goods classified chiefly by material fell from about 21% to 18% during 2005-09. Both miscellaneous manufactured articles category and commodities and transactions not classified together represented 11% of total imports, which modestly increased to 12.1%. Imports in chemicals reached 12.3%, which decreased to 10-11%. Raw materials and fuels imports share was 11.9% and remained with no major change in 2009 with 11.4% share. Live animals, food, beverages, tobacco, oils and fats in imports had very small share each but all together accounted for 5.3% of total imports, which went up to 6.4% during the analyzed period (see Appendix 2.5).

2.2. Slovak Republic

Slovakia became independent republic on its own in 1993 as a result of a peaceful separation of Czechoslovakia. It was very difficult during the transition period because of existing economic and social problems including growing unemployment rate. Slovakia has undergone significant economic reforms in trade liberalization and privatization with high export growth and high level of foreign investment over the last two decades that helped the country to get back on track. Slovakia became a member of the OECD in 2000 and of the EU and NATO in 2004. Slovakia joined the Eurozone in 2009, being the first and the only one until now among V4 countries. Last global crisis impacted many segments of Slovak economy and unemployment rose above 12% in 2010.

⁸⁷ Czech National Bank, Annual Report 1997, pp. 16

2.2.1 GDP

The National Bank of Slovakia (NBS) provides data on GDP from 1993. The growth rate was at 7.2% in 1993, which slowed down to 4.4% in 1997 and even to 0% in 1999. Only in 2000 economic growth was back to its growing tendency at 1.4%. It moved up from 3.5% in 2001 to 5.1% in the year of EU accession. This was the fastest growth among the V4 countries according to the 2004 annual report of the NBS. The main element of such growth was large inflows of foreign direct investment that grew from 21 bn SKK in 2003 to 41 bn SKK in 2004 and also growing exports. FDI concentration was especially in sectors such as the production of machines, electrical equipment, and transport vehicles and in certain service sectors such as trade, transport, and telecommunications. GDP then further grew to 10.5% in 2007. But then the global financial crisis took it down to 5.8% in 2008 and -4.8% in 2009 (see Appendix 3.2).

The affect of the last global recession on Slovakia was to greater extent than other OECD members according to OECD. It is mainly due to its exposure to world trade and specialization in export goods, especially automobiles that are not much sold during the economic downturns. But the recovery was noticed already in 2010 with the growth rate of 4%.

For simplification reasons GDP dollar value is used here as Slovakia has gone through a currency change and available statistics in SKK or EUR do not cover the whole analyzed period. GDP in terms of value was 15.5 bn USD in 1991, which expanded to 42.2 bn USD in 2004 and 87.6 USD in 2009.

UN Statistics Division reports that GDP per capita in dollar rose from 2.950 in 1990 to 7.840 in 2004 and further to 16.200 in 2009. The decreases were observed in 1991, 1999 and 2000 as a result of the general economic downturns in the country (see Appendix 3.1).

2.2.2. Currency and inflation

Between 1993 and 2009 official currency of Slovakia was Slovak crown. Its international acronym was SKK and also abbreviated as Sk. 100 hellers equaled 1 Slovak crown. The banknotes were issued in denominations of 20, 50, 100, 200, 500, 1000 and 5000.⁸⁸

⁸⁸Go CURRENCY.com, Slovakia - <http://www.gocurrency.com/countries/slovakia.htm>

The exchange rate of SKK against dollar was at 29 in 1995 and at 46 in 2000, which then appreciated to 36 in 2003. Moreover, NBS provides the historical exchange rate of SKK against EUR as 42.5 in 1999 which then appreciated to 39 euro in 2004. Slovak koruna had appreciating tendency against euro till 2009 with exchange rate of 30.

The monetary policy was based on fixed exchange regime (peg) during 1993-1998. It was then replaced by floating exchange rate regime. The exchange rate of the crown was determined in relation to euro as a reference currency. In case of excessive volatility of the exchange rate of the Slovak crown the NBS could intervene the foreign exchange market.⁸⁹ NBS began to implement the strategy of inflation targeting since 2005. Inflation target is currently 2% and can be changed if necessary. Since Slovakia joined the EU further process started to become the member of the Eurozone which was fulfilled in 2009. Currently official currency of Slovakia is euro.

Inflation rate was as high as 25.1% in 1993. The main factors were the introduction of the value-added tax and also the currency split after the dissolution of Czechoslovakia. Without the cumulative effect of these two factors the rate would be 12-13% for the whole year. It meant rise of 24% in cost of living in general. Inflation rate slowed down year by year and was at 6.7% in 1998. However, this tendency changed already in 1999 with the rate of 10.6% and 12% in 2000. The lowest inflation rate observed before joining the EU was in 2002 at 3.3% and the 2004 rate was as high as 7.5%. Already in 2005 some improvements were seen with a significant fall in the inflation rate (2.7%). As an impact of the last global crisis, it again increased to 4.6% in 2008 but fell to 1.6% in 2009 and to 1% in 2010 (see Appendix 3.3).

2.2.3. Foreign Trade

After the breakdown of the communism many economic reforms were carried out in order to build a market economy including abolition of foreign trade monopoly, privatization, liberalization of price policy and introduction of convertibility of the national currency. The economic and trade reforms were driven by the objective of readiness for the EU membership.

Total volume of foreign trade dropped by 7% in 1993, in comparison to 1992, and trade balance was in deficit of 32 bn SKK. 11% decline in exports in 1993 was especially due to the sharp decrease in trade with the Czech Republic and the former Soviet Union. Also

⁸⁹ Miroslav Beblavy, Exchange Rate and Exchange Rate Regime in Slovakia Recent Developments, 2002, pp. 7-9

decrease of 4.5% in imports was a result of the temporary decline in imports from the Czech Republic. This was due to the slow consumption and investment demand in Slovakia at that time and the re-orientation of the foreign trade towards the EU and EFTA countries.

For the period until 2004 the trade balance was always in deficit except for a surplus of 2.6 bn SKK in 1994. During 1996-99 import growth was higher than the exports' which in 1999 followed by 46 bn SKK deficit in trade balance. Largest trade deficit for the period was recorded in 2001 at 103 bn SKK. In 2004 the trade deficit as a share of GDP increased by 3.5% in relation to the previous year. Slovakia entered the EU with 49 bn SKK trade deficit which was caused by the excess growth in imports over growth in exports. Since 2004 trade balance was in deficit every year except for 2009 and 2010 surplus. The main cause behind this lasting trade deficit was the growing trade deficit particularly with the former Soviet Union countries.

Foreign trade turnover increased from 363 bn SKK in 1993 to 1837 bn SKK in 2004.⁹⁰ This shows how Slovak economy was gradually integrated into the international trade and the world economy. The share of foreign trade in the Slovak GDP was a proof of a strong functional openness of the economy. Export and import growth was much higher than the GDP growth.

Openness of the economy significantly increased particularly since 1996. Share of imports and exports in GDP was at 114% in 1993, 128% in 1997 and 162% in 2002. On one hand such openness created a high level of healthy competition but on the other hand Slovak economy became dependent and strongly sensitive to the outside world changes.

In regard to the industrial structure of the Slovak exports it can be said that the mechanical engineering, chemical, pharmaceutical and rubber processing and metallurgical industries are dominant. The high share of such industries has been influenced by the presence of the world's large exporters such as Volkswagen, Slovnaft, Matador, Sony and others.⁹¹

The last global crisis and its effects reflected in decrease of the external demand for Slovak goods and services. NBS annual reports provide that Slovak exports fell from 14% growth rate in 2007 to about 5% in 2008. Imports declined from about 11% to 6% respectively for the same period. 2009 had even stronger consequence of the downturn as exports were down by 20% and imports by 22%. Effects of the global economic crisis were

⁹⁰ Stefan Samson, *Foreign Trade of the Slovak Republic*, 2006, pp. 7-9

⁹¹ Jana Srsnova, *An Analysis of Slovak Exports*, 2004, pp 2-3

fading in 2010 and economic recovery and stabilization started. External demand moved up and exports rose by almost 20% and imports by 20.5%.

Territorial Structure

Prior to 1989 most trade was with the Soviet Union and other CMEA countries. Orientation of the Slovak foreign trade changed towards market economies especially the EU. Already in 1991 29% of trade was exchanged with the EU which then rose to 36% in 1995. Slovakia's foreign trade is concentrated in Europe, with 91% of both imports and exports exchanged within Europe, including Russia. Trade with EFTA countries accounts for very small share. CEFTA members made up 38% of the total Slovak trade in 1995 according to the NBS.

The share of exports to the Western industrial countries increased from 19% in 1989 to 71% in 1994. Largest shares of exports went to the Czech Republic and the EU according to the WTO report in 1995. The exports to the EU accounted for 61% in 2004, which increased to 85% in 2008. Slovak Statistical Office reports that in 2002 60.5% of the total Slovak export goods went to EU countries. Hence, almost 90% of the total exports went to the enlarged EU. Among the EU countries the most important trading partner has been Germany, which in 2002 took approximately 26% of the country's total export.

Slovakia's three largest markets for exports as of 2009 are Germany (20.1%), the Czech Republic (12.9%) and France (7.8%). Moreover, Poland represents 7.2%, Hungary 6.3%, Italy 6.1% and Austria 5.8% in exports making them also important foreign markets for Slovak export goods.

Exports to EFTA had falling trend from 1.4% to 0.9% during 2004-08. 28.3% of the export goods went to CEFTA countries in 2002. The Czech Republic dominated with a share of 15.2% among CEFTA countries in 2002 when it was still not the EU member. In 2004 CEFTA represented 24-25% of total Slovak exports.

It has to be pointed out that Slovakia's cost of imports is very high due to the large energy imports from Russia and also substantial imports of machinery and electrical & electronic equipment used in its growing automobile and energy sectors.⁹²

In 1993 imports from the EU, EFTA, former Soviet Union, Poland and China increased but imports from the Czech Republic temporarily decreased.⁹³ The largest shares of

⁹² Empori Bank, Country Trading Profile: Slovakia -<http://www.emporikitrade.com/uk/countries-trading-profiles/slovakia/presentation>

imports were from the Czech Republic, the EU and Russia in 1995 as reported by the WTO. In 2004 imports from the EU constituted 51% and 68% in 2008. EFTA's share in imports declined from 1.3% in 2004 to 0.8% in 2008. In 2004 imports from CEFTA made up 24-25%.

Slovakia's three largest suppliers as of 2009 are Germany (16.8%), the Czech Republic (12.3%) and Russia (9%). Import partners such as South Korea (6.8%), China (5.8%), and Hungary (5.3%) are also important trade partners according to the Slovak Statistical Office.

Commodity Structure

The commodity structure of Slovak trade has undergone some changes in the last two decades. These changes were in the form of increase in one commodity group and decrease in the other.

According to the 1993 annual report of the NBS Slovakia's main exports included material semi-products (45.0%), machinery and transport equipment (16.6%), various industrial products (13.8%), and chemicals (10.5%).

Machinery and equipment's share in Slovak exports equaled only 19% in the early 90s, which increased to 53-55% in the last decade. Manufactures by material in exports saw a major decline from 40.4% to 19-25%. Miscellaneous articles represented 9-10% of total exports with no major change. Share of mineral fuels was 4-5% in exports. Share of chemicals in exports declined by about 8% during 1995-2007. Exports of chemicals accounted for 4-5%. Food and live animals made up 3.5-5% of total exports. In 1990s the export share of crude materials was at about 5-6% and decreased to 2-3% in 2000s (see Appendix 3.4).

Imports to Slovakia were chiefly in machinery and transportation equipment (28.8%), fuels (26.8%), and chemicals (11.7%).⁹⁴ Most of Slovakia's imports have been necessary goods for the production of its export goods.

According to the SITC structure of the Slovak imports machinery and equipment's share rose from 30% in 1995 to 43% in 2007 according to the Slovak Statistical Office. Import share of manufactures by material remained between 15-17% without significant change. Miscellaneous articles accounted for 10-11% of imports. Mineral fuels share has

⁹³ National Bank of Slovakia, Annual Report 1993, p. 42

⁹⁴ US Department Of State, Slovakia, Economy - <http://www.state.gov/r/pa/ei/bgn/3430.htm>

been 11-13% in imports. Imports of chemicals declined by 3% in 1995-2007 and made up 8-10% of total imports during 2008-09. Food and live animals share floated between 4-7% in imports. Import share in crude materials was at about 2-3% in 2000s in comparison to their share of 5-6% in the 90s (see Appendix 3.4).⁹⁵

2.3 Poland

As a result of round-table talks between the communists and the opposition Polish people managed to elect a non-communist government already in 1989. Poland was the first among V4 countries to implement economic transformation policies. However, Poland had to face many political and economic difficulties in the beginning of 90s with considerably high inflation rate. “Sock therapy”, economic policy of the new government in 90s enabled Poland to have long-term robust economy although high unemployment, underdeveloped infrastructure and poor rural class remained to be challenges.

Government reforms during the transition period included reduction of subsidies, liberalization of prices, foreign trade and privatization. The goal of becoming the EU member was behind all these reforms. Poland is a WTO member and it joined OECD in 1996, NATO in 1999. Finally in 2004 the country became a member of the EU.

2.3.1 GDP

Poland’s economy underwent a deep recession in the early 90s. The GDP growth rate was down at -11.6% in 1990 and -7.6% in 1991. A positive growth began in 1992 at 1.5% according to the World Bank report. With 3.8% growth in 1993 and 5.2% in 1994 Poland had highest growth among the V4 during that time. However, it declined from 7% in 1995 to 6% in 1996. It again went up to 6.8% in 1997 making Poland as one of the fastest growing economies of the world as National Bank of Poland provides. In 2002, Polish GDP growth came down to 1.4% and moved up to 5.3% in the year of EU accession. The growth figures did not change significantly after the EU accession but it can be said that the EU membership and access to EU structural funds have provided a major boost to the economy.

Despite the rising global crisis in 2008, GDP grew at a rate of 5.1%, based on rising private consumption, corporate investment, and the EU funds inflows. Poland was the only country within the EU that could maintain positive GDP growth throughout the crisis. It is because Poland’s economy is more closed than other EU members and also in the last five

⁹⁵ Slovak Statistical Office, Yearbook of Foreign Trade of Slovak Republic, 2009, p. 19

years before 2008 Poland experienced more than 5% growth on average.⁹⁶ Moreover, Poland still has its own monetary policy to influence the economic situation as it is still not a member of the Eurozone.

Central Statistical Office of Poland reports that the value of GDP was 337 bn zlotys in 1995, which increased to 924 bn zlotys in 2004 and to 1343 bn zlotys in 2009. In terms of dollar value, GDP was 139 bn, which rose to 252 bn and to 430 bn respectively (see Appendix 4.6).

Poland has followed the path of economic liberalization since 1990 and today it is one of the great examples of success stories among transition economies. However, because of its large population of more than 38 mil. its GDP per capita is still below the EU average. But it increased significantly from 8.810 zlotys in 1995 to 24.215 zlotys in 2004 and 35.210 zlotys in 2009. GDP per capita in dollar was 3.603 which went up to 6.610 and further to 11.311 correspondingly.

2.3.2 Currency and inflation

Polish national currency remained until today as zloty even after the collapse of the communist regime. Liberalization reforms of 1990 removed almost all price controls and substantially reduced the production subsidies which led to the magnifying effects of the pre-existing inflationary forces together with increasing imbalances in the fiscal and monetary accounts. The hyperinflation made the zloty worthless. In 1991, according to the World Bank report, 1 dollar was exchanged for 10.583 zlotys. It further depreciated and 1 dollar was 13.631 in 1992, 18.145 in 1993 and 22.730 in 1994. Hence, the National Bank of Poland had to reintroduce the zloty in 1995.

New coins and banknotes were issued that replaced the old Polish zloty. 1 new zloty was equal 10.000 old zlotys. The original zloty exchange rate against dollar was 2.4 in January 1995.⁹⁷ The rate was higher in 2000 at 4.3 but appreciated to 3.6 in 2004. Zloty had appreciating trend as 1 dollar equaled 2.4 zloty in 2008 but next year it slightly depreciated to 3.1 and again appreciated to 3.0 in 2010. Depreciation of zloty exchange rate in 2009 caused imports fall stronger than exports which contributed to the reduction in the current account deficit.

⁹⁶ Moritz Orendt, Consequences of the Financial Crisis on Europe - bilgesam.org

⁹⁷ Encyclopedia of Nations, Poland-Money - <http://www.nationsencyclopedia.com>

Polish exchange regime was gradually liberalized but remained under certain control of the National Bank until today. Fixed rate system was replaced by crawling-peg regime in 1991. This system was supposed to increase the effectiveness of the monetary policy and to lower the inflation rate, by pegging the rate to euro and dollar currency basket. Finally in 2000 Poland adopted the floating exchange rate system.⁹⁸

The inflation (CPI) figures by the World Bank show that the country was in deep crisis in 1990 that experienced hyperinflation of 585.8%. The inflation although remaining relatively high slowed down to two-digit rate of 70.3% in 1991, to 28.3% in 1995 and further 11.6% in 1998. It finally reached one-digit level of 7.1% in 1999 as a result of reintroduction of the zloty, tightening of monetary and fiscal policies and also decline in food prices.⁹⁹

Once lowest inflation level of 0.8% in 2003 was achieved the policy of inflation targeting was adopted. So far it has been a successful tool. National Bank of Poland uses this tool to keep the inflation under the rate of 2.5%. However, inflation figure was above the target at 3.5% in 2004 as oil prices and other commodity prices increased in world markets. Since the year 2001 the highest rate observed was 4.2% in 2008 as an impact of the economic downturn in the world economy but this declined to 2.6% in 2010 (see Appendix 4.7).

2.3.3 Foreign Trade

Poland reoriented its trade flows from the former CMEA countries towards the Western markets especially the EU after the dismantling of the centrally planned system. The system of foreign trade was liberalized and regional and bilateral agreements were signed with several blocs of countries such as the EU and CEFTA. The liberal trade reforms eliminated quotas and the requirements of licenses and concessions for conducting foreign trade activities. Support of international organizations such as OECD, IMF, World Bank and WTO was important for Poland during the transition period.

According to the IMF the value of Polish exports grew from 13.6 bn USD to 22.8 bn USD and its imports from 8.4 bn USD to 29 bn USD during 1990-95.¹⁰⁰ According to the WTO, import growth exceeded export growth throughout the 1990s. Trade balance incurred a deficit of 11 bn USD in 1997, which represented larger deficit as compared to 1996 (8 bn USD), the National Bank of Poland reports.

⁹⁸ National Bank of Poland, Annual Report 2000

⁹⁹ Inflation.eu – worldwide inflation data, Poland - <http://www.inflation.eu>

¹⁰⁰ International Monetary Fund, International Financial Statistics Yearbook 1999

Volume of exports grew at 18% in 2004, which fell to 6.8% in 2008 as the demand in export markets contracted during the global crisis. Polish foreign trade turnover grew significantly from 38.6 bn USD in 1994 to 161.9 bn USD in 2004 and further to 382.2 bn USD in 2008. Share of foreign trade turnover in GDP represented 39% in 1994, which then gradually increased to 64% in 2004 and 73% in 2008.¹⁰¹

Despite export growth was higher at 7.2% than the imports (1.7%) the trade balance was still in deficit (-13.1 bn USD) according to statistics of 2000. The factors behind the export growth were the rise in the global demand and the positive effects of the export-oriented foreign direct investment in Poland.¹⁰² The Statistical Office of Poland figures for the period of 2000-2010 indicate that Polish trade balance has been negative for the whole period with the lowest deficit of 12.1 bn USD in 2005 and the highest deficit of 38.6 bn USD in 2008. The trade deficit was lower in 2009 as compared to 2008 due to the decline in trade deficit with Russia, China and also some of the EU members.

Drop in economic activities of world economies in 2008 contributed to a slowdown in Polish trade as well. Value of exports rose by 12.5%, which, according to the National Bank of Poland, was the slowest growth since the EU accession. Value of imports on the other hand grew higher at 15.7%.

Since Poland became the EU member it adheres the EU Single Market and its own foreign trade policy was conformed to the EU Common Commercial Policy. It develops its own trade policy within the framework of the EU Common Commercial Policy and respects its principles of EU exclusive competences.

Territorial Structure

Poland's reorientation of its trade towards the Western economies, mainly the EU members gave a lot of trade opportunities and increased a healthy competitiveness of the Polish exporters and the quality of Polish goods respectively. Already in the early 90s half of Polish foreign trade was done with the EU which then increased to 89.9% in 2000 and 91.1% in 2008.¹⁰³ Imports from the EU grew faster at 20.3% in 1996 and the exports were up only by 12.3% which produced a trade deficit of more than 9 bn USD.

The trade integration with the EU however made Poland vulnerable to changes in Europe. In 1992-93 Europe's recession caused Polish exports decline and the trade deficit

¹⁰¹ Ondrej Skubna, Lubos Smutka, Selected Central European Countries' Foreign Trade Development, 2009

¹⁰² National Bank of Poland, Annual Report 2000

¹⁰³ Ministry of Economy of Poland, Poland 2009 Report on Foreign Trade

rise, the World Bank report of 1994 provides. The share of foreign trade with the EU has had an increasing trend as Poland's goal was to integrate fully with the EU in all aspects. Germany has been Poland's most important trade partner since the beginning of 90s. France and Italy are also Poland's major trade partners within the EU taking second and third place with their share in Poland's total trade.¹⁰⁴

From the exports perspective 59.4% of the Polish goods went to the EU countries in 1997. The EU represented 70% of the Polish exports in 2000 and 80% in 2010 provided by the Central Statistical Office of Poland. The increasing EU dominance position was largely due to the Poland's accession to the EU.

Growth in both exports and imports slowed down in 2000 causing the EU share to decline temporarily. Yet, exports grew faster than imports so their trade deficit was reduced.¹⁰⁵

Among the EU members Poland's largest revenues came from exports to Germany which amounted to about 8.3 bn USD that was over 30% of Poland's total exports' value in 1997. In 2010 exports to Germany amounted to 26% (see Appendix 4.8). CEFTA countries made up 10% of the total exports in 1997, which declined to 8.4% in 2000. Exports to the former USSR were 9.4%.

In terms of imports 65.7% of total imports came from the EU countries in 1997, which shrank to 61.2% in 2000 and remained at around 60% in 2010. Imports' value from Germany equaled 11.5 bn USD which was a 19.2% rise compared to 1996.¹⁰⁶ Germany was responsible for 21.7% of total imports in 2010. Imports from CEFTA members increased slightly from 6.6% to 7.1% during 1997-2000. Russia was the second main trading partner until 2009 when replaced by China, constituting 8-10% of total imports particularly supplying majority of oil and gas imports for Poland. Price increase in these commodities led to the trade deficit with the former USSR in general in 2000.¹⁰⁷

Commodity Structure

Polish export goods comprise mainly passenger cars, engines, parts and accessories for passenger cars, furniture, television receivers, tires and refined copper as stated by the Central Statistical Office. It further provides that Poland's most important export commodity

¹⁰⁴ Central Statistical Office of Poland, Concise Statistical Yearbook of Poland 2010, Foreign Trade, p. 385

¹⁰⁵ National Bank of Poland, Annual Report 2000

¹⁰⁶ National Bank of Poland, Annual Report 1997

¹⁰⁷ Central Statistical Office of Poland, Concise Statistical Yearbook of Poland, 2010

category by SITC has been machinery and transport equipment (see Appendix 4.9). It made up 21% of exports in 1995 which further increased to 38.7% in 2004 and to 41.5% in 2010. Manufactured goods classified chiefly by material were the second main export commodity category, which constituted 27.5% of total exports in 1995 and declined to 23.4% in 2004 and to 20.3% in 2010. Miscellaneous manufactured articles share was stable at 20% in exports until 2000 and then fell to 15% in 2004 and to 12.6% in 2010. Agriculture has been important in Poland's domestic income but its share continuously reduced due to the high concentration on industry and also the rising environmental issues connected to the erosion of earth and water. Despite its declining share in foreign trade activities the value and volume of agricultural products has been continuously increasing.¹⁰⁸ Hence, food and live animals share has been 7-10% in exports. Chemicals and related products accounted for 6.2%-7.9% in exports. Export share of mineral fuels had declining tendency with 8.2% in 1995, 5.5% in 2004 and 3.8% in 2010. Crude materials in exports represented 4.5% but contracted to 2.6% and further to 1.9%. Share of beverages and tobacco and also animal and vegetable oils were moderate, below 1% throughout the period, except for 2010 when beverages and tobacco made up 1.4% of total Polish exports.¹⁰⁹

Poland mainly imported passenger cars, parts and accessories to passenger cars, medicaments and petroleum oils.¹¹⁰ Also in terms of imports to Poland commodity category of machinery and transport equipment has been leading, although, its share shrank to 34.1% in 2010 from 38% in previous years. In the second place imports of manufactured goods classified chiefly by material represented 20-21% during 1995-2005 but declined to 17.8% in 2010. Share of miscellaneous manufactured articles in imports has been at around 9-10%. Food and live animals have floated between 4% and 8% in imports with no major change. Poland imported more chemicals from abroad than it exported, as it needed them for the production of its export goods. Hence, this commodity category made up 15% of total imports in 1995, which fell to 14.1% in 2004 and then remained stable. Moreover, share of mineral fuels, lubricants and related materials in imports represented more than 9% throughout the analyzed period. Imported crude materials made up 5.4% in 1995 but then remained under 3.5%. Beverages and tobacco and also category of animal and vegetable oils did not reach even 1% of total imports to Poland (see Appendix 4.9).

¹⁰⁸ L. Smutka, R. Selby, *Visegrad Group of Countries: Agrarian Foreign Trade Development*, 2009, pp. 66, 67

¹⁰⁹ Central Statistical Office of Poland, *Concise Statistical Yearbook of Poland*, 2000, 2005, 2010

¹¹⁰ Central Statistical Office of Poland, *This is Poland*, 2011

2.4 Hungary

Hungary transitioned to market economy from the centrally planned one in 1990 together with the other V4 countries. However, Hungary had a severe problem with growing public deficit and high foreign debt that amounted to 15 bn USD in 1993. The government of Hungary had to issue austerity measures in 1995 to decrease the public deficit and to be able to pay off its short-term debts. The amount of gross external debt reached USD 98.5 bn in 2008, which was almost 100% of GDP.¹¹¹

Collapse of CMEA caused contraction of the foreign markets for Hungary, which respectively resulted in a strong fall in the volume of the external trade. Price liberalization exposed the country to global prices and made the imports more expensive than exports. Re-orientation of the foreign trade towards the EU and CEFTA countries was one of the most important structural adjustments after the break-down of the old communist regime. The goal to become EU member encouraged Hungary to establish the preferential trade with the EU through the Europe Agreement long before the actual accession.

Also high unemployment was an ongoing issue together with the two-digit level inflation throughout the 1990s. Significant inflows of foreign capital helped the development of manufacturing, financial and economic services sectors as Hungary was the first among the V4 to open its economy for FDI and became its top receiver among the V4. In addition, privatization of state-held assets was responsible for significant amount of income for the country.

Hungary joined OECD in 1996 and the EU in 2004. The country is also a member of WTO, IMF, WB and NATO.

2.4.1. GDP

The Hungarian economy had to experience a crisis of transformation in the early 90s due to the loss of guaranteed export and import markets of former CMEA. Also, a strong fall in agriculture and the lack of capital for production and its modernization were also the problem areas.

The GDP growth rate was at – 12% in 1991, which then reached -3.1% in 1992. In 1994 economy revived with a positive growth of 2.9%. However, the stability was the issue. The growth again came down to 1.5% in 1995 and further down to 0.7% in 1996. The austerity measures of the Hungarian government in 1995 to restructure and stabilize the

¹¹¹ Matyas Benyik, Gross and Net External Debt, 2011 - <http://www.cadm.org>

economy improved the fiscal and external balance situations. But the immediate impact was a sharp decline in domestic demand and a slow-down in GDP growth which in the end managed to remain positive at 0.7% in 1996.

By 1997 economy was recovered and the growth was at 3.9% which then remained stable above 3.8% for next few years. Hungary joined the EU with the growth rate of 4.5% but this could not be maintained for long-term. Since 2004 Hungary has not experienced a high rate of growth. For the next two years after the EU accession it remained at 3.2-3.6% but then slowed down to 0.8% in 2007-08 and went further down to negative rate of -6.7% in 2009. It was mainly due to the government measures of 2006 that included raising taxes, decreasing subsidies and restructuring the public sector, which aimed to reduce government deficit. These measures lowered the domestic consumption which in turn led to the decrease in the economic growth.

During 2008-09 Hungarian economy was challenged by the internal measures to improve the situation of balance of payments and by the effects of the crisis on the real estate market. In addition, the global financial crisis was spreading on a large-scale with its impact in almost all sectors of the economy. For the purposes of financial stabilization Hungary reached an agreement in 2008 with IMF, WB and EU to receive a 25 bn USD rescue package. In return Hungary agreed to commit to advance fiscal consolidation and reform the financial and banking sectors.

2010 GDP growth rate was very low but positive at 1.2%. Development of GDP value in terms of Hungarian forints has been upward moving rising from 2.3 tr in 1990 to 20 tr in 2004 and further to 26 tr in 2009. Correspondingly, GDP value in dollar was 36.6 bn and increased to 102 bn and further to 128.7 bn (see Appendix 5.4).

The population of Hungary makes about 10 mil. people. GDP per capita in terms of dollar grew from 3.533 in 1990 to 10.165 in 2004 and further to 15.525 in 2008. Hungarian Statistical Office provides GDP per capita in Hungarian forint, which contains much more numbers as 201.399 in 1990.¹¹² It respectively reached 2 mil. in 2004 and to 2.6 mil. in 2008. However, due to the crisis, GDP per capita fell to 12.886 dollars (2.5 mil. forints) in 2009.

¹¹² Hungarian Statistical Office, National Accounts Hungary, 2010, p. 13

2.4.2. Currency and inflation

“Forint” remained as a national currency of Hungary even after the collapse of the communist regime. The Central Bank of Hungary from 1997 has issued new banknotes. The circulation of “filler” coins ceased in 1999. 100 filler equals 1 forint.

Yearly average forint exchange rate against dollar provided by the Central Bank was 63 in 1990, which increased to 105 in 1995. After further devaluations the rate went up to 282 in 2000 but then appreciated to 202 in 2004. The rate in 2009 was recorded at 202 and in 2010 at 208.

In 2001 forint became a fully convertible currency. Hungary’s obligation issuing from the Accession agreement with the EU is to join the EU Monetary Union and replace forint with euro¹¹³. However, it has been struggling to meet the Maastricht criteria with its unstable economy and high government deficit.

Hungary has used several exchange rate systems since the change of the regime. During 1990-95 adjustable pegged exchange rate regime was in effect in which exchange rate of forint was pegged to a foreign currency basket with an often changing composition and weighting. As a part of the austerity package of 1995 the exchange rate regime was changed to a crawling peg in a narrow fluctuation band of +/-2.25% which then was widened to +/-15%. In this system forint was devaluated at a pre-announced date and then its extent was compared to the currency basket. The weight was often changed between euro, German mark and US dollar. However, since 2000, the currency basket was only euro.

From 2001 crawling peg was abandoned and narrow band exchange rate system was established which reduced the monetary authorities’ control in the exchange rate movements and exchange rate volatility became intense with wider band (fluctuating from 234.69 to 317.52 against euro in the beginning but this was shifted later). In 2008 floating exchange rate system was adopted which provides better conditions for the Central Bank to achieve its inflation target. Within this regime forint exchange rate floats freely in relation to euro as a reference currency and the forint exchange rate movements are determined by the forces of supply and demand.¹¹⁴

Until 2001 the Central Bank followed the monetary policy that aimed to achieve a sustainable decline in inflation assisted by the money supply and exchange rates system. However, the Central Bank implemented new monetary policy strategy, the system of

¹¹³ The same obligation applies to all newly acceded EU countries (in 2004 and in 2007).

¹¹⁴ Ministry of Foreign Affairs of Hungary, Hungary scraps HUF band - How did it come to this? - <http://www.mfa.gov.hu>

inflation targeting in 2001. The inflation target was set at 7% first and then changed to 3%. The target maybe revised after each 3-5 years. The primary objective of the Central Bank is to achieve and maintain price stability.¹¹⁵

Hungary experienced accelerated two-digit hyperinflation in the early 90s although the extent was not as in Poland. In 1991 the price rise reached 35% which followed by moderate rise in the next three years. Average annual growth rate of consumer prices during 1990-94 was 25.5%.¹¹⁶ Due to the government measures of 1995 to restore the economic balance the inflation again accelerated. It was at 28.2% in 1995 then its basic trend was decelerating except for its deviation in some years. In 1999 the rate was better at 10% compared to 14.3% in preceding year but still high due to the increase in regulated prices, restructuring of the pharmaceutical price subsidy system and rapid raise in food prices and world energy prices.¹¹⁷

The inflation rate remained in one-digit range starting from 2000 at 9.8%. The deviation from the decelerating trend was in 2004 when the rate was higher at 6.8% compared to the rate of 4.7% in the previous year. It fell to 6.1% in 2008 compare to 8% in 2007 when food and oil prices increased extremely quickly and in an unpredictable manner. Inflation objective has not been yet achieved and the rate was recorded at 4.9% in 2010. Average annual rate of inflation for the period of 1990-2009 was 13.8%.¹¹⁸

2.4.3. Foreign Trade

Hungary's foreign trade underwent a structural transformation during the last two decades. The reorientation of the trade direction towards the EU and CEFTA countries was the focal point. The collapse of trade with the former CMEA countries caused an immediate shock as the changeover to the global market prices in the former ruble trade area made the imports much more expensive than exports.

The motivation to integrate into the EU was expressed in the trade relations already in the early 90s. At first the Europe Agreement with the EU removed most of trade restrictions between Hungary and the EU which served as a preparation for the EU accession. Trade share with the former socialist countries almost halved between 1990 and 1996.

¹¹⁵ National Bank of Hungary, Annual Report 2001, pp. 23-24

¹¹⁶ Hungarian Central Statistical Office, Hungary 1989-2009, pp. 15-16, 73

¹¹⁷ National Bank of Hungary, Annual Report 2000, p. 12

¹¹⁸ Hungarian Central Statistical Office, Hungary 1989-2009, p. 73

The share of imports was 34% of GDP in 1991, which rose to 41% in 1996 while exports made up 33% of GDP and increased to about 40% according to the WTO. It shows that the Hungarian economy became considerably more open especially in relation to the EU and CEFTA.

The growth in imports was faster than in exports but both grew at a slower pace at first followed by a dynamic two-digit rise during the period of 1997-2000 with the deviation in 2001. Furthermore, the upward trend of growth in both imports and exports was interrupted by the global financial crisis that stroke in 2008, owing to which the volume of both considerably fell.

The trade balance had suffered a deficit until 2009. The average trade balance for the period of 1990-94 was – 172 bn forints and – 472 bn forints for 1995-99. In 2004 the deficit amounted to 986.6 bn forints which then considerably fell to 29 bn forints. Finally the trade balance reached high surplus of 1 tr forints and 1.5 tr forints in the last two years.¹¹⁹

Territorial Structure

Hungary's trade has been concentrated on the EU members since the collapse of the former CMEA trade. Germany replaced the former Soviet Union and became the largest import and export partner for Hungary.

WTO reports that between 1990-98 exports to the EU rose from 45% to 73%. In 2000 the EU accounted for 83.6% of the total exports but contracted to 78-79% in 2008-09 due to the decline in external demand during the global financial crisis.

Exports to Germany represented 36% of total Hungarian exports in 1998. This however shrank to 26% in 2008 due to the lower demand on the German market.

Other top customers of Hungary in 2008 were Italy (5.3%), Austria (5%), France (4.7%), the UK (4.5%) and Sweden and Netherlands each accounting for 3-4%.

The share of the CIS countries fell from 6% to 2.4% in exports in 1998-99. During 1990-96 CEFTA countries' share experienced a slight increase in exports from 1.7% to 2.4%.

Exports to the American continent contracted as its share was 5-6% in 1990s and reduced to 3% in 2009 (see Appendix 5.7). The USA and Canada have been the most important trading partners on the American continent.

Regarding imports to Hungary the EU's share between 1990 and 1998 went up from 49% to 64%. Imports from the EU further moved up to 66% in 2000 and to 68% in 2009 (see

¹¹⁹ Hungarian Statistical Office, Hungary 1989-2009, pp. 34, 84

Appendix 5.7). Imports from Germany made up 28% in 1998. Economic recession took it down to 25% in 2008. CIS countries fell from 7.7% to 6.8% in imports for the period of 1998-99. CEFTA countries made up 7.2% of total imports in 1990, which slightly increased to 8.7% in 1996.

Other main suppliers of Hungarian imports in 2008 were Russia (9%) with its oil and gas, Austria (6%), the Netherlands (4.5%), France (4.4%), China (5.7%) and Japan (2.6%).¹²⁰

After the EU accession the trade with the other V4 countries and also with Romania took a new drive.¹²¹ Imports from Asia rose from about 6% in early 1990s to 17-18% throughout the last decade. According to the 2008 statistics provided by the Hungarian Investment and Trade Development Agency, this growth was mainly related to the trade with China, the most significant Asian supplier, and Japan. Trade relations with the American continent slowed down as imports declining from more than 5% in 90s to 2.8% in 2009.

Commodity Structure

Machinery and transport equipment took the lead in the commodity structure with the increasing share, being a driving force of Hungarian export growth since the changeover to market economy. Its share grew considerably and the share of all other commodity categories became smaller as observed in the other V4 countries commodity structure of their foreign trade during the last two decades.

In the early 90s the share of machinery and transport equipment was at about 30% in exports. This main commodity group represented 57.2% of exports in 1999, 62.4% in 2004 and then remained at 60% in the last three years. Manufactured goods were in the second place with the 30.7% share in exports in 1999 which then has had a stable share of 26-27.5% since 2004. Another important commodity group, food, beverages and tobacco together made 8% in 1999 of total exports and further no major change took place. Fuels export made up only 1.6% but slightly rose to 1.8% (2004) and further to 3.7% (2008). Crude materials' share was as low as 2.5% of the total exports in 1999 and remained below that in 2000s.

Share of machinery and transport equipment was more than 30% in imports in 90s. With growing tendency this commodity group represented 50.2% of the total imports in 1999 and 52.8% in 2004. It then remained between 49-52%. Imports of manufactured goods accounted for 38.5% in 1999. But it went down to 34.3% in 2004 and further to 31.7% in

¹²⁰ Hungarian Investment and Trade Development Agency, Foreign Trade - <http://www.itdh.com>

¹²¹ WTO, Trade Policy Review, Hungary 1998 - <http://www.wto.org>

2010. Imports in food, beverages and tobacco were about 3% in 1999 but increased to 5.5% in 2009. Hungarian imports in fuels are considerably higher than its exports. Fuels import represented 6.1% in 1999 and reached 12.7% in 2008 as the demand for fuels increased in Hungarian market. Imports of crude materials have been low at 2% (see Appendix 5.8).

2.5. Countries comparison from perspectives: domestic production, foreign trade, FDI

Poland's economy is the biggest economy among the V4 with its GDP of USD 468.5 bn in 2010. GDP values reached USD 192 bn for the Czech Republic, USD 129 bn for Hungary and USD 87 bn for Slovakia.

All the V4 members are industrial countries. However, service sector is the main component of the GDP of all the V4 countries. Service sector is responsible for 59.5% of the GDP in Czech Republic, 61.8% in Slovakia, 64% in Poland and 65.9% in Hungary as of 2010 figures.¹²²

Industry is 38.3% of the total GDP in the Czech Republic. Motor vehicles, metallurgy, machinery and equipment, glass, armaments are main types of Czech industrial products. Slovakia's industrial sector accounts for 35.6% of GDP specializing in the production of metal and metal products; food and beverages; electricity, gas, coke, oil, nuclear fuel; chemicals and manmade fibers; machinery; paper and printing; earthenware and ceramics; transport vehicles; textiles; electrical and optical apparatus; rubber products. Poland is less industrial, relative to the Czech Republic and Slovakia. Its industry makes up about 32% of GDP and the production is concentrated on machine building, iron, steel, coal mining, chemicals, shipbuilding, food processing, glass, beverages and textiles. Hungarian industry has the smallest share in its GDP as 30.8%. It focuses on mining, metallurgy, construction materials, processed foods, textiles, chemicals especially pharmaceuticals and motor vehicles.

These countries have their own production of electricity, oil and gas but are very limited and are not able to secure sufficient supplies for consumption. In electricity production Poland ranks in the 23rd place in the world, the Czech Republic in the 35th, Hungary in the 56th and Slovakia in the 64th. Poland has the highest oil production among the V4 ranking 69th place in the world followed by Hungary 74th, the Czech Republic 83rd and

¹²² Global Finance, Country profile - <http://www.gfmag.com/>

Slovakia 97th. In natural gas production Poland is the leading among the V4 once again however in the 49th place in the world. ¹²³

Almost 98% of total consumption of natural gas in Slovakia is imported into the country and Russia accounts for almost 100%. The Czech Republic imports 91% of total consumption in gas and two thirds of the gas imports come from Russia and the rest from Norway. Russia supplies more than 90% of gas imports for Poland and 80% for Hungary. This heavy dependency of the V4 countries on Russia led to the energy crisis that took place in January 2009 when Russia suspended energy supplies due to the dispute between Russian Gazprom and Ukrainian Naftohaz Ukrainy over the gas prices, supplies and debts owed by the Naftohaz Ukrainy. The V4 countries learned their lessons and in an effort to prevent such crisis in the future they have been working on the projects such as “Nabucco” to diversify transport routes for oil and gas and also find alternative suppliers. ¹²⁴

Although the share of agricultural trade is very low it is a traditional part of the economic activities of these countries. Czech Republic is the least agricultural country among the other V4 members currently its agriculture making up only 2.2% of GDP. In this sector the country produces wheat, potatoes, sugar beets, hops, fruits; pigs and poultry. Slovakia has similar agricultural production capacities and the share of agriculture in GDP equals 2.7%. Poland is the most agricultural country among the V4 and its share of agriculture in GDP represents 4% producing potatoes, fruits, vegetables, wheat; poultry, eggs, pork and dairy products. Even though the share of agricultural products in foreign trade is very low, only Poland among the V4 has a comparative advantage in the exports of agricultural products at a world level. ¹²⁵ Hungarian agriculture makes up 3.3% of GDP and produces wheat, corn, sunflower seed, potatoes, sugar beets; pigs, cattle, poultry and dairy products.

The V4 countries’ foreign trade activities have had similar trends and structure. As mentioned already above the V4 countries’ foreign trade was concentrated on the CMEA countries before. Economic reforms that had been implemented in the transition process and the subsequent events associated with the preparation for the EU accession and then the accession to the EU influenced the structure of their economies and also resulted in the changes in the territorial and commodity structure of their foreign trade.

¹²³ CIA, The World Factbook 2010

¹²⁴ Visegrad.info, Energy Security of Visegrad Region - <http://www.visegrad.info/energy-security-infrastructure/factsheet/energy-security-of-visegrad-region.html>

¹²⁵ L. Smutka, R. Selby, Visegrad Group of Countries: Agrarian Foreign Trade Development, 2009, p. 70

Right after the break-down of the central planning regime and in the transition to market economy they decided to refocus their trade direction towards developing countries in particular the EU. By joining the EU in 2004 they committed to comply with the principles of the EU common market and EU laws and regulations. Free movement of goods and services principle is the most important feature in the trade between the EU members as the goods and services move freely without tariffs and other trade barriers only with the exceptions of the limitations in the sake of public good, health and security.

For the comparison of foreign trade of the V4 countries UN COMTRADE statistics are used below. The EU share in the individual V4 countries' total trade turnover accounted for 74.6% in the Czech Republic, 72% in Slovakia, 67.6% in Poland and 66.7% in Hungary according to the 2008 statistics.

During the last two decades, the V4 countries foreign trade exchange values have significantly increased. In 2008 share of foreign trade turnover in GDP has reached 133% in the case of the Czech Republic, in Slovakia 150% and in Hungary 140%. With the exception of Poland where its external trade turnover in GDP equaled only 70% which shows that Poland's economy is less open than the other V4 countries (see Appendix 6.1).

Exports are very important economic driving force in these countries as the export value in their GDP value makes a significant share. The highest share is in Slovakia reaching 74% in 2008 followed by Hungary with 70%, the Czech Republic with 67% and the lowest share in Poland with 33%.

In the commodity structure the share of processed industrial products was dominant in all V4 countries reaching for example as high as 91% of exports and 82% of total imports in the Czech Republic according to the 2008 data. Share of fuels and raw materials in the total foreign trade of the V4 members is in the range of 10%-15% for imports and 5%-7% for exports. The share of agrarian and food products had constantly reduced in trade although its value steadily increased.¹²⁶

The contribution of Foreign Direct Investment (FDI) in the economic growth of the V4 countries since the collapse of centrally planned economy has been enormous. Hungary and Poland were already relatively open to FDI allowing the existence of few foreign joint ventures already in the late 80s. The other two members of the V4 had stricter control of the national economy and the existence of any foreign firm was a very rare case. However, all V4

¹²⁶ O. Skubna, L. Smutka, Selected Central European Countries' Foreign Trade Development, 2009, pp. 27-28

members extensively opened up their economy after the 1990 with their liberal economic reforms that prepared favorable conditions for foreign investment.

Privatization was a major source of FDI inflows in the V4 during the transformation process. These countries needed a capital, technology and management skills offered by the foreign investors. Foreign investors have been attracted to the V4 because of their well-educated and skilled labor force, relatively low tax and production costs, their convenient geographical location and access to the EU common market which gives more opportunities with almost no barriers and high protection under superseding EU laws.

To compare the inflows of the FDI of the V4 the World Bank statistics are used. Hungary managed to attract massive amounts of FDI in 2006 (66 bn USD) and in 2007 (70.8 bn USD) which put Hungary in the first place among the V4 as the recipient of highest inflows of FDI. In 1993 inflows equaled 2.3 bn USD and reached 3 bn USD in 2002 with decreasing trends in some years in between. Poland was in the second place with FDI inflows of 1.7 bn USD in 1993 and 4.1 bn USD in 2002 and with the highest inflow of 23.6 bn USD in 2007. In the Czech Republic it grew from 654 mil. USD in 1993 to 8.4 bn USD in 2002 and the highest inflow of 11.6 bn USD was received in 2005. Slovakia was the recipient of 199 mil. USD, which then grew to 4.1 bn USD for the same period and the most FDI came in 2006 at an amount of 4.2 bn USD. The global economic crisis had an impact on the decision-making processes of the companies as they needed more time for cautious investment decisions and the flow of FDI fell significantly.

Main investor countries for the Czech Republic were the Netherlands (29.6%), Germany (13.7%), Austria (12.1%), Luxembourg (6.8%) and France (6.3%), the Czech National Bank reports. Almost 5.800 foreign-owned companies have been operating in the country as of 2009. In the Czech Republic FDI inflows were placed mainly in financial services followed by real estate. Also trade, motor vehicles, electricity, gas, transport and communication sectors were the attractive economic activities for FDI in the Czech Republic.¹²⁷

Sources of FDI flows to Slovakia in 2008 came mainly from the Czech Republic (54.2%), Cyprus (20.4%), Poland (4.5%), Austria (4%), France (3.5%), South Korea (3.1%), Germany (3%) and Italy (2.6%) according to the statistics by the National Bank of

¹²⁷ The Czech National Bank, Foreign Direct Investment in 2009, pp.. 7-8

Slovakia.¹²⁸ The main sectors of FDI were machinery, industrial production, electrochemical, financial services, IT, trade, transportation and telecommunications.

21.7% of FDI in Poland originated from Germany followed by France (13.95%), Luxembourg (12.7%), Sweden (9.5%), the USA (9.1%) and Austria (5.9%) as main investing countries in 2009. Most FDI in Poland were made in food processing, real estate, business services, financial services, trade, electricity, gas and water supply and transport equipment manufacturing.¹²⁹

Germany is the most important investor for Hungary accounting for 25% of all FDI followed by the Netherlands with 14% and Austria with 13% in 2009. These countries have had strong and stable economic relations with Hungary. The USA (5%) is the biggest non-European investor in Hungary and many investments come through, for example, the Netherlands originate also actually from the USA. Among Asian countries Japan and South Korea are the most important investing countries. Sectors of interest were manufacturing, electricity, gas, water supply, services and other.¹³⁰

¹²⁸ National Bank of Slovakia, Foreign Direct Investment Statistics - <http://www.nbs.sk/en/statistics/balance-of-payments-statistics/foreign-direct-investment>

¹²⁹ Polish Information and Investment Agency, Foreign Direct Investment in Poland - <http://www.paiz.gov.pl>

¹³⁰ Hungarian Investment and Trade Development Agency, Foreign Direct Investment - <http://www.itdh.com>

3. Trade Perspectives of the V4 countries

3.1 The V4 handling the crisis

The negative consequences from the last global crisis affected the V4 countries as well indeed. Danes Brzica, the expert at the Institute of Economic Research of the Slovak Academy of Sciences, states that among the negative affects of the crisis is certainly the continuing process of company relocations, general decline in industrial production, stagnation of the real-estate sector and cautious consumer behavior. He adds that the challenge is therefore to avoid the further decline of national economies, promote investors' confidence and to prepare for future opportunities when recovery begins.¹³¹

From long economic development perspective prolonged crisis requires the countries that suffered most to make structural reforms and adjustments more quickly. This way the economic growth in long-run may be positive providing they implement the necessary economic policies successfully. But the economic adjustments may have negative social consequences as they may concern some austerity measures that affect the citizens' financial position. Each of the V4 countries has formulated different economic strategies under the changed national and international conditions. They had to make considerable adjustments to cope with the last economic crisis. Their economic strategies are different from the recent past in two aspects according to Tamas Novak, a researcher at the Institute for World Economics of the Hungarian Academy of Sciences. Firstly, achieving fiscal balance is a priority number one and secondly, economic growth should not be based on easy credit but rather on savings. These aspects meant that they had to improve their budget position or their external equilibrium. They did not start the implementation at the same initial position and their new economic policy in this direction affecting them differently. The implementation of these policies in short-run results in the decline in economic output and increase in unemployment.

However, the tools that are used in their economic policies are different in Hungary on one side and in the other three countries on the other side with more or less similarities. Currently, Hungary's aim is to cut its government deficit by increasing revenues based on extra sectoral taxes and directing private savings in the pension system to the state budget. Simultaneously cutting corporate and household income taxes is also the main concern. With

¹³¹ Jana Liptakova, Business Prospects in V4, August 2009, published in Slovak Spectator

these policies budget situation may improve in short-run but it is unforeseen what will happen in the long-run. After 2012-13 Hungary plans to reform the sustainability of its public finance and transfer systems such as pensions. The other V4 countries stabilizations measures are mainly based on spending.

The confidence in the economic measures taken by the V4 and their possible improvements are reflected in the ratings of their government bonds. Hungarian government bonds have been rated as junk or very low and the other three countries' ratings are as high in the A category as reported by the Fitch.¹³² However, Hungarian fiscal situation is expected to improve, which will be discussed in more detail below in subchapter 3.5.

Global crisis consequences have changed the international strategies of global companies. Many of them are in search of more cost-cutting to recapture their competitiveness as the demand is expected to be lower than its level before the crisis. Hence, it may result in the closing-down or relocation of the high-cost production plants to lower-cost locations. Nevertheless, V4 countries are relatively low-cost locations and their capacities are very competitive and possess modern technology for example in car industry. Thus, from optimistic thinking, as a result of cost optimization of the multinational companies V4 can expect some additional foreign investments in the near future. It has to be mentioned here that Hungary although having trouble with the economic and fiscal stability, it has recently received several important FDI projects of the big car producers. This shows that the V4 countries are attractive locations for the multinational companies and it is simultaneously an element of a promising export-oriented growth.¹³³

As Visegrad countries are highly linked to the wider European economy the future economic development in the rest of Europe will play a significant role in the stabilization and recovery process of the V4. Once the important trade partners will recover Visegrad countries' economies will follow the same trend as well says Jan Fidrmuc, from the Department of Economics and Finance at Britain's Brunel University, in Uxbridge. However, he adds that potential main threat is collapsing or shrinking of the Eurozone of which probability of happening is very low but not zero any longer. Depending on how this will evolve, it may affect the V4 economies. It may worsen and prolong the recession or actually redirect the investment from other emerging and unstable economies of Europe. Moreover,

¹³²Fitch Ratings - http://www.fitchratings.com/index_fitchratings.cfm

¹³³ Tamas Novak, Divergence in Economic Paths, December 2010, published in the Slovak Spectator

analysts say that the role of the national governments in the implementation of the reforms is essential in the future economic improvements.¹³⁴

3.2 Global and Euro Area Trends

Global and the euro area trends have significant impact on the future economic development in the V4 countries as the openness of their economies is very high and they are dependent on export earnings in their economic growth. But this is less applicable for the case of Poland. Poland with its less open economy and big domestic market can just rely on the domestic demand and the external demand has less importance for it. The recovery of the EU in particular of Germany has a high importance, as Germany is the largest trade partner for the V4 countries. It can be said that trends in German market predetermines the developments in the V4 countries.

Global economic growth slowed down this year due to the high oil prices mainly resulting from the political unrest in the Middle East and North Africa and the natural disaster that hit Japan in March as reported by the Economic Intelligence Unit. Most commodity prices should remain high this year, owing to the robust demand and ongoing supply shortages. Modest decline is predicted in 2013. Private consumption declined in developed countries and manufactures pulled back in Europe and China. Industry continued to growth but in a slower pace than in the beginning of this year as the high energy prices resulted in decline in production and consumption. Primarily thanks to the growth in private consumption in developed countries and growth in domestic demand in developing countries the world economy in 2011 is expected to grow by 4.1%, higher contribution coming from the emerging economies. Modest acceleration to 4.2% is expected for 2012. However, IMF forecast is more optimistic as global GDP growth will be 4.3% for this year and 4.5% for next year. High levels of public and private debts in Europe and the US, higher unemployment trends and still malfunctioning property markets in many economies continue to be hurdle for more positive economic prospects.¹³⁵

In the euro area domestic demand should be the source of economic growth, which is expected to be around 2% until the end of 2012. The imbalance between Germany and other members of the euro zone continue to pose a risk on the EU growth. Ongoing public debt problems in some of the Eurozone members such as Greece, Ireland and Portugal that carry a

¹³⁴ Jana Liptakova, Tackling the Crisis, December 2010, published in Slovak Spectator

¹³⁵ The Economist Intelligence Unit, Global Forecasting Service – <https://www.gfs.eiu.com>

risk of contagion may require more financial aid in which Germany's contribution has been the highest. Germany's GDP is projected to grow by 3.1-3.4% this year owing to growing foreign trade activities, investment and private consumption but decline to 2% at the end of 2012.¹³⁶ Germany's exports were boosted this year especially thanks to the accelerating high demand from the developing countries.¹³⁷

3.3 The V4 Economic Outlook

According to the IMF forecasts the real GDP growth for 2011 is expected to be 3.8% in Poland, 3.6% in Slovakia, 2.8% in Hungary and 1.7% in the Czech Republic. Future Polish economy depends on the international situation and public finance reform says Lukasz Pokrywka, coordinator of the economy and finance program at the Kosciuszko Institute, the Krakow-based think tank. Vladimír Vaňo, chief analyst for Volksbank Slovensko believes that Slovakia will become a regional leader in regard to economic recovery provided the implementation of fiscal consolidation will be carried out successfully. Slovakia has to be more prudent about its public finance. Hungary's economic performance will be mainly influenced by the external environment and global economic growth says Gergely Tardos, head of research at OTP Bank. Hungary with its small and open economy is heavily dependent on exports and German economic growth. Though the domestic demand is expected to revive and have its small contribution in the growth. Moreover, the structural reforms should be successfully implemented in public administration, labor market and healthcare system.¹³⁸ The Czech economy will slow down to 1.5% this year, the Czech National Bank predicts, as a result of a slowdown in domestic demand, which was caused by the fiscal consolidation and low investment in inventories, and also the external growth. However, the growth for the Czech Republic is estimated to be 2.8% in 2012 owing to the potential increase in domestic demand but lower contribution of foreign trade.¹³⁹

It is assumed that the external demand continues to be the main source of the GDP growth in Slovakia in the short-run. Consumption growth is estimated to be modest due to the government measures, rising prices and low consumer confidence. However, contribution to the growth from domestic economy is expected to come mainly from private consumption as

¹³⁶ Czech National Bank, Global Economic Outlook, June 2011, p. 4

¹³⁷ Hungarian National Bank, Quarterly Report on Inflation June 2011, p. 39

¹³⁸ Jana Liptakova, Tackling the Crisis, December, 2010, published in Slovak Spectator

¹³⁹ Czech National Bank, Inflation Report, Q2 2011

the government will be gradually reducing its spending. The domestic demand will gradually improve accompanied by the gradual reduction in the contribution of the net exports to the GDP growth. But external demand is projected to have a positive effect indeed. The forecasts of National Bank of Slovakia for GDP growth are 3.6% in 2011, 4.7% in 2012 and 5.3% in 2013. Exports and imports recorded a robust growth and will remain unchanged in the years ahead. Surplus in trade balance is expected to increase annually though the positive effect of external demand was outweighed by the global prices of the raw materials on the import side this year. In 2012-13 this adverse effect is believed to lessen and the trade balance will improve. The growth in exports is projected to be stronger than in imports in coming years due to the moderate increase in domestic demand. Exports should have a faster growth pace in 2012 when the production of a new car model is launched. Industrial production will continue to have positive growth providing also positive results in the labor market. Inflation (CPI) is anticipated to decelerate in 2012 -13 provided that the effects of the indirect tax and high prices of oil and other commodities will reduce. The estimated rates are 4.1% for this year, 3.3% for the next year and 2.5% for 2013 in Slovakia. Notwithstanding the unemployment rate is expected to decrease in the following years it is still high at the estimated rate of 13.5% in 2011, 11.8% in 2012 and 11% in 2013.¹⁴⁰

The Hungarian National Bank projects the GDP growth to be slightly higher than 2.5% both for 2011 and 2012. In 2013 the growth is estimated to be above 3%. Exports remain as the main driver behind the economic growth. Domestic demand will expand in moderate terms. The reason for weak internal demand is the government's fiscal measures that are expected to limit consumption growth. Exports will be decelerated by the slowdown in the external demand however it will be offset by the new large-scale manufacturing investment projects. On the one hand the potential austerity measures in fast-growing emerging economies and on the other hand fiscal consolidation plans in developed countries will have influence on the demand for Hungarian goods. However, the dynamic growth in Asian countries stimulates growth in Germany and this will have a positive effect in Hungarian exports as well. Reduction in government spending is to have a negative effect on the household consumption as there will be downsizing and wage freezes in public sector. According to the forecast of Hungarian National Bank inflation will be determined by weak internal demand and cost shocks. Commodity prices on global markets will keep the inflation rate high in short-run. The forecast for 2011 inflation is 3.9% and it may be down at 3.6% in

¹⁴⁰ Slovak National Bank, Medium-Term Forecast, Q2, 2011

2012 even without further monetary tightening programs. In 2013 the rate below 3% should be achieved which would meet the Hungarian National Bank's inflation targeting of 3%. Industrial production has had a positive performance since the beginning of 2009 due to the robust global demand and it remains to be the main source of the recovery. However, natural disaster in Japan contributes to the temporary slower growth of industrial production and exports respectively. This is connected with the potential worldwide shortages of Japanese-made top quality spare parts. Owing to this, several car producers in Europe had to restrict their production in order to prevent such shortages. Nevertheless imports are projected to grow by two-digit level due to the exports and also big manufacturing projects that have high import demand in machinery.¹⁴¹

Strong public investment in 2011, partly related to EU-financed infrastructure projects and the 2012 football championships, a recovery in business investment in 2012 and robust private consumption are expected to bring almost 4% expansion in Polish economy for 2011 and 2012 according to the economic forecast by the OECD.¹⁴² The factors such as the depreciation of zloty exchange rate, postponement of fiscal policy tightening, interest rates cuts that have had positive impact on the Polish GDP growth in the last two years will fade away gradually over the next following years. Foreign exchange rate is expected to be relatively stable. Tax burden will increase and public spending will fall in certain sectors. Hence, the National Bank estimates are a bit pessimistic as it projects the GDP growth at about 3% for 2012-13. The main driving force for Polish economic growth is the domestic demand. However, as a result of the measures to cut public deficit, reduction in the EU funds, decline in consumption growth and halting the inventories, the domestic demand may decelerate in the coming years which in turn will take down the overall GDP growth. The consumption growth is low due to the high inflation and low growth in wages and other social transfers. Industrial production may have a weaker expansion as the recent slowdown gives a signal, although it's upward trend in the contribution to the rising employment. The inflation rate (CPI) will be higher in 2011 in comparison to the last year because of the high increase in energy and food prices and also change in the VAT rates from January 2011. The CPI projection for 2011 is about 4%, which should fall close to the level of inflation target (2.5%) in 2012.¹⁴³

¹⁴¹ Hungarian National Bank, Quarterly Report on Inflation, June 2011

¹⁴² OECD, Poland Economic Forecast Summary - <http://www.oecd.org>

¹⁴³ National Bank of Poland, Inflation Report July 2011

The economy of the Czech Republic is very sensitive to the economic trends in Germany. The recession of the Czech economy was due to the fall in export demand mainly from Germany and its revival will be also due to the restoration of German demand as said by David Marek, an analyst for Patria Finance.¹⁴⁴ Czech National Bank provides the below projections in its inflation report from the second quarter of 2011. It is expected that net exports will be lower next year but all components of domestic growth will increase and this will effect higher growth for 2012. The element of higher domestic demand will be connected with the growth in wages and also loosening government measures. Government consumption will remain low for 2011 but its slight increase is expected to contribute to the economic growth next year. As regards to inflation the forecast is close to 2%, the inflation target of the CNB. Due to the planned increase in the reduced VAT rate from 10% to 14% in 2012 the inflation rate may be 1.1% higher than the inflation target next year. In terms of trade the declining trend of imports will continue this year due to the weak growth in exports and inflows of foreign capital, which are very import-intensive demand factors. Yet faster export growth and lower import growth will be maintained until the domestic demand and investment will accelerate in the end of this year and next year. Industrial production has been rising since last year with the increase in number of employed persons and their wages. Growing trend in industry has been supported by the manufacture of mainly export goods such as motor vehicles, trailers and semi-trailers, machinery and equipment and electrical equipment. New industrial orders received in 2011 offer positive expectations in this sector of economy.¹⁴⁵

3.4 Assessment of fulfillment of Maastricht criteria

Slovakia is not evaluated on the basis of Maastricht criteria as it entered the Eurozone already in 2009 being the first and the only one for now among the V4 countries. However, it has to be mentioned that by this Slovakia exposed itself more to the ongoing changes in the Eurozone. The continuous problems of government debt in several Eurozone members pose a high risk on the other Eurozone members including their high financial contributions in the rescue packages. Adoption of euro was much more important and beneficial for Slovakia than for the other V4 countries as it has smaller size of economy and higher foreign trade dependence. The main benefit of the euro adoption is that it eliminates transaction costs in

¹⁴⁴ Jana Liptakova, Tackling the Crisis, December, 2010, published in Slovak Spectator

¹⁴⁵ Czech National Bank, Inflation Report, Q2 2011

euro transactions as both companies and households have to bear such costs in exchanging domestic currency into foreign currency. Also there is no exchange risk against euro which is of high importance in relations with main trading partners whose currency is euro as well.¹⁴⁶

As stipulated in Article 121 of the Treaty establishing the European Community, before joining the Eurozone, the Czech Republic, Poland and Hungary, just like any other EU Member States not using the euro, have to fulfill the convergence criteria – also known as the Maastricht convergence criteria. This was adopted in order to secure the long-term sustainability of the common monetary policy and the ability of the Eurozone members to function without their own monetary and exchange rate policies.¹⁴⁷

There are budgetary and monetary aspects of the Maastricht criteria. The budgetary aspect requires that the government deficit must not exceed 3% of GDP and government debt must not exceed 60% of GDP. Monetary aspects are related to the price stability, long-term interest rates and exchange rate stability. Only one-off fulfillment of the criteria is not sufficient. These criteria have to be fulfilled with a positive sustainable trend.

Inflation rate must not be higher than 1.5% above the reference value i.e. the average inflation rate in three EU member states with the best price stability. In respect of stability of long-term interest rates, returns on ten year government bonds must not be higher than 2% above the reference value i.e. the average returns in three EU members with best price stability. Last but not least the currency of the member state has to be part of ERM II (Exchange Rate Mechanism) for at least two years during which the exchange rate should stay close to the central parity without severe tensions and devaluations.¹⁴⁸

European Commission's Convergence Report from May 2010 is used to evaluate the fulfillment of the Maastricht criteria by the three members of the Visegrad Group. The European Commission's European Economic Forecast of Spring 2011 together with the V4 countries' National Banks' projections is used to demonstrate the expectations in the fulfillment of the convergence criteria by the countries being analyzed.

From the budgetary aspect of the convergence criteria public deficit in the Czech Republic has not been in line with the reference value of 3% for long-term and the European Council recommended fixing the excessive deficit by 2013. The public deficit to GDP ratio in the Czech Republic reached 4.7% in 2010 which is an improvement compare to 5.9% in

¹⁴⁶ National bank of Slovakia, The Effects of Euro Adoption on the Slovak Economy, March 2006, p. 5

¹⁴⁷ Czech Ministry of Finance, Fulfillment of Maastricht Criteria – www.mfcr.cz

¹⁴⁸ European Commission, Economic and Financial Affairs, The Euro - http://ec.europa.eu/economy_finance/euro/index_en.htm

2009. According to the European Commission Spring 2011 Forecast, public deficit will be 4.4% in 2011 and 4.1% in 2012 assuming that no policy change will take place. Poland also has excessive public deficit which accounted for 7.9% of GDP in 2010 and is anticipated to be lower at 5.6% of GDP in 2011 according to the National Bank of Poland (NBP). The Council recommended Poland to improve the situation by 2012. The Commission's forecast is 5.8% for 2011 which is more pessimistic than the forecast made by the NBP. It should further fall to 3.6% in 2012 as an expected result of fiscal consolidations measures. According to the Hungarian Central Statistical Office Hungary's public deficit reduced from 4.5% of GDP in 2009 to 4.2% in 2010 although Hungary still does not fulfill this criterion. The Council recommended putting an end to the existing excessive deficit by this year latest. The Commission's forecast is very positive that Hungary will reach a surplus of 1.6% this year. However, the situation may reverse in 2012-13 due to the planned tax-cuts.

On the basis of government debt criterion, although the government debt of the Czech Republic has had growing tendency over the past few years it has been below the reference value for the long-term. It was registered at 38.5% of GDP in 2010 and is expected to rise further to 41.3% this year and 42.9% in 2012. Hence, the Commission found that the Czech Republic does not fulfill this criterion owing to growing tendency of its public debt though it is below the reference level of 60%. Poland's government debt reached 55% of GDP in 2010 but is projected to modestly increase to 55.4% in 2011 and again decrease to 55.1% in 2012. However, level of certainty in these projections is very limited due to the high exchange rate volatilities in valuation of the part of the debt that is foreign-denominated. Hungary's government debt is well above the reference value accounting for 80.2% of GDP in 2010 but is expected to gradually decrease to 75.2% this year and further to 72.7% in 2012.¹⁴⁹ It can be said that Hungary will not be able to meet this requirement at least for next couple of years. Both Poland and Hungary do not fulfill this criterion according to the Commission.

For the assessment of the average inflation rate in the three members of the V4 countries March 2010 reference value is used. In March 2010, the reference value was 1.0%, calculated as the average of the average annual inflation rates in Portugal, Estonia and Belgium plus 1.5%. From January 2010 onwards, average annual inflation was below the reference value in the Czech Republic. The corresponding inflation rate in the Czech Republic was 0.3%, i.e. 0.7% below the reference value. Poland's average inflation rate was

¹⁴⁹ The European Commission, European Economic Forecast Spring 2011 - http://ec.europa.eu/economy_finance/eu/forecasts/2011_spring_forecast_en.htm

3.9% which was 2.9% above the reference value. In Hungary the situation was even worse. The corresponding rate stood at 4.8% well above the reference value. Hence, Poland and Hungary do not fulfill the criteria on price stability and are unlikely to do so in the near future. But the Czech Republic is expected to remain below the reference value in 2011 and 2012 as well excluding possible changes in indirect taxes and new government measures.

Regarding the average long-term interest rate, the reference value of 6% as of March 2010 was given by the average long-term interest rates in Portugal, Estonia and Belgium plus 2%. The corresponding rate in the Czech Republic in that month was 4.7% which was 1.3% below the reference value. What is worth mentioning is that the Czech Republic has been fulfilling this criterion since the EU accession. In Poland the rate was at 6.1%, slightly above the reference value of 6% however, Poland had been below the reference value between November 2005 and December 2009. The corresponding rate in Hungary has been above the reference value since the EU accession and it was 8.4% as of March 2010 which is 2.4% above the reference value hence Hungary is still not compliant with this requirement.¹⁵⁰

None of the three countries that are being analyzed participate in ERM II and therefore it is not possible to evaluate the exchange rate criteria. Their governments have decided that ERM II membership shall last as short time as possible so that the convergence requirement concerning exchange rate stability is fulfilled. Therefore, the exchange rate of these three countries' currency will not be pegged to the euro until about two years prior to the planned adoption of the euro.¹⁵¹

The Commission considers that none of the three countries fulfill the conditions for adopting the euro based on the assessment of their fulfillment of the Maastricht criteria and also other factors such as legal compatibility that is to say there are some incompatibilities and imperfections in the integration of their Central Banks into the European System of Central Banks (ESCB).

There are no set dates for the Eurozone accession for none of the three countries of the Visegrad Group. Because of the Greek crisis and imbalances caused by the global economic crisis the three countries became increasingly hesitant about joining the Eurozone. The Czech President Vaclav Klaus thinks that the whole project of common European currency failed long time ago. The main Czech political parties declared that the earliest possible date for the

¹⁵⁰ The European Commission, Convergence Report May 2010

¹⁵¹ The Central Bank of Iceland, Outlook for expansion of EMU in coming years, July 2008, Monetary Bulletin, Appendix 4, p. 2

euro adoption is 2015 or 2016.¹⁵² Adopting euro is not an absolute priority for Poland any more. The Polish Prime Minister Donald Tusk yet believes that Poland will be prepared to join the Eurozone in 2015. It can be said that most important decision is the political will of their governments, which, for instance, is completely missing in the Czech Republic at the moment despite the fulfillment of the convergence criteria for long-term. It is also reflected in their fiscal discipline. Czechs and Poles delay the process because they are convinced that their independent central banks can defend their economies in the case of crisis and not be depended on the overloaded European Central Bank. They can rely on their own currencies which have proved to be relatively stable. Robert Holman, the board member of CNB says that it would be very risky and unwise to set a date for adoption of euro. The President of NBP thinks that the Eurozone has to be stabilized before Poland joins.¹⁵³ Gyorgy Matolcsy, the Hungarian minister of economy says that Hungary is not in a hurry to join the Eurozone. The Prime Minister of Hungary, Viktor Orban can not imagine that Hungary will join the Eurozone before 2020.¹⁵⁴

3.5 The V4 Cooperation in Foreign Direct Investment

According to the Slovak Investment and Trade Development Agency (SARIO), in 2009 aggregate FDI inflows into the V4 region reached 12 bn euros and created 24.000 jobs. Majority of the investments came from the other EU members such as Germany, Great Britain, France and Austria. Also, the USA, Japan and South Korea have been active investors in the region. Most FDI flow has gone into the car industry, manufacturing, electro-technical and service sectors. The last economic crisis however, had a negative effect on the FDI inflows as the foreign investors were concerned about the economic stability of the region they became more cautious about their future investment strategies. Hence, the attractiveness of the V4 significantly declined which now requires some individual as well as joint efforts to regain the investors' interest and confidence in the region and in the individual V4 countries.

According to the Doing Business 2011 report prepared by the World Bank, Slovak Republic offers the best business environment among the V4. Its rating on the ease of doing

¹⁵² Visegrad.info, Euro Versus National Currencies in Visegrad Countries - <http://www.visegrad.info/monetary-policy--euro/factsheet/euro-versus-national-currencies-in-visegrad-countries.html>

¹⁵³ Bloomberg Business Week, Joining the Euro: Poland and the Czechs Delay, January 6, 2011 - <http://www.businessweek.com/>

¹⁵⁴ Hungarian News Agency (MTI), Governing party MEP pushes euro adoption for Hungary, February 23, 2011 - <http://www.realdeal.hu/20110223/governing-party-mep-pushes-euro-adoption-for-hungary>

business among 183 countries was 40th place in 2010 which fell to 41st place in 2011. All other three V4 countries made progress this year compare to the last year: the Czech Republic moved from 82nd to 63rd, Poland from 73rd to 70th and Hungary from 52nd to 46th.¹⁵⁵ Over the next two-three years Eastern and Central Europe will be the third most attractive destination for foreign investors according to the Business Attractiveness Survey 2010 from Ernst & Young. The V4 region all together occupies 534.000 square kilometers with the population of about 64 mil. people. Attractiveness of the V4 countries comes from the fact that all four of them are the members of the EU and they offer high productivity but lower costs of labor relative to other countries in the region. But nowadays cost reduction is not the priority criteria for many foreign investors when choosing the investment destination; they are more looking for knowledge and skills in a developed business environment. To refer to statistics, the V4 countries together recorded 100 investments between 2003-2009 in research and development and design and development according to Hajnalka Harsfalvai, the expert from the Hungarian Investment and Trade Development Agency. More than 50% of the investment was targeted at ICT primarily at software development. Besides, automotive engineering and life sciences in the Czech Republic and Hungary proved very good performance.

The experts of SARIO, Tímea Nemesová and Jana Franeková say that they expect FDI in the V4 countries especially in the sectors of manufacturing, science and research and services.¹⁵⁶ They add that the V4 region remains attractive for foreign investors not only because of its strategic location but also because of its quality human resources, favorable economic potential, positive business environment, cost-effectiveness and continually improving living standards. Also, V4 countries offer relatively lower rates of taxes compare to Western Europe. However, it has to be noted that the V4 countries will be facing a strong competition from the new EU members, Bulgaria and Romania and also from the fast growing emerging economies such as India, China and Russia where production costs are much lower than in the V4. The multinational companies who are purely interested in saving labor costs are now expected to move away their operations from the V4 further towards the East. Pietro Andrea Podda, the author of the article “Foreign Direct Investment: Visegrad Countries at a Crossroad” says: “these countries have, in general, reached a level of development that put them beyond that state where they were considered as markets endowed with low workforce and suitable for the location of low value-added and labour-intensive

¹⁵⁵ The World Bank, Doing Business 2011, p. 4

¹⁵⁶ Jana Liptáková, Investing in the V4, December 2010, published in Slovak Spectator

activities. This result can easily be considered as progress. However, this occurrence represents also a further challenge because the Visegrad countries will compete less and less with other markets which attract MNEs moved by the need to save on costs. In other words, despite the wages in the Visegrad area being on average lower than in Western Europe, they are still higher than in other CEECs, let alone certain Asian countries". But these competing destinations may not be attractive enough for foreign investors operating in most technology intensive sectors, to move away their projects there from the V4 countries. Hence, it can be said that the V4 countries can be attractive to those investors who are engaged in high value-added and knowledge intensive activities because the V4 countries' qualified labor is still cheaper than in Western Europe. For such investors safety and efficiency of legislative/institutional environment is also a very important criterion which suggests that the V4 countries need to make some efforts to improve in this field because they are still behind average Western standards. In this respect the Western European countries are strong challenge for the V4. Corruption level in the country is also very important aspect of the investor's decision and the V4 in this matter is more attractive than the above mentioned competing countries in the East. However, for some investors cost saving may be more important than safe institutional environment and corruption level. Usually low-cost destinations seem to have less efficient and less safe institutions and higher level of corruption.¹⁵⁷

Considering the existing and potential challenges the V4 countries would need to create a joint strategy to expand the awareness and attractiveness of the region among distant foreign investors. SARIO confirms that the V4 countries together could be assessed as a dynamic region. Moreover, it would be better that the V4 countries present the region as a whole when establishing contacts with the countries outside the EU and share their risks in trade with them.

However, this kind of cooperation is to a very limited extent in reality as there is a strong competition even among the V4 countries themselves. Such joint cooperation in the V4 region has its upsides and downsides states Stepanka Filipova, the director of the marketing and PR department at the CzechInvest. The V4 countries together can offer more of everything that foreign investors are looking for: bigger market, more skilled human resources, better logistics and etc. Yet, such cooperation would need harmonization of several laws and regulations in related fields, including investment incentives, in all the four

¹⁵⁷ Pietro Andrea Podda, Foreign Direct Investment: Visegrad Countries at a Crossroad

countries. The fact is that foreign investors would eventually place their investment in one of the V4 countries. This would bring new opportunities to the country's labor market, subcontractors and tax income for the state budget. Hence, Stepanka Filipova believes that such joint cooperation is not realistic at least in coming years due to the fact that they compete for such benefits. Other analysts from Investment Agencies also think that it is unlikely that the V4 will act in a coordinated fashion as one region in this matter.¹⁵⁸

Hungarian ambassador to Slovakia, Antal Heizer, believes that competition in the region is natural but it is crucial that they understand that together they have an appeal for foreign investors who are looking at the whole region when selecting their new homes. Vladimir Galuska, the Czech ambassador to Slovakia says that V4 competition is mainly in trade and economics but they can closely cooperate in other areas such as building infrastructure which can make the whole region more attractive for foreign investors. Antal Heizer points out that a rapid development of car industry in Slovakia has opened several opportunities for Hungary as well, for example, through the spread of sub-supplier network their annual turnover reached 5 bn euros which represents a 40% growth.¹⁵⁹

¹⁵⁸ Jana Liptakova, Investing in the V4, December 2010, published in Slovak Spectator

¹⁵⁹ Beata Balogova, V4 Stands Together to Attract Investors, December 2010, published in Slovak Spectator

Conclusion

The V4 countries, Czech Republic, Slovakia, Poland and Hungary have gone through common historical path in their economic development. Thesis proves with detailed analyses of economic indicators in the V4 that their economic development was halted during the communist regime which lasted from the end of the WW II till 1989-90. Their transition to market economy has brought them to the high level of economic development that they currently stand at. During the communist era their economies were centrally planned which meant a strict governmental control over production, prices, exchange rates and foreign trade. Almost all sectors were in state ownership and state monopoly had been enforced. Hence there was no competition and these economies generally could not have competed with their low quality of goods on Western markets. Foreign transactions were limited and majority of their trade exchanges was done with the CMEA countries. Machinery and transport equipment were leading commodities in both their exports and imports. Their domestic production was concentrated on heavy industries that demanded excessive energy that they had to export from the Soviet Union. Chronic commodity shortages did not allow people to buy what they wanted and their living standards remained quite low in comparison to the West. Pace of economic growth was disturbed by frequent downturns that required some structural reforms for full and long-term recovery but such reforms could not be successfully implemented as general policies of their governments' were restrictive. With an exception of Czechoslovakia, the governments of Poland and Hungary took foreign loans in an effort to improve the economic situation. Although it led to short-term growth it caused serious economic downturns which consequently shied away the growth. They simply could not pay off their foreign debts with their low export earnings. Their export earnings were needed to buy the necessary imports for their production of export goods.

However, such hard communist regime could not be tolerated any more and their existing opposition took an active participation in the change of regime. The V4 countries were freed from the communist regime in 1989-90 as a consequence of a revolutionary movement that led to the round-table talks between the communist and opposition and followed by the free elections.

After the collapse of the communism, the V4 countries shifted to the establishment of a market economy and implemented several reforms to restructure their economies. Foreign trade was liberalized and it found its natural trade partners in the EU countries. Their

common goal of becoming EU member was reflected in their structural reforms. Sharp decline in trade with the CMEA was followed by growing share of the EU. Since the beginning of the 90s the EU has accounted for the majority share of their foreign trade. In terms of commodity structure of their trade, the main change was the increasing share of machinery and transport equipment and decreasing share of other commodity categories. Their economic growth accelerated although they had to face deep economic downturns in several years. Today the V4 countries are the members of the EU and the progress they have made in their economies is incomparable with the communist period.

However, the last global economic crisis caused imbalances in their economies as the external demand significantly declined. Their recovery also depends on the external economic trends because their small size and open economies (except for Poland) are depended mainly on exports. Also necessary government reforms, such as fiscal consolidation measures, have been taken up for stabilization purposes and for the future euro adoption. Increasing FDI inflows will contribute to the economic growth but there are challenges that the V4 countries could overcome more efficiently in a coordinated fashion.

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Appendix 1: Czechoslovakia – Statistics

1.1 Czechoslovakia, GDP Value, 1970-1989 (in US dollar)

Year	in million	Year	in million	Year	in million
1970	92592	1977	116073	1984	128313
1971	95756	1978	117489	1985	129313
1972	99142	1979	118488	1986	131700
1973	102445	1980	121763	1987	132366
1974	106165	1981	121153	1988	135308
1975	109301	1982	123512	1989	136418
1976	111050	1983	125371		

Source: Maddison A

1.2 Czechoslovakia, Commodity Structure of Foreign Trade, 1980-1990

<i>Category and SITC No.</i>	<i>1980</i>	<i>1985</i>	<i>1989</i>	<i>1990</i>
<u>Exports</u>				
Food and livestock	1.1	1.03	4.63	5.46
Beverages and tobacco (1)	0.7	0.63	0.35	0.41
Crude materials (2)	3.4	2.57	3.68	3.74
Minerals, fuels (3)	3.6	2.52	5.19	4.36
Animals and vegetable oils (4)	0.0	0.02	0.13	0.34
Chemicals (5)	5.3	5.00	7.55	9.03
Mfd. goods classified by material (6)	15.4	14.8	22.44	25.63
Machinery and transport equipment(7)	59.5	60.3	44.39	39.16
Miscellaneous manufactures.(8)	10.82	11.2	9.67	10.40
Other transaction and goods	0.6	1.8	1.96	1.46
Total		100.0	100.0	100.0
<u>Imports</u>				
Food and livestock (0)	18.7	13.4	6.94	5.63
Beverages and tobacco (1)	1.1	0.8	0.71	0.80
Crude materials(2)	16.9	16.4	8.76	8.32
Minerals, fuels (3)	2.2	2.82	17.31	14.32
Animal fats and vegetable oils (4)	0.4	1.1	0.36	0.56
Chemicals (5)	16.3	16.7	9.34	10.19
Manufactured goods classified by material (6)	11.8	12.3	10.42	10.65
Machinery and transport (7)	26.0	28.7	36.95	37.29
Miscellaneous manufactures(8)	4.6	6.6	6.15	9.11
Other transaction and goods	1.9	0.9	3.05	3.13
Total	100.0	100.0	100.0	100.0

Source: The World Bank

1.3 Czechoslovakia, Territorial Structure of Foreign Trade, 1980-1990 (in %)

			1980	1985	1989	1990
			Exports			
CMEA			55.4	58.6	54.9	43.4
USSR			30.8	35.5	30.5	25.2
Other Socialists			6.9	7.5	5.9	5.6
OECD countries			26.9	23.1	31.2	42.4
Developing countries			10.8	10.6	8.0	8.6
Total			100.0	100.0	100.0	100.0
			Imports			
CMEA			56.4	64.2	56.1	44.4
USSR			31.2		29.7	21.6
Other Socialists			6.3	6.4	6.2	6.8
OECD countries			27.0	23.2	31.1	42.6
Developing countries			6.8	5.9	6.6	6.2
Total			100.0	100.0	100.0	100.0

Source: The World Bank

Appendix 2: Czech Republic - Statistics

2.1 Czech Republic, GDP, 1990-2009

Gross Domestic Product (GDP)

Year	GDP at current prices		GDP at constant 2005 prices		Per Capita GDP	Growth rate
	Czech Koruna	US Dollars	Czech Koruna	US Dollars	US Dollars	Percent
1990	664,943,781,617	37,037,343,945	2,421,244,555,846	101,064,509,147	3,595	
1991	800,417,572,710	27,153,509,379	2,140,018,396,333	89,325,924,665	2,634	-11.6
1992	894,771,800,772	31,751,076,705	2,129,178,296,841	88,873,451,026	3,078	-0.5
1993	1,083,422,914,839	37,163,554,652	2,130,496,348,697	88,928,467,470	3,601	0.1
1994	1,255,986,396,752	43,633,238,167	2,177,782,503,149	90,902,225,956	4,226	2.2
1995	1,466,522,000,000	55,255,657,984	2,307,090,239,507	96,299,624,939	5,355	5.9
1996	1,683,288,000,000	62,011,168,451	2,400,006,906,701	100,178,034,222	6,016	4
1997	1,811,094,000,000	57,135,156,593	2,382,466,341,808	99,445,878,283	5,553	-0.7
1998	1,996,483,000,000	61,846,680,469	2,364,383,519,120	98,691,088,109	6,024	-0.8
1999	2,080,797,000,000	60,192,136,075	2,396,054,550,726	100,013,060,008	5,875	1.3
2000	2,189,169,000,000	56,716,549,254	2,483,460,154,394	103,661,433,490	5,547	3.6
2001	2,352,214,000,000	61,842,873,536	2,544,463,021,848	106,207,737,556	6,059	2.5
2002	2,464,432,000,000	75,276,222,794	2,592,727,368,853	108,222,326,511	7,387	1.9
2003	2,577,110,000,000	91,357,722,713	2,686,125,034,594	112,120,813,023	8,974	3.6
2004	2,814,762,000,000	109,524,878,647	2,806,587,943,978	117,149,022,494	10,758	4.5
2005	2,983,862,000,000	124,548,570,554	2,983,862,000,000	124,548,570,554	12,217	6.3
2006	3,222,369,000,000	142,610,569,175	3,186,998,803,301	133,027,648,500	13,948	6.8
2007	3,535,460,000,000	174,214,943,907	3,382,394,252,649	141,183,596,700	16,966	6.1
2008	3,688,997,000,000	216,088,860,685	3,465,728,385,136	144,662,024,014	20,940	2.5
2009	3,625,865,000,000	190,204,322,510	3,321,933,642,989	138,659,926,870	18,344	-4.1

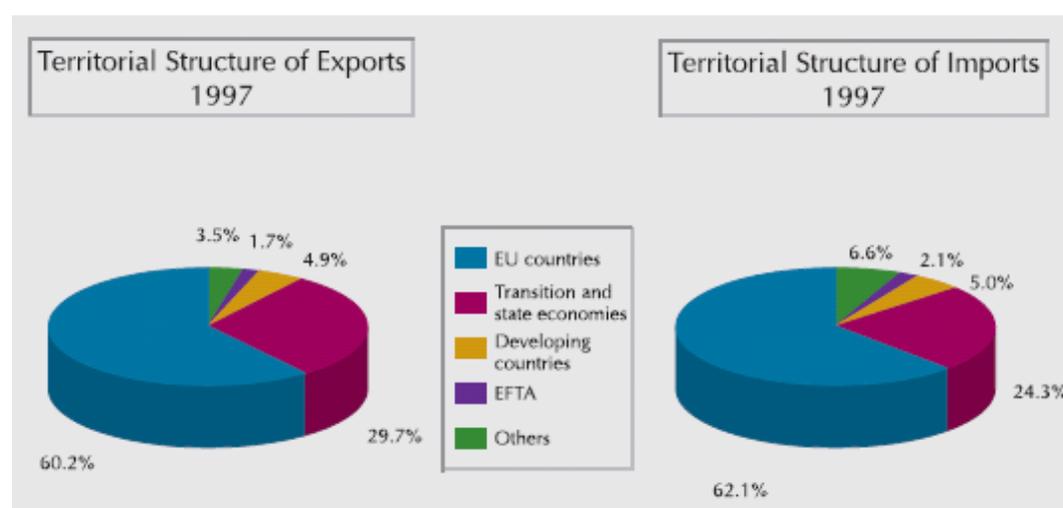
Source: UN National Accounts Statistics

2.2 Czech Annual CPI Inflation Rate (average in %)

Year	1995	1996	1997	1998	1999	2000	2001	2002
Inflation rate (%)	9.1	8.8	8.5	10.7	2.1	3.9	4.7	1.8
Year	2003	2004	2005	2006	2007	2008	2009	2010
Inflation rate (%)	0.1	2.8	1.9	2.5	2.8	6.3	1.0	1.5

Source: Czech Statistical Office

2.3 Czech Republic, Territorial Structure of Foreign Trade



Source: Czech National Bank

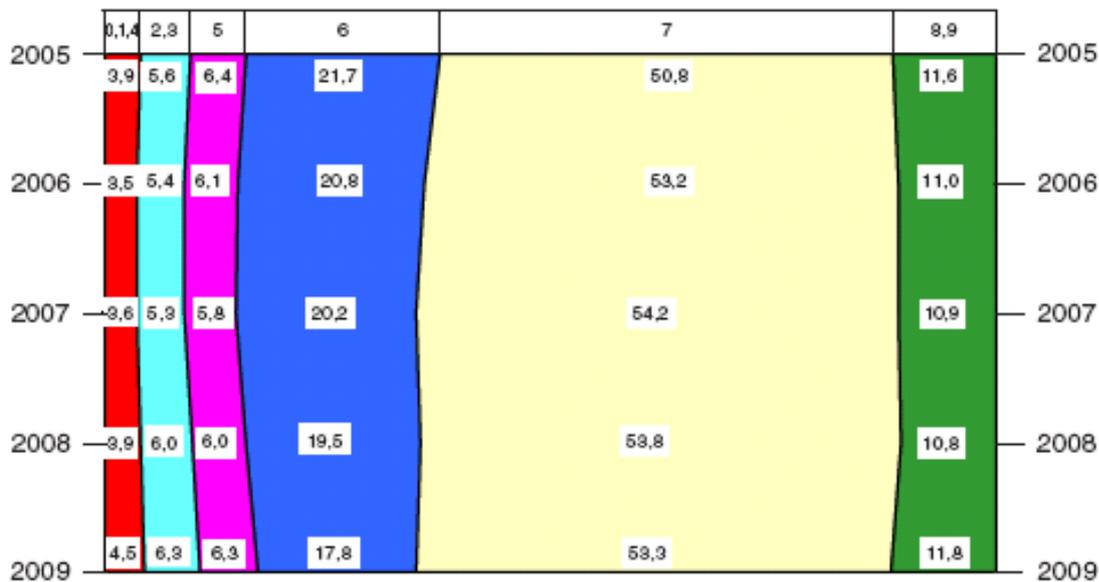
2.4 Czech Republic, regional Structure of Foreign Trade

	2006	2007	2008	2009
Exports, total (CZK bn, FOB)	2 144,6	2 479,2	2 473,7	2 138,6
Developed market economies	1 967,9	2 259,1	2 241,4	1 935,0
EU 27	1 837,1	2 113,6	2 107,9	1 812,0
Germany	685,0	762,3	759,7	694,5
Slovakia	180,5	214,8	227,6	186,9
EFTA	39,7	50,3	46,8	45,6
Developing economies	69,7	84,7	82,5	92,1
European transition economies	22,0	26,1	24,4	18,5
CIS	73,3	92,4	106,3	75,1
Other	10,5	15,9	14,3	17,0
China	9,0	14,0	13,2	15,9
Imports, total (CZK bn, CIF)	2 104,8	2 391,3	2 406,5	1 989,0
Developed market economies	1 674,1	1 896,0	1 817,3	1 498,7
EU 27	1 487,3	1 693,0	1 611,4	1 327,8
Germany	599,4	670,2	643,3	528,6
Slovakia	112,8	127,9	133,3	108,6
EFTA	43,4	37,3	42,0	38,8
Developing economies	117,3	137,6	145,4	137,4
European transition economies	6,3	6,5	8,0	6,0
CIS	173,3	158,0	213,6	133,9
Other	131,4	189,8	217,1	204,9
China	128,2	185,7	212,5	199,9

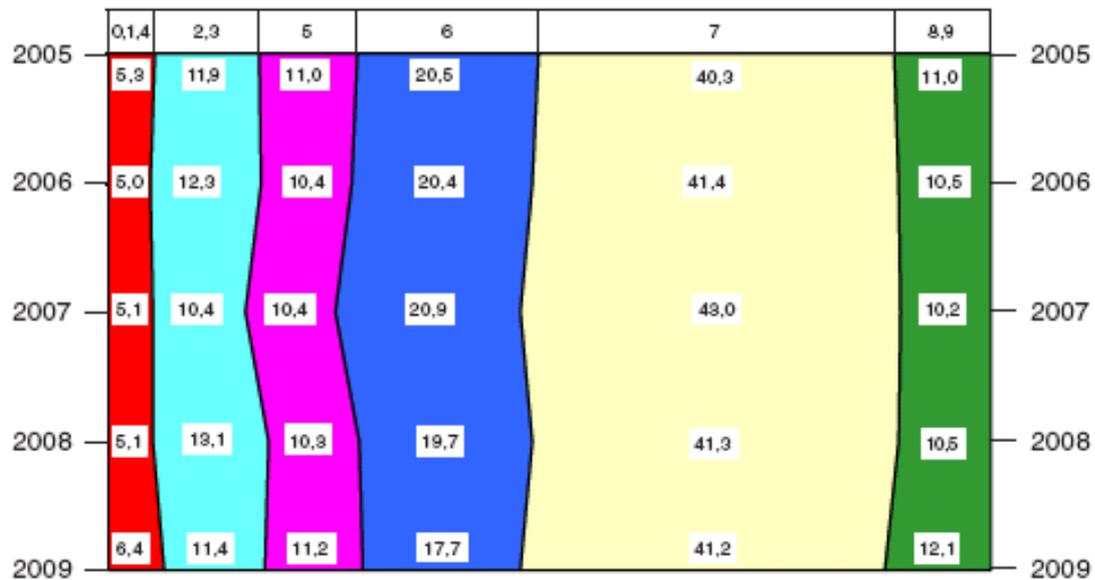
Source: Czech National Bank

2.5 Czech Republic, Commodity Structure of Foreign Trade

Exports



Imports



Legend:

- | | | | |
|---------|--|------|---|
| 0, 1, 4 | Potraviny a živá zvířata, nápoje a tabák, živočišné a rostlinné oleje, tuky a vosky
Live animals, food, beverages, tobacco, oils and fats | 6 | Tržní výrobky tříděné hlavně podle materiálu
Manufactured goods classified chiefly by material |
| 2, 3 | Surové materiály nepoživatelné, minerální paliva, maziva a příbuzné materiály
Inedible raw materials and fuels | 7 | Stroje a přepravní zařízení
Machinery and transport equipment |
| 5 | Chemikálie a příbuzné výrobky
Chemicals | 8, 9 | Různé průmyslové výrobky, komodity a předměty obchodu nezatříděné
Miscellaneous manufactured articles, commodities and transactions not classified |

Source: Ministry of Industry and Trade and Czech Statistical Office

Appendix 3: Slovak Republic - Statistics

3.1 Slovakia, GDP, 1990-2009

Gross Domestic Product (GDP)						
Year	GDP at current prices		GDP at constant 2005 prices		Per Capita GDP	Growth rate
	Euro	US Dollars	Euro	US Dollars	US Dollars	Percent
1990	9,227,900,000	15,484,573,828	33,499,445,506	32,535,823,114	2,946	
1991	10,612,100,000	10,845,564,400	28,628,328,857	27,804,825,712	2,055	-14.5
1992	10,612,100,000	11,344,594,422	26,740,979,193	25,971,766,272	2,141	-6.6
1993	13,654,800,000	13,369,193,217	28,660,652,839	27,836,219,885	2,513	7.2
1994	16,452,500,000	15,467,330,095	30,439,152,042	29,563,559,982	2,898	6.2
1995	19,319,000,000	19,587,252,470	32,835,382,803	31,890,862,390	3,660	7.9
1996	21,527,400,000	21,156,773,719	35,114,590,657	34,104,508,093	3,946	6.9
1997	23,867,400,000	21,389,389,800	36,675,352,558	35,620,374,172	3,984	4.4
1998	26,171,900,000	22,378,035,797	38,274,707,119	37,173,722,781	4,164	4.4
1999	28,109,100,000	20,472,841,881	38,289,148,243	37,187,748,502	3,808	0
2000	31,177,100,000	20,402,691,738	38,813,136,984	37,696,664,537	3,793	1.4
2001	33,881,200,000	21,108,645,420	40,164,627,068	39,009,278,571	3,923	3.5
2002	36,806,700,000	24,463,228,539	42,005,248,005	40,796,953,452	4,546	4.6
2003	40,612,000,000	33,271,146,890	44,011,070,430	42,745,077,745	6,182	4.8
2004	45,161,400,000	42,178,003,262	46,236,995,514	44,906,973,373	7,835	5.1
2005	49,314,200,000	47,895,661,077	49,314,200,000	47,895,661,077	8,893	6.7
2006	55,080,900,000	55,876,122,988	53,505,238,476	51,966,142,974	10,368	8.5
2007	61,555,000,000	75,094,391,291	59,135,036,246	57,433,997,790	13,921	10.5
2008	67,007,300,000	94,500,376,604	62,578,995,503	60,778,890,444	17,501	5.8
2009	63,050,700,000	87,589,472,269	59,586,570,378	57,872,543,396	16,203	-4.8

Source: UN National Accounts Statistics

3.2 Slovakia, GDP growth rate, 1993-2010

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
GDP growth rate (%)	7.2	6.2	7.9	6.9	4.4	4.4	0.0	1.4	3.5
Year	2002	2003	2004	2005	2006	2007	2008	2009	2010
GDP growth rate (%)	4.6	4.8	5.1	6.7	8.5	10.5	5.8	-4.8	4.0

Source: Slovak National Bank

3.3 Slovak Annual CPI Inflation Rate (average in %)

Year	1993	1994	1995	1996	1997	1998	1999	2000	2001
Inflation rate (%)	23,2	13,4	9,9	5,8	6,1	6,7	10,6	12,0	7,3
Year	2002	2003	2004	2005	2006	2007	2008	2009	2010
Inflation rate (%)	3,3	8,5	7,5	2,7	4,5	2,8	4,6	1,6	1,0

Source: Slovak National Bank

3.4 Slovakia, Commodity Structure of Foreign Trade, 2008-2009

v mil. Eur FOB/FOB

Mill. EUR FOB/FOB

Kód SITC	Triedy SITC	Celkový dovoz / Total Import		Celkový vývoz / Total Export		Sections SITC	Code SITC
		2008	2009	2008	2009		
	SPOLU	50 280	38 775	49 522	39 721	TOTAL	
0	Potraviny	2 303	2 184	1 647	1 526	Food & live animals	0
1	Nápoje a tabak	295	327	80	89	Beverages & tobacco	1
2	Surové materiály	1 513	1 008	1 321	932	Crude materials	2
3	Nerastné palivá	6 474	4 586	2 523	1 823	Mineral fuels	3
4	Oleje a tuky	154	136	46	97	Oils & fats	4
5	Chemikálie	4 314	3 690	2 365	1 777	Chemicals	5
6	Trhové výrobky	8 415	5 825	10 185	7 419	Manufactures by material	6
7	Stroje a zariadenia	21 626	16 443	26 668	21 752	Machinery & equipment	7
8	Priemyselné výrobky	5 070	4 435	4 576	4 189	Miscellaneous articles	8
9	Ostatné	116	140	111	117	Others	9

Source: Slovak Statistical Office

Appendix 4: Poland – Statistics

4.1 Poland, GDP and GNP, 1970-1980, (at constant 1977 prices)

Year	Population million (June)	GDP(A) billion zloty	Per Capita GDP(A) zloty	GNP billion zloty	Per Capita GNP zloty
1970	32.5	1,292.0	39,753.8	1,218.3	37,256.9
1975	34.0	1,936.4	56,952.9	2,021.5	59,455.9
1980	35.6	2,112.8	59,348.3	2,115.2	59,415.7
		Rates of Growth (%)			
1970-75	0.9	8.4	7.5	10.7	9.8
1975-80	0.9	1.8	0.8	0.9	0.0
1970-80	0.9	5.1	4.1	5.8	4.8

Source: The World Bank

4.2 Poland, GDP, 1970-1989

Gross Domestic Product (GDP)						
Year	GDP at current prices		GDP at constant 2005 prices		Per Capita GDP	Growth rate
	Zloty	US Dollars	Zloty	US Dollars	US Dollars	Percent
1970	110,659,028	27,664,757,000	379,569,105,877	117,314,498,878	847	
1971	119,253,904	30,630,283,570	407,714,614,897	126,013,511,087	931	7.4
1972	124,625,701	33,865,679,629	426,788,342,158	131,908,682,008	1,021	4.7
1973	134,294,936	40,088,040,609	444,635,456,258	137,424,740,124	1,199	4.2
1974	149,335,969	44,980,713,568	476,252,430,899	147,196,688,047	1,334	7.1
1975	159,005,205	47,893,134,036	504,548,312,811	155,942,176,432	1,408	5.9
1976	177,269,316	53,394,372,289	544,536,761,170	168,301,519,455	1,556	7.9
1977	196,607,787	59,219,212,952	583,124,593,449	180,227,970,097	1,711	7.1
1978	221,318,055	67,066,077,273	614,614,825,224	189,960,745,244	1,920	5.4
1979	249,251,402	62,064,592,131	638,259,888,404	197,268,791,908	1,761	3.8
1980	255,697,559	57,828,320,920	599,964,209,172	185,432,637,835	1,626	-6
1981	280,340,653	54,804,878,158	540,140,081,741	166,942,625,288	1,526	-10
1982	564,754,545	66,579,439,232	514,391,777,295	158,984,523,887	1,836	-4.8
1983	705,077,618	77,015,578,154	543,011,639,858	167,830,145,890	2,104	5.6
1984	873,302,376	77,119,602,261	573,641,593,102	177,297,032,314	2,089	5.6
1985	1,055,681,638	71,745,934,508	594,508,248,751	183,746,348,691	1,929	3.6
1986	1,309,166,516	74,687,170,502	619,628,315,599	191,510,278,917	1,995	4.2
1987	1,712,134,701	64,588,748,823	631,759,791,452	195,259,788,528	1,716	2
1988	2,994,618,599	69,554,002,551	657,868,837,310	203,329,385,299	1,839	4.1
1989	11,958,563,501	83,092,656,089	658,923,748,255	203,655,429,613	2,188	0.2

Source: United Nations, National Accounts Statistics

4.3 Poland, Territorial Structure of Foreign Trade, 1985

	(\$m)	(%)
Total	22,633	100
Convertible currency area, total	11,507	50.8
excl. clearing trade countries^a	9,449	41.7
OECD countries	7,610	33.6
CMEA countries^b	11,580	51.2
Socialist Countries^c	12,958	57.3
Nonsocialist Countries	9,675	42.7

^a Both the list of nonsocialist clearing trade countries and statistical data of the respective trade volumes are incomplete.

^b CMEA: Albania, Bulgaria, CSSR, Cuba, GDR, Hungary, Mongolia, USSR, Vietnam.

^c CMEA countries plus China, Yugoslavia, Korea (PR).

Source: The World Bank

4.4 Poland, Commodity Structure of Exports, 1975-1986 (in million USD)

	1975	1980	1983	1984	1985	1986
0 Food and Live Animals	807.7	1035.5	777.5	851.7	862.8	968.0
1 Beverages & Tobacco	66.7	101.4	69.2	72.6	76.2	80.0
2 Crude Materials, Inedible Except Fuels	352.8	856.0	679.3	767.3	822.1	789.0
3 Mineral Fuels, Lubricants & Related Materials	1863.0	2409.7	2012.2	2059.8	1801.2	1594.0
4 Animal & Vegetable Oils & Fats	36.1	5.5	3.6	29.4	25.4	18.0
5 Chemicals	784.2	933.4	641.6	713.2	705.1	776.0
6 Manufactured Goods Classified Chiefly by Material	1241.2	2601.5	1867.6	1832.0	1720.3	2111.0
7 Machinery and Transport Equipment	2244.7	4715.0	4816.8	4542.4	4530.1	4693.0
8 Miscellaneous Manufactured Articles	990.0	1510.3	686.2	728.9	778.6	870.0
9 Commodities & Transactions Not Classified According to Kind	15.5	23.1	17.8	152.5	167.6	170.0
T O T A L E X P O R T S	8401.9	14191.4	11571.8	11749.8	11489.4	12073.0

Source: The World Bank

4.5 Poland, Commodity Structure of Imports, 1975-1986 (in million USD)

	1975	1980	1981	1982	1983	1984	1985	1986
0 Food and Live Animals	1213.6	2681.7	2868.9	1509.0	949.4	1109.4	991.1	1065.0
1 Beverages & Tobacco	68.3	163.5	139.2	96.6	110.9	91.3	102.0	134.5
2 Crude Materials, Inedible Except Fuels	1524.1	1742.2	1182.9	1256.7	1132.7	1175.1	1148.8	924.6
3 Mineral Fuels, Lubricants & Related Materials	1169.4	3112.6	2379.4	2254.9	2773.6	2479.0	2416.9	2330.3
4 Animal & Vegetable Oils & Fats	97.5	135.8	103.1	97.4	70.9	87.6	93.1	65.1
5 Chemicals	942.4	1546.3	1136.8	991.5	948.1	935.3	980.0	1091.9
6 Manufactured Goods Classified Chiefly by Material	2154.2	2244.8	1385.2	1399.9	1530.2	1520.1	1510.5	1540.0
7 Machinery and Transport Equipment	3483.9	4227.0	2785.3	2521.7	2695.0	2974.0	3336.4	3649.8
8 Miscellaneous Manufactured Articles	452.0	808.0	601.7	548.2	701.0	581.6	568.2	701.8
9 Commodities & Transactions Not Classified According to Kind	0.5	27.9	16.3	10.5	14.8	31.8	37.7	32.5
T O T A L I M P O R T S	11105.9	16689.8	12598.8	10648.3	10926.6	10985.2	11184.7	11535.5

Source: The World Bank

4.6 Poland, GDP, 1989-2009

Gross Domestic Product (GDP)

Year	GDP at current prices		GDP at constant 2005 prices		Per Capita GDP	Growth rate
	Zloty	US Dollars	Zloty	US Dollars	US Dollars	Percent
1989	11,958,563,501	83,092,656,089	658,923,748,255	203,655,429,613	2,188	0.2
1990	61,322,115,626	64,549,595,396	582,838,296,434	180,139,483,467	1,694	-11.5
1991	88,526,990,438	83,705,089,030	541,948,816,412	167,501,656,037	2,189	-7
1992	125,807,359,705	92,325,964,269	555,578,713,305	171,714,286,883	2,406	2.5
1993	170,502,474,199	94,122,433,310	576,347,969,656	178,133,499,783	2,446	3.7
1994	246,371,916,087	108,425,140,169	606,852,926,830	187,561,753,318	2,813	5.3
1995	337,222,000,000	139,061,574,306	649,041,271,792	200,601,024,615	3,603	7
1996	422,436,000,000	156,684,099,254	689,534,416,715	213,116,355,634	4,059	6.2
1997	515,353,000,000	157,153,755,257	738,396,759,802	228,218,378,440	4,073	7.1
1998	600,902,000,000	172,901,536,514	775,180,983,458	239,587,382,655	4,486	5
1999	665,688,000,000	167,801,820,386	810,251,710,825	250,426,791,718	4,360	4.5
2000	744,378,000,000	171,275,921,377	844,766,840,682	261,094,480,685	4,456	4.3
2001	779,564,000,000	190,420,870,075	854,948,828,993	264,241,456,658	4,961	1.2
2002	808,578,000,000	198,179,263,241	867,290,008,386	268,055,779,936	5,170	1.4
2003	843,156,000,000	216,801,167,373	900,829,495,328	278,421,924,183	5,663	3.9
2004	924,538,000,000	252,768,883,411	948,977,028,177	293,303,018,563	6,610	5.3
2005	983,302,000,000	303,911,934,847	983,302,000,000	303,911,934,847	7,956	3.6
2006	1,060,031,000,000	341,597,458,503	1,044,537,000,000	322,838,009,777	8,951	6.2
2007	1,176,737,000,000	425,129,427,916	1,115,411,689,761	344,743,450,930	11,149	6.8
2008	1,275,432,000,000	529,391,475,188	1,172,593,839,776	362,416,900,033	13,893	5.1
2009	1,343,657,000,000	430,639,741,251	1,191,942,000,777	368,396,890,968	11,311	1.7

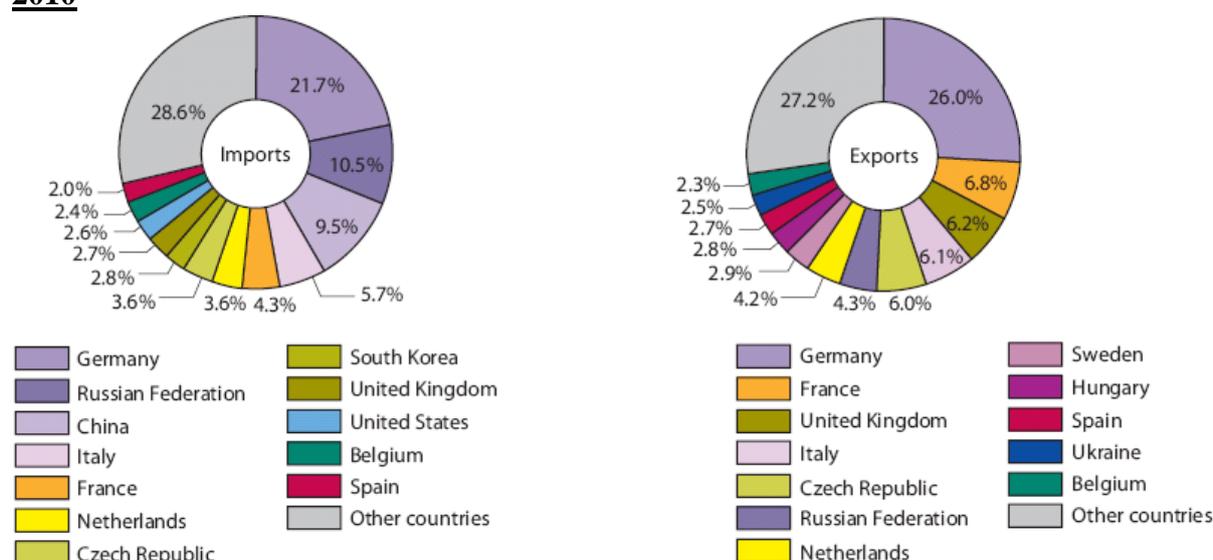
Source: UN National Accounts Statistics

4.7 Polish Annual CPI Inflation Rate, 2001-2010

Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Inflation rate (%)	10.1	5.5	1.9	0.8	3.5	2.1	1.0	2.5	4.2	3.5	2.6

Source: Central Statistical Office of Poland

4.8 Poland, Territorial Structure of Foreign Trade, 2010



Source: Central Statistical Office of Poland

4.9 Poland, Commodity Structure of Foreign Trade

	2003	2010	2003	2010
	imports		exports	
Total in mln euro	60 354	130 870	47 526	117 382
in % of total:				
food and live animals	4.6	6.5	7.6	9.3
beverages and tobacco	0.3	0.6	0.3	1.4
crude materials, inedible, except fuels	3.0	3.0	2.6	2.2
mineral fuels, lubricants and related materials	9.1	10.9	4.3	3.8
animal and vegetable oils, fats and waxes	0.4	0.3	0.0	0.2
chemicals and related products	14.8	14.3	6.5	8.6
manufactured goods classified chiefly by material	21.0	17.8	23.8	20.3
machinery and transport equipment	38.0	34.1	37.7	41.5
miscellaneous manufactured articles	8.7	10.3	17.1	12.6

Source: Central Statistical Office of Poland

Appendix 5: Hungary – Statistics

5.1 Hungary, Commodity Structure of Foreign Trade, 1986 (in%)

Commodity Group	Imports	Exports
Fuel and electricity	19.4	3.5
Raw materials, semifinished goods, and spare parts	44.8	30.2
Machinery and capital goods	16.7	30.0
Industrial consumer goods	11.7	16.2
Agricultural goods	7.4	20.1
TOTAL	100.0	100.0

Source: Hungarian Central Statistical Office

5.2 Hungary: Growth Rates of External Trade (in constant prices) and Trade Elasticities, 1970-1983

	Exports				Imports					
	1980 (B111 US\$)	1970-1978 % Chg/Elast. a/		1978-1983 % Chg/Elast. a/		1980 (B111 US\$)	1970-1978 % Chg/Elast. b/		1978-1983 % Chg/Elast. b/	
Total Merchandise Trade	8.677	8.6	2.2	6.2	3.3	9.212	7.8	1.3	-0.3	-0.2
Manufactures	5.709	9.6	2.5	5.2	2.8	5.741	10.8	1.9	-0.1	-0.1
Primaries	2.968	6.8	1.7	7.9	4.2	3.470	3.8	0.7	-0.6	-0.3
Non-fuels	2.548	6.4	1.6	6.2	3.2	1.958	2.1	0.4	-1.9	-1.2
Fuels	0.420	9.4	2.4	16.2	8.5	1.512	6.5	1.1	1.2	0.8
To/From Eastern Europe	4.374	7.0	1.6	4.7	2.8	4.334	4.6	0.8	-1.3	-0.8
Manufactures	3.095	7.6	1.8	3.5	2.1	2.540	6.0	1.0	0.1	0.1
Primaries	1.279	5.7	1.3	8.0	4.7	1.794	2.7	0.5	-3.7	2.3
Non-fuels	1.235	5.7	1.3	10.1	6.0	0.611	-0.8	-0.1	-3.1	-1.9
Fuels	0.044	5.8	1.3	-20.3	-11.9	1.183	5.4	0.9	-4.0	-2.5
To/From Industrial Countries	2.564	7.3	2.3	5.0	3.1	3.509	12.5	2.2	-1.5	-0.9
Manufactures	1.434	12.7	4.0	5.7	3.6	2.829	17.2	3.0	-1.4	-0.9
Primaries	1.130	3.5	1.1	4.2	2.6	0.680	-0.3	-0.1	-2.0	-1.3
Non-fuels	0.993	4.3	1.3	2.5	1.5	0.575	0.1	0.0	-1.6	-1.0
Fuels	0.137	-3.2	-1.0	19.2	12.0	0.105	-5.6	-1.0	-9.9	-6.2
To/From Developing Countries	1.623	16.8	2.9	11.2	3.6	1.367	11.3	1.9	2.4	1.5
Manufactures	1.122	14.2	2.5	8.6	2.8	0.371	13.8	2.4	8.3	5.2
Primaries	0.501	24.2	4.2	15.7	5.1	0.995	10.5	1.8	0.0	0.0
Non-fuels	0.262	18.6	3.2	5.7	1.8	0.772	8.0	1.4	-1.1	-0.7
Fuels	0.238	39.3	6.8	25.4	8.2	0.223	36.2	6.2	4.1	2.6
To/From High-income Oil Exporters	0.116	32.4	4.6	10.5	5.8	0.001	19.7	3.4	222.9	139.3
Manufactures	0.058	27.5	3.9	19.7	10.9	0.001	18.0	3.1	26.6	16.6
Primaries	0.058	39.0	5.6	-2.0	-1.1	0.000	55.8	9.6	390.8	244.3
Non-fuels	0.057	39.0	5.6	-2.0	-1.1	0.000	-100.0	-17.2	*	*
Fuels	0.001	*	*	*	*	0.000	*	*	390.6	244.1

a/ Merchandise export growth divided by GDP growth of the trading partner.

b/ Merchandise import growth divided by Hungary's GDP growth.

* Very high growth rates and elasticities due to low base year values.

Source: The World Bank

5.3 Hungary, Commodity Structure of Exports, 1970-1985

Item	1970	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Billions of Current Forints												
Fuels and Electric Energy	1.3	4.3	5.0	5.8	7.3	10.7	11.7	12.2	19.1	31.4	32.5	19.5
Raw Materials and Semi-finished Goods	32.2	52.9	60.4	71.6	71.1	87.6	87.8	88.2	88.3	107.3	124.1	128.1
Capital Goods and Trans. Eq.	23.5	54.2	55.0	63.7	66.1	78.0	73.5	75.8	87.3	96.4	105.0	122.4
Manufactured Consumer Goods	20.8	37.1	36.2	42.5	44.1	46.8	45.1	47.7	49.1	53.0	58.5	64.1
Foods, Raw and Processed	26.4	50.1	47.3	54.9	52.0	59.0	62.9	75.5	80.7	86.0	93.8	90.4
Statistical Discrepancy	-0.5	0.0	0.0	0.0	-	-	-0.0	-	-	-	-	0.1
Total Exports	103.7	19	24.8	238.6	240.7	282.1	281.0	299.4	324.5	374.1	414.0	424.6
Percent Distribution												
Fuels and Electric Energy	1.3	2.2	2.4	2.5	3.0	3.8	4.1	4.1	5.9	8.4	7.9	4.6
Raw Materials and Semi-finished Goods	31.1	28.0	29.5	30.0	29.6	31.1	31.2	29.5	27.2	28.7	30.0	30.2
Capital Goods and Trans. Eq.	22.7	27.5	27.3	26.7	27.5	27.6	26.2	25.3	26.9	25.7	25.4	28.8
Manufactured Consumer Goods	20.0	18.7	17.7	17.8	18.3	16.6	16.1	15.9	15.1	14.2	14.1	15.1
Foods, Raw and Processed	25.4	25.2	23.1	23.0	21.6	20.9	22.4	25.2	24.9	23.0	22.7	21.3
Statistical Discrepancy			0.0	0.0	0.0	-	-	-0.0	-	-	0.1	-
Total	100.0											

Source: The World Bank

5.4 Hungary, GDP, 1989-2009

Gross Domestic Product (GDP)

Year	GDP at current prices		GDP at constant 2005 prices		Per Capita GDP	Growth rate
	Forint	US Dollars	Forint	US Dollars	US Dollars	Percent
1989	1,895,105,362,182	32,084,353,097	17,604,488,939,419	88,206,575,924	3,086	0.7
1990	2,314,452,581,590	36,617,686,042	16,988,919,858,400	85,122,292,077	3,533	-3.5
1991	2,557,152,325,742	34,216,086,299	15,046,365,018,268	75,389,200,046	3,307	-11.4
1992	3,011,965,373,552	38,131,747,083	14,585,317,258,715	73,079,138,996	3,688	-3.1
1993	3,631,820,606,432	39,505,002,163	14,501,290,003,714	72,658,123,852	3,820	-0.6
1994	4,467,598,653,364	42,483,636,190	14,928,665,432,850	74,799,471,060	4,109	2.9
1995	5,746,248,000,000	45,720,741,947	15,151,031,707,610	75,913,628,237	4,425	1.5
1996	7,113,667,000,000	46,602,177,141	15,250,944,644,698	76,414,237,945	4,517	0.7
1997	8,814,578,000,000	47,189,985,144	15,842,652,255,595	79,378,964,867	4,583	3.9
1998	10,453,044,000,000	48,754,490,404	16,598,493,055,033	83,166,074,456	4,747	4.8
1999	11,640,204,000,000	49,084,581,569	17,284,120,291,553	86,601,381,842	4,792	4.1
2000	13,368,903,000,000	47,377,356,585	18,131,703,919,849	90,848,165,144	4,638	4.9
2001	15,307,183,000,000	53,430,077,839	18,815,877,246,007	94,276,187,772	5,245	3.8
2002	17,231,288,000,000	66,817,289,249	19,595,463,439,680	98,182,272,693	6,578	4.1
2003	18,838,254,000,000	83,984,369,613	20,374,501,704,447	102,085,612,238	8,290	4
2004	20,822,396,000,000	102,701,967,570	21,296,325,630,610	106,704,373,533	10,165	4.5
2005	21,970,780,000,000	110,083,699,723	21,970,780,000,000	110,083,699,723	10,924	3.2
2006	23,730,035,000,000	112,790,698,227	22,768,875,069,337	114,082,522,613	11,218	3.6
2007	25,321,478,000,000	137,897,144,102	22,944,847,048,504	114,964,223,058	13,745	0.8
2008	26,753,906,000,000	155,443,541,078	23,134,724,758,027	115,915,597,600	15,525	0.8
2009	26,054,327,000,000	128,764,022,899	21,586,388,885,414	108,157,723,675	12,886	-6.7

Source: UN National Accounts Statistics

5.5 Hungarian Annual CPI Inflation Rate, 1995-2010

Year	1995	1996	1997	1998	1999	2000	2001	2002
Inflation rate (%)	28.2	23.6	18.3	14.3	10.0	9.8	9.2	5.3
Year	2003	2004	2005	2006	2007	2008	2009	2010
Inflation rate (%)	4.7	6.8	3.6	3.9	8.0	6.1	4.2	4.9

Source: Hungarian Central Statistical Office

5.6 Hungary, Territorial and Commodity Structure of Foreign Trade, 1998

	Exports		Imports	
	mUS\$	share %	mUS\$	share %
By group of countries				
OECD	19373.0	84.2	20571.0	80.0
EU (15)	16782.0	72.9	16479.0	64.1
Germany	8420.0	36.6	7249.0	28.2
EFTA	310.0	1.3	472.0	1.8
CEFTA	2039.0	8.9	1766.0	6.9
CIS	1382.0	6.0	1971.0	7.7
Total	23005.0	100.0	25706.0	100.0
By group of products				
Food, tobacco, drinks	2424.2	10.5	959.9	3.7
Raw materials	676.6	2.9	762.4	3.0
Energy	435.1	1.9	1691.0	6.6
Processed foods	7522.1	32.7	10330.2	40.2
Machinery, equipment	11947.3	51.9	11962.9	46.5
Total	23005.3	100.0	25706.4	100.0

Source: Hungarian Ministry of Economic Affairs

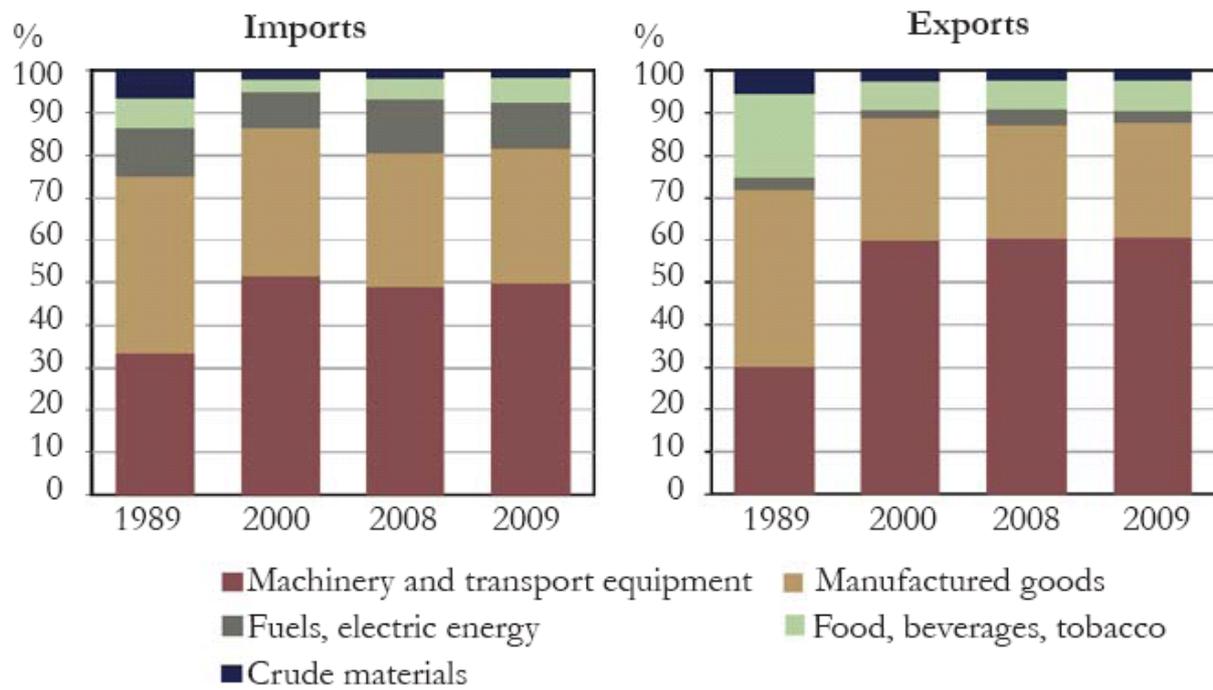
5.7 Hungary, Territorial Structure of Foreign Trade, 1989-2009

Group of countries	1989	2000	2008	2009
Imports				
Old member states (EU-15)	45.9	58.4	53.3	53.6
New member states ³⁾	11.0	7.7	14.7	15.3
European Union, total (EU-27)	56.9	66.1	68.0	68.9
Other European countries	30.9	11.2	13.4	10.5
Asia	5.9	16.8	16.1	17.7
America	5.2	5.4	2.4	2.8
Africa, Australia and Oceania	1.0	0.5	0.1	0.1
Total	100.0	100.0	100.0	100.0
Exports				
Old member states (EU-15)	39.2	75.1	57.2	59.4
New member states ³⁾	10.6	8.5	20.9	19.8
European Union, total (EU-27)	49.8	83.6	78.1	79.2
Other European countries	34.3	6.5	12.6	11.1
Asia	8.6	3.4	5.2	5.5
America	5.0	6.0	3.0	3.0
Africa, Australia and Oceania	2.2	0.5	1.1	1.1
Total	100.0	100.0	100.0	100.0

³⁾ In 1989 excluding the data of Estonia, Latvia, Lithuania and Slovenia.

Source: Hungarian Central Statistical Office

5.8 Hungary, Commodity Structure of Foreign Trade, 1989-2009



Source: Hungarian Central Statistical Office

Appendix 6: The V4 - Statistics

6.1 Share of Foreign Trade Turnover in GDP

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Hungary	61%	62%	63%	88%	104%	110%	126%	121%	108%	108%	113%	116%	134%	136%	140%
Poland	39%	37%	39%	43%	44%	44%	47%	45%	48%	56%	64%	63%	69%	71%	73%
Slovakia	85%	84%	80%	100%	106%	104%	121%	130%	127%	134%	136%	138%	155%	156%	150%
Czech Republic	71%	85%	80%	87%	95%	92%	108%	113%	123%	109%	121%	124%	132%	137%	133%

Source: United Nations Commodity Trade Statistics Database