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EXPLANATORY NOTES

The following symbols have been used throughout this *Survey*:

.. = not available or not pertinent

– = nil or negligible

* = estimate by the secretariat of the Economic Commission for Europe

| = break in series

In referring to a combination of years, the use of an oblique stroke (e.g. 1998/99) signifies a 12-month period (say, from 1 July 1998 to 30 June 1999). The use of a hyphen (e.g. 1999-2001) normally signifies either an average of, or a total for, the full period of calendar years covered (including the end-years indicated).

Unless the contrary is stated, the standard unit of weight used throughout is the metric ton. The definition of "billion" used throughout is a thousand million. The definition of "trillion" used throughout is a thousand billion. Minor discrepancies in totals and percentages are due to rounding.

References to dollars ($) are to United States dollars unless otherwise specified.

The membership of the United Nations Economic Commission for Europe (UNECE) consists of all the states of western Europe, eastern Europe, the Commonwealth of Independent States (CIS), North America and Israel.

The term EU-15 refers to the aggregate of the following 15 member states of the European Union: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom.

EU-25 refers to the 15 above-mentioned member states plus the 10 countries that joined the European Union in May 2004: Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia.

WECEE comprises the EU-25 plus the countries of Iceland, Norway and Switzerland.

EU-8 (central Europe and Baltic states) includes the new member states listed above excluding Cyprus and Malta.

For the convenience in presentation, countries are sometimes grouped into the following subregions, based on geographical proximity:

- Baltic states: Estonia, Latvia and Lithuania;
- Central Europe: Czech Republic, Hungary, Poland, Slovakia and Slovenia;
- South-east Europe: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, Serbia and Montenegro, The former Yugoslav Republic of Macedonia and Turkey;
- Caucasian CIS: Armenia, Azerbaijan and Georgia;
- Central Asian CIS: Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan;
- European CIS (excluding Russia): Belarus, Republic of Moldova and Ukraine.

ABBREVIATIONS

BBC	British Broadcasting Corporation
BEC	broad economic category
BIS	Bank for International Settlements
CEFTA	Central European Free Trade Agreement
CEPR	Center for Economic Policy Research
c.i.f.	cost, insurance, freight
CIS	Commonwealth of Independent States
CMEA	(former) Council for Mutual Economic Assistance
CPI	consumer price index
ECB	European Central Bank
ECE	Economic Commission for Europe
ECLAC	Economic Commission for Latin America and the Caribbean
EITO	European Information Technology Observatory
EME	ECE emerging market economies
EMU	Economic and Monetary Union
ERM-2	Exchange Rate Mechanism-2 (of the EU)
EU	European Union
EURIBOR	euro interbank offered rate
FDI	foreign direct investment
FTA	Free Trade Agreement
G7	Group of Seven
G-20	Group of Twenty
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
HICP	Harmonized Index of Consumer Prices
HWWA	Hamburgisches Welt-Wirtschafts-Archiv (Hamburg Institute of International Economics)
ICT	information and communication technologies
IDA	International Development Association (of the World Bank)
IEA	International Energy Agency
IFI	international financial institution
IIF	Institute of International Finance
ILO	International Labour Office

IMD	International Institute of Management Development
IMF	International Monetary Fund
ISM	Institute for Supply Management
LFS	labour force survey
NBER	National Bureau of Economic Research
OECD	Organisation for Economic Co-operation and Development
OPT	outward processing trade
PMI	Purchasing Managers' Index
PPI	producer price index
PPP	purchasing power parity
R&D	research and development
SITC	Standard International Trade Classification
SME	small and medium enterprises
TACIS	Technical Assistance for the Commonwealth of Independent States (of the EU)
ULC	unit labour costs
UNCTAD	United Nations Conference on Trade and Development
UNECE	United Nations Economic Commission for Europe
VAT	value added tax
WEF	World Economic Forum
WIFO	Österreichisches Institut für Wirtschaftsforschung (Austrian Institute of Economic Research)
WTO	World Trade Organization

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FOREWORD

The global economy performed quite favourably in 2004. The recovery spread to all major regions and the average rate of economic growth was the highest in three decades. That such a performance was possible despite the large increase in crude oil prices is testimony to the much greater resilience of economic activity in most of the major economies to oil price shocks than in the 1970s and 1980s.

A striking feature of Europe is the contrast between the persistence of moderate growth in the euro area and the economic dynamism in most of the rest of the region. In the euro area, the recovery, which had relied largely on exports, weakened significantly in the second half of 2004. Current forecasts, however, assume that this is only a pause before growth resumes, albeit at a moderate rate, in the course of 2005. In the new EU member states and in south-east Europe, economic growth has continued at much higher rates than in the "old" EU member countries. Their relatively high rates of growth have been broadly based on robust domestic demand and rapid export growth, and the outlook for 2005 is that this relatively strong performance will be maintained.

The CIS, together with developing Asia, was one of the two fastest growing regions of the world economy in 2004 (as in 2003). Rapid growth was propelled by the surge in international demand and prices for primary commodities and associated spillover effects on domestic demand. CIS growth is also expected to be maintained at a high rate in 2005.

The global economic outlook, however, remains subject to a number of major downside risks. A major challenge is how to achieve a gradual reversal of the United States huge current account deficit without triggering disruptive capital flows and a possible financial crisis with the risk of a serious setback for global economic growth. This is not only a task for the United States but one that will require a high degree of collaboration and policy coordination among the major economies. A stronger rate of growth of domestic demand in Europe, especially in the euro area, would be an important element in supporting a gradual adjustment in the United States external balance.

Despite their moderate impact in 2004, if oil prices remain at a high level they could eventually dampen global economic activity, at least in the short and medium term. The short-term outlook for Europe, moreover, is sensitive to developments in the foreign exchange markets: a further sharp depreciation of the dollar would most likely put a brake on the recovery. Disruptions to and increased instability of international capital flows, with consequent pressures for higher interest rates, would also adversely effect the ECE emerging market economies, given their reliance on foreign capital to finance their current account deficits. The fortunes of the CIS region are closely linked to developments in the international markets for oil and other raw materials.

Benchmarks for gauging relative economic performance differ across individual countries and regions. For the more advanced west European countries, a major target is to strengthen their competitiveness in order to catch up with the level of real income in the United States. The European Union's Lisbon Agenda is designed to promote this process, but so far has been falling short of its ambitious targets. The recent review and proposed streamlining of the strategy is perhaps a first step towards closing the gap between the rhetoric and actual implementation of the required policies.

In fact, the large gap in real income between the United States and the European Union reflects not so much differences in productivity (in terms of output per hour worked) but rather the lower proportion of persons of working age actually in work and, to a lesser extent, the smaller number of total hours worked per worker in Europe. This explains why increasing the employment rate is a major objective of the EU. But raising competitiveness, growth and employment will not be possible without much higher rates of investment in major growth factors such as education and training, research and innovation, and in ways to accelerate the diffusion of advanced technologies. Such investment may need to be complemented by further reforms of product and labour markets, but it will especially require a more flexible macroeconomic policy framework that will underpin business confidence that GDP growth will be sustained at rates above those of recent years. A reform of the EU's fiscal policy framework is therefore urgently needed. Moreover, monetary policy in the euro area is too narrowly focused on price stability to the exclusion of other objectives, namely the achievement of a high level of employment and sustained economic growth, that are accepted by central banks elsewhere.

In the new EU member states and south-east Europe, the challenge is to sustain sufficiently high rates of growth that will allow them to continue catching up with the real income levels of western Europe. The *acquis communautaire* as well as the Copenhagen criteria provide them with anchors for the necessary deepening of institutional reforms; this is also the case for the prospective member states for which the prospect of membership is a major incentive for reform. A key requirement is to improve the quality of education systems in order to meet the skill requirements of increasingly knowledge-based economies. These countries have been drawing extensively on the excess savings of the rest of the world to promote the renewal of their productive capacity, a normal feature for their stage of development. But in several of them the associated cumulative current account deficits are now quite large and, in some cases, also appear to be increasingly driven by consumption rather than fixed investment. Such a pattern is not sustainable in the medium term. There is therefore a need for domestic policies to reduce these deficits to more sustainable levels. This will reduce their vulnerability to sudden changes in investor sentiment, which can trigger capital outflows and the risk of a currency crisis. The need for more prudent policies could become more acute in 2005 if international interest rates rise significantly more than currently expected.

Despite the current economic boom in the CIS, there is a real need to broaden the basis of economic activity and thereby reduce the vulnerability of the member states to adverse developments in the international commodity markets. This is evidently a longer-term agenda, which will not only require structural and institutional reforms on a broad front but also the design of a strategic industrial policy. The European Union’s “New Neighbourhood” Policy may be helpful in this context, especially if it includes the promotion of institutional development geared to the specific socio-economic circumstances in these countries, greater access to the EU market, facilitation of labour mobility and effectual levels of technical assistance.

The search for sustained and rapid rates of growth in much of the ECE region is taking place under conditions of intensified competitive pressures arising especially, but not only, from the emergence of China and India as important suppliers of manufactured products and, to a lesser extent, certain services. Each country has to find its own niche in the evolving international division of labour, but doing so is becoming more difficult for middle-income countries, including many of those in central and eastern Europe. On the one hand they are subject to intense competitive pressures from low-wage, developing countries, but, on the other, they are not yet in a position to compete effectively in the markets for high-tech, knowledge-intensive products. At the same time there are also increasing concerns in some of the more advanced economies at the alleged adverse labour market implications of “outsourcing” higher-skilled activities. More generally, there is a need to develop appropriate institutions and effective economic policies to deal with the adjustment costs originating in the process of globalization; if these costs are ignored – and they can affect both labour and capital – the consequence is likely to be a resurgence of protectionist pressures.

Brigita Schmögnerová
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