Russia’s Health Reform: A Complicated Operation

The large, centrally planned health sector of the former Soviet Union provided cheap medicines and free medical services to all. But the low-priority status of consumption and health-related activities in that shortage economy resulted in poor sanitation, severe environmental pollution, malfunctioning medical institutions, and a backward pharmaceutical industry.

In late 1991, with the fragmentation of the unified Soviet health sector, Russia inherited a disproportionately large share of health resources. Initially it maintained the state-financed national health service and continued reforms of institutions and procedures that were started during perestroika. For example, polyclinics and hospitals have offered more services for fees to individual patients and economic organizations. Local experiments were incorporating the concept of "managed competition" in St. Petersburg and Ekaterinbourg (see box on page 3).

Over time a more radical health reform program has been developed. It calls for emphasis on preventive medicine, reduction in the role of the state in financing and managing health care, introduction of health insurance, opening public health institutions to the private demand, and involvement of foreign firms in the transformation of the health sector. Some positive results have been achieved. The health policy process has become more democratized, the management more decentralized, patients have been given greater rights to choose doctors and medication, and various medical facilities have become more efficient. On the whole, though, the Russian health sector have not improved in the transition period (see table).

Symptoms of Sickness

- Real wages, welfare benefits, per capita income, and consumption have dropped since 1991, resulting in a larger share of the population living in poverty. Diets have worsened, and adults have continued to drink and smoke heavily. Cuts in social investment have accelerated the physical deterioration of public facilities, housing, neighborhoods, and water and sewage systems.

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Health indicators in Russia, 1990-93

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<td>Life expectancy (years at birth)</td>
<td>69.2</td>
<td>69.0</td>
<td>68.6</td>
<td>67.2</td>
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</table>

Source: The author

"Insufficient funds have been allocated to ecological programs, and the risk of major health catastrophes has grown due to poor maintenance in industrial enterprises and nuclear power stations. Sanitary standards have fallen in the food industry and in food distribution via unregulated private markets.

"Most illness rates have increased. There is a high incidence among infants of rickets and infectious diseases, such as mumps and whooping cough. Occurrences of salmonellosis have risen, and by the first half of 1993, the rate of diphtheria was more than three times higher than it had been in 1991. Cholera has appeared in some southern cities of Russia. The incidence of tuberculosis is 34 percent higher than in 1991, of syphilis four times as high. Cancer and vascular illnesses have continued to climb. Alcohol poisoning, attempted suicides, traffic accidents, and criminal woundings have also soared. The infant mortality rate rose to an estimated 18.8 deaths per 1,000 live births by mid-1993 and the maternal mortality rate remained at a high 52 deaths per 100,000 births, despite the decline in the birth rate. Life expectancy in Russia has fallen from 69.2 years in 1990 to an estimated 67.2 years in 1993.

"During 1992-93, the real value of state allocations to the medical system has been reduced. These amounted to 6.2 percent of the total budget and a low 2.3 percent of GDP in 1992. Medical wages have fallen in real terms (the wage for a doctor has hovered just above the poverty line) and relative to those of other professional groups. In September 1993 medical and pharmacy workers announced plans for a national strike. Only minor repairs have been made to medical facilities or machinery that were in miserable shape before the transition. Polyclinics and hospitals have encountered difficulties in obtaining all types of inputs. Medicine budgets have been held down, drug prices have risen substantially, domestic output has fallen, and imports of pharmaceuticals have been cut back.

"The quantities of services provided have fallen in many cases, because of shortages of medicines, anesthetics, and instruments. Quality of care has deteriorated, with doctors forced to limit diagnostics, reuse disposable equipment, and forgo prescribing necessary drugs. However, standards have been maintained in the subsystem that serves the Russian elite and in the private, hard currency facilities that treat foreigners.

"State pharmacies have been partially commercialized. However, most are effectively bankrupt because the state has imposed tighter limits on the sale prices of medicines than on their costs. The privatization of pharmacies began in 1993, but in a disorganized manner and accompanied by concerns that acquisitions would be made for speculative reasons. An increasing share of medicines is sold outside the formal pharmacy system by vendors with no training. The informal private markets have unregulated prices and quality standards. Many outdated foreign medicines are dumped in Russia, through some poorly organized humanitarian aid.

"Medical industry enterprises have experienced severe disruptions of supplies, while their existing capital stock is almost completely obsolete. The demand for their products has been depressed by the declines in both real incomes and medical establishment budgets. Medical industry output has fallen and met only 15 to 25 percent of pharmacy requirements in 1992.

"Foreign trade in the health sector is now carried out on a hard currency basis. The value of Russian imports of medicines rose by 6 percent in 1992 to US$1.04 billion, but this was only half the amount called for by a presidential decree. In the first quarter of 1993, imports of medicines dropped by 85 percent to US$73 million (one-half their
value in the first quarter of 1991). By the half-year mark, these purchases amounted to US$195 million. Only US$30 million of these were financed by 1993 allocations of hard currency, with the balance reflecting deliveries according to 1992 contracts. Foreign aid programs have provided medical supplies, but their volume has been insufficient to compensate for the collapse of domestic medical production and trade.

Challenges and Prospects

The difficulties of the Russian health sector are in part a product of the transition process itself, which has both offered reform opportunities and created additional problems (see table above). Establishing a new national health sector is a major administrative undertaking even in the best of circumstances. Moscow wants to completely and simultaneously transform several components, introducing medical insurance, privatization, and promotion of marketing relations. But present economic and political preconditions do not favor such a drastic overhaul. Central control over the regions’ health care finance, sanitary conditions, and the quality standards of medical facilities and pharmacies has weakened. Conflicts within Russia (for example, in Chechen-Ingushetia) and in neighboring states (Georgia, Armenia, Azerbaijan, Tajikistan) have placed further pressure on the national medical system.

Future developments in health will be determined by both general factors, such as economic success, and specific factors, such as better diets, improved sanitation and environmental conditions, and reduced consumption of alcohol and tobacco. The effectiveness of medical care needs to be enhanced, by a budget-financed contribution supplemented by a new insurance-based health care system. Medical research institutes, pharmaceutical factories, and pharmacies need to be radically reformed. Foreign aid could help by financing temporarily the import of medicines and help re-

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**The St. Petersburg Fix**

Among the regional experiences in health care administration decentralization in Russia, St. Petersburg's is one of the most promising.

St. Petersburg (population 5 million) has 100 hospitals, with 57,000 beds, 400 polyclinics (providing outpatient service and, if necessary, referring patients to hospitals), as many as 29 research institutions, and 4 training schools. The health care sector employs a workforce of 150,000, including 30,000 doctors and 50,000 nurses. In 1991, for every 187 citizens, 20 had hospital stays. Patients length-of-stay in hospitals average seventeen days. The occupancy rate for St. Petersburg's hospital beds is about 75 percent.

In May 1992 St. Petersburg launched a health reform program that envisaged downsizing hospital capacity to 40,000 beds, while making better use of the remaining facilities. Excess hospitals were to be sold or rented, and the proceeds reinvested in the health sector. By the end of 1992 five hospitals had been closed down without major difficulties.

In preparation for a major reform, St. Petersburg's Municipal Health Committee launched the following initiatives:

- A high-powered committee has surveyed the condition of the city's hospitals and polyclinics.
- The committee's findings were that twenty-four facilities should shut down immediately. 200 got the green light to carry on for one to three years; and 170 were granted six months to improve their standards to an "acceptable level" or else.
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- The committee's findings were that twenty-four facilities should shut down immediately. 200 got the green light to carry on for one to three years; and 170 were granted six months to improve their standards to an "acceptable level" or else.
- A computerized health management information system was set up to register hospital admissions and discharges and to provide information for financial and evaluation purposes.

Hospitals are to be paid according to medical discipline, on a per patient basis. Payment using a patient classification system is envisaged down-the-road. Hospital doctors, in order to earn more refunds, will be motivated to increase patient turnover and to put a stop to chronic underutilization of beds. Hospital departments will have the incentives of salary increases and new equipment, proportional to their productivity.

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Christopher M. Davis
(The author is Lecturer in Russia and East European Political Economy at Oxford University. He contributed to the survey, “Health Care Crisis in Eastern Europe and the FSU,” Radio Free Europe/Radio Liberty Research Report, vol. 2, no. 40, October 8, 1993.)
n reviewing my work with Marek Belka and Stefan Krajewski on Polish state enterprise behavior, Martin Schrenk (Transition, vol. 4, no. 6, July-August 1993, p. 13) describes the “common wisdom” on state-owned enterprises. In trying to explain why Polish state-owned enterprises defied these negative stereotypes, Mr. Schrenk focuses on one aspect of the puzzle: the motivations of the managers. While extremely important, this is only part of the story.

The Bottom Line

If our study has a bottom line, it is that hard budgets and competition can stimulate state-owned enterprises to restructure even before privatization. And the incentive effects of anticipated privatization are very important.

We found (Brian Pinto, Marek Belka, and Stefan Krajewski, “Transforming State Enterprises in Poland: Evidence on Adjustment by Manufacturing Firms,” Brookings Papers on Economic Activity, 1993, pp. 213–70) that four factors were crucial in explaining the unanticipated positive response of state-owned enterprises:

* The government’s “no bailout” signal has been consistent and unambiguous right from the start, in spite of occasional political instability.
* Rapid trade liberalization (by increasing competition) and the elimination of subsidies (by signaling hard budgets) forced companies to focus on efficiency and profits.
* Changed bank behavior as a result of improved supervision and governance in late 1991 diminished soft loans and began directing resources to better firms.
* Managers care about their reputations and expect to gain when privatization occurs.

Viewed from the perspective of events in 1990 and 1991, these findings are remarkable. In 1990 the surprise was that state companies did not go bankrupt. On the contrary, hard currency exports—mostly from the state sector—grew a huge 40 percent and companies appeared to thrive. Any triumph was short-lived, however. When Council for Mutual Economic Assistance (CMEA) trading arrangements collapsed in 1991, companies lost hidden subsidies on energy and raw materials as well as the advantage of a captive Soviet market. Corporate profits and taxes fell, leaving a big hole in the fiscal accounts. Poland seemed set for a high-inflation collapse. Both the response capacity of state-owned enterprises and the sustainability of the reforms were in question. But by the end of 1991 a revival in manufacturing was under way. This coincided with the shift to a crawling peg in late 1991 that followed the first devaluation of the zloty almost seventeen months after the big bang in May 1991.

Today, the private sector is thriving and accounts for half of GDP. And there is concrete evidence of deep adjustment among many state firms, with solid success stories emerging. While the private sector success is perhaps not surprising, the positive response of the state firms has certainly surprised most people. At a minimum, this finding contradicts the expectation in 1990 that managers and workers would squander assets and then ask the government for a fiscally ruinous bailout, precipitating hyperinflation.

Lessons from Poland

The lessons are numerous and sobering:

* Adjustment takes time.
* Credibility of hard budgets is acquired neither instantly nor permanently. The government must give consistent signals on the absence of bailout and must eliminate subsidies. Such a tough stance is not easy when most of the taxes come from state-owned enterprises.

* The role of banks is crucial in the allocation of resources. In a situation where state-owned banks are used to doing business with state-owned companies, the supervision and control of banks is perhaps more important instance than positive incentives.

* Managers care about their reputations and workers care about job security. It is not that easy to decapitalize companies: if managers run the company into hard budgets and competition can stimulate state-owned enterprises to restructure even before privatization. And the incentive effects of anticipated privatization are very important.

Mr. Schrenk raises a question about the nonrandom sample on which this study is based. Nonrandom does not mean "irrelevant" for the following reasons:

* The firms selected are well-known companies with considerable geographical and product diversity, that is, incorporating a high degree of stratification.

* The firms were selected based on their 1989 sales and their fortunes have evolved in random fashion since. This is the crucial point of the study: can we take a set of firms with similar initial conditions in terms of behavior, bargaining power, and size and see whether their response to the economic program...
Transition and the outcome are different? In short, do we see evidence of adjustment? "It is true that the sample is representative of large firms; but these are the crucial ones. If these firms respond, one can assume with some confidence that smaller, more flexible firms have also responded.

"There is much evidence that the state sector as a whole has been responsive to the government's economic program; the conclusions of this study are in line with general findings on the economy. (See Ian Hume and Brian Pinto, "Prejudice and Fact in Poland's Industrial Transformation," Finance and Development, (June 1993) pp. 18-20."

"Finally, it is worth stressing that while the sample is representative of the behavior of large companies, we deliberately excluded the giants such as URSUS and the biggest shipyards and steel mills, which in our view represent special, politically sensitive cases that are very limited in number."

Recently, the debate on shock therapy versus gradualism has resurfaced with Sir Alan Walters taking a strong stand against shock therapy ("Polish Lessons for Hopeful Russians," AIG World Markets Advisory, September 1993). Our study suggests that some aspects of shock are unavoidable. If the goal is to make a clean break with the past, transparent signals and a drastic approach are necessary. This applies all the more to Poland, where the 1990 reforms were preceded by fifteen years of various failed reforms. If the goal is to change behavior, then the incentives must change. The only way to do this is to liberalize prices, eliminate subsidies, introduce competition (which in the first instance is easier to create in the form of imports than from new domestic entrants), and signal that there will be no bailout. This is what Mr. Balcerowicz was able to achieve, and our study shows that the resulting hard budgets and import competition led to increased efficiency and substantial adjustment in spite of the delay in privatizing.

Decent Proposals
But Alan Walters is quite right in arguing that large state-owned enterprises were able to initially escape the shock therapy by recourse to bank loans from their old banker friends. The evidence from our study shows that it took a good twenty-one months before bank loans to weak companies started shrinking. And even then our suspicion is that this was due more to introducing stricter supervision and direct control of nine commercial banks in late 1991 (including banning lending to some 2,000 companies, public and private) than to improved banking expertise. (These banks spun off from Poland's Central Bank.) After all, Poland did not really have a banking system until 1989. The dilemma is that those relatively new financial institutions are relied on to figure out early in the game which companies are merely rolling over loans and interest and which are borrowing for genuine expansion.

There is also the vexing issue of output loss. While it is true that the fall in industrial output wildly exceeded all predictions at the start of the reforms in 1990, this is no proof that a more gradual approach would have led to a smaller decline or lower welfare losses in present value terms. This is a point on which there is no clear-cut answer; but the bulk of the evidence from the enterprise study shows that consistency in applying a hard budget standard helped establish the credibility of Poland's reforms. This, in turn, yielded improvement in manufacturing output, efficiency, and resource allocation.

Ultimately, the debate over the methods and speed of privatization—over shock therapy versus gradualism—is not going to be resolved in Washington or London, or even Boston. It helps to take a stand on these complex issues now, when empirical evidence is accumulating, to visit state companies in various stages of transformation and learn straight from them which policies work and which do not. That is what we have tried to do.

Brian Pinto is Lead Economist in the International Finance Corporation's Economics Department.
Central European Access to EC Markets: Hard or Easy?
An Unorthodox View

Over the past year the European Community (EC) has been under severe criticism for denying market access to exports from the transition economies of Central and Eastern Europe (the Czech Republic, Slovakia, Hungary, Poland, Bulgaria, and Romania). Some are accusing the EC of erecting a new iron curtain around the former Soviet Block countries, preventing a timely recovery of the transition economies.

In my view, however, the picture is not so bleak. Tariff and nontariff measures did not prevent the CEE countries from expanding their presence in EC markets (with the exception of Romania, for domestic reasons) between 1988 and 1992. The CEE countries have been granted significant preferential treatment over most other countries. There is no evidence of discrimination despite the economic slump in the EC. The potential threat of the EC resorting to “new protectionism” is real, however. This threat will decline if the CEE countries’ competitive position shifts from low-skill to skilled labor-intensive products and if Central European associate members bring their economic regulatory framework in line with the EC.

True, changes in access to EC markets can be assessed against the ideal of free trade or full EC membership. I prefer to look at it in the context of EC preferential trading arrangements. These can be visualized as a pyramid, with the ascending levels occupied by groups of countries enjoying the more privileged access to EC markets. Certainly, the pyramid only considers tariffs and says nothing about nontariff barriers.

Secrets of the Pyramid

Until the late 1980s, most-favored-nation (MFN) tariff rates applied to the exports of the Comecon countries—the same tariffs imposed on goods of non-European OECD countries. The CEE countries, helped by the trade liberalization commitments of Brussels, fast emerged from the bottom of the pyramid—where most trade restrictions apply—and have already almost reached the “free trader” top. At present, the peak position is occupied by the European Free Trade Association (EFTA) countries, as their manufactured goods trade freely with the EC members. If the provisions of the European Association Agreements, including concessions granted by the Copenhagen summit (June 1993), are fully implemented, the Visegrád Group (Czech Republic, Slovakia, Hungary, and Poland) will reach the top of the pyramid in 1997 and Bulgaria and Romania will do so a year later.

Duty-free Treat

Since the collapse of central planning in 1990, the EC has granted General System of Preferences (GSP) status to Hungary and Poland, and from 1991 did the same for Bulgaria and the former Czechoslovakia. (Romania had already been granted limited GSP status in 1972.) Due to GSP preferences, average tariff rates on imports from these countries dropped to 1-2 percent from 6-7 percent. As a result, the CEE countries have gained better access to EC markets than have non-European OECD countries, which are subject to significantly higher MFN rates. The CEE countries have better access than most

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<td>8000</td>
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<td>Romania</td>
<td>F. Czechoslovakia</td>
<td>Hungary</td>
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September, 1993
developing countries, including members of the Lomé Convention and that of the states of the FSU. Moving away from GSP zero rates to duty-free access, however, does benefit the CEE exporters, including potential investors, as GSP eligibility is subject to annual review.

For the Visegrad Group, the share of duty-free products in industrial imports into the EC was around 60 percent during the first year of the Association Agreements (1992), and will rise to 70 percent in 1995 (in terms of their 1992 export baskets) and to 100 percent in 1997. For Bulgaria, the duty-free share in the first year (1993) is about the same as for the Visegrad Group while in 1996 this share (60 percent) will be ten percentage points smaller. Because of its huge share of textiles exports, Romania starts from a lower level of duty-free exports and its duty-free share remains around 20 percentage points lower than Bulgaria’s share until 1998.

The EC concessions also include the gradual reduction of tariff rates for a whole array of products as well as annual increases in tariff quotas or ceilings. Although textile and clothing products will be subject to quotas as long as the Multi-Fibre Arrangement (MFA) is in force, duties on these items will be reduced and abolished within five years. Those measures will give exporters from the CEE countries an extra edge over competitors.

The Other Side of the Fortress

Despite its generous-sounding Interim Agreements, the European Community is indulging in a veritable feast of antidumping duties and “voluntary” export restraint agreements that give rise to serious doubts about the EC’s commitment to free trade.

A spate of studies by economists in recent months [asserts] that EC and EFTA countries have far more to gain than lose from opening up their markets. Last year, both the EC and EFTA had trade surpluses of $19 billion with the region. Given the still relatively low levels of trade, some economists estimate that Western exports could increase by more than 10 percent annually for well over a decade before stabilizing at a normal level. Apart from adding considerably to GDP growth, this kind of export expansion will mean significant job creation in the West. But it will only be sustainable if Western Europe buys more from Eastern Europe. Otherwise, a combination of continued stagnation, balance of payments difficulties, and pressure for counterprotectionism — all three very visible this year as the region’s exports have faltered — will put an end to the boom.

Less directly free trade with Central and Eastern Europe is an important factor in Europe’s bid to regain global competitiveness vis-à-vis NAFTA and the Far East. This is so in two respects. First, both of these global competitors have the advantage of low-wage areas that allow for an efficient distribution of labor. Second, in order to compete effectively, Western Europe has to restructure those parts of its industry that suffer from overcapacity and inefficiency — a process that is being prodded along by competition from Eastern Europe.

Countries can choose to protect those sectors that are damaged by competition from Central and Eastern Europe — in particular agriculture, steel, textiles, and chemicals — at the cost of losing revenues and jobs in the competitive, export-oriented sectors. Or they can give priority to exporters by opening up markets and exposing weak domestic producers to potentially damaging competition. Choosing the first strategy goes directly against the kind of restructuring advice that the West has been doling out liberally in Eastern Europe.

At present, the protection of sensitive sectors appears to be gaining ground. [West European producers] are complaining loudly that it’s unfair to expect them to compete with Eastern Europe, where low labor, social security, and environmental costs, subsidized energy and transport prices, and soft budget constraints make for super-cheap exports.

From Delia Meth-Cohn’s article “Fortress Mentality,” published in the monthly Business Central Europe, Vienna, October 1993.

Sensitive Barriers

The trade-restructuring effect of the European Community’s nontariff barriers is never easy to estimate. The CEE countries will be affected differently, according to their export baskets and export performance. Agricultural products are protected by the Common Agricultural Policy (CAP), coal and steel products are regulated by the European Coal and Steel Community (ECSC), and textile and clothing products are subject to the MFA. Imports of capital-intensive products (with the exception of steel), raw materials, and energy are relatively free of any constraints.

In 1990, nontariff barrier coverage rates for Poland and Romania — that is, the share of their EC exports affected by nontariff barriers — were 25 percent, for Bulgaria and (the former) Czechoslovakia 33 percent, and for Hungary 39 percent. These ratios were higher than those of the EFTA countries (5 to 12 percent), around the same as of Japan (36 percent), and significantly lower than of many Mediterranean countries (Turkey’s ratio, for example, has been 53 percent).

There are reasons to believe that nontariff barriers are both less restraining and affect a lower share of CEE country exports — especially those originating in the Visegrad countries — than originally thought. Between 1988 and 1992 Bulgaria increased its share in EC imports of nontariff barrier-covered products by 74 percent, (the former) Czechoslovakia by 81 percent, Hungary by 24 percent, and Poland by 56 percent. Romania’s share in such EC imports fell by 3 percent, as compared with a 45 percent contraction in total imports. Such significant gains in the share of EC imports of sensitive products suggest that the ramparts of “fortress Europe” are porous.

The aggregate Central European exports of sensitive products fell back this year, mainly as a result of the disap-
pointing performance in agricultural exports. The contraction in agricultural output was a major factor affecting the Visegrád Group's total exports. Poland, a traditional net exporter of agricultural products to the EC, ran a deficit in its agricultural trade with the EC, while Hungarian agricultural exports to the EC decreased by 30 percent in the first seven months of this year. [In fact, Hungary's western trade, overall, dropped by the same percentage during the same period.]

Although the CEE countries are not amply endowed with energy resources, a large part of their traditional exports to EC markets has been energy-intensive products (including steel, cement, aluminum, and the like) due to cheap Soviet oil and the distortions of central planning. The CEE countries have comparative advantage in labor-intensive products (their textile and clothing exports increased recently) and in sophisticated engineering goods (given the relatively high quality and extent of scientific education). Machinery and transport equipment, electrotechnical products, and durable consumer goods are also playing an increasing role in the Visegrád Group's exports to the EC.

Since wage differentials between the CEE countries and the EC are particularly substantial for high-skilled labor, one may expect that export composition will keep moving toward skilled, labor-intensive engineering products subject to lower levels of protection. Moreover, the Association Agreements provide an institutional environment for the development of intratrade trade, which is likely to become another engine of growth for CEE country exports being much less vulnerable to protectionist measures than traditional exports.

Quotation of the Month: “Anyone Who Farmed More than Thirty Hectares, or Had More than Three Cows, Was Vilified As an Enemy of the State”
U.S. Study Places Russian Agrarian Reform in Historic Perspective

The following contains excerpts from a recent study by R. L. Prosterman and others, "Agrarian Reform in Russia," published at the Rural Development Institute, Seattle (more details on page 20).

Nineteenth-century Tsarist Russia was overwhelmingly agrarian. Major processes of rural change began with the emancipation of the serfs in 1861. Though ostensibly freed from their long bondage to the squire, the former serfs found themselves burdened with heavy redemption payments for the land they received and, worse, were limited in favor of the large landowners -- to about one-fifth of the land they had formerly cultivated.

Redemption payments were abolished as a result of the peasant upheaval of 1905. Shortly afterward Prime Minister Pyotr Stolypin introduced a limited reform program. This was not a classic "land reform" in the sense of redistributing the large quantity of land still held by the large landlords to those with too little land or to the many families who earned a considerable part of their living as short-term lessees or agricultural wage laborers. Rather, the program attempted to reform the obshchina (village communes), in which most peasants lived and obtained their primary livelihood. Under the obshchina system ultimate ownership of a village's agricultural lands resided in the village community. The community determined the agricultural calendar and made decisions about the crops to be grown. Typically, each family had rights for the use of a series of individual strips of land, which were scattered to ensure access to land of various qualities. The peasant family was given the right to farm the strips of land without payment and, in a minority of cases, to pass them down to their heirs; but they did not have the right to sell, buy, or mortgage the land. Moreover, in many if not most obshchinas, parcels were periodically reallocated in accordance with the formation of new households and changes in the size of existing households.

The Stolypin reforms sought to replace such communal forms of land ownership and control with individual land ownership by enabling the peasantry to claim title to their scattered strips, consolidate them, and separate from the commune. Initially, to be withdrawn land had to be in a consolidated parcel, though this requirement was later relaxed, for administrative and political reasons, to allow withdrawal of the separate strips once peasant farmers had been given full and permanent ownership rights. By 1915 about half of all the households in Russia had become private owners of former obshchina lands. Land titles had been given to about 2 million to 7 million households, but only 1.2 million had been able to consolidate their holdings into separate farms. The obshchinas fought this process, often obstructing consolidation.

The Stolypin reforms were terminated when World War I broke out in 1914. Although the reforms had given greater
control of the land resources formerly inside the obshchinas to millions of peasants, the holdings of the large landowners living outside the obshchinas, had not been touched by the reform. On the eve of the war, a third or more of Russia’s population still consisted of agricultural families who were substantially dependent on cultivating lands solely, or in addition to their lands within obshchina boundaries—that belonged to large landholders. These families worked such lands either as paid workers or, increasingly, as short-term tenants paying high rents.

The war had serious consequences for the peasantry. It drained money away from secondary uses, such as agricultural credit, and destroyed the emerging market for commercial crops. Stocks of cereals accumulated without any prospect of being moved to market—as railroad rolling stock was preempted for the war effort, and it was largely peasants who were conscripted.

After the first revolution and the overthrow of Tsar Nicholas II in February 1917, the Social Democrats and Kerensky temporized on the issue of what was to be done with the vast holdings of large landowners. Although there were peasant disorders in many parts of Russia, with peasants seizing land and livestock, the provisional government recommended that the peasants come to a “voluntary agreement with the landlords,” and threatened them with penalties for “taking the law into their own hands.” Although the Kerensky government exhorted the peasants to await whatever action on land reform the Constituent Assembly might take, the Bolsheviks (at that point subsidiary actors) adopted a resolution in April 1917 approving forcible land seizures from the landlords by the peasants.

After the October coup the Bolsheviks moved quickly. As E. H. Carr put it, "The two burning issues which would determine the attitude of the great mass of the population, that is to say, of the peasants, to the revolution were the war and the land," and on those issues the two decrees submitted to the Congress of Soviets on October 26, 1917 proved decisive. The first decree withdrew Russia from World War I. The second decree, the Land Decree, nationalized all agricultural land without compensation to the former owners. What was to become of the land thus appropriated was spelled out in terms that are particularly poignant in light of later events:

"The lands shall be distributed among those who use them on the principle of equalization, that is, on the basis, as determined by local conditions, of the normal labor or food units. No restrictions shall be placed on the mode of land tenure, the separate village-communes determining whether it shall be household, individual, communal, or cooperative tenure."

In this sweeping land-to-the-tiller reform, there was no elaborate central-government apparatus. The peasants were, in effect, urged to step in and administer the decree themselves. Their rights to the seized lands of the large landowners, and the legality of their actions, thereafter depended entirely on a Bolshevik victory, for which they provided the bulk of the rank-and-file manpower in the 1917-21 civil war.

From 1917 to 1929 the peasants continued to farm their individual parcels (except for those on a small number of experimental collectives), now amplified by the lands seized from the large landowners. During the early and mid-1920s, under Lenin’s "New Economic Policy," the peasants could even function in a market, and were generally free of government crop seizures. The Soviet state, however, continued to own the land, as it had since the Land Decree. In the late 1920s, Stalin began a campaign against the kulaks (rich peasants). As older peasants recalled from the time of their fathers, anyone who farmed more than thirty hectares, or had more than three cows, or ran a small shop, or hired any labor was vilified as a "kulak" and enemy of the state.

In 1929 forced collectivization began in earnest. A combination of ideological reasons prompted collectivization, including the desire for state control over the distribution and use of agricultural production and concern for political control of the peasantry. Production plummeted, and Stalin briefly discontinued the decollectivization policy in 1930, at which time most of the farmers left the new collectives. Stalin, however, reasserted the policy and completed the collectivization process over the next several years. A simultaneous drive to "liquidate the kulaks as a class" drove millions of peasants from the land they farmed. The disruption of production was awesome. Farmers slaughtered much of the country’s livestock, preferring to butcher them for meat rather than give them to the collectives. More than 5 million people died in the resulting famine. The memory of the twin processes of "dekulakization" and forced collectivization six decades ago is still alive among the Russian rural population.

Soviet collectivized farming proved to be a black hole down which vast resources disappeared, and from which little light emerged.
Research Update: Corporate Governance in Central Europe

The countries of Central and Eastern Europe (CEE) are moving rapidly to privatize state enterprises and remove centralized administrative controls over the economy. This move to private ownership is based on the idea that the incentives created by private ownership will lead to a more efficient economy. For this to happen, however, ownership in a firm must be coupled with some degree of shareholder control over managerial decisionmaking. While good corporate governance is a key to the sound functioning of any private market economy, it can be argued that the need for massive enterprise restructuring in reforming economies heightens the importance of effective corporate governance (and may change the nature of governance issues) in those settings.

A new World Bank research project, "Corporate Governance in Central Europe," will focus on issues and patterns of corporate governance in large, private or newly privatized firms of the Czech Republic, Hungary, and Poland. A separate component will analyze analogous issues in Russia. The research will examine how the broad legal and regulatory regime—including the privatization programs, the underlying corporate and securities laws, and specific regulations governing ownership by financial intermediaries and certain other types of investors—is influencing (or is likely to influence) the extent and effectiveness of shareholder monitoring in these countries.

In particular, the research will address the following question: do existing legal and regulatory frameworks in the CEE region promote active, independent, and effective shareholder monitoring, including, if necessary, pressure for restructuring?

The main components of the project will be:

* To identify and analyze laws and regulations that influence patterns of ownership and the process of corporate governance in the relevant CEE economies including laws governing ownership of equity by financial intermediaries (including banks, insurance companies, pension funds, and mutual funds), ownership by employees or contracting partners, public ownership, and shareholder rights, and oversight mechanisms.
* To provide an overview of emerging ownership patterns of large private sector firms. Data will be collected and compared to analogous data from advanced market economies—particularly in the United States, Germany, Japan, and perhaps Great Britain and France.

The goal will be to determine the relative degree of ownership dispersion and the nature of the owners—two factors that appear to have a strong influence on the type and efficacy of shareholder monitoring.
* To shed light on how the legal framework for corporate governance (through both voice and exit) is functioning in practice. This will involve two sets of surveys:
  - A survey of about 100 large private firms in each of the three countries (and a smaller number in Russia) to determine how they are governed and how such modes of governance affect firms' ability to restructure and react flexibly to changing external circumstances.
  - Case studies of fifteen to thirty intermediaries who own shares in each of

Managers under Surveillance—of Whose?

Shareholder control over managerial decisions ("corporate governance") is just one of the constraints on managerial behavior in advanced market economies. Others include economic constraints (product, capital, and labor markets, the desire to avoid bankruptcy, and so on), legal constraints (government regulations and laws on fiduciary responsibility), and cultural constraints (norms of commercial behavior prevailing in a society). Shareholder monitoring is important in the transition economies, where markets for products, capital, and managerial labor are still not strong enough to exert competitive pressures on managers. The experiences of Germany, Japan, and the United States point to certain lessons and tradeoffs for consideration in Central and Eastern Europe. There is probably a tradeoff between the efficacy of corporate governance and

\[ \text{distribution of wealth} \]

Tighter ownership patterns lead to better corporate performance. But more widely dispersed ownership patterns have other economic and social benefits that to some extent motivate and affect the speed of "mass privatization" plans.

\[ \text{industrial structure} \]

Smaller firms mean fewer owners, greater stakes per owner, and greater incentives and lower costs for shareholder monitoring. Historically, industrial structures of CEE economies have tended to be highly concentrated. Preserving such concentration in some industries may bring some benefits, but privatization policies should not leave the governance issue out of the equation.

\[ \text{financial intermediaries} \]

The United States limits active participation of banks, insurance companies, pension funds, and mutual funds in corporate governance. Germany and Japan allow financial intermediaries a major voice in corporate governance. In Central and Eastern Europe, due to high risk and the relative weakness of legal and information systems, large institutional holdings might undermine the safety and soundness of financial intermediaries. On the other hand, in the absence of active shareholder monitoring, few constraints could discipline company managers.

Drawn from Gray, Cheryl W., and Rebecca J. Hanson, Corporate Governance in Central and Eastern Europe: Lessons from Advanced Market Economies, the World Bank, WPS 1182, 1993, 30p. To order: Ms. Maxine Berg, the World Bank, tel. (202)473-1450.
the three countries to determine (1) their own regulatory and governance structure and (2) their role in monitoring the companies in which they own shares. Outputs of the research project will include a series of studies, phased over the eighteen months of the project, and seminars. The studies will be written up and disseminated in various forms, including individual publications (targeted to policy analysts and academic audiences), reader-friendly summaries (targeted to policymakers, legislators, and Bank staff), and eventually one or more books integrating the various pieces. Seminars will be held in the Bank and in the project countries to discuss and disseminate findings. Other modes of dissemination—including perhaps a longer in-depth conference or a series of seminars in each of the countries studied—will be considered as the project proceeds. The output will complement the extensive academic work being done on the topic in advanced market economies, and will help guide policymakers and legislators in the countries being studied and in other post-socialist economies, including those of the former Soviet Union.

The project is scheduled to be completed in fall 1994. It is managed by Cheryl W. Gray, PRDTM, the World Bank. For additional information contact Cheryl W. Gray, tel. (202) 473-9188 or Roland Michellitsch, tel. (202) 478-0768.

The Czech Republic: A Triple B

In August, Standard and Poors gave the Czech Republic a BBB rating. This puts the country into the "investment" category, on a par with Chile, Israel, Turkey, and China, and two points above Hungary (which is in the "speculative" category). Some of the trends international investors are watching:

*Economic growth* of 1 percent is predicted for 1993 as a whole. Czech GDP started to grow in October 1992 for the first time since 1989. However, the dissolution of Czechoslovakia in December caused a 20 percent drop in trade with Slovakia, which fed through into a 24 percent fall in Czech GDP in the first quarter of 1993. In the first half of 1993, industrial output fell 4.6 percent, construction 5.2 percent, transport 20.1 percent, and agriculture 1.5 percent. However, a second-quarter recovery meant that first-half GDP fell by only 1 percent.

*Fiscal balance* has been maintained, with the government running a surplus of 5.6 billion korona (Kcs) in the first six months, on expenditure of Kcs 145 billion. This was largely due to spending on unemployment benefits being much lower than anticipated.

*Unemployment* stands at a mere 2.8 percent (140,000), in contrast to 13.3 percent in Slovakia. It ranges from 4.6 percent in the coal-mining region of Ostrava to less than 0.3 percent in Prague. Unemployment is unlikely to top 5 percent by the year's end, as several hundred thousand pensioners and women have left the work force. The number of full-time self-employed surged from 70,000 in 1989 to 430,000 today. Real wages—a mere Kcs 6,658 (US$220) a year in industry—are low, below wages in Poland or Hungary.

*The balance of payments* showed a surplus of Kcs 900 million for the first half-year. Foreign trade (excluding Slovakia) rose 8.3 percent to Kcs 256 billion, while trade with Slovakia fell 24 percent, to Kcs 63 billion; exports increased 7.8 percent and imports 16.1 percent; and imports from Russia fell 22 percent, while imports from the EC rose 40 percent. Investment worth US$391 million entered the Czech Republic during the first half of 1993.

*Monthly inflation* was 0.4 percent in June and 0.7 percent in July and August, so inflation is expected to fall to 1 percent for 1993 as a whole. Inflation was a modest 11.1 percent in 1992, but surged 8.5 percent in January 1993 alone, after the introduction of the new value-added tax system. For the first half of 1993, inflation ran at an annualized rate of 21.7 percent.

The government remains worried about a possible wage-price spiral. It has claimed that nominal wages rose 27.8 percent in the first quarter, signifying a rise in real wages of 5.2 percent. This would be a violation of the 1993 tripartite agreement, which pledged to keep the average real wage increase below 5 percent. The trade unions have disputed this data, and half-year figures seem to show an average rise in real wages of only 1.4 percent. Nevertheless, from July 1, 1993 the government announced new penalties for excessive wage increases in all firms with more than twenty-four employees—state and private. Wage increases that exceed firms' sale increases by more than 15 percent in one quarter will be subject to a 100 percent tax, and wage increases 30 percent higher than sales will be taxed 200 percent.

Second Privatization Round

On October 1, the second round of large-scale privatization began in the Czech Republic, with the publication of the new privatization strategies. As of late-July 1993, privatization schemes of 548 firms with assets of Kcs 79 billion had been approved (schemes worth another Kcs 60 billion worth are in the works). Bidding for shares is scheduled to begin on January 1, 1994. The procedure for the second wave is the same as for the first, except that the Ministry of Privatization, which has become more powerful, can reject a firm's privatization
projects—and imposes specific conditions on resubmissions.

The first round of voucher privatizations, which ran from May 1992 to January 1993, saw the distribution of some Kčs 1,200 billion in assets in 1,500 firms, of which Kčs 300 billion were sold for vouchers to the general public. The private sector now accounts for 36.2 percent of industry, 11.4 percent of construction, and 66.1 percent of retailing. Much of this shift in ownership came from the programs for restitution to former owners and the auctioning of small businesses. The former transferred some Kčs 150-Kčs 200 billion worth of property. The latter saw 22,000 retail units auctioned, raising Kčs 32 billion.

Micro Changes at the Micro Level

There has been little immediate radical change in the economic situation of firms privatized in the first wave. Typically, each firm is owned by two or three privatization investment funds (PIFs)—limited by law to a maximum ownership of 20 percent each—and a host of individual shareholders, with a large tranche of shares still resting with the National Property Fund. Shareholders’ meetings began in late May. New boards of directors were appointed at the meetings.

Despite problems with nonpayment of debts (now amounting to Kčs 220 billion), most firms reported operating profits to their shareholders. Most declined to issue dividends, preferring to plough back profits into businesses. The new bankruptcy law, which came into effect on April 22, seems to have had minimal impact. By the end of June, only forty state-owned firms had filed for bankruptcy, alongside one or two newly privatized firms. The low number of bankruptcies can be explained by the lengthy court proceedings and the government’s willingness to protect vulnerable firms it deems important. (According to a recent report in the Financial Times, about a third of the privatized companies are believed to be technically bankrupt.)

The issuing of shares in 987 former state enterprises began on May 25, and trading began on June 22. There are two securities markets—the Prague Stock Exchange, which opened on April 6, and an over-the-counter system run by the RMS company. (RMS is a subsidiary of PVT, the firm that designed and operated the computer system for voucher privatization. PVT is in turn owned by subsidiaries of three PIFs—Harvard C&C, Zlatabraña, and Komercní bank.) Prices in the RMS system have been 20 to 50 percent lower than on the stock exchange, which has been forced to widen the band of price changes it allows in each trading round from 20 percent to 50 percent.

The main question now facing the funds is how to meet the promises made to their investors. The 240 PIFs hold 72 percent of the shares, with the 13 largest funds controlling 35 percent. (The Harvard Fund, with 814,000 shareholders, has concentrated its shares into fifty-one joint stock companies. They own 18 percent of Komercní bank, 13 percent of Savings Bank, 6 percent of the giant Czech Energy Works, 5 percent of the Czech Insurance Company, and the maximum 20 percent of Sklounion Glass Works, Slovnaft Oil Company, Spolana Pharmaceuticals, and the Kutna Hora Tobacco firm, which is majority-owned by Philip Morris. The Savings Bank fund, with 1 million investors, holds shares in 500 companies, but more than half of their stock is concentrated in 48 companies, in which they hold 10 to 20 percent of shares.)

Most of the funds promised cash payments of Kčs 10,000-Kčs 15,000 within one year to citizens investing their privatization vouchers with them. These promises are now falling due. If the funds start dumping shares on the fragile stock markets, the latter could collapse completely, leaving the funds short of cash to meet their obligations.

Based on Reports of Oxford Analytica Ltd., Oxford
Conference Diary

For the Record

Bottom-up Transformation in Eastern Europe: The Role of Small and New Firms in Postsocialist Countries
September 9-11, 1993, Freiberg, Germany

The Second Freiberg Symposium on Economics was organized under the auspices of the European Association for Comparative Economic Studies (EACES) at the technical university, Bergakademie, Freiberg, Germany. The meeting focused on the evolution of entrepreneurship in Eastern Europe. Topics included: Entrepreneurship in Eastern Europe: Neither Magic nor Mirage; Developing New Technology-based Firms in Russian Science Parks; Big Problems of Small Businesses in Estonia; New Firms in Bulgaria: The Impact of Structural and Institutional Changes; Small Firm Policy in Southeast Europe; Mass Privatization versus Private Sector Development; How To Become an Entrepreneur in Eastern Europe.

Information: Mr. Uwe Steinborn, tel. (49-3731) 513-159 or Ms. Claudia Werker, tel. (49-3731) 313-238, fax (49-3731) 512-733.

Forthcoming

Conversion of Russian Military Enterprises
November 12-14, Berlin, Germany

International Workshop, sponsored by the Volkswagen Foundation.
Information: Dr. Petra Opitz or Prof. W. Pfaffenberger, Berlin, University of Oldenburg, fax (4930) 441-0221.

Output Decline in Eastern Europe: Prospects for Recovery
November 18-20, Laxenburg, Austria

An international conference sponsored by IIASA (International Institute for Applied Systems Analysis), Laxenburg; the Ludwig Boltzmann Institute for Economic Analysis; the Austrian Chamber of Commerce; the University of Vienna; and the Commission of the European Community, Brussels.

Topics for discussion: Measurement of Output Decline (An artifact of the NMP/SNA measurement problems? Measurement of the informal economy; the structure of output decline and employment trends; Country experiences of Poland, Hungary, the Czech Republic, and Slovakia; Common causes or structural adjustment?); Causes of Output Decline (Consequence of the demise of the CMEA and U.S.S.R.; Aggregate supply shock versus aggregate demand shock; The impact of perverse incentive structures; The labor market structure and wage setting; The consequence of financial market problems; Comparing international experiences); and Policy Issues and Measures for Recovery (opening Western markets, monetary and fiscal policy implications of enterprise bad debt, fostering property rights and speeding up privatization, individual country programs or regionwide restructuring?).

Information: IIASA, A-2361 Laxenburg, Austria, tel. (432236) 71-521, ext. 556, fax (432236) 73-147.

Labor Market Changes in Central Europe: Lessons for Social Policy
January 21-23, 1994, Vienna, Austria

Third Central European Forum, sponsored by Institute for Human Sciences (Institut für die Wissenschaften vom Menschen [IWM]). This Central European forum will address the most pressing social issues of the postcommunist transition. The topics correspond to IWM's comparative research project on Social Costs of Economic Transformation in Central Europe. Initiated in 1992, the project aims to identify common labor market and welfare responses to economic transformation and provide lessons for policymakers throughout the region. The three sessions on the subject will examine labor market developments in transforming economies; social policy effects of labor market changes; and international comparative perspectives on labor markets and social policies.


Fourth Trento Workshop
Centralization and Decentralization of Economic Institutions: The Role in the Transformation of Economic Systems
February 28 - March 1, 1994, Trento, Italy

Information: Bruno Dallago, Department of Economics, University of Trento, Via Inarna 1, 38100 Trento, Italy, tel. (39-461) 882-211, fax (39-461) 882-222.

Annual Bank Conference on Development Economics
April 28-29, 1994, Washington, D.C.

Organized by the World Bank, with keynote address by Vice President Michael Bruno on Aspects of Adjustment, Transition, and Reform. Topics include: Transition in Socialist Economies: Macropolicy-Theory and Practice (Stanley Fischer, Leszek Balcerowicz), Property Rights in Transition (Andrei Shleifer), The Economy of the FSU: Retrospect and Prospect (Jeffrey Sachs, Anders Aslund), Chinese Reform Experience with State and Nonstate Enterprises (Thomas Rawski, Gary H. Jefferson, Nicholas Stern, Shahid Burki).

World Bank/IMF Agenda

Two IDA Credits for Albania

On September 14 the International Development Association (IDA) approved $5.4 million to help Albania develop an active labor market and improve the operation of its local labor offices. The IDA credit will also support a fund aimed at training unemployed workers and creating small enterprises. Some 10,000 people could take part, with up to 7,000 expected to gain permanent jobs from the plan. (Albania’s jobless rate grew to 27 percent by the end of 1992 from 9 percent earlier that year.) The second IDA credit, also for $5.4 million, will assist Albania in reforming its social safety net. New systems will be put in place to fight recipient fraud and abuse, and a computer system for determining benefit eligibility will be developed. Training and research at institutions that manage cash benefits will also be strengthened to improve and modernize service delivery.

First World Bank Loan to Czech Republic

On September 9 the World Bank approved an $80 million loan in support of the Czech Republic’s three-year, $891.5 million telecommunications program. The Bank loan is the first to the Czech Republic since it joined the institution on January 1 as a successor state to the Czechoslovak Federation, and it follows a $55 million loan made in July to the Slovak Republic for improvement of its telecommunications. The European Investment Bank and the European Bank for Reconstruction and Development are cofinancing the Czech plan with $80 million each. The project will transform the Czech telephone system to one based on digital technology using new fiber optic cables. Currently, only 16 of every 100 Czechs have access to a telephone, a much lower number than in nearby Western European countries. Also, although 30 percent of Prague residents have phones, only 2 to 6 percent of people in outlying villages have access. The waiting time for a phone in the Czech Republic averages 5.3 years. When the system is used heavily, only 30 to 40 percent of long-distance calls are connected. That number drops to 20 percent, and even as low as 5 percent, when congestion continues and the network jams.

Good Morning Viet Nam

Viet Nam officially cleared its $140 million arrears with the IMF in late-September, paving the way for renewed IMF and World Bank support. In turn, the IMF disbursed its first loan to Viet Nam since 1981 in the amount of $223 million. Of the total, $85 million will be used to pay off the syndicated bridging loan that Hanoi obtained in September (from a fifteen-nation group of donors, cochaired by France and Japan), to settle its longstanding IMF debt. Some $17 million represents the first of two STF tranches, while the rest is a stand-by available over the next twelve months to support the government’s economic and financial reform program. The Fund said Viet Nam has made major progress since moving toward a market-oriented system, and cited as positive factors the move toward family-based farming, liberalization of agricultural prices, reforming the tax system, and establishing a two-tier banking system. The IMF said that under its 1993-94 program, Viet Nam planned to limit its budget deficit to 5.5 percent of GDP in 1993 and 4.5 percent in 1994 by containment of growth in current expenditures to cut inflation to 7 percent by end-1994 from a 38 percent annual rate; and to maintain economic growth of 7 to 8 percent. The program calls for further foreign exchange and trade liberalization, including removal of nontariff barriers and reform of the import licensing system. Bankruptcy and labor laws already are being drawn up. Land use rights will be clarified, and the government will speed up a restructuring of state enterprises.

IBRD President Lewis Preston announced the World Bank’s first loan to Viet Nam since 1978, a $70 million education credit. Another IBRD loan of $158.5 million for upgrading roads have been approved by the World Bank in October.

Camdessus’s Field Visit

IMF Managing Director Michel Camdessus began a visit to Viet Nam on October 10. The four-day visit to Hanoi and Ho Chi Minh City follows the settlement of Viet Nam’s arrears with the Fund Camdessus said Viet Nam faces a formidable list of challenges, but that he is convinced the country will soon catch up with the performance of the “radiant” Southeast Asian economies. He noted the country’s success in cutting inflation, increasing exports, and reducing the current account deficit in the past few years, despite shocks caused by the collapse of Communist aid and trade with the former Soviet Union and Eastern Europe. He also told his hosts that the IMF would help Viet Nam reschedule its $4.5 billion debt in negotiations next month with the Paris Club.

Transition Economies and the World Bank

The magnitude and pace of political and economic changes in Central and Eastern Europe, the Baltic states, and the former Soviet Union have posed an unprecedented challenge for the entire international community, states the World Bank Annual Report 1993. The Bank’s total commitments to the Europe and Central Asia region (including those made by the IDA) in fiscal 1993 amounted to $3.84 billion, about 16 percent of all commitments made by the Bank and IDA in that fiscal year. Major structural changes undertaken by the postcommunist countries include price and trade liberalization, privatization, creation of legal and institutional frameworks to help the development of pri-
private enterprise, financial sector reform, and setting up mechanisms to protect the most vulnerable social groups during the transition period. Just as political and economic heritages of these countries are diverse, so, too, do they differ from one another in their ability to push through reforms. Eleven of the Soviet Union’s successor states joined the World Bank in fiscal 1993, as did Latvia and Lithuania. The Russian Federation and Estonia had already joined in June 1992. The Czech and Slovak Republics became separate members on January 1, 1993. The Bank’s executive directors terminated the membership of Yugoslavia in February 1993, permitting the five successor republics to become members. Croatia and Slovenia joined in February 1993. By the end of the fiscal year, application procedures were pending on membership for Bosnia-Herzegovina, the Republic of Macedonia, and the Federal Republic of Yugoslavia.

**Stand-by to Hungary**

In mid-September the IMF approved a $478 million stand-by credit to Hungary in support of the country’s economic program through end-1994. Hungary’s goal is to attain an annual economic growth rate of 2 percent, reduce the rate of inflation to 17.3 percent in 1994, and stabilize the current balance of payment deficit. The budget deficit is to be cut from almost 7.3 percent of GDP in 1992 to 5.3 percent in 1994, keeping it under 250 billion forints. Hungarian residents will be encouraged to participate in the privatization procedure. Other reforms include recapitalizing the banks, improving the bankruptcy process, and strengthening the governance of firms remaining under state control.

**Cambodia Full IMF Member**

The IMF has authorized Cambodia to draw anew on its financial resources and has approved its first financial assistance to the country in nearly twenty years. The Fund approved a $9 million loan under its Systemic Transformation Facility, designed to help once centrally planned countries make the leap to a market economy. Earlier, Cambodia had cleared $52 million in arrears with the Fund. Cambodia has also completed negotiations on a $62.7 million emergency loan from the World Bank to finance essential imports. International donor countries pledged $119 million in new financial aid to Cambodia to help Phnom Penh rebuild its economy. The aid package was announced at the end of a two-day meeting of the International Committee for the Reconstruction of Cambodia, which includes thirty-one donor countries and eleven international organizations. The donations, which are to be disbursed in early 1994, include $20 million from Japan and 62 million francs from France. A total of $714 million of the $880 million promised last year has been disbursed and another $135 million is expected to be committed by early 1994, officials said. Cambodian Finance Minister Sam Rainsy told donors that his government needed $10 million-$13 million in external assistance per month to keep the government running and provide basic public services.

**IMF Approves STF Credit to Moldova...**

The IMF approved a $32 million credit to Moldova from the Fund’s Systemic Transformation Facility to help steady the country’s shaky economy and rein in rocketing inflation. The country wants to bring monthly inflation down to single digits by the end of 1993 from an average of more than 25 percent in the first quarter of the year. Moldova has experienced persistent difficulties in obtaining key raw materials from other countries of the former Soviet Union, the Fund said in announcing the loan. The deputy chairman of the central bank, Dumitru Ursu, said Moldova plans measures to control inflation. The bank will issue 10 billion rubles of new cash, and the temporary five-lei banknotes will be withdrawn from circulation. ...and Supports Kyrgyzstan

The IMF authorized Kyrgyzstan to draw $23 million as a second tranche of the Fund’s Systemic Transformation Facility, and a further $3 million under a stand-by credit, approved in May 1993. Although the economy is experiencing a steeper decline than expected, stabilization is beginning to take hold (partly due to the successful introduction of the som), inflation has been contained, and external reserves have been built up, asserts the IMF statement.

**World Bank Loan to Kazakhstan**

In mid-September the World Bank announced a $180 million loan to Kazakhstan, a country of 17 million people where industrial output fell by one-quarter between 1990 and 1992 and is expected to drop another 8 percent in 1993. Kazakhstan has launched radical economic reforms to turn the tide. The Bank loan is broken into two parts. Some $94 million will help expand Kazakhstan’s ailing foreign exchange auction market, which aims to make hard currency available to importers. The new foreign exchange will help meet the rising demand from new businesses that need cash to buy essential imports. The other $86 million of the loan will pay for vital imports in agriculture, energy, transport, and health.

**IFC Follows Suit**

The IFC announced the approval of its first investment in Kazakhstan. The International Finance Corporation will take an equity holding of 20 percent in ABN-Amro Bank Kazakhstan. ABN-Amro Bank Group, the leading Dutch bank, will be the technical partner and will have 51 percent of the bank’s capital. Kramds Bank, the largest local private group in Kazakhstan, will hold 29 percent. The newly established bank will focus on supporting foreign trade and will offer financial advisory services.
Milestones of Transition

**Russian** President Boris Yeltsin has extended the validity of privatization vouchers to July 1, 1994 (they were due to expire at year-end). First Deputy Prime Minister Yegor Gaidar has been drawing up plans for deregulating commodity markets, opening up foreign trade, and furthering privatization. Finance Minister Fedorov has drawn up a program of measures aimed at achieving macroeconomic discipline, including a ban on the use of foreign currency (see next entry); an increase in the value-added tax of 7 percentage points; an increase in the marginal rate of income tax on top salaries to 50 percent; higher import duties on cars and other goods; further restriction on credit to most sectors of industry; a review of capital investment; postponement until 1997 of interest payments on government debt to the Russian central bank; and 30 percent cuts on imports of raw materials. Boris Fedorov expressed hope that the Russian state would be able to keep deficit spending within the R 4.7 trillion borrowed from the Russian central bank for the last quarter of 1993, line with a proposed 1993 shortfall of R 16 trillion.

The **Russian** central bank is to ban all transactions in foreign cash, effective January 1, 1994. Enterprises are to hand in all foreign banknotes to banks by December 31. Transactions using hard currency credit and charge cards and other internationally accepted forms of financial dealing will still be permitted. Permission to trade in foreign cash will be withheld, effective November 1. Finance Minister Boris Fedorov said that Russian banks held $11 billion in deposits from private citizens and enterprises. Fedorov claimed that government reserves have doubled and that 75 to 80 percent of rubles in circulation are now backed by hard currency.

The **Russian** government has prepared a draft decree on agrarian reform that gives people the right to own land and dispose of it freely; Commonwealth television announced in early October. The decree appears to supersede a previous restrictive ruling by the former supreme legislature, the Congress of People's Deputies, which President Boris Yeltsin dissolved in September after accusing it of blocking reform. The Congress allowed private ownership of land but banned the sale and purchase of land for ten years, effectively preventing a free market.

**Russia's** total foreign debt stood at $72.5 billion by the end of the first quarter of 1993, including $4.7 billion in overdue interest payments, according to a central bank report published in early September. The total debt figure compares to $74.6 billion on January 1, when overdue interest payments were $2.8 billion. Debt on tied medium-term credits totaled $32.7 billion, down from $36.3 billion on January 1. And non-tied credits were $20.4 billion, compared with $21 billion. The debt on commercial credits was $7.2 billion as of April 1, 1993, up from $6.6 billion. The bank said the former Soviet Union’s debt to the Paris Club of official creditors was $35 billion, and debt to commercial bank creditors $16 billion-$22 billion.

**Belarus** is in a deep economic crisis; production has fallen by 15 percent from 1992, and the country's finances are completely dependent on the price of Russian energy, asserted Stanislav Shushkevich, chairman of the Supreme Soviet, at the September 15 session of Parliament. Belarus officials are hopeful that a proposed pipeline running from Yamal in northern Russia to Central Europe via Belarus will ease the economic blow of paying world prices for its energy supplies. Belarus officials saw it as an opportunity to buy Russian gas more cheaply. The pipeline would transport 80 billion cubic meters of gas through Belarus annually, four times the current amount. (The pipeline was part of a gas transport agreement signed between Presidents Boris Yeltsin and Lech Walesa in August. As the new line would divert a substantial portion of the gas currently piped through Ukraine, the deal is being criticized by Ukrainian officials as “anti-Ukrainian.”)

The energy crisis has forced the **Ukraine** government to place strict limits on electricity use in the fourth quarter of 1993. Half of the industries in Kiev have already been shut down because of inadequate gas, fuel, and coal supplies, even though Ukraine is self-sufficient in coal. In September the government took measures to reduce energy consumption by fining factories that used too much fuel and electricity and by cutting off supplies to customers who failed to pay their energy bills. The crisis has been prompted by Russia’s moves to increase the price of its gas and oil to world prices. Ukraine’s second supplier, Turkmenistan, also wants to be paid world prices for its gas even though it has an agreement with Ukraine allowing it a 40 percent discount.

**Ukraine** Economics Minister Roman Shpek said Kiev needs to take a gradual approach in shaking off the legacy of seven decades of communism. Acting Prime Minister Yefim Zvyagilsky’s government is working on a new anticrisis program that will place renewed emphasis on stabilizing the economy through central control, slowly weaving in market reforms. In the latest round of subsidies to agriculture and social security, the government and central bank agreed to raise the ceiling on state credits in the third quarter by one-third, to $1.1 billion.

President Nursultan Nazarbaev told **Kazakhstan’s** Supreme Soviet at its current session that total production in 1992-93 is down 25 percent in comparison with 1991, the last year before independence. Industrial output is down 22 percent, capital investment 70 percent,
and retail trade turnover 41 percent. Nazarbaev attributed Kazakhstan's dismal showing to the trade barriers within the former U.S.S.R.

The leaders of nine former Soviet republics signed a treaty in Moscow on September 24 creating an economic union. The treaty was signed by Azerbaijan, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, and Uzbekistan. Ukraine signed as an associate member; Georgia signed some of the provisions, as an observer; and Turkmenistan said it might join later if amendments were made in the provisions on taxes, company law, and finance. The treaty envisages the gradual reduction and eventual abolition of all customs tariffs and other internal trade barriers; equal legal status for companies in all member states to encourage the creation of jointly owned enterprises; and a payments union, or multicurrency clearing system, that would be run through an interstate bank and could eventually become a currency union.

Moldova launched a sell-off of state property with an auction of seven food shops and two cafes to citizens holding privatization vouchers. Vouchers for variable amounts have been issued to 3.5 million Moldovans and can be used to buy a stake in any of the 1,595 state-run enterprises—three-quarters of Moldova's state property—that the country aims to sell by the end of 1994.

Poland's servicing of both its internal and external debt is expected to increase expenditures to 115 trillion zloty ($5.8 billion) in 1993. Poland will be unable to contain its spiraling public debt without a substantial write-off on its $12 billion debt to foreign commercial banks, disclosed Osiatynski, the former finance minister, in an early September interview. The creditor banks have offered 30 percent, but Poland is hoping for a 50 percent write-off.

Central planning chief Jerzy Kropiwnicki said in mid-September that Poland's GDP could grow by as much as 4.5 percent in 1993. Industrial production was 7.8 percent higher than in the same eight-month period of 1992, labor productivity was up by 11 percent; the financial health of enterprises continued to improve; and the situation in agriculture was less gloomy than expected, despite the effects of the 1992 drought. Kropiwnicki's major worry was Poland's negative trade balance, which grew to more than $1.4 billion in August. Poland's gross domestic product grew by 1.5 percent last year, revised figures from the Central Statistical Office show. GDP in 1992 reached $84 billion, or $2,200 per capita. The private sector's share of the economy grew to 49.7 percent as its output expanded by 11.3 percent, against a 6.6 percent fall in the output of the public sector.

Polish government officials announced that income from privatization for 1993 is running ahead of schedule for the first time since the program began, and that the annual revenue goal of 4 trillion zloty ($211 million) planned in the budget was met in September. Since August 1992, privatization contracts have won guarantees of new investments worth 13 trillion zloty ($684 million) over the next five years and have secured 110,000 jobs. So far this year, thirty-seven major state firms have found new private owners through "capital privatization," officials said. The ministry plans to sell another thirty firms by the end of October.

The Institute for International Finance, which represents many of the world's large commercial banks, called for new approaches by the World Bank and other multilateral institutions to improve their effectiveness in using private funds for developing countries. IIF Managing Director Charles Dallara in a letter to the Chairman of the Interim Committee, Belgian Finance Minister Philippe Maystadt, points out that the World Bank and its private-sector affiliate, the IFC, should in some instances—particularly in transactions that can be largely carried out by the private sector—play a supportive rather than a lead role. The international financial institutions should discuss the "gray areas" of loans with the private banking sector, letting bankers know where commercial risk ends and political risk begins. The development banks should reconsider whether it is appropriate to insist on borrowing-government guarantees for all lending, suggested Dallara.

Hungary's industrial production was up 2.5 percent in the first seven months of 1993 compared with the same period last year. (Industrial output has declined by some 40 percent over the past four years.) Production of manufacturing industries was up 20 percent during the first seven months, while machine industry production rose 12.9 percent, with domestic sales up 16.8 percent. The food, drink, and tobacco industries reported an 8.3 percent loss in domestic sales and a 31.7 percent drop in export sales in the same period. Real GDP will drop another 2-3 percent by the end of the year, the balance of payment deficit will exceed $2 billion, and the consumer price index will rise to 22-23 percent compared with 1992, according to reports in mid-September from the Hungarian News Agency, which quoted government forecasts.

In the first four months of 1993, Hungary's gross foreign debt increased by $2.2 billion, to $23.6 billion, reported the Budapest economic daily, Napi Vilaggazdasag, on September 15. To help meet Hungary's credit needs, the Hungarian national bank, through Credit Lyonnais and four other French banks, in Paris on October 12 issued bonds with a six-year maturity worth one billion French francs. The day before, October 11, the national bank, with the assistance of a consortium of Swiss, German, American, and Japanese banks, had also issued in Switzerland six-year bonds worth 200 million Swiss francs with a 6.75 percent annual yield.
Foreign investors committed more than $42 billion to more than 1,700 projects in the twenty-eight countries of the former Comecon countries in the eighteen months leading up to end-March 1993, according to figures compiled by the East European magazine, Investment.

President Ion Iliescu of Romania says quick privatization and shock therapy are not the way to modernize the country’s sluggish economy. Speaking in Bucharest in early October, at the official launching of a mass education campaign by the government’s National Privatization Agency, he said the inertia of the economic system has proved greater than that at the political system and that it cannot endure brusque and radical changes. He went on to say that privatization is not an easy process, especially when it comes to privatizing 6,000 large state-owned enterprises. Reorganization provokes disorganization. The most complicated task, Iliescu added, is to change the mentality of people.

Romania has failed to complete postcommunist land distribution under a law adopted two-and-a-half years ago, Gheorghe Antochi, secretary of state at the Ministry of Agriculture, told the business newspaper, Meridian. The ministry has issued 420,000 property deeds since the land reform law was adopted in March 1991, but Antochi said that “a further 5 million Romanian citizens are waiting to get their land ownership certificates.” He said the issuing of documents has been hindered by an acute shortage of ministry staff, adding, “We have now the necessary data to issue another 153,000 deeds.”

China’s economy is in for a hard landing in 1994, with a rapid recovery in 1995, following counterinflationary policies imposed to curb the overheated economy. These are the findings of a study by the Amsterdam-based Mees Pierson Securities (Asia) Ltd., which projects that China’s real GNP growth will fall to 6.5 percent in 1994, from 12.7 percent in 1993. Chinese Finance Minister Liu Zhongli told the World Bank/IMF Annual Meetings that China would speed up reforms. It will introduce value-added tax, reform state-owned enterprises, and adopt a new budget mechanism that will help control the deficit.

The Banco de Angola devalued the kwanza by 38.5 percent to 6,500 per U.S. dollar to narrow the gap between the official and black market exchange rates. Angolan Finance Minister Emanuel Carneiro has flown to Europe to explain arrears on the country’s $8 billion external debt and to seek the unblocking of credit lines. Arrears grew this year as the government directed resources to its renewed war against the rebel UNITA movement.

The first private sector commercial bank opened in Tanzania, ending nearly three decades of state banking monopoly in the country.

(We appreciate the contributions from the RFE/RL Research Institute.)
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Hungarian agricultural production has remained protected through import licensing, and agricultural export subsidies have become a large share of total government subsidies. Harmonization of Hungarian agricultural sector policies to those of the EC could mean the introduction of a Common Agricultural Policy (CAP)-type system, and the continuation of export subsidies. Authors developed a computable general equilibrium model, calibrated for the year 1990, to evaluate the consequences of possible Hungarian policy actions. The results show that import protection, export subsidies, or imposition of a CAP-type system would be costly, inefficient policies. The tariff equivalent of the import licenses is estimated through a detailed price comparisons study, the first of its kind for Hungary. The removal of import licenses in the presence of export subsidies would generate byproduct distortions in the export market and little gain in welfare may ensue. Piecemeal removal of export subsidies, on the other hand, will not generate byproduct distortions, but the gains would be to the detriment of adjustment cost.


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Central Asian and Transcaucasian Newly Independent States’ tax policy strategies conform to neither an optimal nondistortional tax structure as a one-shot action nor to an interim tax structure with identifiable and clearly understood distortional elements focused on closing the fiscal deficit. NIS policies are rapidly acquiring complex features comprising multiple rates, exemptions, and other properties, which are difficult to administer. Steady—and perhaps prolonged—effort needs to be made if simple, broadly based, and revenue-productive tax structures are to be achieved.


The economic performance of independent Ukraine has been disappointing. It has been less exposed to the disruption of trade and higher energy prices following the breakup of the Soviet Union than most other ex-republics but it has one of the worst inflation rates in the region (a monthly 50 percent). Credit provided at negative real interest rates and a growing government budget deficit have meant high and rising rates of monetary emission. De facto price controls continue to distort markets and most trade in food products remains in the state sector. The privatization process has moved ahead only slowly. [The ceiling on state credits in the third quarter has been raised by one-third, to 16 trillion karbovanets (US$1.1 billion).]

Large subsidies have been directed to agriculture, which has suffered from recent increases in fuel costs due to higher Russian prices. Over the summer, the government granted subsidies to collective farms exceeding 7 trillion karbovanets (US$530 million). The Ministry of Agriculture has requested additional subsidies of 10.6 trillion karbovanets.

The failure to control inflation has made it more difficult to establish a strong system of public finance, start meaningful private sector development, and restructure the banking system. Ukrainian experience demonstrates what happens when partial and gradual anti-inflation measures fail.

The number of individual peasant farms in Russia has grown from less than 1,000 in the fall of 1990 to 258,000 by July 1993, accounting for about 5 percent of the agricultural population and more than 4 percent of Russia's cropland. Most state and collective farms have reorganized into some form of joint stock enterprise, in which each worker has both land and nonland (property) asset stocks that can be turned into actual land and other assets to start an individual peasant farm. The holders of the 41 million small plots account for another 4 percent of cultivated land (including the household plots held by workers on present or former state and collective farms, garden lots, orchard plots, and dacha plots held by urban residents). They have full ownership over these plots, with the right to buy and sell their property.

Other recent papers by Simon Johnson (and others) published by The National Council for Soviet and East European Research:

- Reform in Russia, Rural Development Institute (RDI), in collaboration with the Agrarian Institute, Moscow Monographs on Foreign Aid and Development, no. 11, 1993, 50 p.

The number of private farms could possibly increase to around 800,000 by the mid-1990s. Russia appears likely to undergo a much more gradual process of decollectivization than China. Even the most accelerated scenario would probably result in no more than 1.5 to 2 million individual farms by the end of the decade, while perhaps half the farmland would remain in a reformed collective and state farm sector and be farmed jointly.

The direct purchase and sale of agricultural land between broad categories of individuals should be sanctioned. Purchase and sale rights would enable farmers and banks to use the existing right to mortgage. Thus, a true credit and land market could be created. Farms should operate according to market economic principles, rather than relying on subsidized credit and inputs.

Marketing and processing of agricultural products need to be further developed. The experience of industrialized democracies should be drawn on for the agrarian reform in Russia, including technical assistance to design alternative farming models. Private investors should be encouraged to build tractors and
equipment suitable for individual-farm use. (The average cost of starting a peasant farm today would be equivalent to about $4,000.) For $400 million in aid, perhaps 100,000 families could start individual farming.


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Central and Eastern Europe


The survey confirms the view that there is unlikely to be a large immediate expansion in foreign direct investment (FDI) to the transition economies of Central and Eastern Europe (including states of the FSU). The lagging regions of the Community do not have much to worry about. Given market potential and political and economic stability, investors are not making location choices based on capital costs and the availability of cheap labor, and have not, as yet, seen the need to compare CEE countries and the lagging regions of the EC. If the potential is there, they will invest in both. It is wrong to think of a "fixed" quantity of investment, where an increase in one country's FDI can only be at the expense of another.

If reform proves successful, a progressive reduction in the industrial concentration of CEE exports to the EC is expected. Economic structures in the CEE countries should become increasingly similar to those of comparable OECD economies. Potential growth of EC manufacturing exports to Eastern Europe and the FSU is expected. The CEE and FSU countries have to face large projected trade deficits in manufactures with the EC. There is scope for considerable growth in intraindustry as well as interindustry trade.

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Qingzhao, Hua, From Yalta to Panmunjom: Truman's Diplomacy and the Four Powers, 1945-1953, Cornell East Asia Series, Cornell University East Asia Program, no. 64, 1993.


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The ESMAP Connection, newsletter of the Joint UNDP/World Bank Energy Sector Management Assistance Program.

To order: The ESMAP Connection, the World Bank, 1818 H Street, N.W., Washington, D.C. 20433.
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