

Hamburg Institute of International Economics (HWWA) (Ed.)

Article — Digitized Version

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Intereconomics

*Suggested Citation:* Hamburg Institute of International Economics (HWWA) (Ed.) (1989) : Economic developments in Eastern Europe, Intereconomics, ISSN 0020-5346, Verlag Weltarchiv, Hamburg, Vol. 24, Iss. 4, pp. 197-202,  
<https://doi.org/10.1007/BF02928633>

This Version is available at:

<https://hdl.handle.net/10419/140197>

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# Economic Developments in Eastern Europe

*Every spring, the Department of Socialist Countries and East-West Economic Relations at the Hamburg Institute for Economic Research (HWWA) submits a summary of the past year's economic developments and of current trends in CMEA countries.<sup>1</sup> The main results are presented here.*

## USSR

In 1988 the Soviet economy again failed to develop as planned. Important plan targets were not achieved and the reform measures did not lead to the results aimed for. For the first time it was admitted that the Soviet Union has had a budget deficit for about 10 years, which has grown further since the middle of the eighties. Although the national income produced was able, according to the plan fulfilment report, to achieve a higher rate of growth than in the previous year, the plan target was not achieved. Price increases in the economy as a whole were again not stated.

Industrial production as a whole was increased as planned. The Statistical Yearbook for 1987 had already shown a greater increase in the production of consumer goods (Group B) than producer goods (Group A) – in contrast to the previous year's plan fulfilment report – and this target was also achieved in 1988. Individual branches of industry were, however, once more unable to meet requirements. The mechanical engineering complex was unable, in spite of a considerable (above average) growth in production, to fulfil its task in the modernization of industry as planned. Trends in the fuel/energy complex remained stable. The other basic industries were, particularly in the case of modern and highly effective materials, unable to expand production as planned. The discipline of industrial production units with regard to the meeting of orders continued to improve, although many units were still unable to fulfil their obligations.

Developments in agriculture were certainly a shock for the Soviet planners. The disappointing result of the previous year could not be compensated for; gross production increased only slightly by 0.7 %. The cereals harvest was considerably worse than planned; the result was the worst so far within the current five year plan. The relatively high imports of cereals intensified the already strained foreign exchange situation.

For the first time in the current five year plan, foreign trade turnover again showed an increase and reached a value of 132 billion roubles. At the same time, the USSR was forced to accept another worsening in its terms of trade. The low level of success in the attempts to diversify the structure of exports, one-sidedly oriented towards raw materials and fuels, made itself noticed yet again.

Supplies of goods and services to the population were also a problem area. Money incomes increased considerably more strongly than intended; the resulting increased demand could not be satisfied, however. Retail turnover increased more than planned but this was obviously above all due to price increases. The supply of foodstuffs remained a problem and there was also dissatisfaction with the supply of consumer goods.

In 1988, the Soviet Union was able to show some slight progress in its efforts to step up efficiency. The growth of produced national income was achieved alone by increases in the productivity of labour with a falling number of workers. Modernization investments rose, albeit not to the planned extent. The reorganization took place too slowly, however. The introduction of technical innovations proceeded only hesitantly. The quality of mechanical engineering products was not decisively improved and the urgently necessary concentration on important investment projects was not realized.

The reform measures were less successful than had been hoped. Although those production units which had

<sup>1</sup> Klaus Bolz (ed.): Die wirtschaftliche Entwicklung in ausgewählten sozialistischen Ländern Osteuropas zur Jahreswende 1988/89, Verlag Weltarchiv GmbH, Hamburg. The report on the USSR was written by Sybille Reymann, that on the GDR by Peter Plötz, that on Poland by Andreas Polkowski, that on Romania by Petra Pisulla and that on Albania by E. Ullrich Cichy, all from the Hamburg Institute for Economic Research (HWWA). The contribution on Bulgaria was written by Ilse Grosser of the Wiener Institut für internationale Wirtschaftsvergleiche, Vienna. The author of the report on Czechoslovakia was Richard Frensch, Osteuropa-Institut, Munich. The report on Hungary was contributed by Andreas Wass von Czege, University of Hamburg.

gone over to commercial accounting and self-financing were able in some branches to achieve better results than those which continued to work on the basis of the old principles, considerable problems nevertheless arose, among other things due to the lack of radical changes in material-technical supplies. The new cooperative movement, in spite of its rapid growth, did not lead to any great improvements in the supply to the population of goods and services.

## German Democratic Republic

The growth prospects of the GDR, in comparison to 1987, did not improve in the last plan year, which the GDR itself regarded as the key year in the present medium term plan period 1986-1990. The growth curve continued to flatten out, and the plan figures have not been achieved in wide areas on both the production side and the application side of national income.

Whereas at the beginning of the eighties developments in the GDR were marked above all by external adversities which could not be foreseen (the reduction of Soviet oil supplies, drastic changes in the credit policy of Western banks, the continuingly high level of interest rates), present problems are caused by domestic difficulties, among others the concrete form of the planning and management system. The central bodies do not take realistic account of domestic economic frictions and scarcities in their short and medium term plan targets. The application of key technologies continues not to take place to the necessary extent and intensity (isolated solutions instead of general solutions), the "reserves in the first line" have been used up, innovation problems – largely immanent to the system – have not been overcome, the potential labour supply is exhausted, plant is obsolete, energy and materials are in scarce supply.

The growth of the national economy was only about 2.6%. With the exception of the crisis year 1982, this is the lowest growth rate since the beginning of the sixties. For the third year running the GDR's growth rate fell. Industry did not achieve its plan target in 1988. The industrial production of goods (gross production), with a growth of 3.7% over 1987 in the centrally directed units, remained 0.4 percentage points below the target figure, and the net production of the centrally directed units, with an increase of 7%, was a full percentage point below the target. The frictions and scarcities mentioned above thus influenced above all the most important sector of the economy, industry. The weak points in the economy's development are, particularly noticeable

here. The figures for the economy as a whole are negatively influenced especially by trends in the production of cereals etc. The contribution of agriculture and forestry to national income in 1988 was 8% less than that in 1987. Cereals production showed a drop of 11.3% compared to 1987 and was 8% short of the plan target. This result is understandable when climatic conditions are taken into account: a winter which was too mild and too wet made it difficult to work the fields in time and caused the early growth of plants; this was followed by extreme late frosts in the middle of April and then by a long period of drought.

On the application side of national income the strong expansion of investments is conspicuous. The volume of investment in the first half of the eighties was clearly too low for the structural adjustments necessary for the stabilization of growth to take place to the extent required. Following years of stagnation, the investment ratio is now rising; the investment strategy followed in the last five year plan has been renounced.

Private consumption, measured by retail trade turnover, increased nominally by 3.9%, almost in line with plan targets. Retail trade turnover and net money income of the population again increased in parallel. Reports about repeated supply bottlenecks indicate, however, that the standard of living of the population has not yet increased to the extent which the GDR leadership would like us to believe.

The plan was also not fulfilled in the foreign trade sector. Turnover (exports plus imports) more or less stagnated and the surplus on the balance of trade in 1988 was 3 billion valuta marks.

The plan for the national economy for 1989 shows signs of a certain change in trend. The growth rate for the economy as a whole is reduced slightly compared to the plan figure for last year. The gap between disposable income and the supply of goods having widened considerably in 1986 and 1987, against the wishes of the economy's leaders, leading to a considerable surplus in purchasing power, in 1989 the supply of goods is to grow at an average rate of 4%, whereas the planned rate of growth of the net money income of the population has been reduced (+3.5%). International trade in goods is again planned to show a surplus whereby the increase in turnover (+3.6%) as well as the expansion of both exports (+4.3%) and imports (+2.9%) seems very ambitious. Tendencies in energy prices, namely, mean that a nominal stagnation in intra-bloc trade is to be expected, so that trade with the non-socialist economies must expand accordingly. The most important global targets for the economy as a whole in the present five

year plan can no longer be achieved, even if the targets for the current year are met. Industry will not be able to achieve the targets set out in the five year plan, whereas agriculture will probably be more successful.

## Poland

Poland had a turbulent year in 1988, economically, socially and politically. Following the controversial reform of prices and incomes at the beginning of last year, inflationary processes in the economy accelerated, the supply situation worsened and the dissatisfaction of the population reached a climax.

The Communist Party, concerned to stabilize its power, gave the unsuccessful economic policies of the Nessner government the blame and forced the government to resign.

The new Prime Minister, Rakowski, emphasized his determination to enforce fast and radical reforms. The Communist Party wishes to support this reform process effectively and to reform itself correspondingly. The Party has recognized that it can no longer carry the responsibility for all the problems in the country alone, and that it also no longer really wishes to do so. It is therefore attempting to "socialize" the exercise of power and give the active opposition a share of responsibility. In the talks "at the round table" a social consensus has been reached, which should help the reforms to be successful.

Gross national product rose in 1988 by 4.5-5.0% and produced national income also showed a growth of 4.5-5.0%. Sales of the products of socialist industry showed an increase of 5.4%. But in spite of the positive economic indicators the shelves remained empty, the surplus in the money supply rose and social differences increased. After many years of reforms the Polish economy is like a car, which is permanently being repaired, whose motor achieves a higher and higher number of revolutions, but which never gets into gear.

The Polish economy continues to have among the highest requirements of materials and energy in the world. The decapitalization process in Polish industry continues to spread; more than 70% of all machinery must be replaced. The present degree of mechanization of Polish agriculture is roughly equivalent to that of the USA in the late forties, and as regards its biological achievements (means and methods of increasing plant and animal production) to the level of the sixties.

In spite of the positive trend in Polish foreign trade in 1988 the country's payment situation continues to be a

burden to the economy. Foreign exchange earnings from exports of goods and services to hard-currency countries as well as monetary transfers to the tune of US \$ 1.4 billion were again in 1988 almost the only source of finance for hard-currency imports and debt servicing. Constructive talks on rescheduling could open up access for Poland to new loans, which are essential for the export-oriented reorganizing of the economy.

Against the background of unsolved problems in cooperation within the CMEA, Poland is directing its attention towards Western Europe, to the European internal market, and is already taking steps towards a unification of norms and systems. Warsaw expects to sign a trade and cooperation agreement with the EC in 1989.

## Czechoslovakia

Following the 2% growth of gross national income in 1987 – the lowest so far in the current five year plan – it was possible to raise the growth rate again to an estimated 3% in 1988. Nevertheless, the quantitative fulfilment of the five year plan, which foresaw an average annual rate of growth of gross national income of 3.5%, is now out of the question and is obviously also no longer aimed for, as the plan figures for 1989 show.

In addition to the disequilibria problems which have already existed for a long time in the production sector of the Czechoslovakian economy, documented by growing stocks and a continuously high propensity to invest, last year the problem also arose of a growing disequilibrium on the consumer goods market, which is unusual for Czechoslovakia.

Altogether, it appears that aggregate demand is increasingly slipping out of the control of the central directing bodies: total investment, which was supposed to decrease by 2.5%, rose by 4.5% and retail trade turnover grew by 4.7% instead of the planned 1.9%.

The growth of gross industrial production by 2%, which was in any case modest compared to the targets set out in the five year plan, is further put in perspective by the facts that a quarter of all production units did not achieve their plan figure, that the largest engineering plants are practically bankrupt and that roughly half of the growth in production served only to increase stocks.

The demand for consumer goods, fed by a growth rate in money income which was twice as high as planned and by the population's falling propensity to save, rose by 4.7%. The beginnings of a supply crisis led to a

downright tariff war among the CMEA countries which is still continuing.

In the field of foreign trade, the CSSR enjoyed a further rise in its terms of trade, which was however due solely to falling import prices for raw materials, above all from the USSR. There was a further reallocation of exports from the developing countries' zone to the socialist countries (with the exception of the USSR) and strengthened export efforts towards Western countries. The marketing problems of Czechoslovakian mechanical engineering, which is responsible for more than half of total exports, on Western and also on CMEA markets could not be solved, however. Because of this, Czechoslovakia's gross foreign debts with the OECD countries also rose from mid 1987 to mid 1988 by US \$ 227 million to US \$ 4,661 million.

In December 1988 Czechoslovakia was the second member of the CMEA, following Hungary, to sign a trade agreement with the EC.

In spite of the change in the Office of Prime Minister from Lubomir Štrougal to Ladislav Adamec, there has been no noticeable change in the country's – depending on the interpretation – over-careful or prudent economic reform course. The legal basis for the reform appears quite solid, a reform (or change) of wholesale trade prices is taking place, and for the foreign trade sector a very far-reaching law on joint ventures has been passed which even allows foreign partners to have a majority holding.

Although the reform steps which have been indicated or even implemented by now often show a conflict between the long-term aims of regulative policy and short-term economic necessities, they certainly guarantee increased independence and responsibility for the production units, even if the steps introduced in no way allow the conclusion that Czechoslovakia is on the path towards changing into a market economy within the foreseeable future.

## Hungary

In 1988, Hungary's economy again showed essential signs of a stagflation: gross domestic product grew only by not quite 0.5% instead of the planned 1-1.5%, industrial production stagnated at the previous year's level and gross agricultural production grew only by 4.5%, which following the decline in production in 1987 due to bad weather conditions meant that it remained below the 1986 level. The stagnation of overall production was accompanied by continuously accelerating inflation. The growth rate of the cost of

living reached a post-war record of almost 16%, according to official calculations.

Not least due to the high inflation rates, consumption by the population from domestic supplies fell by 4-5.5% and taking the considerable amount of private imports into account by 2%, in spite of nominal increases in income of 7-8%. Investments in expansion and modernization also declined, sinking by 7.7% in real terms. Altogether, the share of investment in domestic expenditure increased.

In spite of the decrease in domestic expenditure, to which not only the population and enterprises but also the government budget contributed – besides an increase in revenue, a reduction in subsidies led to the relief of pressure on government finances –, gross debts in convertible currencies continued to grow in 1988. The impetus of the debt increase slackened off, however, in comparison with previous years. The new foreign currency deficit was greater than the US \$ 500 million planned, but it remained lower than the previous year's level, which was above all a result of a trade surplus in convertible currencies of a level which had not been expected.

The positive trend in the balance of payments is intended to continue in 1989, whereby the deficit in convertible currencies is to be further reduced by US \$ 50-100 million and the surplus in transferable roubles by 100-200 million roubles.

Again for 1989, an improvement in the impetus of growth in the Hungarian economy is not expected due to the multitude of restructuring measures, e.g. the reduction of the multiplicity of subsidies for production, exports and consumption and at the same time an increase in investments by enterprises in the socialist sector of up to 8%. Gross domestic product in 1989 will not be greater than that of last year, while continuingly high increases in the cost of living (plan figure: 15%) are to be expected.

## Romania

The permanent supply crisis in Romania, which not only affects private consumption but also the producing sector, shows up again now in the official statistics for the economy, after high rates of growth for the economy as a whole had surprisingly been shown for the years 1984-86. Produced national income, for which the plan had foreseen a growth rate of 9-10%, rose in 1988 by only 3.2% compared to 1987 in real terms; nominally it even rose by only 2.9% to 822.3 billion lei. The overall price level thus fell slightly in 1988 for the third year

running thanks to strict price controls and the legally stipulated so-called upper limits to profitability.

Since as a result of Ceausescu's continued policy of economy – directed towards the repayment of debts – a surplus on the balance of trade was achieved in 1988 which, at 63.3 billion lei, had yet again grown considerably, applied national income, with a nominal growth of only 0.6 %, remained virtually at the previous year's level.

Investment activity fell clearly behind the plan, with a real drop of 1.3 % instead of a growth of 3-3.5 % over 1987 as foreseen. Altogether 243.4 billion lei were invested, mainly in mining and the fuel and electricity industries, in industrial and agricultural production, in transport and in building.

Trends in industry also did not run according to plan in 1988. Instead of 7-8 % the industrial production of goods (including semi-finished goods) increased by only 3.6 %. In spite of the sometimes considerable increases in the production of sources of energy, industry suffered from a scarcity of electricity. In particular the frequency of breakdowns in the electricity works, the incorrect operation of plant and machinery and the use of inferior coal led to the power stations' producing to only 45-50 % of their installed capacity in 1988.

Agricultural production rose in 1988 by 2.9 % gross and 3.0 % net. Cereals showed a new record harvest to the tune of 32.6 million tonnes, the production of field vegetables was 10.05 million tonnes and of fruit and grapes 5.125 million tonnes. In order to further increase agricultural production, the cultivated area is to be extended in 1989. The measures announced for this purpose – the planned levelling of circa 7,000 villages and the conversion of rural areas into around 550 new so-called agro-industrial districts – brought Ceausescu and Romania into the headlines of the Western press in the early summer of 1988.

Romanian foreign trade grew in 1988 according to the plan fulfilment report by 6 % at current prices to 329.5 billion lei; imports stagnated at 133 billion lei while exports alone increased by 10.5 % to 196.4 billion lei. Converted at the annual average exchange rate for 1988 (14.28 lei/dollar), the surplus was US \$ 4.43 billion, of which about US \$ 4 billion are said to have been achieved in the balance of trade in convertible currencies. According to official statements the convertible surplus was thus US \$ 1.2 billion higher than in the year before.

Whereas almost all other CMEA countries expanded their debts with the West last year, Romania used the

high surpluses in its Western trade balance, as in previous years, to reduce its debts drastically. Romania's total long-term debt, which at the end of 1987 stood at US \$ 5,425 million (according to the World Bank's World Debt Tables) – of which \$ 2,039 million were with the World Bank and \$ 500 million with the IMF – was completely repaid by the end of March, 1989.

## Bulgaria

Following an official increase of just over 5 % in each of the two preceding years, the real growth of national product in 1988 accelerated to 6.2 % (plan: 6.1 %), according to the plan fulfilment report. The growth of the economy was supported by a relatively mild winter, improved supplies of fuels and electricity and by vigorous increases in imports from non-socialist countries – at the price of a drastic worsening of the regional balance of trade. On the other hand, however, with the continued improvement in the terms of trade there must have been a real outflow of resources to the Soviet Union.

Whereas the growth of industrial production accelerated as planned to 5.1 % (1987: 3.8 %), agriculture showed a further drop in production in 1988 of 0.7 % (1987: –5.1 %); the plan had foreseen a growth of at least 5.5 %.

On the application side an increase of real per capita income according to plan of 3.4 % (1987: 4 %) is reported; the slower development in the standard of living was accompanied by a worsening in the supply situation. The growing disequilibrium in the consumer goods markets was reflected in the increase of average nominal wages (246 leva per month) by 5.1 % as opposed to only 3.4 % for retail trade turnover at current prices. The worsening of the supply situation in spite of a number of measures to counteract this was demonstrated in the form of a growing list of scarce goods and in growing queues and, due partly to production shortfalls in agriculture, even hit basic foodstuffs such as fruit and vegetables (fresh and preserved), potatoes, meat, milk and milk products, bread and bakery goods, sugar products, pepper etc.

Gross fixed capital formation (10.4 billion leva at current prices) increased, with a growth rate of 3.6 %, somewhat more slowly than planned. The share of modernization investments increased to 26 % and that of investment in machinery and equipment to 44 %. Thanks to the growth of exports of 4 % and the fall in imports of 1.8 % the balance of trade in 1988 turned around to show a surplus of altogether 533 million valuta

leva. This improvement was due to the trade with the socialist countries, including the USSR. The balance of trade deficit with the non-socialist countries multiplied itself by three: the drastic shrinking of the surplus with the developing countries played a decisive role here. The resultant further worsening of its hard currency position is treated by Bulgaria with silence. Bulgaria's hard currency debts probably rose in 1988 by US \$ 1.2 billion to an estimated US \$ 7.1 billion gross or US \$ 5.9 billion net by the end of the year, whereby the revaluation of the US dollar in relation to other Western currencies had a dampening effect.

The reform package, which took effect at the beginning of the year, was followed in the course of the year only by isolated further measures, and the reform discussion concentrated on the fields of science, culture (where there were wage increases as of August 1st), education and health, and – since the autumn – agriculture. At the beginning of 1989 a new round of extensive economic reforms was, rather surprisingly, decided upon. The legal form of a Decree by the state council ("ukaz" no. 56 for economic activity) which was chosen this time is higher in rank than a Cabinet Order, which was the usual form until then, and should be followed soon after by the passing of a corresponding law. The Decree lays down a new framework, putting the Order which had been passed only a year before, and which was to be valid until the end of 1990, out of force earlier than planned.

According to the Decree, economic activity in Bulgaria is to be based on a combination of state planning and regulation with the independence of the "firms" and the functioning of the market mechanism in accordance with the law, and it must (!) take account of environmental protection requirements.

## Albania

Stagnative tendencies again characterized the Albanian economy in 1988. The cause of the unsatisfactory economic trends was, as in the previous year, periods of summer drought, which had a negative effect not only on agriculture but also, because of its influence on the supply of electricity – more than 85 % of Albania's electricity is produced in hydro-electric power plants – on industrial production. In addition to this there were inroads into production caused by the often obsolete capital of the Albanian enterprises and the general barriers to output and innovation of the bureaucratically administered economy. Particularly in agriculture, but also in other sectors of the economy, important plan targets were not realized. Due to

inadequate plan fulfilment imports, especially those of foodstuffs, had to be expanded above the plan figures.

The inadequate plan fulfilment is reflected in correspondingly high plan targets for 1989, some of which are far above the average growth rates of the current five year plan. Thus, for example, agricultural production is to increase by 16.9 % and industrial production by 6.8 %, whereas the five year plan foresees a rise of about 6.2 % and 5.3 % respectively. As in previous years, the intended increase in production is to be achieved mainly by the intensification of production and only in the second place by an expansion of existing capacities. It is intended to increase investment in industry by 2.2 %.

In the application of investment funds those projects have priority which promise an improved utilization of the rich resources of raw materials. The deposits of chromium ore, in particular, are to be more intensively exploited. An increase in the production of chromium ore of 20 % is foreseen for 1989. In order to put the chromium to more profitable use, building on a new ferro-chromium works within the integrated metallurgical plant in Elbasan was begun in October 1988. When it is completed in 1990 it should allow Albania to process a greater share of the chromium within the country and to increase its income from chromium three times by exporting the finished products.

For Albania it is an urgent necessity to expand its range of exportable goods. In 1988 it was again a problem to satisfy foreign demand as regards both quality and quantity. There was not only an inadequate amount of exportable chromium ores, oil and oil products, but there were also not enough agricultural products and electricity. The dependency of both electricity production and agriculture on the weather meant that these two sectors again last year were only suitable to a limited extent for the building of stable trade relationships.

Altogether, Albania is interested in expanding its foreign trade relations and in importing more Western technology in order to improve the quality of Albanian products. The country is therefore attempting to expand its economic relationships not only with its immediate neighbours in the Balkans but also with the European Community. In order to stimulate foreign trade, regulations have been created to allow the import of first-class technologies despite the continuing constitutional prohibition of borrowing abroad. The Albanian state bank may in future give special bank guarantees for the fulfilment of compensation deals.