THE NEWSLETTER ABOUT REFORMING ECONOMIES

TRANSITION NEWSLETTER

The World Bank Group
Our Dream is a World Free of Poverty

THE WILLIAM DAVIDSON INSTITUTE
AT THE UNIVERSITY OF MICHIGAN BUSINESS SCHOOL

Vol. 11, No. 6 Nov.-Dec. 2000/Jan. 2001

Contents

We are pleased to announce that the Local Government and Public Service Reform Initiative (LGI/OSI), a member of the Soros/Open Society network of foundations, is joining our team of contributors and sponsors. With their help we will be able to expand our coverage on such important issues as decentralization and public administration reform in the transition economies.

World Bank's Ukraine Team on Unchartered Territories—Learning from Past Mistakes

Interview with Country Director Luca Barbone

Preparation of the World Bank's new Country Assistance Strategy (CAS) for Ukraine broke new ground last year, when for the first time a draft CAS was put on the Internet to generate countrywide discussions. The CAS outlines the Bank's planned policy and lending program for 2001–03. This initiative enjoyed the support of Ukraine's reform-oriented government, which was elected to office last year. In addition to posting the CAS draft on the Internet, the Bank's Ukraine team organized roundtable discussions across the country, gauging the public's reactions to various aspects of the new strategy, including poverty reduction, environmental protection, energy sector reform, and the fight against corruption. At these meetings, more than 200 NGOs, business groups, professional associations, think tanks, and media representatives were able to criticize and praise the Bank's "three-year plans" and put forward new suggestions. Transition editor Richard Hirschler asked Country Director Luca Barbone, in charge of the Bank's operations in Ukraine and Belarus, how the Bank benefited from this free-spirited dialogue with Ukraine's civil society.

Q. What have been the major lessons learned from the mistakes of the Bank's earlier assistance strategy in Ukraine? NGO comments criticized the lack of transparency but focused primarily on the ineffectiveness of World Bank loans. Was the Bank ready to make the necessary adjustments when the new strategy was finalized?

A. Complaints about past lack of transparency were justified because during the preparation of the first assistance strategy we weren't holding consultations in Ukraine. But there was a more fundamental issue, which became clearer during the implementation of the strategy between 1997 and 2000. We really learned a lot. The way I, and many others, see it is that the Bank's and the international community's approach to the former Soviet Union has been an evolving concept. We didn't really fully grasp the deep legacy of the Soviet Union. We didn't quite understand how deeply the ideology and the organization of the old system affected society, even after the break-up of the Soviet Union. At their forming, the new independent states were still basically left with a power structure and an organizational and institutional structure that reflected 70 years of "socialism" and authoritarianism, not the previous few years of reforms. I think that this underestimation is the main reason we and the rest of the international community failed in many ways in pushing reforms. We used the lessons gained from Poland and the other countries in Central Europe, without realizing that a huge institutional gap existed.

Public Disclosure Authorized

Based on these reflections, which I am just caricaturing here, we adopted a number of hypotheses. First, we have to plan for the long run—and formulate our strategy—by accepting ups and downs in the transition process, and this should also define our lending policy. More important, we must deemphasize policies and emphasize institutions. Institutions in the sense in which Douglass North interpreted them: ideas, ideologies, prejudices, rules of behavior, not organizations or other physical entities. To transform these kinds of institutions, the culture must be changed. This involves much more than simply privatizing state-owned enterprises or passing laws. It involves changing the attitudes of public officials, even the attitude of the private sector.

Second, we realized that the government cannot just create and legitimize new institutions and behavioral norms and parachute them from the top to the public through laws and policy actions. Civil society should feel the need for change. Therefore we have to be in a position to help both the public and the government—both sides of this transformation. That is why we decided early on that the draft of the country assistance strategy would be the subject of substantive discussion with civil society, which had initially been weak and fragmented, as in other former communist countries. The Bank had been targeting partnership with NGOs for a couple of years; it was talking a lot. But from an operational point of view, it had done relatively little. So for our team it was a year of intensive learning. We set up new activities, often changed our way of doing business, scrutinized our actions in the light of whether they would help civil society, whether they would advance legitimacy of new institutions.

Q. Through this dialogue with civil society, the Bank has to communicate sometimes delicate policy issues that might hurt those whom these NGOs represent. For example, in pressing for the collection of market-oriented utility tariffs, you have to face the furor of the poor, who might be evicted from their homes if they cannot pay the bills.

A. The issue of cash collections was, of course, discussed with NGOs and stakeholders. But their perspective was a lot different from what we expected. They made the point that those responsible for the situation are the state-owned enterprises, which have accumulated huge arrears and are withholding payment to their employees and suppliers. Your specific example was not on the agenda, probably because social safety net mechanisms in some degree ease the pain of higher energy prices.

Q. How many of the recommendations of civil society have been integrated into the new CAS?

A. Some of the recommendations were not feasible. There were, for example, a lot of requests for changing Ukraine's government policy. But in many cases we received extremely useful suggestions and reacted positively. We found the environmental concerns of many NGOs legitimate. We recognize that the government needs to strengthen its operations to monitor emissions in a meaningful way, fine polluters, and finance environmentally friendly projects from a national environment fund, which could pool these fines and fees. We have put back this issue in our work program, will review it, and, in agreement with the government, use our Programmatic Adjustment Loan to support capacity building of the government to deal with environmental issues.

Q. How have you organized your interactions with the third sector at a practical level?

A. We have changed—and are still in the process of changing—the way we do business. On a day-to-day basis, we have formed a contact group representing Ukraine's civil society. With their help, we have identified projects in which NGOs will have a crucial role to play, participating both in project preparation and implementation. We receive continuous feedback from NGOs.

In addition, we are helping the government formulate new laws on civil code and taxation that will ease the present financial squeeze on the NGO sector. Right now by law NGOs are not permitted to sell services. They cannot accept reimbursement, even for such service as treating AIDS patients. As a result, they depend too much on foreign contributions. We cannot hire local groups that care about the poor, because the legislative framework is so inadequate. We are also sponsors of the People's Voice project, modeled after the famed initiative in Bangalore, which is helping change the relationship between citizenry and local officials in a few cities.

The Ukraine team has developed a series of initiatives aimed at increasing information flows. One project will finance installation of the Internet in Ukraine's library network. We are also working both with the government and with civil society organizations to help them provide, gain access to, and benefit from more information by using the Internet. Another project will develop tools and methodologies to increase the accountability of public officials. In this sense the civil society strategy has become an integral part of our actions. We travel uncharted waters, learning by doing.

Q. The country strategy was approved last September. Can it still be adjusted?

A. The CAS is a living document. Probably in a year or a year and a half, we will

review what has been achieved. We will collect more feedback and more suggestions. There is also a CAS interim document. Depending on how the economic situation evolves in Ukraine, we might even increase our assistance.

Q. According to Oxford Analytica, Ukraine's GDP should grow 4–4.5 percent this year, industrial production 7–8 percent, almost as good as last year.

A. I agree, this year should be another successful year in Ukraine. Last year was the first year of growth since independence; GDP increased 6 percent, industrial production was about 10–11 percent higher than in 1999. Exports have grown substantially, faster than imports. But what is especially heartening is that this positive outcome does not reflect merely the effect of external circumstances, growth in Russia, for example.

There is some evidence that domestic reforms are producing positive effects. Take the progress in energy payment. Not too many people realize that the increase in cash payments in the energy sector has been due to a hardening of budget constraints of unheard of proportions. The authorities disconnected 23,000 enterprises and entities that were not paying their electricity bills, something that is without precedent. Reduction in nonpayments results in a better-oiled economic system, enterprises that can respond to changes in demand, workers that have cash to buy what they want.

It's not all roses, of course. When you start enforcing payment discipline it means many enterprises that were used to getting free gas or electricity start to pay for it. Many of these enterprises are owned by oligarchs and have very strong political connections and strong connections in the judiciary. These are not pain-free reforms we are pushing.

Programmatic Adjustment Loan (PAL)

The PAL supports medium-term government programs that involve continuous, incremental policy reforms and institution-building over several years, mostly in the public sector. These programs aim at strengthening budget management and improving governance, resource allocation, and public service delivery. A series of one-year loans are made over three to five years, each building on the preceding loan. Traceable indicators (targets, benchmarks) are built into each loan, and disbursements are carried out ex post, as the reform progresses, in proportion to targets reached.

Q. Why is the Programmatic Adjustment Loan a major feature of the CAS?

A. Because the concept of these loans better match the way we want to support the government's reform program. We have made tremendous progress in preparing the first Programmatic Adjustment Loan (PAL). In our CAS we agreed on a three-year program. The program is the government's program. They used to negotiate, bargain over conditions. This time when they said they could not reach the targets, we asked them, "O.K., how far can you go?" They told us they could go half way. We agreed. On the government's side they were genuinley surprised.

The point is, we try to ensure their maximum ownership. Keeping the institutional focus of the CAS, we concentrated not so much on policies and laws but on trying to define benchmarks of outcomes, clear changes in behaviors, and rules of the game that we think are associated with faster growth and a more inclusive society. We have been working with the Ukrainians based on this new concept for a year now. The Ukrainian government achieved a sufficiently critical mass of results and we can provide the loan, once the Bank's Board of Directors approves it. And we will go ahead every time with these one-tranche operations if we feel confident that there is a critical mass of change.

Q. So they have to achieve something first and then they get the money? But won't these programs be costly initially?

A. The point we are making is that if they do the right thing, they are not going to need our money. I never really believed in the concept of prepayment of the costs of reforms.

Q. How would you respond to the concern that the disbursed money will disappear into the budget, making monitoring impossible?

A. We have put a lot of effort into trying to improve the way in which the government handels its money, not just the World Bank's money. Adjustment loans are budgetary support, so the issue is not what happens to the relatively small amount of money the Bank would put in the budget but how well the budget is executed. That is why, for instance, budget reform and improvements in budget management are very high on the agenda in our PAL. That is the way we need to go. The issue of monitoring individual tranches is a bit irrelevant, because we know the argument of fungibility. The question is the integrity of the whole program.

Q. How much impact can the Bank have in Ukraine in the next three years?

A. It's not the Bank that is going to have an impact, it is the government that should solve fundamental problems. In the end, it is their program; our success is measured by their success. We have good relations not only with the new government but also with the presidential administration and the parliament. Another benchmark we have chosen for ourselves is to see to what extent we can succeed with the civil society leg of our strategy. This will imply asking much more often what Ukraine thinks of us. We ran a detailed client survey across Ukraine with focus groups to determine how Ukrainians perceive our activities. We will repeat it year after year to check whether we are sending the right message and if it is understood.

Voices of the People: Comments on the Bank's Country Assistance Strategy for Ukraine

The views presented here have been posted on the Internet or gathered during surveys conducted by the World Bank's team in Ukraine.

About the First Country Assistance Strategy (1997–2000)

National Ecological Center of Ukraine, Kyiv

Although the World Bank provided more than $2 billion to the Ukrainian government during this period, economic reform was not implemented and Ukraine's economy could not expand. One reason was that the Bank's Country Assistance Strategy (CAS) was not discussed with representatives of the public, giving the public no chance to participate in supervising the strategy's implementation. No mechanisms were introduced to keep the public informed about the implementation of Bank projects. This lack of information enabled some local bureaucrats to arbitrarily manipulate disbursed funds, which hurt the World Bank's image in Ukraine.

While poverty increased in Ukraine—about 30 percent of the country's population is currently living at or below the poverty level—the ratio of state debt to GDP increased from 22.1 percent in 1997 to 40.8 percent in 1999. The share of state debt owed to the World Bank rose from 11.6 percent in 1997 to 40.8 percent in 1999. The increase in poverty and state debt should be discussed at public hearings.

Alter-Eco, Ecological Coalition of Ukraine, Sevastopol

The CAS for 1997–2000 did not pay enough attention to the specifics of the country, and the public was not well acquainted with the World Bank's strategy or with concrete World Bank projects. Documents prepared by World Bank experts and government officials were not presented to the public. World Bank loans failed to improve the well-being of most citizens. Significant groups in the society became disenchanted with the Bank. An appraisal of the 1997–2000 CAS accomplishments, including information on the implementation of concrete projects within the CAS framework, should be published and widely circulated.

About the Second Country Assistance Strategy (2001–03)

Alter-Eco, Ecological Coalition of Ukraine

The main weakness of the CAS is the disparity between the Bank's intention to support civil society and the absence of concrete mechanisms for providing funds for developing such a society. The World Bank envisages only economic studies to be conducted in this area. During preparation of each project the World Bank should use public hearings to inform representatives of civil society about the implementation of projects. The Bank should recognize the specifics of Ukraine and take advantage of the experience of local specialists during project implementation.

As long as civil society is weak, reducing the state's watchdog role in environmental issues would violate citizens' rights, including their ecological rights. There is a great risk that hazardous waste will continue to be dumped near residential areas, that unsafe labor practices will be maintained, and that public information will be concealed, contributing to the continued degradation of the environment in Ukraine. Thus state influence should be reduced only in parallel with the strengthening of civil society. If civil society is weak while many bureaucrats are motivated solely to enrich themselves, foreign loans (and domestic budgetary resources) intended for the public sector could be squandered by officials.

The majority of the public is not feeling the positive impact of the loans. The CAS is not linking the well-being of the population to the preservation and revitalization of the environment. Environmental preservation remains an appendage to economic growth.

National Ecological Center of Ukraine

The World Bank should encourage the government to involve NGOs in preparing and monitoring investment projects and restructuring programs. The Bank should advocate transparency of government institutions, in particular by helping set up public information departments at ministries and other government organizations. The World Bank should promote creation of a favorable legislative environment for NGO activity.

The Bank should prevent possible negative consequences of using Programmatic Adjustment Loans (PAL) as key elements of financing. Injecting these funds into the state budget makes it impossible for the public to trace their whereabouts. Supervising the use of funds should therefore be strengthened. The World Bank should include NGO representatives in working groups that will participate in preparing and implementing PALs.

Environmental issues are granted a rather modest place in the strategy. The main

emphasis is on the GEF Biodiversity Conservation Project for the Azov-Black Sea Ecological Corridor. The CAS does not clarify what part of the World Bank's total loan portfolio, including the PAL, will be used for conservation. The World Bank should help finance ecological education in Ukraine's secondary schools and universities. A National Ecological Fund should be established to pool all ecological fees, and these and other funds should be used for environmental protection (currently, only 10 percent of collected ecological fees and fines are spent on ecological activity).

I. Malakhov, International Charitable Fund Research Center for Social Policy, Kyiv

The CAS ignores judicial system reform in Ukraine. The structure of judicial bodies was established in 1939, at the height of the Stalinist terror, and has not changed since then. It may well be that World Bank resources will be lost because of lack of civilized justice. One can create as many laws as possible and allocate funds in support of the most progressive projects, but the laws will never be executed and funds will get into someone else's pocket. To overcome corruption, a well-operating civilized judicial power must be established. In addition, the CAS lacks programs that support national science and culture, vital elements of civil society.

Semion Gluzman, President, International Charitable Fund Research Center for Social Policy, Kyiv

This document destroys the myth—established long ago by professional demagogues of the modern Ukrainian political establishment—that the cruel "world plunderer" (the World Bank) brutally devours the naive Ukrainian lamb. This document should be published and circulated in all regions throughout Ukraine. It should be printed in the Ukrainian mass media.

S. Fedorinchik, Head of Information Center, Zeleny Svit (Green World), Ukrainian Environmental Association, and Co-Chairman of Coalition for Energy Safety, Citizen Awareness, and Rights, Kyiv

To improve awareness of reform by the population and ensure its participation in the discussion of draft laws, it is critical to provide email facilities in all 778 administrative areas of Ukraine. To ensure public access, personal computers and modems have to be installed in all regional libraries. To ensure the introduction of an effective land code that would also achieve environmental objectives, including equitable land distribution and incentives for ownership reform, public hearings should be organized across the country. To prevent corruption and ensure transparency and awareness of citizens, the World Bank, together with other donors and the government of Ukraine, should see that all foreign loans and grants are deposited under the relevant central and local budget headings, so that the public can monitor use of these funds. The World Bank should not provide any money to the government unless the government specifies how the public can be involved in project evaluation.

T. Semyhyna, Social Policy and Social Work Magazine

A more detailed description of priorities in restructuring social infrastructure would be advisable. Involvement of civil society in the social sector reform is not articulated, and World Bank support in this area is not specified. It is important to include public education on key social policy issues in the list of priorities.

Malyi Yuriy Ivanovych, Director, Tov Finkombudservis

The CAS should be more specific about improving the delivery of social services (social assistance, pension benefits, health and education services). Nonetheless, it is extremely useful that the World Bank is aware of the need to address these problems and is trying to help Ukraine.

Olena Volodymyrivna, Financial Director of MPP Studio

Drastic administrative reform has to be implemented. State interference in the activities of a commercial enterprise had not been reduced. Deregulation should be carried out, not merely legislated .

Ivantsova Lyudmyla Romanivna, Director, PP Iva

All government officials should read the CAS.

Andriy Ignatov, graduate student, Iowa State University

The World Bank's operations are not sufficiently transparent to the Ukrainian public, although the government is using the money of Ukrainian taxpayers, who have the right to know the details. Some general information about the Bank's projects is available on the Bank's Web site, but it is not detailed enough. It should be expanded to include progress reports about specific projects, details of related loan conditions, identification of beneficiaries and those responsible for implementation, and assessments of completed projects.

The greatest value-added of the World Bank in Ukraine would be assistance in striking a balance between the government and the private sector. Eight years after independence, the balance between these sectors has not been established. There is still too much government presence in the private sector. Areas in which the private sector could succeed are dominated by government agencies.

A second problem is government salaries. How can the government be efficient if a cabinet minister earns 1,000 hryvnias (less than $200) a month, a prosecutor general is paid close to 500 hryvnias (less than $100), and a professional in public service has a monthly salary of 100 hryvnias (less than $50)? With such low pay it is no wonder that civil servants seek rents.

Ukraine's New Country Assistance Strategy in A Nutshell

The second Country Assistance Strategy document of the World Bank Group for Ukraine comes at a crucial time. The appointment of a pro-reform administration, supported by a newly established parliamentary majority, at the beginning of 2000 opened a window of opportunity for Ukraine to reverse the weak performance of the past. But difficult challenges remain in the short term, beginning with the still uncertain picture for external financing. Moreover, it has become increasingly clear that the problems faced by Ukraine are of a long-term nature, linked to the historic lack of institutions that can support socially and environmentally sustainable economic growth. Given these problems, to achieve sustained growth and reduce poverty, Ukraine must ensure good governance, transparency, and accountability in the public sector and develop inclusive, market-oriented institutions.

Weak Performance and Institutional Problems in Ukraine

The period since independence has been one of great disappointment in terms of economic and social development in Ukraine. Growth was achieved for the first time only in 2000, and recorded output is still 60 percent below its 1991 value. Poverty has increased (27 percent of Ukrainians consume 75 percent or less of median consumption) and other social indicators have also deteriorated.

These weak economic and social outcomes are due to the lack of pro-development institutions and to the still limited voice that civil society has in influencing its own destiny. The institutional framework is in transition, with old (Soviet) and new rules operating side by side. The result has been poor governance in the public and private sectors. Transaction costs are excessive because of anti-competitive practices and corruption. Property rights are not adequately defined or protected. While government strategic thinking and management have improved, weaknesses remain. In this environment, the logical choice, for those who can, is rent-seeking, which hurts private investment.

Ukraine's own recent history, as well as international experience, strongly suggest that in the absence of an increased voice by civil society and pressure for greater accountability of public officials, true institutional change is unlikely to be sustained for long. Greater involvement of civil society will have to emerge from within, but the international community can have an important role in both supporting reform efforts at the top and facilitating the emergence of stronger demand for good government from the bottom.

The World Bank's strategy—as envisaged under the Country Assistance Strategy (CAS) approved in 1996 for 1997–2000—did not materialize as expected, for several reasons. True government ownership was lacking, and the government was unable to deliver—symptoms of institutional weakness and political paralysis. The design of the adjustment assistance, based on separate sector adjustment operations, proved to be a major shortcoming. Stand-alone operations had difficulty addressing cross-sectoral institutional and governance issues. As a result, reforms were reversed or stalled in some areas while Bank resources were being disbursed in others. Weak institutional capacity in key government agencies further hampered implementation.

The Bank's New Country Assistance Strategy

The Country Assistance Strategy for Ukraine for the 2001–03 aims to help the government and civil society implement a broad-based poverty-reduction strategy and create jobs and sustainable economic growth. To do so, the strategy directly addresses the institution-building challenges faced by Ukraine from both the demand side (civil society) and the supply side (government). The strategy seeks to foster environmentally sustainable development by moving Ukraine closer to European Union standards.

The strategy will be implemented in two key phases (see table on next page). In the first phase, the low-case lending scenario, IBRD loans and nonlending activities, including IFC technical assistance program, of up to $461 million are extended. The loans have to meet two crucial tests, which the government supports. First, they must demonstrably help civil society increase its voice for better government and social service provision or provide tangible benefits in globally sensitive areas. Second, they must be sufficiently shielded from possible paralysis at the center of government so as to stand a good chance of success even under less than favorable conditions.

Once these triggers (benchmarks) are achieved, the second phase of World Bank assistance begins. Under the base-case scenario, an additional $1.4 billion is provided in a mixture of nonlending activities and adjustment lending through performance-based Programmatic Adjustment Loans (PALs) and institution-building operations. Moving to such a scenario requires establishment of a sustainable macroeconomic framework and achievement of agreed-upon benchmarks in five cross-cutting areas: financial

discipline in the public and private sectors, an improved regulatory framework for business, transparent definition and protection of property rights, public sector accountability and effectiveness, and mitigation of the social costs of transition and improvements in the delivery of social services.

The first one-tranche PALoan will be presented to the Executive Board for approval once the benchmarks have been achieved:

- Improvement in financial discipline through elimination of nontransparent budget offsets and a major reduction in budget arrears and energy payment debts.

- Easier business entry and operation, confirmed through independent surveys.

- Enhanced property rights in agriculture through abolition of *kolkhozes*, transparent privatization of large industrial enterprises, and legislation enabling privatization of at least 25 percent of the state telecommunications company.

- Improved public sector accountability, through a transparent budget process, including a formula-based transfer system; adequate progress in public administration reform; and significant reduction in tax exemptions.

- Improved social sustainability, through a review of special privileges currently extending surrogate social protection and progress in preparing the pension reform.

Two subsequent PAL operations would be presented to the Board (probably at one-year intervals) if the agreed-upon benchmarks for each tranche were met and the overall pace of implementation of reforms was satisfactory.

The Bank's strategy envisions a major expansion of assistance to reforms in the social sectors and a withdrawal of investment in areas (such as infrastructure and power) in which investment operations have proven unable to achieve for systemic results or demonstration effects. Appropriate nonlending vehicles will be substituted to conduct policy dialogue.

To date, the World Bank has approved 16 loans and 6 environmental grants for Ukraine, amounting to more than $3 billion. The latest loan, $18.29 million for the Kyiv Public Building Energy Efficiency Project, was approved in January 2000.

Based on the Country Assistance Strategy Executive Summary, available on the Internet, at: ***http://wbln0018.worldbank.org/ECA/ECC11/UkraineCAS/AR/DocLib.nsf/Table+Of+Contents+Web?OpenView***

IBRD Tentative Lending Program—FY2001/03 (US$ million)

FY01		Low Case Lending FY02		FY03	
TB/AIDS	40	Private Sector Development	40	Social Sector TA	50
Coal Restructuring	100	Social Investment Fund	30	(Education/Health)	
Wetlands (GEF)	[8]	Title Registration and Distribution	100	Environmental Pollution	20
Lviv Water	24	Environmental TA (GEF)	[15]	Statistics Modernization	30
Sevastopol Heat	17	Methane Safety LIL	5		
		Municipal Development Loan LIL*	5		
Subtotal	**181**	**Subtotal**	**175**	**Subtotal**	**100**
		Base Case Lending			
Low Case lending plus Programmatic Adjustment Loan (1st loan)	181 250	Low Case Lending plus Programmatic Adjustment Loan (2nd loan)	175 250	Low Case Lending plus Programmatic Adjustment Loan (3rd loan)	100 250
Tax Administration Modernization	100	Public Administration Incentives Reform	60	Social Sector Adjustment/APL	100
		Pre-Export Guarantee Facility	100	Rural Finance/Farm Restructuring	100
		[Municipal Development APL]*	[150]		
Total	**531**	**Total**	**735**	**Total**	**550**

*If base case proceeds Municipal Development Loan will become Adoptable Program Loan (APL).
TA: Technical Assistance.
LIL: Learning and Innovation Loan.

Reform Electricity Market in Transition Economies

How to Avoid Traps of Deregulation

by Martin Siner and Jon Stern

Before 1990 infrastructure industries in the communist countries of Central and Eastern Europe and the Soviet Union operated as state-owned monopolies, and their activities (and management) were dominated by government policy. Since 1990 fiscal and commercial imperatives together with the need to promote economic efficiency have resulted in the structural reform of many of these industries. This restructuring has typically involved commercialization (separating government policy from the commercial management of companies, often culminating in privatization); legal and regulatory reforms (separating government policy and company management from economic regulation); and liberalization (unbundling of potentially competitive activities, such as the generation of electricity and its supply to customers). In this process, these countries have followed trends in Western Europe. However, the pace of implementation of these reforms has been much slower than expected.

Following the collapse of communist regimes in the late 1980s, GDP in Central and Eastern Europe and the Commonwealth of Independent States (CIS) fell rapidly. In Central and Eastern Europe the economies were able to recover (or nearly recover): by 1999 real GDP in Poland was higher than it was in 1989; in Central and Eastern Europe (including the Baltic States) GDP was more than 95 percent of the 1989 level. In contrast, in the CIS the level of GDP in 1999 was only slightly more than 50 percent of the 1989 level.

Demand for Electricity and Economic Growth

There is a close relation between changes in GDP and electricity demand. Between 1989 and 1993, when output was falling, electricity sales and production levels also fell, albeit by much less than GDP. The fall in electricity output was largest in countries that experienced the largest declines in GDP (the Baltic states and the CIS).

With the revival of economic growth in Central and Eastern Europe in the mid- to late 1990s, electricity production also increased (table 1). Electricity production grew at about 2 percent a year in Bulgaria, the Czech Republic, and Hungary between 1993 and 1997. In contrast, in the CIS, in which GDP continued to decline, there was a continuing—and in some cases sharp—decline in electricity production.

Major Obstacles to Cost Recovery

A striking feature of these electricity markets over the past decade has been the change in the demand mix. The fall in industrial output (particularly heavy industry) exceeded the fall in GDP. The decline reduced both the absolute and relative level of demand for electricity by industry. In contrast, residential demand rose. Between 1989 and 1998 total residential consumption increased 8 percent in Poland, 20 percent in Slovenia, 56 percent in the Slovak Republic, and 84 percent in Romania.

Table 1. Annual Growth of Electricity Production, 1989–98
(percent)

	1989–93	*1993–98*	*1989–98*
Central Europe			
Czech Rep.	-2.5	1.9	-0.1
Hungary	2.7	2.5	2.6
Poland	-2.1	1.0	-0.4
Slovak Rep.	-0.7	1.5	0.5
Slovenia	-1.9	3.3	0.9
Southeastern Europe			
Bulgaria	-4.3	2.2	-0.7
Romania	-7.5	0.7	-3.8
Baltic states			
Estonia	-15.2	-1.3	-7.7
Latvia	-9.3	7.9	-0.1
Lithuania	-16.6	4.0	-5.7
CIS			
Russian Fed.	-2.9	-2.9	-2.9
Ukraine	-6.1	-5.5	-5.8
Kazakhstan	-3.6	-8.7	-6.5

Source: IEA Energy Statistics of OECD Countries and *Energy Statistics of Non-OECD Countries.*

The changing demand mix has significant implications for the industry and its reform. The relative increase in residential demand increases peak-load demand (during the evening and the winter, for example). In some countries (the Czech Republic, for example), winter peak demand is now significantly higher than it was before 1990. This changing demand profile for electricity creates problems. Most generating capacity in these countries has been designed to run continuously rather than to meet peaks in demand. Running base-load plants to meet peak demand requirements is very inefficient. Satisfying peak demand requires costly arrangements, such as importing electricity or new investment in peak load plants.

The shift away from industrial toward residential demand also has significant financial implications. In most countries in the region the average price paid by residential consumers is still below the average price paid by industry; elsewhere it is only slightly higher. In OECD countries, where prices reflect the relative costs of supply, average household electricity prices are about twice the level paid by industry. Industrial electricity consumers in Central and Eastern Europe—and particularly the

CIS—are thus effectively cross-subsidizing residential consumers.

The reduction in industrial demand will create a financial shortfall unless residential prices are increased to compensate for the decline. In all transition economies household utility rates are low in absolute terms; in most of these countries the household price is 50 percent or less of the OECD average (figure 1). As a consequence, residential demand is higher than it would be if prices were higher, exacerbating the revenue shortfall of the utility companies.

Nonpayment of bills represents another serious problem. In 1997 total collection rates were just 50 percent in the Russian Federation and Kazakhstan, 80 percent in Ukraine, and 85 percent in Bulgaria and Lithuania. In contrast, in the Czech Republic, Estonia, Latvia, Romania, the Slovak Republic, and Slovenia overall collection rates were at least 95 percent. Noncollection is primarily an industrial consumer problem, causing it to have a disproportionately large impact on electricity suppliers' revenues.

As electricity companies do not have good prospects of recovering their costs and earning a reasonable rate of return, new investment is an unattractive proposition, particularly to private investors, whether local or foreign. Overall, with significant excess capacity in both generation and transmission, the lack of investment could become a problem only in the medium to long run. But some areas require immediate investment. These include expanding generating capacity, especially for peak consumption; ensuring the safe and reliable operation of plants in Bulgaria, Romania, and the CIS, where considerable investment is required to maintain plants in operation; and reducing detrimental environmental impacts by reducing the use of coal-fired power stations and upgrading or decommissioning some major nuclear plants, such as Chernobyl in Ukraine and Kozlodui in Bulgaria, for example.

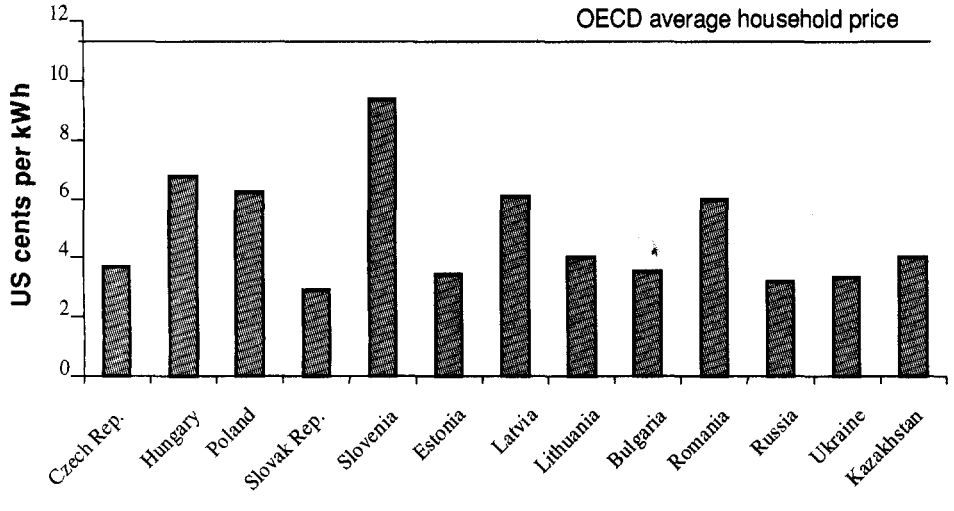
Impediments to Reform Remain

Not surprisingly, reform has proceeded most rapidly in the more developed Central European economies, particularly Hungary and Poland. But despite the importance to these countries of meeting requirements for EU accession, including the 1996 EU Electricity Directive, progress has not been rapid even there. Some impediments to reform include the following:

- Regulators are not independently setting electricity prices. Urzad Regulacji Energetyki, the regulator in Poland, has to approve prices proposed by electricity companies. Although it has recently exercised its power over retail tariffs by rejecting the price proposals of 30 of the 33 power distributors, questions remain over how independent it is of the government. In Hungary the energy regulator is formally independent of the government, but it is not responsible for setting tariffs and the government has continued to hold down prices, particularly retail prices.
- Generation markets remain highly underdeveloped. In July 2000 Poland became the first Eastern European country to establish a power exchange. (Gielda Energii currently operates a day-ahead market, with plans for an hour-ahead and futures markets). Although this market has shown steady growth, in September 2000 it accounted for only 0.75 percent of the electricity consumed in Poland, with the vast majority of trade occurring through long-term power purchase agreements. In Hungary a regulated pricing system has been proposed to replace long-term power purchase agreements, but its structure has been strongly criticized by foreign investors as strengthening the state-owned grid and generator company rather than promoting competition.
- Most industrial consumers are still unable to purchase electricity from sources other than the local distribution companies. Some 200 large users (with annual consumption of more than 40 GWh) are able to choose their suppliers in Poland, but contract prices are regulated. In none of the states that are candidates for EU membership can industrial customers choose their electricity supplier, although both Hungary and the Czech Republic are working on new electricity laws that would allow consumer choice before 2005.

The limited progress in reform achieved so far is shown in the lack of competition, low levels of private sector investment and, in

Figure 1. Household Electricity Prices in Central and Eastern Europe and the CIS, 1997



Source: EBRD *Transition Report* 2000.

some Central and Eastern European countries, difficulties in privatization (at least at acceptable sales prices). In contrast, in telecommunications, private companies have made significant new investments, and privatization has proceeded relatively smoothly, at good sales prices.

The key difference is that consumer demand for telecommunications services—both for better existing services and for new services—has increased dramatically. Retail and particularly business consumers, among whom demand for high-value telecommunications services is growing rapidly, are willing to pay economic prices for telecommunications services. As a result, investors have the potential to earn an adequate return on their investment. This contrasts sharply with electricity, where price structures fail to allow a reasonable rate of return on capital.

To set free the liberalization process, the simple solution would be to readjust tariffs by increasing prices to residential consumers and removing cross-subsidies between industrial and residential consumers. However, the political difficulties associated with readjusting tariffs remain significant, impeding reform (see box). A positive byproduct of price readjustment would be that it would provide much stronger incentives for energy efficiency, which is very low in these countries.

Progress toward electricity industry reform in the region has been affected by the progress of general economic reform. Given the amount of legislation passed in the early 1990s, it was difficult to find the time and resources to develop and adopt the necessary laws in the power sector. Moreover, a limited legacy of well-defined and credible political institutions created uncertainty, which hindered regulatory effectiveness. This problem persists, particularly in the CIS. A related problem, particularly in the smaller Central and Eastern European countries and the poorer CIS countries, is the lack of people with the required skills to design, implement, and run regulatory institutions.

Prospects for Reform

A clear divide has emerged between the Central and Eastern European countries (including the Baltic States) and the CIS—a divide that could well grow. In Central and Eastern Europe the prospect of joining the EU has created new incentives to pursue liberalization measures that comply with the EU Electricity Directive. Bulgaria, for example, finally passed its long-awaited energy law in August 1999. This act anticipates opening up the market in line with the EU directive, unbundling the national power monopoly's core activities, and eliminating cross-subsidies and raising tariffs to increase to cover costs. In the Czech Republic residential prices are expected to have exceeded industrial prices by 2002 (with proposed household price increases of 14 percent in 2001, and 13 percent in 2002). Progress in these countries is being helped along by an increasing familiarity with democratic institutions and procedures, which is reducing legal and commercial uncertainty. In contrast, reform in the CIS is lagging behind. There has been little readjustment of tariffs, collection rates remain low, and political interference is prevalent. In Ukraine, for example, basic reforms to create a competitive market were initiated, but the government and Parliament want to maintain control of power generation and distribution. As in many other areas of reform in the transition economies, much remains to be done to create well-functioning electricity markets.

Martin Siner (martin.siner@nera.com) is an analyst and Jon Stern (jon.stern@nera.com) a senior adviser at National Economic Research Associates, in London.

People's Power—Energy to the Poor

In countries with well-developed electricity distribution networks, a key issue is ensuring that the neediest (the elderly, the sick, the disabled) can afford a basic level of services. There are a number of ways this can be achieved:

- The best solution is to price electricity services at commercial rates and provide assistance to low-income groups through social assistance programs, such as pensions, benefits to low-income families with children, and so forth. However, such an approach requires sophisticated management and delivery systems for social benefits.

- The next best solution is to introduce a "lifeline" rate by reducing the price of electricity for the first 50–100 kWh per month to all households. The lifeline rate would help cover most essential electricity needs. If cross-subsidies are avoided (as they should be), subsequent units of electricity have to be priced slightly higher than the standard cost-based average household tariff in order to recoup the revenue lost on the lifeline rate.

- Addressing energy poverty through a cross-subsidy from industrial consumers (as is currently done) is grossly inefficient, with most of the benefit going to middle- and upper-income consumers. This approach is also unsustainable if industry can choose its supplier (as is required under the EU Electricity Directive 96/92).

The difficulty in Central and Eastern Europe and the CIS is that, for understandable reasons, governments have been unable or unwilling to raise household electricity prices. Policymakers are reluctant to raise rates because real income levels have remained low and have not grown as fast as was hoped in 1990. Moreover, similar relative price increases are needed for housing, public transport, water and sewerage, health, and other basic goods, and it is not possible to sharply increase the prices of all of these services simultaneously.

The Tale of Two US States: California and Texas Diverge on Electricity Deregulation

California and Texas have approached electricity deregulation in very different ways. To allow consumers to choose among competing providers rather than buy power from the regulated monopoly utility serving their region, Texas is on course to deregulate its electric power industry beginning in mid-2001, just as California did in 1998. The Texas design, however, bears no resemblance to the complex California plan, which broke down last summer in the face of power shortages and soaring wholesale electricity prices.

The two largest California utilities—Pacific Gas and Electric Co. (PG&E) and Southern California Edison Co., which together serve about 25 million people—have been stung by a fivefold increase in wholesale prices since June. The two companies have spent an estimated $11 billion more on wholesale power than they were allowed to charge customers under California's two-year-old deregulation plan. The Southern California Edison (SoCal Edison) utility can charge customers only $64 per megawatt hour for power delivered—far lower than the current spot-market price of $307.

The utilities have tapped out their credit lines. In early January SoCal Edison announced 1,450 layoffs over the next several months to conserve what is left of its cash. PG&E and SoCal Edison say they face insolvency if they cannot obtain more cash soon. Two credit-rating agencies cut their ratings to one step above noninvestment grade (junk) status. The stock prices of the two widely held companies have plummeted in recent weeks. No new plants have been built in California in the past 12 years (although five new power plants are under construction). Stringent environmental regulations make it too costly for private utilities to consider investment.

Under Texas's plan, electricity rates can go up twice a year to reflect higher costs for producing power, including higher gas costs. The state is awash in power plants, and more are being built. Twenty-two new gas-fired generating plants have come on line since 1995, and 15 are under construction, with completion scheduled by the end of 2002. To speed plant construction, Texas cut away many of the regulations that had restricted plant location. If a plant meets state air-quality regulations—as modern gas-fired power plants do—it can be built. The new supply will ensure price competition.

California's Governor Gray Davis has called the state's power system deregulation "a dangerous and colossal failure" and threatened to seize the generator plants of wholesalers who cheat consumers or utilities. (Many of these wholesalers are out-of-state suppliers, rendering this threat idle). The governor has indicated that he wants to carve out a larger role for state government, reversing years of state deference to federal energy policies. He proposes to create a state power authority to construct power plants and overhaul the bidding system used to set prices in the state's energy auction, to be controlled jointly by the state and more than two dozen municipal utilities. He also proposes expanding the governor's emergency powers in the event of imminent power outages and giving the state attorney general $4 million to investigate and prosecute cases of market manipulation. He proposes making withholding electricity by generating companies a criminal act punishable by a prison term.

Davis has also called for cutting the red tape that has kept new power plants from being built and for committing public lands to that purpose "on the condition that energy be distributed solely in California." (Implementing such a condition would be difficult given that the state's electric grid is interconnected with 10 other states, Canada, and Mexico. Interstate commerce law forbids the state from preventing companies from selling to other state markets. Indeed, without such a practice, California might be in even worse shape, since the state is a net importer of electricity.)

Davis has pledged to set aside $1 billion in the 2001–02 state budget to stabilize the supply and price of electricity and provide new power generation. The program would include providing low-interest loans for insulation and other weatherization efforts, doubling the state's $50 million effort to provide money to businesses that invest in equipment that allows them to decrease consumption when demand is high and energy even more expensive, revising the state's energy efficiency standards for appliances and buildings, and providing cash incentives for consumers.

Based on reports from the Washington Post *and* Wall Street Journal

Darkness at Noon: Outcome of the Wrong Deregulation

Source: Transition Newsletter

China's Infrastructure Needs Great Leap Forward

by Chi Fulin

If China is to maintain dynamic growth, the nonstate sector (including both private businesses and township and village enterprises) will have to play a major role in the reform and development of the country's public utilities and infrastructure. As China opens up and allows foreign capital to invest in public utilities and infrastructure, more opportunities must be created for domestic nonstate firms to enter the sector. Those enterprises will be ready to invest in the sector, however, only if the state abandons its administrative control and gives up its monopoly in this sector.

Once the proper incentives are created, domestic private enterprises could become the principal investors, major market players, and cooperating partners of foreign companies in infrastructure, including public utilities, transportation, and telecommunications. These incentives could include long-term low-interest loans, tax benefits, and permission to issue long-term construction bonds.

In Wenzhou, Taizhou, and some other regions in Zhejiang province, private enterprises have been major players in modernizing infrastructure. There and elsewhere, experience shows that as long as firms are fully owned by or dominated by the state, there is no way to engage them in market competition, the driving force of development. Principal investors thus should be enterprises, not the state. Ownership should be separated from management. Once the relative weight of nonstate investment increases, conditions for a level playing field can be created. The state should preserve its majority only in enterprises of strategic importance.

Once public utility and infrastructure firms are transformed into joint-stock companies, private enterprises will be able to invest in the sector. The government should refrain from imposing unnecessary administrative interference or controlling the personnel, operations, and finance of companies officially owned by private owners. The government's scope of activities, regulations, and functions should fundamentally change from direct control and administration to monitoring.

Enterprise reform is imperative, especially in the telecommunications, civil aviation, railway, and power industries. Hainan Airlines provides compelling evidence for the need for this change. In 1991, when the airline was founded, the government invested a mere 10 million renminbi in the company. After its transformation into a joint-stock company, the company's equity increased to 200 million renminbi. Today its total asset value is about 6 billion renminbi. The airline has undergone rapid development and become an engine for economic growth.

What should be the agenda for enterprise reform in infrastructure?

- In industries in which the profit outlook is favorable (transport, telecommunications, energy), large- scale commercialization of enterprises (transformation into joint-stock companies) should be carried out. The transformation should be gradual, in accordance with market development.

- Enterprises that can be transformed into standard shareholding companies should go public as soon as possible.

- Enterprises that cannot be transformed as a whole should be broken into separate units and transformed into public companies on a piecemeal basis.

- National bonds should be issued to finance shareholding-oriented reform in public utilities and infrastructure. Individual savings in China total about 6 trillion renminbi (about $720 billion) in banks—an enormous investment potential, even if only part of this money is reallocated through the banks and the capital market to infrastructure development.

Policy measures to promote the role of the nonstate sector in the reform and development of public utilities and infrastructure should include the breaking up of monopolies to protect competition. In sectors in which strong monopolies exists, price regulation should be strengthened to maintain market order and protect the rights and interests of consumers.

A proactive fiscal policy should also provide increasing support to private investment while reducing the government's direct involvement in the development of public utilities and infrastructure.

China's government is forging ahead with institutional innovations and measures that remove barriers to market access of the nonstate economy. Legislation is needed to provide legal protection for the nonstate economy.

Chi Fulin is executive director of the China Institute for Reform and Development (CIRD) in Haikou, Hainan Province.

Battered and Cherished: The Private Sector in China

The private sector is playing an increasingly important role in China's economy, emerging as a major source of employment and output growth and benefiting from increasing official recognition. Prior to 1979 the private sector was virtually nonexistent, restricted by policies that discouraged capitalist activities on ideological grounds. When the Communist Party seized power in 1949, it initially tolerated free enterprise. However, in 1952 the party began a series of anti-capitalist campaigns to undermine entrepreneurs, many of whom were condemned as "counterrevolutionaries." By 1956 private firms were required to be jointly owned and run by the state; in practice, the state controlled and administered the businesses. The party next sought to exert control over China's 29 million full-time handicraft producers—in effect, self-employed entrepreneurs—by requiring them to form cooperatives. Similar policies during the late 1950s led to the collectivization of farming and the abolition of private plots. During the Cultural Revolution (1966–76), private enterprise became unacceptable.

An objective of former leader Deng Xiaoping in the initial stages of reform was to revive individual businesses as part of efforts to promote growth. While private enterprises reappeared during the early 1980s, the stigma of capitalism discouraged many individuals from starting businesses.

Despite an improved political climate in the early to mid-1980s, the private economy lacked a defined legal position. However, in April 1988 the National People's Congress adopted a constitutional amendment recognizing the legality of individually owned economic entities. It stated that they were a "complement" to the socialist public economy and would operate according to state guidance, supervision, and administrative regulation.

The growth of the private sector was further encouraged after Deng's southern tour of China in 1992, in which he proclaimed the government's commitment to deepening reforms and opening up to the outside world. In 1993 the Constitution was amended to indicate that the government's goal was to establish a "socialist market economy" and that the private sector was a complement to it. This represented official recognition that the market system was not incompatible with socialism. The Constitution was further amended in 1999 to state that the private sector was an "important component of China's socialist market economy."

The Nonstate and Private Sectors

The nonstate sector in Chinese government statistics consists of township and village enterprises, urban collectives, foreign-funded enterprises, and privately owned Chinese firms and small-scale entrepreneurs. The private sector is generally classified as consisting of domestic private enterprises and entrepreneurs (including self-employed individuals but excluding farmers). However, other nonstate categories might be classified broadly as part of the private economy. Many urban collectives and township and village enterprises, although they are usually owned and controlled by local governments, could be deemed private enterprises: they are generally run like private firms, operating according to market principles. Foreign-funded enterprises could also fall under the private sector category, since the parent company usually is a private business. Finally, many private companies prefer to register as township and village enterprises or state-owned enterprises simply to avoid harassment and interference from government officials.

Several studies indicate that nonstate firms are largely responsible for the rapid economic growth enjoyed since 1979, while the role of the state in industrial production has diminished markedly. It is largely because state-owned enterprises are less efficient and competitive than their nonstate counterparts. While state-owned enterprises accounted for 77.6 percent of gross industrial output in 1978, this share fell to 26.5 percent in 1998. The nonstate sector overtook the state sector in industrial output in 1995, accounting for 57.3 percent of total industrial output, rising to 73.5 percent in 1998. The nonstate sector is most involved in the consumer goods and export sectors, while the state sector dominates heavy and extractive industries, such as iron and steel, coal, and petroleum extraction and refining, as well as utilities, banking, and transportation.

Private Sector Absorbs Unemployed

According to official data, the private sector's share of industrial output rose from 1.9 percent in 1985 to 5.4 percent in 1990 and about 16.0 percent in 1998. The number employed in the private sector (private firms or self-employed) rose from 4.5 million in 1985 to an estimated 81.3 million in 1999. Most private enterprises are small firms involved in production and services that are related closely to daily livelihood, such as light industry, manual trades, transport, construction, commerce, food services, and repair industries. While some large private firms exist (there are 40 private firms with capital of more than $12 million), the average enterprise in 1998 had a registered capital of about $60,000 and employed 14 people.

The growth of the private sector has to a large extent arisen from the government's efforts to reform and restructure state-owned enterprises. At the Communist

Party's Fifteenth National Party Congress in 1997, President Jiang Zemin stated that the government planned to end support to and privatize the 307,000 state-owned enterprises and keep under state control, changing into globally competitive enterprises, about a 1,000 "flagship" enterprises.

Employment by state-owned enterprises has fallen from a peak of 112.6 million in 1996 to an estimated 81.2 million in 1999. Workers who have been laid off from state-owned enterprises have been encouraged by the government to find jobs in the private sector and start businesses. In 1999 an average of 4,000 laid-off state-owned enterprise workers a day are estimated to have re-entered the workforce in the private sector.

To date, the government has adopted a largely pragmatic approach to the private sector, although private firms are still barred from a variety of industries and services, unable to compete directly with state-owned enterprises. They often find it difficult to obtain bank loans, owing to policies that require state banks to give preferential treatment to state-owned enterprises (in 1996 state-owned enterprises absorbed 87 percent of total state bank loans). Entrepreneurs must seek financing elsewhere and at higher cost. Only a handful of private firms has been allowed to raise funds in the stock and bond markets.

Legal vacuums in the areas of property rights, legitimate business practices, and other basic features of a market economy have given officials huge discriminatory powers. Private firms must rely on connections (*guanxi*) with government officials to obtain licenses, bank loans, and raw materials. Even so, central and local government officials tend to give special treatment to enterprises they own or control and are often unwilling to establish business relations with private entrepreneurs.

New Situation: WTO Membership

Officials recognize that WTO membership will benefit China in the long run but could lead to short-term disruptions in many industries. As a result, the government has taken steps to promote the expansion of the private sector to help deal with expected layoffs resulting from increased foreign competition.

The government is aware that it must give domestic firms the same trade and investment opportunities that are afforded to foreign firms and investors under WTO commitments; otherwise, Chinese firms will be at a distinct disadvantage. It has therefore enacted laws and regulations that would give private firms trading rights (the right to import and export goods), create guidelines to facilitate borrowing from state banks by private firms, permit the establishment of four private banks, and lower the minimum capital needed to start a private business. In January 2000 the government pledged to scrap all obstacles to the development of the private sector, except in areas relating to national security and certain state monopolies.

Excerpted form Oxford Analytica, the Oxford-based international research group.

The Thinker

From the Hungarian Daily *Magyar Hirlap*

Kosovo's Albanian Diaspora: Blessing or Curse on the Economy?

By Barbara Balaj

The 1999 conflict in Yugoslavia badly hurt Kosovo's economy. Much of Kosovo's housing stock, agriculture, and infrastructure—most of it in western Kosovo—was destroyed or severely damaged in the conflict. As a result, industrial and agricultural output declined precipitously.

Kosovo's economy was weak even before the conflict, as a result of decades of economic backwardness, neglect, and misguided and exploitative economic investments and programs. Per capita GNP in 1995 was estimated at $400, long the lowest in Europe. Endemic and chronic unemployment has been a serious problem.

During the hostilities 800,000 Kosovars (out of a total population of 2.2 million) fled to other parts of Kosovo, neighboring countries, and Western Europe. They added to the already large Kosovar diaspora, about 70 percent of which (some 750,000–800,000 people) live in Germany and Switzerland. In Germany the Kosovar Albanian community numbers 350,000–400,000. Some 740,000 people from the former Yugoslavia live in Germany, making them the second largest foreign group after the Turkish community. In Switzerland the 160,000 Kosovar Albanians are the second largest foreign group after Italian nationals. Repatriation of these emigrants will have a significant impact on Kosovo.

Waves of Emigration

Three distinct migration waves of Kosovar Albanians moved to Germany and Switzerland.

The first wave—mostly unskilled, poorly educated people from rural Kosovo—left Kosovo in the late 1960s and early 1970s. If these emigrants returned to Kosovo, they could bring new skills, knowledge of foreign languages, and investment capital with which to establish businesses and create jobs. Some would split their time and resources between the host country and Kosovo by establishing homes and investing in businesses in both places.

A second wave—mostly of better-educated and skilled Kosovar Albanians from urban areas, including young men seeking to avoid military service in the Yugoslav army during the Balkan wars—left Kosovo during the 1980s and early 1990s. If repatriated, they would also bring new skills, knowledge of foreign languages, business practices, and investment capital. (In addition, this group has a more modern mentality than the first group, oriented toward the "new economy.") Many of these people would like to set up homes and businesses both in Kosovo and abroad. Their children, if they also return, would provide a new infusion of well-educated and trained human capital.

The third wave of asylum seekers and refugees fled Kosovo in dire circumstances during the 1998–99 conflict; many have no homes or jobs to which to return. These emigrants may nevertheless have acquired useful skills and training abroad, as well as financial and material resources from government programs sponsored and financed by their European hosts.

World Bank Assistance to Kosovo

The World Bank created a special trust fund for Kosovo, to which it allocated more than $60 million in 1999–2001. Some of these funds went to the Economic Assistance Grant for budgetary support ($5 million), the Education and Health Project ($4.4 million), the Emergency Farm Reconstruction Project ($10.6 million), the Urgent Road Project ($5 million), the Community Development Fund ($6 million in tandem with other donors) and recurrent cost support for the health and education sectors ($1 million) (both through the Post-Conflict Trust Fund), Pilot Credit Line for small and medium enterprises ($4.5 million), and the Water Supply Project ($4.6 million).

The European Commission and the Bank are jointly leading the resource mobilization effort for the Kosovo reconstruction and recovery program, estimated at $2.3 billion for four to five years. Two donor conferences have produced $1.4 billion in pledges to date.

The Bank has worked closely with the IMF and the United Nations Mission in Kosovo (UNMIK) in providing economic policy advice in such areas as economic and fiscal management, banking, commerce, and private sector development.

In addition, a social assessment—including a chapter on the Kosovo Albanian diaspora, from which this article was drawn—has been conducted to identify key institutional and social issues relevant to future development in Kosovo.

Many of these emigrants were traumatized by the conflict; received inadequate education; and suffered unemployment, separation from family members, discrimination, and poor living conditions abroad. Some young men in this group have gotten involved in criminal activities. Repatriating young men from this group will present a special challenge that will require new programs.

Effect of Influx of Returning Emigrants

Host European governments have provided incentive programs for Kosovars to return to Yugoslavia, with the highest incentives paid to those who return home the soonest. Germany required 60,000 Kosovar Albanians to return to Kosovo in March 2000; another 180,000 are expected to return in the near future. Some 18,500 Kosovars returned to Kosovo from Switzerland in 1999; another 65,000 were required to return last year. These returnees are likely to put further strains on Kosovo's already tight housing and jobs markets as well as on educational, health, and other public services.

Kosovar emigrants play a key role in the economic, social, and political development of Kosovo. Remittances from the diaspora have contributed to the very survival of people in Kosovo, almost 80 percent of whom receive monthly remittances between $250–$500. Together with donor assistance and domestic savings, these remittances have played a major role in the recovery of Kosovo's economy. A recent survey estimated that these remittances provided 45 percent of Kosovo's annual domestic revenues—up from 25 percent before the war. Remittances from both Germany and Switzerland are expected to decline as more Kosovars are repatriated, with adverse consequences for the social welfare of many families in Kosovo.

Barbara Balaj is a consultant to the Environmentally and Socially Sustainable Development Sector Unit (ECSSD) of the World Bank, ECA region.

From the Transition Archives: Wandering in the Past Part II: 1992

We continue our recollection of the past decade. In 1992 the newly independent states (many of which had been independent long before the Soviet Union was born) were taking their first steps as sovereign nations. All but the Russian Federation said goodbye to the ruble and created their own new currencies. But most transition economies sank into recession. Calls for a new Marshall Plan fell on deaf ears in the West. Instead, the multilateral financial institutions offered some grants but mostly loans against promises of early reforms. The trinity of stabilization, liberalization, and privatization enjoyed wide support among policymakers, although debates flared over a variety of issues (big bang versus incrementalism, mass privatization versus individual sales to strategic investors). The public was still hoping—in vain—that the recession cycle would come to a swift end and that they would enjoy Western wages and Eastern social benefits.

George Soros Urges Action in the Ex-USSR (January 1992)

We are now in the climatic stage of the revolution. In some ways it resembles the climax in Eastern Europe in 1989. But there is one major difference: in the case of Eastern Europe the climax marked the beginning of a new era. When the communist system was swept away, the foundations of an alternative system were already present. There were nations with long histories; there was a more or less well-organized opposition and a general desire to become part of the modern world.

Not so in the Soviet Union. The foundations for an alternative system of organization are missing. We are at a loss even to describe the territory we are talking about. It will take a long time and a great deal of effort to transform the republics into independent states with well-functioning administrations. The same applies to the state-owned enterprises that make up the bulk of the economy. In these circumstances, the collapse of the Soviet system is unlikely to give birth to a new system. It is more likely that one revolutionary climax will be followed by another until the very foundations of civilization will be destroyed. How far the process of destruction can go is anybody's guess. But the Russian Revolution of 1917 provides some indication: industrial production in 1917 had already fallen to 25 percent of its level in 1913, and by 1921 it had fallen to 16 percent.

What can the international community do in the face of this seemingly inexorable descent into chaos? The key is to help bring a functioning monetary system into existence. There can be no market economy without money; money is primarily a question of credibility, and in today's conditions it is impossible to establish a monetary system that would enjoy the confidence of the people without Western involvement. In the midst of decay and disintegration, there are some forces at work on integration. They need to be reinforced. I realize that the private sector cannot do much about monetary reform, but the government can.

Coupon Privatization in Czechoslovakia (January 1992)

Registration in Czechoslovakia for its voucher-based large-scale privatization scheme was due to close on January 31, but officials have extended the deadline. For the past two months, citizens have been buying voucher booklets at 35 crowns each, paying a registration fee of 1,000 crowns ($35), a little more than the

weekly average wage. Later the coupons can be exchanged for shares in state companies, representing about 40 percent of the economy.

So far 271 investment funds have been registered. These funds will be able to bid for firms where direct voucher bids amount to less than the book value. The funds may also solicit vouchers from citizens and invest them on citizens' behalf. Several funds are aggressively advertising to attract investors. For example, the Harvard Capital and Consulting Fund is running advertisements guaranteeing investors a tenfold return on their 1,000 crown voucher.

After the Soviet Break-Up: Chaos with Signals of Hope—Lessons from a Colloquium (February 1992)

The present situation in the former Soviet Union is marked by chaos and extreme fragility—in the words of George Soros, the situation is "not just grim but potentially cataclysmic." On the economic front, output is falling rapidly across the region, with no immediate end in sight. Interrepublican trade is threatened with collapse, with potentially catastrophic effects on the economy of the region. On the political front, a variety of personalities—the former Communist Party, the military, national minority groups—are emerging in Russia to challenge President Boris Yeltsin.

Few would have predicted a decade ago that a peaceful dissolution of the Soviet empire was possible. This is the third great transformation of the 20th century. The first two (the two world wars) resulted in 60 million deaths, but the CIS is now providing an institutional framework for a peaceful third transformation—a critical role even if the CIS eventually becomes "little more than a footnote in history," in Strobe Talbott's words. *(Cheryl Gray)*

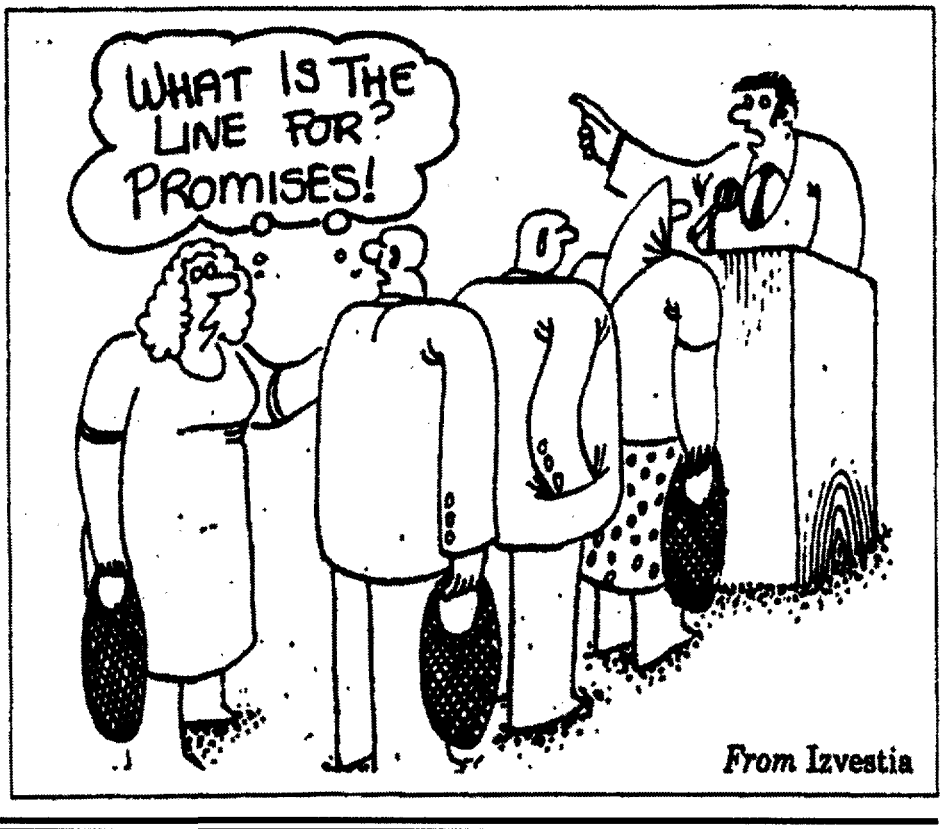
Observations of Larry Summer (then Chief Economist of the World Bank)
Make no mistake, this is one of the greatest economic challenges in history. However, it's different from most economic reform challenges. The Soviet Union, a staggering economic underachiever, is not lacking in resources. That region is the number one owner of natural resources. Petroleum reserves rival those in the Persian Gulf. It has terrific technological resources; it is third in the world's stock of scientists and engineering. The USSR has devoted as many resources to research and development as the United States or Japan. What ultimately led to the current collapse—the fall of output to the present level—was that incentives were spectacularly misaligned for such a long time.

The World of Welfare Socialism and the Transition to Capitalism (March 1992)

We can expect poverty to increase in countries in transition and to become quite pervasive in the Balkan countries and the former Soviet Union. Limited administrative capacity could prove to be the most serious bottleneck, as meritocratic bureaucracy has little recent tradition in these countries. Furthermore, the task of income redistribution is particularly difficult, because a great percentage of the poor live in rural areas that are hard to reach. This argues for retaining simple and reasonably efficient support schemes that are already in place (such as family allowances). Targeting should be done by identifying the needy by certain easily verifiable characteristics (for example, unwed mothers, children under a certain age, the aged); complicated means-testing programs should be avoided. *(Branko Milanovic)*

Public Enterprise Restructuring: The Achilles' Heel of the Reform Process (March 1992)

The presence of a large number of firms that are nonviable under competitive conditions, considerably complicates the reform strategy, as full implementation of liberalization and stabilization could generate a level of enterprise bankruptcy and unemployment that no government could survive. The depressed level of demand could undermine even the healthier enterprises and cut into fiscal revenues. A vi-



From Izvestia

cious cycle of recession and inflation could be the result. In addition, private investors, whether domestic or foreign, will be less interested in assuming ownership of existing firms that are insolvent or require costly restructuring and will opt instead to start new ventures, free of the legacies of the past, including liability for environmental damage.

Macroeconomic policy must take account of the potential conflict between the speed of reforms and the rapidity with which it is possible to liquidate nonviable firms. These considerations suggest the need for more careful coordination between the implementation of reforms at the macro level and that at the enterprise level. Given the relative difficulty of the latter, a pace of reform that is restrained only by implementation capacity will not necessarily be an optimal or very sustainable approach to the transition. *(Sanjay Dhar)*

Call for New $100 Billion Marshall Plan to the Former Soviet Republics (March 1992)

It is in the United States' self-interest to have a strong and vibrant commercial presence in the former Soviet republics. Steps taken now to establish and ensure growing economies in the former Soviet republics will create new buyers for U.S. agricultural products, manufactured goods, and services.... However, the United States is currently playing a very small role in aiding and assisting the former Soviet republics. Only about 6 percent of the aid and assistance to the former Soviet republics, or under $5 billion, is currently coming from the United States. The United States is providing less aid and assistance than Italy, which has an economy approximately one 10th the size of that of the United States. It is useful to remember some of the features and lessons of the original Marshall Plan. George C. Marshall presented the general outline of what became known as the Marshall Plan on June 5, 1947. The independent Economic Cooperation Administration was established to administer the program, which provided $13.3 billion in assistance to Europe from 1948 to 1952. In 1992 dollars this is equal to approximately $100 billion. *(National Planning Association)*

Haunting Spirit of the CMEA: Dilemmas of Economic Integration (April 1992)

It is widely believed that the collapse of Council for Mutual Economic Assistance (CMEA) trade in 1990 and a further decline of intraregional trade in 1991 (when it dropped by 15–40 percent in real terms) led to sharply reduced economic activity in Central and Eastern Europe and the former USSR. According to this belief, a decline in exports led to unused capacity in export industries while raw material and energy shortages in Central and Eastern Europe and the unavailability of manufactured inputs in the USSR produced supply bottlenecks that reduced aggregate output. Many observers conclude that a revival of intraregional trade, through a mechanism that could substitute for the defunct CMEA, is needed to stimulate economic recovery in the region. But if intraregional trade was, in the past, uneconomically high, then efforts to prevent its decline may be either futile or counterproductive.

The deeper integration of Poland, Hungary, and Czechoslovakia into the European Community poses a number of problems despite their association agreements. Will the European Community be willing to admit more member countries with relatively low incomes, thus creating greater budgetary strains on the Community? What about economies with large but relatively inefficient agrarian sectors and with a large proportion of their industry in such sectors as steel—sectors in which current EC members face painful restructuring problems of their own?

Although the temptation to engineer general solutions to the region's problems is great, it is unlikely that such broadly based proposals can be implemented in the near term. The most important advice that may be given is that, as prices are rationalized, protectionist policies should be eschewed as much as possible. *(Josef C. Brada)*

Cooperation instead of Rivalry with the World Bank: An Interview with the EBRD's Rolf B. Westling (April 1992)

Q. During the Budapest meeting rumors surfaced about a certain rivalry between the World Bank and the EBRD. How would you characterize the EBRD's relationship with the "bigger brother"?

A. Without doubt the World Bank is a venerable institution that has gained massive experience in the past decades; we are still in the process of building up our operations. But this should not lead to rivalry. On the contrary, it makes a lot of sense to make the most of resources through coordination of our efforts, especially when it comes to cofinancing opportunities in public sectors of the member states, developing infrastructure, and, particularly, participating in energy, transport, telephone, and environmental projects of the postcommunist economies. We should not be seen as competitors in the market; that is certainly not very constructive. A coordinated approach would benefit us and recipient countries as well. Providing conflicting technical assistance, for example, could lead to disastrous consequences.

Wilfried Thalwitz on the Bank's Operations in the Former USSR (April 1992)

What can the World Bank do? The first actions of the Bank will be geared toward alleviating import constraints in areas where we can get the quickest and largest payoff. We hope that during the next 12 months we will be able to commit something like $2.5 billion, about half of which could go to Russia, in line with the relative size of that country. There will be a general import rehabilitation operation for Russia; when the other republics are

ready, we're prepared to implement similar programs. At this stage, negotiations about import alleviation loans are most advanced with the Baltic countries, Kyrgyzstan, and Kazakhstan, and preparation has started in Ukraine and Armenia. For fiscal year 1995, which begins in July 1994, we hope to be able to commit about $4.5–$5 billion to the successor states of the Soviet Union. The first slew of operations is a general import rehabilitation program. We would like then to quickly move to a second generation of operations whose structural and policy elements are still to be agreed on. I refer in particular to oil and agriculture.

A Sociologist's Perspective: Can Design Capitalism Work in Central and Eastern Europe? (May 1992)

Should far-reaching marketization of all aspects of economic life be the policy goal in Central and Eastern Europe? Surely one goal of marketization has been to modernize production processes and improve international competitiveness in these damaged economies. Yet recent currents of thinking contend that in certain sectors of the modern capitalist economy the most competitive forms of coordination are neither market nor statist but new forms that we are only beginning to understand (networks, alliances, interfirm agreements, and the like.) A policy of all-encompassing marketization across all sectors would therefore pose a new obstacle to international competitiveness. Markets are but one of many coexisting coordinating mechanism in modern capitalism. (*David Stark*)

Women's Employment in Central and Eastern Europe: The Gender Factor (June 1992)

The gap between men's and women's wages in Central and Eastern Europe is not so very different from Western wage differentials, despite the socialist ideology of gender equality. The average compensation of women is 67 percent that of men in Czechoslovakia, 73 percent in Hungary, and 77 percent in Poland. On the other hand, extensive maternity and childcare leaves, rights to return to employment after leave, and enterprises' provision of crèches and kindergartens have facilitated the employment of women with small children in most Eastern European countries. According to an estimate for Hungary, mothers of small children work on average 50 percent of the standard working hours because of legal entitlements and leave taken for children's illnesses.

As unemployment hits Central and Eastern Europe, women may be given lower priority than men both because employers tend to view women as less productive workers and because their first responsibility is perceived to be in the home. Younger women are also likely to be affected by a decline in childcare services. (*Monica Fong and Gillian Paul*)

Persistent Economic Decline in Central and Eastern Europe: What Are the Lessons? (July–August, 1992)

More than two years have gone by since the series of political changes in Central and Eastern Europe, and hopes for a rapid transition to prosperous market economies have all but faded. Startling changes were observed in most of these countries. But the initial euphoria has been replaced by a more sober assessment of the magnitude of and complications entailed in the task ahead—which in turn is dwarfed by the challenge facing the ex-Soviet states.

Four major causes of the declines in output:

- *Statistical overstatement.* Official statistics may not adequately capture the growing private sector, and they can face daunting index number problems. In addition, measurements do not account for efficiency gains resulting from the elimination of shortages and lines.
- *Trade shock.* CMEA trade has fallen since 1989, mainly because of the disappearance of 85–90 percent of trade with the former USSR. In addition, the shift to world prices, especially for Eastern Europe's manufactures, has imposed substantial terms of trade losses, averaging 4 percent of GDP for Czechoslovakia, Hungary, and Poland.
- *Macroeconomic policies.* The open question is whether the "big bang" policies were overly restrictive—whether hyperinflation could have been avoided at a lower cost to output.
- *Enterprise behavior.* Important area for more research. *(Mario Blejer and Alan Gelb)*

The Russia File: Phasing in Assistance—An Interview with IMF Department Director John Odling-Smee

Q. Recent economic surveys indicate that a large part of Russian industry is heading toward bankruptcy. The Russian Minister of Economy predicts an 18 percent decline of GDP this year. There are already signs that monetary and fiscal restrictions are causing pervasive poverty. In the first six months of this year the cost of living increased 10 times "by a factor of 10", while the average monthly income in June reached only 4,100 rubles (less than $30 at end-July exchange rate). Don't you think that overly drastic actions could throw the country's economy into a deep recession?

A. The monetary and fiscal measures we are talking about are to ensure the macroeconomic stabilization of Russia, which is a key to further progress in the economy. Only if enterprises feel the heat from being overmanned or in a redundant line of business will they be willing to make adjustments. We at the Fund think that the government should not excessively subsidize enterprises or provide them with cheap or easy credit. Unemployment must come at some stage; it will be the result of the need to close or scale back the old plants before new employment opportunities have had a chance to develop. The most important thing is to ensure that the government has an adequate social safety net in place. I do not think, however, that

there is a magic solution to avoiding the pain of transition. Of course, the costs of adjustment should be minimized as much as possible. A key way to minimize them is to move quickly in reforming enterprises and enforcing the hard budget constraint.

Leszek Balcerowicz Defends the Shock Therapy: An Interview with the Man behind the Polish Stabilization Program (September 1992)

Q. The Balcerowicz plan, a model for all subsequent postsocialist shock therapies, began in Poland on January 1, 1990. To achieve maximum impact, drastic economic measures were introduced in a matter of days: a wide array of prices were set free, the zloty was devalued and made convertible, foreign trade was liberalized, and a tax was introduced to prevent wage hikes. The package was labeled by the press as shock therapy, and your name was closely associated with it. Would you apply the same drastic policy if you were given the chance to start all over again?

A. Yes, because we didn't have any better alternatives at that time. But I would be careful about using the term "shock therapy" and would distinguish between different phases of the transition process. Each phase encompasses different policy instruments.

Macroeconomic stabilization could be accomplished fast. Shock treatment—in other words, fundamental shifts in macroeconomic policy using such instruments as the exchange rate, interests rate, and budgetary measures—could bring quick results. Liberalization is not a technically complicated process and could also be accomplished rapidly. I never suggested shock therapy in dealing with basic institutional reforms (particularly privatization), which requires overhauling the legal and organizational frameworks, retraining former administrators, and recruiting new staff. These measures take a long time and cause lots of uncertainty.

"I'm sorry to disturb you for the second time today, but I have to keep pace with inflation."

From the Budapest magazine *The Hungarian Economy.*

Currency Reform in Slovenia: The Tolar Standing Tall (September 1992)

In spring 1991 the Slovenian government designed an economic program to achieve economic sovereignty. The main objectives of the program were to avoid the resurgence of hyperinflation that plagued the rest of the former Yugoslavia. On October 7, 1991, the parliament declared the tolar the sole legal tender in Slovenia. During the subsequent monetary conversion the commercial banks were closed for three days. Borders were closed to prevent illegal inflows of Yugoslav dinars. The conversion of dinar into tolar banknotes was largely accomplished in the first 36 hours. All contracts and bank accounts were converted to the tolar on a one-to-one basis. Dinar cash notes were converted to tolar notes, with a limit of $500 per person.

The Slovenian experience shows that:

- It is possible to move quickly on macroeconomic stabilization with the help of well-conceived monetary reform.
- Convertibility (at least for trade transactions) should be introduced at the beginning of monetary reform.
- Technical work on conversion can be done quickly (confirmed also by Estonia, which benefited from a careful examination of Slovenia's experience).
- Trade will reorient itself to new markets as soon as the economy opens sufficiently.

(Boris Pleskovic and Jeffrey Sachs)

The Case of National Currencies in the Former Soviet Union: Crowning the Estonian Kroon (October 1992)

Estonia adopted a specific monetary mechanism—a currency board—designed to make the kroon a stable and convert-

ible currency from the start. The IMF tried at first to delay introduction of Estonia's currency, arguing that the country was not yet ready and that the currency should be introduced late in 1992 or in 1993. As it turned out, Estonian authorities decided to proceed on their own, in view of the urgency of the situation and with confidence that the monetary reform could be carried out quickly and successfully. On the eve of the monetary conversion, the IMF provided some last-minute technical support and followed up with negotiations for a stand-by loan after the monetary reform had taken place.

The kroon was to be introduced at a fixed exchange rate vis-à-vis the Deutsche mark and with full backing of gold and foreign exchange reserves. The monetary conversion was undertaken June 20–22, at a conversion rate of 10 rubles per kroon for bank balances, wages, prices, and other contracts. The postconversion monetary policy guarantees the convertibility of kroons into Deutsche marks at the fixed rate of 8:1 for all current account transactions. The Estonian monetary reform clearly points the way for the new states of the former Soviet Union. Most, or all, will have their own national currencies. (*Ardo Hansson and Jeffrey Sachs)*

Letter to the Editor: IMF Comment on Hansson and Sachs' Recent Article on the Estonian Kroon (November 1992)

I would like to comment on the references to the IMF in the article "Crowning the Estonian Kroon" by Messrs. Sachs and Hansson in your October 1992 issue. Specifically, I believe that this article seriously misrepresents the role played by the IMF in the run-up to the introduction of the kroon on June 20, 1992.

The facts are that Fund staff began serious discussions with the Bank of Estonia on currency reform in January 1992 and initiated negotiations on a stand-by arrangement in early April. The Bank was already keen in January on an early reform. IMF staff continued to work closely with the Bank of Estonia throughout the spring and summer, providing assistance both in the general policy area and, in particular, on all aspects of the currency reform right up to the date the kroon was introduced. *(John Odling-Smee)*

Leading Economic Adviser to Russia Urges Stronger Western Involvement: An Interview with Anders Aslund (November 1992)

Q. Let me quote from your latest paper: "If Russia becomes really successful, it might come to resemble the United States near the end of the 19th century, that is, a Wild West economy with few regulations but therefore limited corruption." You suggest that private businesses should lead Russia out of the present mess. Can you really trust rent-seeking businesspeople to sort out distribution problems and get the country moving again? Will market forces be sufficient to reach socially optimal levels of output in the present Russian situation?

A. I'm convinced that in Russia more government regulations lead to more monopolization, more excessive profits, and more conspicuous consumption. The market is a far better equalizing force than any kind of regulation, given a very corrupt state administration in Russia. According to opinion polls, 1 percent of Russians are extremely rich, and I have no doubt that extreme income differences could be socially dangerous. But the way to mitigate social tension and prevent rent-seeking is to go ahead with liberalization and privatization and create a large middle class. My worry is that liberalization is not going far enough, while the policymaking apparatus is disintegrating. Therefore, I support the introduction of constitutional changes, the call for new parliamentary elections, and as a result, a gathering of a new democratic assembly. In the meantime, the government should tighten up the macroeconomic policy as far as possible.

Q. Without doubt, Gerashenko, [head of Russia's Central Bank], represents a solid block of economic opinion in Russia, which claims that even flagship industries could be crushed if they have to restructure production and management and redirect sales while being exposed to indiscriminate taxes, spiraling costs due to hyperinflation, and a centrally orchestrated credit crunch. Why not give them at least a little breathing space through carefully managed policies?

A. There is a legitimate case for cutting taxes in Russia, where people complain about the excessive tax burden. Public expenditures amount to only one-third of GNP, which indicates the country has already moved far in the right direction.

Q. As a foreign adviser, you take a surprisingly fierce attitude in defending the economic reforms of the government. A few weeks ago at the Financial Times conference in Moscow, you were rebuking Arkadi Volski, head of the Union of Industrialists and Entrepreneurs, who felt compelled to defend himself publicly against your charges.

A. What Volski really suggests is that we learn from the Japanese and the Chinese models. But this is unrealistic. Those countries pursued prudent monetary and fiscal policies. Most had far better civil services and state administration than Russia has today.

Q. As an adviser to the Russian government, you have been spending one week a month in Moscow since November 1991. How do you fulfill your role as an adviser, and who is funding your activity?

A. I try to keep up with major current policy issues and provide advice on a general level, while others give more technical advice on specific issues. I work with a team of 10 senior people, among them Jeffrey Sachs, Davis Lipton, and Andrei Schleifer. I'm funded primarily by the Ford Foundation and the Swedish government, and we

have some other sources of funding. Basically, this is a form of technical assistance for the Russian government.

How to Contain Economic Inertia in the Transition Economies (December 1992–January 1993)

In transition economies managers of state enterprises are gradually liberated from central control. In these new conditions state managers are still not motivated to maximize profits. This situation will change only if managers are subjected to effective control by financial markets through the exercise of shareholders' voting rights and the associated threat of hostile takeovers. Neither the dispersion of shares among a large number of uninformed private shareholders nor the concentration of shares in investment funds is likely to achieve such effective control; diffused share ownership will leave managers still quite comfortable to exercise their discretionary powers. *(Domenico Mario Nuti)*

Fact-Finding Tour of Russia's Industrial Firms: Eyewitness Report (December 1992–January 1993)

Our visits suggest that reforms in Russia have left firms in an environment of enormous uncertainty and high perceived risks. Many firms are starting to adapt, in the face of sudden inflation and large relative price shocks. Price liberalization has had some salutary effects on behavior. At the same time, local monopolies, vertical integration, and problems in the payments system slow the growth of competition. Improving the payments system is a top priority, although regularizing the settlement process could cause a further real decline in money holdings.

There are strong forces urging integration of the enterprise and banking sectors—an understandable response in the short term but one that in the longer term could make the economy structurally vulnerable in a crisis. Ownership and control are evolving rapidly, and it looks as though "insiders" will dominate in the foreseeable future. *(Alan Gelb and I. J. Singh)*

A Case for Direct Hard Currency Transfers to Russia's Needy: Comment on George Soros' Recent Proposal (December 1992–January 1993)

Recently, Mr. George Soros, an émigré from Hungary who is a businessman and humanitarian, came up with an innovative idea for Western assistance to the former Soviet Union. Soros proposes a massive injection of hard currency—$10 billion a year—to be paid out directly to the needy in Russia and other successor states of the defunct Soviet Union. This externally financed social safety net could generate demand for domestic and foreign goods and services without causing a drain on foreign reserves. It could check runaway inflation and stabilize the ruble, thus enabling unimpeded domestic financing of investment from private sources through the 1,500 commercial banks already in operation and through other credit institutions.

In combination with George Soros' suggestions of creating a social safety net and setting up a hard currency zone within the CIS, the establishment of effective private credit institutions could provide the basis for the economic growth of a free economy in the former Soviet Union. *(Abdul G. Khan)*

From the Soviet daily Pravda and the World Press Review

THE WILLIAM DAVIDSON INSTITUTE
AT THE UNIVERSITY OF MICHIGAN BUSINESS SCHOOL

Latest from the Davidson Institute's Publication Profiles

Enterprise Break-Ups and Performance During the Transition from Plan to Market

by Lubomir Lizal, Miroslav Singer, and Jan Svejnar

Forthcoming in *Review of Economics and Statistics*, February 2001, 83 (1). An earlier version of this article appeared as WDI Working Paper 13.

As countries embarked on the transition from planned to market economies in the early 1990s, the restructuring of state-owned enterprises became a major policy issue. One of the most important forms of restructuring was the massive breakup of state-owned enterprises in Czechoslovakia and to a lesser extent Hungary in the early 1990s. In Czechoslovakia many subsidiaries of state-owned enterprises applied to their supervisory ministries for permission to break away from their "master enterprises" in the 1990–91 period. The ensuing negotiations among government officials, top managers of the state-owned enterprises, and divisional managers resulted in a wave of spin-offs that created a large number of new firms led by new senior management. In 1990 Czechoslovakia had about 700 industrial enterprises employing more than 25 workers; by mid-1992 the number had almost tripled, to about 2,000. This restructuring preceded other major reforms: prices were still under state control in 1990, and even in 1991, when prices were by and large free, the state still owned the firms.

Did the break-up of large state-owned enterprises improve or worsen the performance of the spun-off subsidiaries, the remaining master enterprises, or both? The economics literature on the desirability of takeovers, mergers, and break-ups of firms in market economies focuses on the tradeoff between transactions costs in markets and the internal inefficiencies within organizations. In the context of transition, the conceptually more relevant studies focus on the bargaining among the key decisionmakers (managers, government officials, workers, new private owners).

In Czechoslovakia break-ups and spin-offs were initiated by the management teams of master enterprises or subsidiaries. Four hypotheses can be posited to explain why these break-ups took place:

- Hypothesis 1: Top managers of the state-owned enterprises spun off poorly performing divisions in order to improve the performance of the (remaining) master enterprises.
- Hypothesis 2: Managers of the divisions (subsidiaries) of state-owned enterprises spun more efficient units off from the master enterprises.
- Hypothesis 3: Large state-owned enterprises suffered from diseconomies of scale. Break-ups resulted in superior performance of both the spun-off units and the remaining master enterprises.
- Hypothesis 4: Managers of subsidiaries benefited from becoming senior managers of firms, even if the performance of their unit and the master enterprise worsened as a result of the break-up.

The hypotheses can be tested by examining the effects of the break-up on the master enterprise and the subsidiary (table 1).

Table 1. Effect of Break-Up on Master Enterprise and Subsidiary

	Positive effect on subsidiary	*Negative effect on subsidiary*
Positive effect on master enterprise	Hypothesis 3	Hypothesis 1
Negative effect on master enterprise	Hypothesis 2	Hypothesis 4

Analysis and Results

Our empirical analysis is based on quarterly and annual data reported by firms to Czechoslovakia's Federal Statistical Office and the Ministry of Finance during the 1990–92 period. The data cover all industrial enterprises employing more than 25 employees.

Our econometric estimates suggest that the major wave of break-ups of state-owned enterprises that took place in Czechoslovakia in the early 1990s had an immediate significant effect on the efficiency and profitability of industrial firms. The effect was positive for small, medium-size, and slightly above average–size spin-offs; it was negative for very large ones. We cannot reject the hypothesis that the estimated effect of spin-offs on performance was identical for the spun-off subsidiaries and the master enterprises that experienced the spin-offs. Taken together, the positive short-term effects on performance of both the master firms and the spun-off units are consistent with hypothesis 3 (that the large state-owned enterprises suffered from inefficiencies that were rapidly overcome by the break-up into smaller units). The finding that the short-term performance effect was negative for very large spin-offs is consistent with the notion that sizable break-ups involve large adjustment costs and thus have a negative short-term effect on performance.

We find that most 1992 estimates are similar to those for 1991 but that many yield statistically insignificant effects, including the negative one for sizable break-ups. We conclude that the lack of significance is likely caused by two factors: the increased competition brought about by the break-ups of the large firms into competing units and the 1992 elimination of the 20 percent import surcharge (the main trade protection measure) and the dissipation of profit by management as central controls were gradually eroded. Dissipation of profits reflects hypothesis 4 and is consistent with recent reports of siphoning off of profits and asset stripping ("tunneling") by managers in the Czech Republic, Slovakia, the Russian Federation, and other transition economies with weak ownership structures.

Lubomir Lizal is professor of economics at CERGE-EI, Prague and a research fellow at the William Davidson Institute. Miroslav Singer is an economist at CERGE-EI, Prague and Expandia Holding. Jan Svejnar is Executive Director of the William Davidson Institute and C. Everett Berg Professor of Business Economics at the University of Michigan Business School.

The Great Human Capital Reallocation: A Study of Occupational Mobility in Transitional Russia

by Klara Z. Sabirianova

Summary of WDI Working Paper 309

This study represents the first attempt to understand the magnitude, determinants, and consequences of occupational mobility in Russia between 1985 and 1998. The restructuring environment in general, and Russia in particular, represents a good basis to study occupational mobility as an individual behavioral response to structural economic shocks in the labor market. The conclusions are relevant for other emerging and transition markets in which structural and technological changes cause substantial reallocation of human capital.

The study answers five important questions about the effect of economic transition on occupational movements and the costs of such movement for individual workers. First, does the restructuring process lead to a higher rate of occupational reallocation? Both gross and adjusted measures show an unambiguous increase in occupational transitions after 1991, when reforms began. The number of people moving to another occupation was considerably higher during the first four years of reform (1991–95) than during the preceding six years (1985–91). During seven years of transition (1991–98), 42 percent of employed respondents changed their occupation—nearly twice as many as did so during the six pre-reform years. Occupational flows were most intense during the first five years of reforms; after 1996 the rate of occupational mobility began to fall. This decline could be partially due to the diminishing rate of structural change and the relative stabilization of occupational composition.

Second, does the restructuring process change the structure and direction of occupational mobility? We hypothesize that structural changes make occupational mobility more complex, in that changes in occupation, firm, and industry are occurring simultaneously. The data confirm this hypothesis, showing that the share of people who change occupation when changing firm or industry increased in 1991–98 compared with 1985–91 (with a decline in 1996–98).

A large increase in the magnitude of flows to service-providing occupations also occurred. Flows to these activities were almost three times higher in 1991–98 than during the pre-reform period. Comparing occupational structures in 1985 and 1998, we observe an increase in the share of managers, entrepreneurs, specialists in business and law, customer service clerks, people, and other service-providing workers (table 1). (Interestingly, the number of protective services workers rose by more than 200 percent for the same period). At the same time, there was a strong decline in the number of engineers and skilled laborers, possibly reflecting a shift away from goods-producing industries toward service-providing industries.

Third, what explains the increase in occupational mobility in transitional Russia? Are people involuntarily forced to change their occupation because previously accumulated skills become obsolete and unusable? Or does increased occupational mobility reflect the creation of new opportunities?

To answer these questions, the study examines whether occupational change is caused by a decline in returns to a previous occupation or by an increase in returns to alternative options. The analysis shows that the probability of occupational switching increases with returns to alternative occupations before and after the mobility decision. In other words, people respond to new opportunities and alternative options. People also respond to perceived future changes in payments, or returns, to their current occupation. However, a 10 percent decrease in returns to the current occupation brings about more occupational mobility than a 10 percent increase in returns to alternative occupations, suggesting that people are often forced to move to another occupation because their current occupation is losing its market value.

Fourth, what impact does the local economic environment have on occupational mobility? Are the magnitude and direction of occupational mobility different across Russian regions? We hypothesize that local labor market conditions—which reflect an uneven speed of structural change and unequal outside opportunities across regions—are critical determinants of occupational shifts.

Results of empirical analysis show that people change occupations more often in regions with a higher local job destruction rate and a higher employment share in newly created firms. However, a 10 percent increase in the local job destruction rate in the industrial sector resulted in more occupational changes than a 10 percent increase in the local share of employment in newly created firms. Again this result implies that a relatively large part of occupational mobility in the transition period is driven by destructive forces.

Among other local characteristics, the industrial employment concentration index is found to be negatively related to occupational mobility. This finding suggests that poor outside alternatives reduce the opportunities for occupational mobility.

Table 1. Changes in Occupational Composition in the Russian Federation, 1985–98
(percent)

One- and two-digit occupational categories	*1985*	*1991*	*1998*	*Percent change 1985-98*
Officials and managers				
Officials	0.20	0.09	0.14	–30.0
Corporate managers	0.62	0.77	1.53	146.8
Small firm managers	0.66	0.91	1.98	200.0
Entrepreneurs and independent farmers	0.00	0.21	1.79	n.a.
Professionals				
Physicists, mathematicians, and engineers	6.47	5.87	3.59	–44.5
Life science and health professionals	1.92	2.04	2.31	20.3
Teaching professionals	3.56	3.61	4.39	23.3
Business and law professionals	1.70	1.72	2.05	20.6
Other professionals	0.86	0.74	0.80	–7.0
Associate professionals				
Technicians	3.62	3.44	3.82	5.5
Life science and health associates	2.96	3.10	3.94	33.1
Teaching associates	2.34	2.74	2.55	9.0
Finance and business associates	1.48	1.64	1.77	19.6
Others	4.84	4.85	4.70	–2.9
Clerks				
Office clerks	5.85	5.65	5.03	–14.0
Customer service clerks	1.37	1.68	1.91	39.4
Service workers				
Personal services workers	2.43	2.36	2.88	18.5
Catering services workers	1.97	2.08	0.99	–49.7
Protective services workers	1.02	1.45	3.42	235.3
Salespersons	2.72	2.78	4.56	67.6
Craft workers				
Extraction and building trades workers	4.09	3.66	3.90	–4.6
Metal and machinery workers	12.79	12.76	9.47	–26.0
Other craft workers	2.72	3.27	2.95	8.5
Operators and assemblers				
Stationary-plant operators	3.25	3.51	3.40	4.6
Machine operators and assemblers	3.09	2.51	2.12	–31.4
Drivers and mobile-plant operators	14.03	13.88	11.47	–18.2
Other				
Elementary occupations	11.95	10.88	11.21	–6.2
Military specialists	1.50	1.79	1.30	–13.3
Sample size	4,527	4,704	4,236	

n.a. not applicable.
Source: Author's estimates from the Russian Longitudinal Monitoring Survey.

Fifth, to what extent does occupational reallocation increase the discrepancy between previously accumulated human capital and the market demand for skills? Intuitively, we would expect the connection between previously acquired education and occupation in the new market economy to weaken as a result of a transitional shock. Changes in the demand for occupation-specific skills and overall changes in wage distributions across occupations may induce people to end their old careers regardless of how successful they were under the previous system and to begin a new career in a completely different field with lower skill requirements.

In fact, the data show that a significant number of people choose new occupations that do not correspond to their education. In 1998 only 38.9 percent of engineering graduates held jobs as professionals. Some had become managers or entrepreneurs, but some had accepted jobs as laborers or service workers with lower skill requirements.

Table 2 shows ranking indices and ranks of 28 occupational categories according to level of schooling and level of earnings in 1998. Although the correlation between the two ranking indices is high, some discrepancies are apparent. Entrepreneurs and farmers rank 1st in terms of earnings but 15th in terms of education. Physicists, mathematicians, and engineers rank fourth in terms of schooling but ninth in terms of earnings. Movement up the schooling ladder is thus not necessarily associated with upward earning mobility.

Movement to occupations that on average require fewer years of schooling (a switch from engineer or technician to salesperson or guard, for example) appears common during transition. The data show that downward occupational mobility is forced by negative demand shocks and poor firm performance.

Finally, was the change of occupation beneficial for individual workers? What are the returns to occupational mobility in terms of earnings and subsequent wage growth?

Table 2. Rankings of Occupations in the Russian Federation by Level of Schooling and Earnings, 1998

	Schooling		*Earnings*	
Two-digit occupational category	*Ranking index*	*Rank*	*Ranking index*	*Rank*
Life science and health professionals	0.813	1	0.944	5
Teaching professionals	0.753	2	0.943	6
Business and law professionals	0.722	3	0.991	2
Physicists, mathematicians, and engineers	0.718	4	0.805	9
Officials	0.682	5	0.976	3
Other professionals	0.642	6	0.872	7
Corporate managers	0.641	7	0.969	4
Small-firm managers	0.583	8	0.804	10
Military specialists	0.517	9	0.867	8
Finance and business associate professionals	0.508	10	0.621	13
Teaching associate professionals	0.445	11	0.606	15
Technicians	0.444	12	0.700	11
Life science and health associate professionals	0.410	13	0.513	17
Other associate professionals	0.403	14	0.668	12
Entrepreneurs and farmers	0.399	15	1.328	1
Protective services workers	0.397	16	0.617	14
Office clerks	0.363	17	0.421	23
Customer service clerks	0.351	18	0.330	24
Metal and machinery workers	0.308	19	0.500	18
Stationary-plant operators	0.308	20	0.469	22
Salespersons	0.307	21	0.323	25
Catering services workers	0.290	22	0.149	26
Extraction and building trades workers	0.286	23	0.524	16
Other craft workers	0.278	24	0.487	20
Elementary occupations	0.264	25	0.093	27
Machine operators and assemblers	0.256	26	0.496	19
Personal services workers	0.256	27	0.000	28
Drivers and mobile-plant operators	0.255	28	0.476	21

Source: Author's estimates from the Russian Longitudinal Monitoring Survey

We test two conflicting hypotheses on the returns to occupational mobility. The "destructive" theory of occupational mobility suggests that people who are forced to move may lose benefits they had in their previous occupation. They may, for example, agree to lower wages than they had before their career change. In contrast, the "creative" theory of occupational mobility suggests that voluntary occupational switches in response to positive demand shifts and new opportunities bring additional benefits to individuals.

We test these hypotheses by estimating the returns to occupational mobility in terms of subsequent wage growth. The data show that occupational mobility reduces wage growth, thus supporting the "destructive" theory of occupational mobility during transition.

Klara Sabirianova is Assistant Professor at the William Davidson Institute. Before obtaining her Ph.D. in economics at the University of Kentucky, she was Professor of Economics at Ural State University in the Russian Federation.

Priorities and Sequencing in Privatization: Theory and Evidence from the Czech Republic

by Nandini Gupta, John C. Ham, and Jan Svejnar

Summary of WDI Working Paper 323

Privatization of state-owned enterprises has been one of the most important aspects of economic transition. But no transition economy has privatized all of its state-owned enterprises simultaneously. Even in the Czech Republic, Estonia, the Russian Federation, and Ukraine, which strove to privatize their state-owned enterprises rapidly, some firms were privatized earlier than others.

What determines the order in which firms are privatized? Do governments strategically sequence privatization? An answer to this question is important for understanding the behavior of governments and firms in transition economies and for determining whether empirical studies of the effects of privatization need to take into account the potential selection bias brought about by strategic sequencing. This issue is also relevant for countries such as China, India, and Mexico, which have large state sectors and are currently pursuing privatization.

This is the first study that examines both theoretically and empirically how competing government objectives may give rise to different privatization outcomes. To obtain testable predictions about which factors affect the sequencing of privatization, we develop new—and adapt existing—theoretical models of sequencing strategies for the following government objectives: maximizing sales revenue and public goodwill, increasing economic efficiency; and reducing the political costs associated with layoffs.

Regarding the maximization of privatization revenues, we show that it is a reasonable strategy for a government pursuing this objective to privatize more profitable firms first. The same outcome will arise if the government objective is to generate public good will from free or subsidized transfers of firms to citizens. Regarding efficiency, one strategy is to privatize inefficient firms first, so as to induce major restructuring and improvement in enterprise performance. Assuming that private firms are more efficient in responding to information, the government may also want to privatize firms in industries that face the greatest uncertainty in terms of demand and cost shocks. Privatizing more profitable firms may also reduce the political cost associated with layoffs, as our model shows that such firms are likely to have fewer layoffs than less profitable firms.

The Czech government carried out one of the most extensive mass privatization programs. To determine which objectives the government was pursuing, we examined firm-level data. Those data provide strong evidence that the Czech government privatized more profitable firms first. This outcome is consistent with the hypotheses that the government sought to maximize privatization revenues and public goodwill and minimize the political costs of unemployment. The fact that labor market conditions were not an important determinant of privatization allows us to rule out the hypothesis that reducing the political costs of unemployment was an important priority for the Czech government (not a surprising result in view of the low unemployment rate). We also find that the privatization process was consistent with the hypothesis that firms likely to be more responsive to changes in demand conditions were privatized first. However, inefficient firms are not being privatized first, suggesting that the government did not pursue the objective of productive efficiency. These conclusions provide insight into privatization strategies that may be adopted when different, sometimes competing, objectives are pursued by the government.

Our results have important implications for studies evaluating the effect of privatization on firm performance. Several such studies measure gains from privatization by comparing the performance

of privatized firms to firms remaining in the public sector. However, such comparisons are valid only if firms are randomly chosen for privatization. If the government selectively privatizes more profitable firms (as our results suggest), it should not be surprising to see these firms perform better than firms that remain public, even if privatization has no effect on firm performance. A similar statistical problem arises in studies examining the effect on firm performance of the length of time since privatization. Our result that more profitable firms are likely to be privatized early implies that unobserved firm characteristics that make firms more profitable may be correlated with the length of time the firm has been privatized.

Nandini Gupta is visiting assistant professor at the William Davidson Institute and the University of Michigan Business School. John C. Ham is professor of economics at Ohio State University and a WDI Research Fellow. Jan Svejnar is Executive Director of the William Davidson Institute and C. Everett Berg Professor of Business Economics at the University of Michigan Business School.

Davidson Institute Conference Announcements and Calls for Papers

The William Davidson Institute and the Centre for Economic Policy Research Annual International Conference on Transition Economics
Portorož, Slovenia, June 23–26, 2001

Deadline: January 31, 2001

This conference seeks to create a forum in which leading transition economists from different countries meet, present new research, and develop long-term collaborative relationships. The conference will bring together key policymakers in the region with researchers, facilitating discussion and the exchange of ideas.

The organizers of the conference are Jan Svejnar (William Davidson Institute; CERGE–EI, Prague; and CEPR) and Gérard Roland (Research Center of the Faculty of Economics, University of Ljubljana; CEPR; and the William Davidson Institute). Janez Prašnikar (Research Center of the Faculty of Economics, University of Ljubljana; CEPR; and the William Davidson Institute) is the local organizer.

To apply to present a paper at the conference, please send a copy of your paper to Deborah Jahn (djahn@umich.edu) by January 31, 2001. It is anticipated that demand will exceed the space available, so preference will be given to those who plan to stay for the entire meeting. Decisions about conference participation will be made by March 1, 2001.

2001 William Davidson Institute/ Journal of Financial Intermediation Symposium—Banking in Emerging Markets
University of Michigan, Ann Arbor, MI, June 15-17, 2001

Deadline: January 10, 2001

The William Davidson Institute at the University of Michigan and the *Journal of Financial Intermediation* are pleased to cosponsor a symposium on banking in emerging markets. Papers are invited on various aspects of this topic, including the following:

• *Ownership structure of banks.* What are the determinants and effects of foreign ownership of banks in emerging markets? (Both theoretical and empirical papers are welcome.)

• *Impact of technology on the banking sector.* How is technology shaping the evolution of banking in emerging markets? How will ecommerce affect and be affected by the evolution of banking? Will the introduction of new technologies (such as cellular phones) allow foreign banks to penetrate emerging markets without a brick-and-mortar presence?

• *Bank regulation.* What regulatory structure is desirable? To what extent should regulation be entrusted to national regulators? How should bank regulation in emerging markets differ from that in industrial countries? What are the key risk management challenges for regulators in emerging markets? What are optimal recapitalization policies?

• *Venture capital.* How do the form and evolution of financial intermediation affect which technologies get funded? Why is venture capital booming in some countries (such as Israel) and not others (such as China)?

• *Capital markets and banks.* What is the interaction between the development of capital markets and that of banks? How does the integration of international capital markets affect banking in emerging markets? In particular, how does the open versus closed nature of capital mobility in an emerging market affect the fragility of the banking sector? How do exchange rate crises affect banking?

• *Impact of the legal environment* How does the legal environment—debtor- versus

creditor-friendly laws, the nature of contract enforcement, and so forth—affect the development of banking and capital markets in emerging countries? How are soft budget constraint problems addressed?

Patrick Bolton, of Princeton University, is the program chairperson for the symposium and will be selecting the papers. He is also the guest editor for a special issue of the *Journal of Financial Intermediation* that will be dedicated to papers submitted to the symposium that are also accepted for publication in the *Journal of Financial Intermediation*. Submitted papers will go through the same reviewing process as papers published in regular issues of the *Journal of Financial Intermediation*. The submission fee will be waived, however. Submitting a paper to the *Journal of Financial Intermediation* is not a prerequisite for submitting a paper to the symposium.

Please send five copies of your paper by January 10, 2001 to: Professor Anjan V. Thakor, University of Michigan Business School, 701 Tappan, Rm. D6214, Ann Arbor, Michigan 48109-1234, United States.

WILLIAM DAVIDSON INSTITUTE RESEARCH COMPETITION

Public Policy and Business Development in the Balkans, Central Asia, and the Caucasus

Deadline: January 31, 2001

The William Davidson Institute is supporting postdoctoral research by U.S. scholars on business development and performance and public policies that affect the development of markets. Research should focus on, but need not exclusively address, the Balkans, Central Asia, and the Caucasus.

Through funding provided by the U.S. Department of State under Title VIII, two to seven grant awards of $10,000–$50,000 will be awarded for research on the Balkans. One to five grant awards of $10,000–$50,000 will be awarded for research on Central Asia and the Caucasus. Grants will be awarded for up to two years. Priority will be given to projects that will be cofunded. Grant recipients may be asked to present their findings at Davidson Institute and U.S. Department of State policy forums.

Applicants must have completed a Ph.D. and demonstrate commitment to the study of transition economies in Central and Eastern Europe, the Russian Federation, or Eurasia. Collaborative projects are eligible, but non-U.S. collaborators must be funded from other sources. Grant funds may be used for travel, summer support, salary replacement, research assistants, and data acquisition. The research papers resulting from the grants will be added to the Davidson Institute Working Paper Series, and data accumulated under the grant will be deposited at the Davidson Institute Data Center and made available to other researchers within a negotiated time frame.

For application guidelines and procedures, please contact Deborah Jahn, Research Administrator for the William Davidson Institute, at djahn@umich.edu,or go to the Davidson Institute's Web site, at www.wdi.bus.umich.edu.

CEPR Transition Economics Workshop for Young Academics

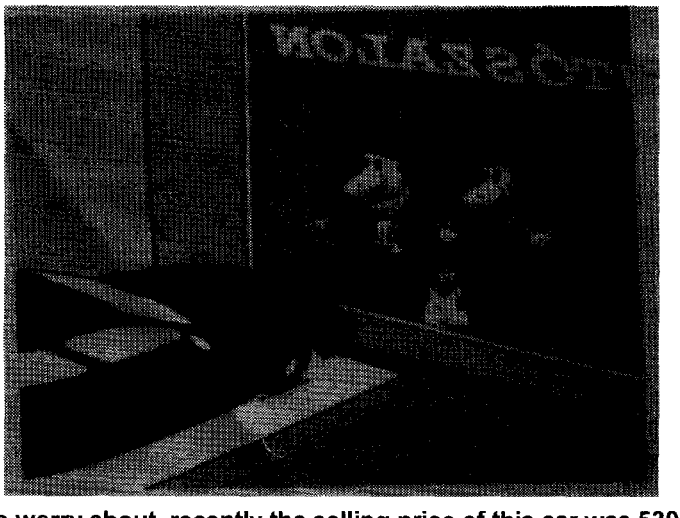
Portorož, Slovenia, June 27–July 5, 2001

Deadline: February 28, 2001

CEPR is pleased to announce its third Transition Economics Workshop for Young Academics, organized by Mark Schaffer (Centre for Economic Reform and Transformation, Heriot-Watt University, Edinburgh; the William Davidson Institute; and the IZA Institute for the Study of Labour, Bonn); Janez Prašnikar (Research Center of the Faculty of Economics, University of Ljubljana; CEPR; and the William Davidson Institute); and Gérard Roland (ECARES, Université Libre de Bruxelles; CEPR; and the William Davidson Institute).

Research in transition economics is evolving rapidly, but many people in the field conduct their research in relative isolation. The problem is particularly pronounced for young academics. This

Let the Good Times Roll



"Nothing to worry about, recently the selling price of this car was 530 times that of the minimum wage, but today it only costs 400 times as much."

From the Hungarian Economic Daily *Világgazdaság*

workshop will promote the research activities of Ph.D. students and recent Ph.D.s from the European Union and the Phare countries of Central and Eastern Europe (Albania, Bosnia and Herzegovina, Bulgaria, the Czech Republic, Estonia, the Former Yugoslav Republic of Macedonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia). Young academics will receive feedback on their work in progress from established academics in the field and from one another.

The workshop will also enable participants to learn about recent developments in the field and to establish contacts with other researchers that will continue beyond the summer. A selection of the papers presented by the young academics will be published in CEPR's Discussion Paper series.

Program: About 20 young academics from EU and Phare countries will participate, along with senior faculty (including Professors Schaffer, Prašnikar, and Roland). The program will be based on presentation of papers by the young academics, with time for discussion and comment by all participants. Several afternoon or evening sessions will be devoted to guest speakers (established academics or practitioners).

Eligibility: Applications will be accepted from students working in the economics of transition who are permanent residents or citizens of EU or Phare countries and from junior academics working in the economics of transition who received their Ph.D.s after January 1, 1996, and who are based in EU or Phare countries.

Funding: Accommodations, transportation (to and from EU and Phare countries only), and a small per diem allowance will be covered by CEPR. Young academics will also receive an honorarium of €1,000.

Application: Workshop participants will be selected on a competitive basis. All applicants must submit an official application form, a description of their current research in the economics of transition, a short summary of the paper they intend to present at the workshop, and one or two supporting letters of reference. Application forms, available on CEPR's Web site (http://www.cepr.org), should be sent to Alice Warr, at CEPR, 90–98 Goswell Road, London EC1V 7RR, United Kingdom. Fax: 44 207 878 2999, email: awarr@cepr.org.

Recent Working Papers of the William Davidson Institute

www.wdi.bus.umich.edu

Schaffer, Mark E., and Gerard Turley. **Effective versus Statutory Taxation: Measuring Effective Tax Administration in Transition Economies.** No. 347, November 2000.

Pissarides, Francesca, Miroslav Singer, and Jan Svejnar. **Objectives and Constraints of Entrepreneurs: Evidence from Small and Medium-Size Enterprises in Russia and Bulgaria.** No. 346, October 2000.

Lízal, Lubomír and Evžen Koèenda. **Corruption and Anticorruption in the Czech Republic.** No. 345, October 2000.

Konings, Jozef. **The Effects of Direct Foreign Investment on Domestic Firms.** No. 344, October 2000.

Puhani, Patrick A. **On the Identification of Relative Wage Rigidity Dynamics.** No. 343, October 2000.

Bevan, Alan A., and Saul Estrin. **The Determinants of Foreign Direct Investment in Transition Economies.** No. 342, October 2000.

Weber, Klaus, and Gerald F. Davis. **The Global Spread of Stock Exchanges, 1980–1998.** No. 341, October 2000.

Nuti, D. Mario. **The Costs and Benefits of Euro-isation in Central-Eastern Europe Before or Instead of EMU Membership.** No. 340, October 2000.

Guriev, Sergei, Igor Makarov, and Mathilde Maurel. **Debt Overhang and Barter in Russia.** No. 339, September 2000.

Walsh, Patrick Paul, and Ciara Whela. **Firm Performance and the Political Economy of Corporate Governance: Survey Evidence for Bulgaria, Hungary, Slovakia, and Slovenia.** No. 338, July 2000.

Campos, Nauro F., and Jeffrey B. Nugent. **Investment and Instability.** No. 337, May 2000.

Pye, Robert B.K. **The Evolution of the Insurance Sector in Central and Eastern Europe and the Former Soviet Union.** No. 336, August 2000.

Kogut, Bruce, and Andrew Spicer. **Institutional Technology and the Chains of Trust: Capital Markets and Privatization in Russia and the Czech Republic.** No. 335, August 2000.

Berkowitz, Daniel, and David N. DeJong. **The Evolution of Market Integration in Russia.** No. 334, August 2000.

Halpern, László, and Gábor Kőrösi. **Efficiency and Market Share in Hungarian Corporate Sector.** No. 333, July 2000.

Local Government and Public Service Reform Initiative

The Local Government and Public Service Reform Initiative

The Local Government and Public Service Reform Inititive (LGI) is an international development and grant-giving organization within the Soros/Open Society network of foundations. Its mission is to promote democratic and effective government in Central and Eastern Europe and the former Soviet Union by supporting research and operational activities in the fields of decentralization, public policy formation, and the reform of public administration systems.

LGI seeks to fulfill its mission by developing sustainable regional networks of institutions and professionals, supporting comparative and regionally applicable policy studies tackling local government issues, and delivering technical assistance to implementing agencies. It also provides assistance to Soros foundations in countries throughout the region, develops curricula and organization of training programs, and publishes books, studies, and discussion papers on decentralization, public administration, and good governance. LGI has also begun to support policy centers and think tanks in the region. Since 1999 LGI has focused more of its efforts on in-house policy analysis and research projects, with the intention of becoming a full-fledged think tank in the next few years.

LGI develops and funds in-depth policy studies, particularly those that are regional and comparative in scope. Activities in this field fall into several policy areas:

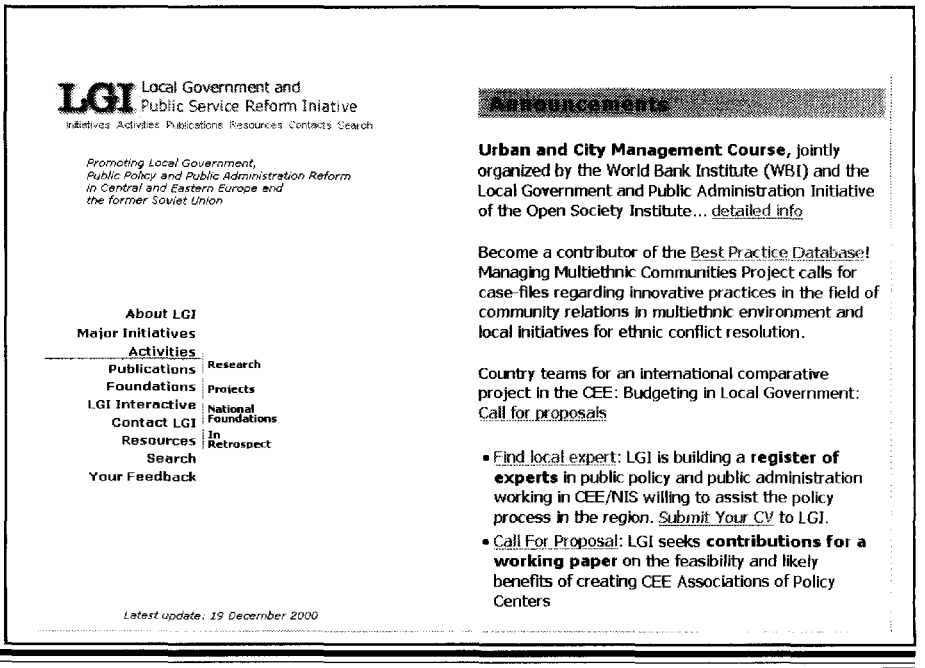
- *Public administration and legislative reform.*
- *Government and governance issues* of ethnic and multicultural policies; corruption, transparency, and ethics in public administration; public participation in government; and development of civil society.
- *Municipal fiscal issues* assisting transition economies carrying out reform of intergovernmental fiscal relations; improved financial good governance and increased financial autonomy of subnational governmental units.
- *Public service management* in urban services and social policy.
- *Local economic and regional development,* urban development.

LGI works closely with other international organizations, including the Council of Europe, the Department for International Development, USAID, UNDP, and the World Bank. Under these cooperation agreements, LGI co-funds larger regional initiatives aimed at supporting reforms at the subnational level. The Local Government Information Network (LOGIN) and Fiscal Decentralization Initiatives (FDI) are two examples of this cooperation.

We hope that LGI's contribution to *Transition* will support the policy dialogue on decentralization and public administration reform in transition economies.

For additional information, please contact us at the following address: Local Government and Public Service Reform Initiative, P.O. Box 519, H-1397 Budapest, Hungary. Tel: 36-1 327-3104; fax: 36-1 327-3105; email: lgprog@osi.hu; Http://www.osi.hu/lgi.

LGI Web site with the Latest Messages



LGI Local Government and Public Service Reform Iniative

Initiatives Activities Publications Resources Contacts Search

Promoting Local Government, Public Policy and Public Administration Reform in Central and Eastern Europe and the former Soviet Union

About LGI
Major Initiatives
Activities
Publications
Foundations
LGI Interactive
Contact LGI
Resources
Search
Your Feedback

Research
Projects
National Foundations
In Retrospect

Latest update: 19 December 2000

Announcements

Urban and City Management Course, jointly organized by the World Bank Institute (WBI) and the Local Government and Public Administration Initiative of the Open Society Institute... detailed info

Become a contributor of the Best Practice Database! Managing Multiethnic Communities Project calls for case-files regarding innovative practices in the field of community relations in multiethnic environment and local initiatives for ethnic conflict resolution.

Country teams for an international comparative project in the CEE: Budgeting in Local Government: Call for proposals

- Find local expert: LGI is building a **register of experts** in public policy and public administration working in CEE/NIS willing to assist the policy process in the region. Submit Your CV to LGI.
- Call For Proposal: LGI seeks **contributions for a working paper** on the feasibility and likely benefits of creating CEE Associations of Policy Centers

Decentralization: Experiments and Reforms in Central and Eastern Europe

by Tamás M. Horváth and Gábor Péteri

During the first decade of transition various models of local government were designed. Political mechanisms, economic systems, institutions, and management practices were restructured. During the long learning process of establishing new local governments, several shifts in objectives and modifications took place. These modifications have left different government structures in place in the eight countries of Central and Eastern Europe.

Structural Changes

As an important first step of transition, a new democratic and pluralistic model was introduced at the local level. The European Charter of Local Self-Government summarized the minimum structural and legal requirements for preparing and establishing local institutions. Administrative reforms and models vary both across countries and over time. Due to the fluid and sensitive political balance that exists in Central Europe, reform concepts about local government undergo relatively frequent changes.

Reform of Poland's local government, for example, reached a dead end in the mid-1990s, breeding disillusionment. Then, in 1999, limits on local jurisdictions were suddenly changed, with far-reaching political-administrative implications. In Lithuania crucial reform revisions were initiated in 1995, replacing the two-tier system of local government with a single tier. In the Czech Republic the institutions and mechanisms of local democracy have been radically reformed and municipalities have taken over all self-governing functions—but debates on the establishment of an intermediate government tier dragged on for a decade.

Organizational Models

In the first wave of constitutional changes, legislation on local government and free local elections was codified. In the second wave, legislation established the scope of local government, approved civil servant and public employee acts, specified the scope and duties of public administration at each level, and regulated property transformation.

Attitudes and the operation of local governments were changed as a consequence of the introduction of market agents and public participation. The influence of the private and nongovernmental sectors increased in public services. Financial cutbacks forced customers to contribute to the costs of these services. While the withdrawal of government from public services was more drastic in Central and Eastern Europe than in the West, policy responses to these challenges were more mooted.

Further development of local governments in these countries is proceeding in four major directions:

- *Reforming public administration.* After 10 years of almost continuous changes, public administration reform is still on the political agenda in most of Central and Eastern Europe. Major targets include the further decentralization of local government structures (in Slovakia) and decisionmaking powers (in Slovenia). The relation between the functions of existing central public administration and the new municipal administrations are also subject to change. For countries involved in the EU preaccession process (the Czech Republic, Hungary, and Poland), the role of the intermediary level of government is a crucial issue.

- *Improving service provision.* Estonia and Latvia are focusing on creating more efficient local government services, improving management techniques, and developing new rules of modern administrative ethics. They are also trying to increase the professionalism of local government staff and municipal service organizations in order to improve service provision.

- *Reforming local government finance.* Earlier in the reform process, the focus was on intergovernmental fiscal relations, especially the system of transfers. Today the principal objective is to increase independent revenues as the basis of extending local autonomy. Suggested methods are more sophisticated and include not only local taxation but also personal income tax sharing schemes, which are being developed in Estonia and Poland.

- *Introducing local governance and management methods.* Greater public participation, more transparent operation of municipalities, and establishment of direct contacts with citizens are high priority goals of reform in Lithuania and the Slovak Republic.

Tamás M. Horváth is Research Director, HIPA (Hungarian Institute of Public Administration). Gábor Péteri is Research Director, OSI-LGI. *This article is based on an article that appeared in* Local Governments in Central and Eastern Europe, *edited by T.M.Horváth (Budapest: LGI Books, OSI/LGI, 2000).*

European Union Enlargement and the Open Society Agenda

Local governments and NGOs should take a more active and effective part in the EU enlargement process. This article examines some issues related to EU enlargement from the point of view of local governance and administration, identifying ways in which donor organizations, including the Open Society Institute Local Government Initiative, can play a role.

EU accession will affect four broad areas of local governance and public administration:

- ***Regionalization and regional development.*** As both economic and political entities, regions are important in the accession countries. They are basic units of funding for regional development and play a significant role in decentralizing decisionmaking. These functions made them increasingly important in political terms as well.
- ***Sectoral issues and local public services.*** Environmental services, such as water and waste management, are often provided by local governments and regulated by local laws, directives, and EU policies. Employment guidelines are generally built into legislation, but local governments can play a role in supporting workers' adaptability and equal opportunities.
- ***Procedures and regulatory frameworks.*** Procedures and regulatory frameworks affect public procurement, consumer protection, and local finances (through their effect on the size of the public deficit and subsidies to local service organizations, for example). Local governments are affected by EU legislation in many areas (public utility services, competition in the energy sector).
- ***Government efficiency and effectiveness.*** Local governments should be involved in policy development, if only to defend the interests of their districts or regions and benefit from regional development or structural funds. The experience of current member states shows that participation in the EU policy process increases competition among local authorities, forcing them to improve administrative quality.

The need to develop local administrative capacity is becoming more acute as central administrations shed more functions. There is a need to improve local staff's managerial competence and its awareness of European integration–related issues, as well as to streamline local government organization itself.

The importance of developing staff qualifications and capacities of local government—in order to take advantage of the few tools available to influence the EU policy process—has often been underestimated at the local level. Improving the central government's administrative capacity should go hand in hand with upgrading local structures and organizational systems. It should not be forgotten that in many areas the European Commission has the exclusive authority to initiate policies affecting local authorities. If local authorities wish to influence draft legislation that ultimately will affect them, they must focus on the activity of the Commission. Reform efforts should also aim at developing stable and workable financial and legal frameworks governing local-central relations, as well as creating institutionalized consultation mechanisms. Crucial components of intergovernmental relations are the clear division of labor between central government and self-governments, separation of county and municipal property from state property, and definition of the relations between local stategovernments and local self-governments.

Attention should also be paid to developing local-local relations among municipalities. Policy coordination and joint planning mechanisms are especially important if local governments want to create regions on a "problem" basis in order to attract EU funds. Developing strong partnership ties with local NGOs and citizen groups should also be a top priority in order to guarantee smooth communication and understanding among local institutions and their constituents. Contracting out practices at the local level have to be fostered in order to make local public service delivery more effective and efficient.

The main preconditions for effective assistance are adequate absorption capacities, a proactive attitude on the part of beneficiaries, flexibility of programs, and well-designed packages of measures. In order to cover institutional gaps, various institution-building measures have to be applied in Central and Eastern Europe, including support for developing staffing strategies and functional reviews, reassigning certain functions.

To help candidate countries cope with the challenges of the accession process, donors should support policy institutes that develop second opinions on EU positions. They should also provide assistance for building institutions that can support strategic planning and policy analysis. Donor involvement is beneficial at the central level to help assess the impact of draft legislation, particularly its effect on economic sectors and vulnerable groups in society.

The article is based on report published by LGI in March 2000.

Project Summary: Local Government Information Network (LOGIN)

The Local Government Information Network (LOGIN) is a local government information clearinghouse designed to promote the professional development of local government officials and their staffs and to strengthen the capabilities of organizations that support the reform of public administration at the local level. Sponsors include USAID, the Council of Europe, the Open Society Institute/Local Government and Public Service Reform Initiative, UNDP, and the World Bank.

With limited budgets, local governments in emerging democracies in Central and Eastern Europe and the former Soviet Union are working to provide services, promote economic development, communicate effectively with citizens, and operate more efficiently. The autonomy of these local governments depends largely on their ability to find solutions to local problems without seeing increased central government funding as the only option.

Municipal associations, foundations, and corporations have emerged throughout the region to assist local governments. Now LOGIN offers these organizations and local government officials a new way to share information, develop networks, and improve the services they provide to municipalities.

Hailed by former U.S. Secretary of State Madeline Albright for its innovativeness, LOGIN facilitates the exchange of information through the Internet. It also uses traditional dissemination methods, including workshops, publications, conferences, and training. The Internet component of LOGIN is more than a Web site. It is a Web-based, database-driven tool for storing and exchanging information worldwide. It allows individuals from different countries and speaking different languages to collect, store, manipulate, and exchange information.

The LOGIN network is made up of organizations that are committed to serving local government (associations of local authorities, NGOs, for-profit companies). The network is completely open and can be accessed by anyone. Partners in the network include:

- *Bulgaria: Foundation for Local Government Reform* **(http://www.flgr.bg).**
- *Hungary: Kozigkonzult Co./Telecottage Public Benefit Co.* **(http://onkormanyzati.penguinpower ed.com).**
- *Latvia: Union of Local and Regional Governments of Latvia* **(http://www. lps.lv/).**
- *Lithuania: Municipal Training Center of Kaunas University* **(http://www.smc. ktu.lt/).**
- *Poland: Foundation in Support of Local Democracy/ Municipium* **(http://www.frdl.org.pl and http://www.wspolnota.org.pl/muni cipium.html).**
- *Slovakia: Association of Towns and Municipalities (ZMOS)* **(http://www.zmos. sk).**

These partners offer country-specific information and news, legislative updates, calendars of country-specific and regional events of interest to local governments, and an online library. Partner Web sites also provide formation about the roles and responsibilities of various European institutions and their components, especially the European Union and the Council of Europe. Sponsoring partners also make available information on funding opportunities for local government initiatives in the region and training events for local government practitioners in the region.

The LOGIN database includes the following categories:

- Citizen participation.
- Culture.
- Economic development and investments.
- Education.
- Environmental issues/urbanization.
- European integration.
- Healthcare.
- Information systems.
- Land use planning.
- Legislation.
- Local government finance, budgeting, municipal credit.
- Management methods and tools.
- Municipal property management/privatization.
- Procurement.
- Public works and utilities.
- Service provision.
- Social services.
- Taxes.
- Transportation.
- Youth activities.

The LOGIN Web site (http://logincee.org) provides information on project development and access to the English language portion of the library. The LOGIN network database can be accessed through the Bulgaria country site, at http://www.flgr.bg. All partner organizations' Web sites will be integrated with the LOGIN services by the end of the first quarter of 2001.

For further information, please contact Kristóf Varga, LGI Project Manager, at kzvarga@osi.hu.

Making Local Government Transparent in Eastern Europe: Anti-Corruption Workshop in Riga

Corruption has become a formidable impediment to the transformation and improvement of living standards in Central and Eastern Europe and the former Soviet Union. The international anti-corruption movement has focused on corruption at the international and national levels. But as subnational levels of government have gained power and responsibilities, local-level corruption has come to have a growing impact on the lives of citizens in transition economies.

Municipal government—and the integrity or lack of integrity of that government—has an important effect on people's everyday lives. Ideally, local governments should be more responsive to the needs, requests, and demands of individuals or groups than the central government. The local level is thus the ideal environment for civil society to mobilize to help improve government services and increase integrity in government; as the smaller size of communities can yield greater cooperation among principal actors.

During a two-day workshop sponsored by the Open Society Institute and Transparency International in early November, participants from Estonia, Latvia, Lithuania, the Russian Federation, and Ukraine met with professionals from well-known international organizations to focus on how to combat corruption at the municipal level in Eastern Europe. The workshop represented an "East-East" exchange of ideas, information, and approaches toward fighting corruption. Workshop participants came out with the joint Riga Declaration, laying out the major criteria of local government transparency in Eastern Europe.

The principal aim of the Riga workshop and the subsequent declaration was to develop a model for a local integrity system akin to the National Integrity System developed by Transparency International. To that end, participants agreed to the following pillars of integrity:

- *Political will for change* is a necessary component of any comprehensive integrity system. It is necessary to build coalitions of well-respected, reform-minded, exemplary top managers and mayors and use them to introduce and publicize innovative anti-corruption practices.
- *Participation by civil society is* vital to any anti-corruption program. The importance of civil society groups working directly with local authorities—helping to write codes of conduct, for example—cannot be overestimated. The business community is equally crucial in maintaining high business standards, creating ethical business associations, and training businesses on how to deal properly with government representatives.
- *An active, independent media* can serve as a watchdog and can report on reform successes. For this to happen, appropriate standards must exist for investigative journalism, and freedom of information acts and a system of legal protection for journalists must be established.
- *Fighting corruption in the civil service through civil service reform* can be facilitated by writing and enforcing codes of conduct and conflict of interest guidelines, establishing performance measures, setting higher selection standards, providing better training, making salaries public, forcing disclosure of assets, and focusing on the quality rather than the number of civil service members.
- *To enforce anti-corruption measures,* local governments need a clean, professional judiciary; laws permitting the prosecution of bribe givers as well as bribe takers; an Office of the Ombudsman; accessible legal advice; telephone hotlines for the expression of ideas; and effective institutions and adequate funding to investigate and prosecute cases of corruption.
- *Transparent financial institutions and oversight organizations* are critical. Key tools include independent auditing institutions, independent audits by internationally recognized organizations, transparent public procurement, budgets, privatization processes, public hearings, public participation in decisionmaking, and the guaranteed financial autonomy of local governments with respect to higher tiers of government.
- *Viable, self-sufficient local government units* in the countries involved in the workshop require administrative-territorial reform. Key steps that need to be taken in the areas of *legislative and regulatory* reform include contracting service provision to private businesses and NGOs, privatizing publicly owned businesses, giving a strong role to independent lawyers in providing advice and drafting legislation, informing citizens of their rights, closing legal loopholes, and lifting some of the immunity afforded deputies, government officials, and judges.

The participants at the Riga workshop believed that this model offers a better guide to reforming local institutions in their countries than Transparency International's national model, as it is slightly more descriptive. Although it remains to be seen whether this model can serve as an effective subnational model, its simple nature lends itself to use in various contexts.

SITE
Stockholm Institute of Transition Economics
STOCKHOLM SCHOOL OF ECONOMICS

Power Shift between Interest Groups: The Political Economy of Transition in the Russian Federation

EERC-CEFIR Conference in Moscow

The transition changed the structure and relative power of interest groups in Russian society, dramatically altering the way interests translate into policy. Over the course of the transition, the shape of the institutions that frame the political decisionmaking process has itself become a matter of political bargaining.

These were some of the conclusions drawn at the Fourth Annual Conference of the Economic Education Research Consortium (EERC), sponsored jointly by the Center for Economic and Financial Research (CEFIR). The conference, "The Political Economy of Russia's Transition," was held December 17, 2000, in Moscow. The organizing committee included Erik Berglöf (SITE, CEFIR, and CEPR), Eric Livny (EERC), and Gérard Roland (Research Center of the Faculty of Economics, University of Ljubljana; CEPR; and the William Davidson Institute). The conference program combined cutting-edge political economy theory with the practical experience of economic reforms in transition and developing economies throughout the world, including China and Latin America.

All of the papers presented at the conference can be downloaded at **http://www.eerc.ru/activ/conf00/PapersCollection.htm**. Summaries of the papers are presented here:

- Torsten Persson (IIES, Stockholm University); Guido Tabellini (Bocconi University, Milan); and Francesco Trebbi report that corruption is inherently related to electoral rules. In "Electoral Rules and Corruption," they argue that larger voting districts and individual, as opposed to party, lists of candidates are associated with less corruption. Torsten Persson and Guido Tabellini ("Political Institutions and Policy Outcomes: What Are the Stylized Facts?") investigate the effects of electoral rules and political regimes on the size and composition of government spending and government deficit.

- In "The Political Economy of Latin American Growth," Francisco Rodriguez (University of Maryland) discusses how such factors as political instability, inequality in the distribution of political and economic power, corruption, rent-seeking by national governments, and a combination of populist policies and policies benefiting powerful vested interests can account for the region's poor growth performance.

- Gérard Roland (ECARES, Université Libre de Bruxelles; CEPR) synthesizes the main lessons from 10 years of transition. He compares various political and economic aspects of two approaches to reform: the Washington consensus (the shock-therapy view) and the evolutionary-institutionalist perspective (the gradualist view). He analyzes the impact of transition research on economics in general, emphasizing the role of the institutionalist perspective in modern economic research.

- In "Political Economy of Scale and Endogenous Rule of Law," Leonid Polishchuk (IRIS; University of Maryland) argues that if the rule of law is not a matter of indisputable legal and political tradition but rather a policy variable for the government, the investment climate depends not only on the government's decisions but also on the number of investors. Thus a shock that increases the need for external investment might lead to higher investments and better enforced rule of law.

- Ekatherina Zhuravskaya (CEFIR, Moscow; CEPR) presented two papers on tax arrears and subsidies, "Determinants of Government Subsidies to Industrial Firms: Firm-Level Evidence," written with Zhenia Orlov (NWU and Lena Paltseva (CEFIR and SITE), and "Federal Tax Arrears: Liquidity Problems, Federal Subsidies, or Regional Protection," written with Maria Ponomareva (Northwestern University). She and her coauthors claim that common explanations of federal tax arrears—such as the lack of liquidity in enterprises and the federal government's willingness to implicitly subsidize firms by tolerating arrears—are inconsistent with the data. The evidence suggests that in the second half of the 1990s, regional governments' political resistance to federal tax collectors caused the accumulation of federal tax arrears.

- In "Models of Transition and Multi-Stage Reform," Allan Drazen (University of Maryland) summarizes some of the main conclusions from his recent textbook on political economy.

For more information, please visit www.eerc.ru or www.cefir.org.

Recent CEFIR Research

Natalya Volchkova, CEFIR, Does Financial-Industrial Group Membership Affect Fixed Investment? Evidence from Russia

This study estimates an accelerator model of fixed investment using a Russian industrial enterprise data set. The data set contains individual firms' accounting data for 1996 and 1997. The sample of firms was divided into two subsamples, based on ownership structure. It compares sensitivities of investment to changes in net worth for unregistered financial-industrial groups and independent firms. Based on the empirical results, it concludes that the model works well when applied to Russian firms' investment behavior in 1996–97. Russia's financial system provided external finance primarily to the largest enterprises; most firms received no outside financing.

Given the same investment opportunities and size class, medium and large firms from unregistered Russian financial-industrial groups invested a larger proportion of their retained earnings than did independent firms. This result is consistent with the hypothesis that banks in such groups—which are able to monitor financial flows of firms in the groups more easily than they can monitor independent firms—exercise systematic control over managerial actions. This efficiently reduces managerial discretion over retained earnings, which results in the implementation of a larger number of investment projects among these firms than among independent firms of the same size and with the same investment opportunities.

These results indicate that the role played by banks in Russian financial-industrial groups differs from that played by banks in Japanese and Korean groups. Banks in Russian groups do not reduce the information asymmetry problem for group firms, but they could help solve the problem of contract enforcement in firms participating in those groups. In an economy with inefficient banking and financial systems, this would increase the volume of investment implemented by group firms relative to independent firms facing the same investment opportunities. Such integrated structures thus play an important role in an economy in which both insufficient investment and weak corporate governance are substantial impediments to structural and political reforms.

Introducing *Baltic Economic Trends*

In November SITE launched a new quarterly publication, *Baltic Economic Trends* (BET). The new journal is edited by Alf Vanags, of the University of Latvia and the University of London (alf@eurofaculty.lanet.lv), and Peter Westin, of SITE (Peter.Westin@hhs.se). It is part of the Baltic International Centre for Economic Policy Studies (BICEPS) project to build an economics research and policy center in Riga, Latvia. The new journal represents a new, innovative channel for communicating the results of the latest research on the Baltic economies.

Since the start of the transition, the three Baltic states have made tremendous progress in reforming their economies. They have become market economies and have reintegrated successfully into the world economy. Their achievements have fostered a rapidly growing interest in the Baltic states that has generated significant per capita levels of foreign investment.

BET's approach is to study and interpret economic development in the Baltic economies in the framework of their integration into the world community and the European Union. The economic statistics produced by official sources in the three Baltic states are accessible and of good quality. *BET* aims to complement existing analytical and statistical sources with in-depth comparative analysis. It will also provide analysis of developments in the Baltic Rim, their impact on the Baltic economies, and the process of EU enlargement.

The introductory issue of BET includes three feature articles: "Trade Policy in the Baltics: Whither the Baltic Free Trade Agreement?" by Alf Vanags, "Are the Baltic Currencies Overvalued?" by Iikka Korhonen, and "Risk and Return in Central and Eastern Europe," by Anete Pajuste and Peter Högfeldt. It also contains economic updates on Estonia, Latvia, and Lithuania and tables of key economic indicators.

The introductory issue of BET is available free of charge at www.hhs.se/site. To subscribe to BET, write to SITE@hhs.se or fax +468 31 64 22. Please include your name, address, email, and affiliation. One-year subscription rates for 2001 are $65 (650 SEK) for individuals, $180 (1,800 SEK) for academic institutions, and $300 (3,000 SEK) for corporate institutions. Subscriptions paid in SEK include VAT.

New Web Site on Business and Finance in the Baltic Economies

In cooperation with the Stockholm-based Baltic Financial Network, SITE is building an Internet information resource on business- and finance-related developments in the Baltic region. This new Web site will provide information, contacts, and links. The target group of users are decisionmakers in the private sector, but the site will also have appeal as a resource for the policy community, university students, and research institutions. The site will include:

- A calendar of upcoming events of interest; key statistics and business information; information on business meetings, conferences, and international visits; and other relevant information.
- Descriptions of recent and planned economic events.
- Statistics and databases on the Baltic economies from SITE publications and other sources.
- Links to related sites.
- Information on research grants and funds.

If you would like to be notified by email when gatewaybaltics.com becomes active (in early 2001), please send your address to site@hhs.se.

World Bank/IMF Agenda

Social Inequality in Moldova Is Comparable to That in Latin America

Social inequality in the former Soviet republic of Moldova is comparable to that in Latin America, and poverty is still on the rise, notes Ruslan Yemtsov, Senior Economist at the Poverty Reduction and Economic Management Sector Unit of the World Bank. The Gini coefficient, a measure of income inequality, rose by a factor of 1.7 between 1990 and 1999, reaching 44.1 percent in 1999. In 1999 the revenues of the richest quartile of the population were 11 times those of the poorest. That figure fell to 10 during the first quarter of 2000. The poor account for just 4.5 percent of total revenues, while the rich account for 49.0 percent. Among the former Soviet republics the gap between rich and poor is largest in Armenia, Kyrgyzstan, Moldova, and the Russian Federation.

World Bank, IMF Report Progress on Financial Study

Assessments of the vulnerabilities and development needs of the financial sectors of the 36 countries targeted in the initial phases of a joint World Bank and IMF program are likely to be completed by the middle of 2001, according to Gerard Caprio, director of the Bank's Financial Sector Strategy and Policy Group. As part of the Financial Sector Assessment Program, teams of financial sector specialists from the World Bank, the IMF, and cooperating national and international bodies perform detailed analyses of banking systems, a broad array of other financial institutions and markets, and financial infrastructure.

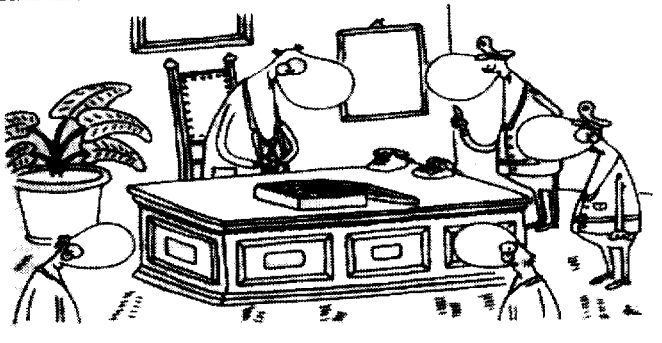
The program, begun partly in response to the international financial crises of 1997 and 1998, and partly to facilitate closer collaboration between the World Bank and the IMF in their financial sector monitoring and analysis. Over time, the program will include virtually all industrial economies and emerging markets. Twelve countries, including Estonia, Hungary, and Kazakhstan, were covered in the pilot phase; assessment of another 24 countries is underway or planned for the current fiscal year.

Corruption Deters Foreign Investors, Warns World Bank-Brookings Study

Corruption acts as a strong deterrent to foreign direct investment and forces investors to form joint ventures with local companies, according to a recent World Bank study. In fact, it may be as important to foreign investors as variations in labor costs or corporate tax rates. By placing a premium on local knowledge and the ability to bypass local bureaucracy, it may discourage high-technology companies from investing overseas, since businesses with more complex outputs tend to want to retain full control over production processes.

The study, "Corruption and Composition of Foreign Direct Investment: Firm-Level Evidence," was written by the World Bank's Beata K. Smarzynska and the Brookings Institution's Shang-Jin Wei (NBER Working Papers 7969, Web site: http://ideas.uqam.ca/ideas/data/Papers/nbrnberwo7969.html). The researchers compared foreign direct investment in 22 Eastern European and former Soviet bloc

Disappointment



"Mr. Attorney, don't be so greatful, this is not your bribe, but the bait in our fight against corruption."

From the Hungarian magazine *Hócipõ*

countries during the 1990s with various indices of corruption developed by private sector researchers and the World Bank.

New Russian Privatization Web Site

A new Web site, http://russia.privatizationlink.com, designed to cast light on the often shady world of Russian privatization, was launched in October at the fourth annual U.S.-Russian Investment Symposium in Boston. The site—designed by the Multilateral Investment Guarantee Agency (MIGA), part of the World Bank Group, with the cooperation of the Russian Property Relations Ministry and the Canadian International Development Agency—was created to encourage new investment in the Russian Federation. The site's main feature is an investment databank that profiles more than 100 state-owed firms slated for privatization.

Women Shoulder Most of the Social Cost of Transition

The social costs of transition and the restructuring of economies in the Europe and Central Asia region have affected women more severely than men, concluded an international conference held in Warsaw in January. Women bear more of the brunt from reduced social expenditure, especially from the closing of day care centers and maternity clinics. Declining school attendance of girls in many Central Asian countries may erode prospects for economic growth. Female labor force participation fell more than 30 percent in Hungary and 25 percent in Latvia—a much sharper decrease than among men. Entrepreneurship may help improve women's access to top managerial positions, higher incomes, and traditionally male-dominated areas of activity.

The conference was sponsored jointly by the World Bank, the United Nations Economic Commission for Europe (UN ECE) and the United Nations Development Fund for Women (UNIFEM). Academics, NGOs, government officials, and private sector representatives from the Baltic states, Kazakhstan, the Russian Federation, Ukraine, Uzbekistan, and other CIS countries attended the conference.

EBRD, IMF Approve Membership of FR Yugoslavia; the World Bank Is Getting Ready

On December 20 the Executive Board of the IMF determined that the "Federal Republic of Yugoslavia has fulfilled the necessary conditions to succeed to the membership of the former Socialist Federal Republic of Yugoslavia in the IMF." (Yugoslavia was suspended from the IMF in 1992.) Its quota in the IMF will be SDR 467.7 million (about $604 million). With the accession of the Federal Republic of Yugoslavia, IMF membership now totals 183 countries. Under the IMF's policy on emergency postconflict assistance, the Board also approved a loan of about $151 million in support of a program to stabilize the Yugoslav economy and help rebuild administrative capacities. About $130 million of the loan will be used to repay the bridge loans Yugoslavia received to eliminate its arrears with the IMF.

With membership in the IMF established, the Federal Republic of Yugoslavia (FRY) is now a step closer to membership in the World Bank. The next task is to resolve the $1.7 billion in IBRD debt that have accumulated since 1993, when the membership of the former Socialist Federal Republic of Yugoslavia was suspended.

Even before FRY's membership, however, the Bank has embarked on a program of analytical and advisory services, which it hopes to expand through trust funds. Key is the Bank's effort (in partnership with the European Union) to develop with the Yugoslav government a medium-term Economic Recovery and Transition Program Report. To this end, expert teams are in FRY this month to assess economic and structural reform priorities and investment and capacity building needs. The Economic Recovery and Transition Program Report is expected to be ready in April 2001. Shortly thereafter a Donor Pledging Conference could be organized (following up on a Coordination Meeting in December at which donors commited over $500 million for urgent needs).

Detailed membership discussions are now underway. Once FRY's arrears are settled, the Bank will be able to provide new loans to help the country achieve a lasting economic recovery after more than a decade of turmoil.

Yugoslavia's output, which has only partly recovered from the economic devastation caused by the Kosovo war, stands at about 40 percent of its 1989 level. About half of the workforce is unemployed, and the country's infrastructure is in disrepair, following years of inadequate investment and the damage inflicted during the Kosovo war. About 900,000 refugees and internally displaced persons live in Yugoslavia under difficult conditions. The macroeconomic situation is very fragile, with the ratio of external debt to GDP having risen to about 140 percent in the absence of debt servicing.

The European Bank for Reconstruction and Development (EBRD) became the first international financial institution that approved FR Yugoslavia's membership last December. The EBRD expects to assist Yugoslavia by supporting local, creditworthy banks; providing funding to micro-, small, and medium-size enterprises; funding export-oriented companies undergoing privatization; and making infrastructure investments in the public sector. Yugoslavia will be the 27th country to benefit from EBRD investment.

Bank of Finland
Institute for Economies in Transition

Winners and Losers in Latvia During the Transition

by Franziska Gassmann

A decade ago the world was confronted with the phenomenon of the collapsing communist system in the Soviet Union and other Central and Eastern European countries. Now, 10 years later, the question arises: What happened to people during the transition? Who are the winners, and who are the losers?

Poverty has been studied extensively in economies in transition since the beginning of the 1990s, but the dynamics of living standards have received scant attention. A 1998 survey of 3,200 households in Latvia sheds some light on the perceptions of households about the effects of transition. The majority of respondents (62 percent) reported consuming much less in 1998 than in 1991. Another 14 percent reported consuming somewhat less, 12 percent reported consuming about the same level, and only 9 percent reported consuming more in 1998 than in 1991.While these figures reflect respondent opinions, not actual consumption, correlation between households' welfare level and their perception indicates that most respondents have a fairly accurate understanding of their economic situation.

One important result of the survey is that both improvement and deterioration are closely related to employment and employment possibilities. People who are employed tend to live in households that report consuming as much as or more than in 1991. In contrast, among the unemployed, 80 percent live in households that report consuming far less today than in 1991. Households with a main income earner with a nonagricultural job are generally better off than those with income from employment in agriculture or from social transfers.

On average, households that believe that they consume more today are larger and have more children, more prime-age adults, and fewer elderly. These results differ from results of other surveys. Other poverty assessments in Latvia—as well as surveys in other countries—have found that households with children are worse off than other households. Households with members over 60 years of age are not among the losers in transition in most other countries, and the elderly do not belong to the most vulnerable groups in Latvia.

Interestingly, the gender of the breadwinner is a significant determinant of household perception of well-being. Households headed by men have a more positive view of their possibilities than households headed by women. Ethnicity is also important: Russian and other non-Latvian households have more negative perceptions than do Latvian households.

Respondents tend to be more pessimistic when asked about improvements in general than when asked whether things improved (or at least did not get worse) with respect to specific items (food, clothing, equipment). However, the vast majority of people believe that life in Latvia has become more difficult: gains in terms of consumption possibilities are the privilege of the upper-income minority. For most people, consumption possibilities have declined.

More than 75 percent of the population believe that they are among the losers from transition. The perception of the past and the changes that occurred during transition depends on where one stood before the transition. In general, those that had much to lose believe they lost more than those who did not have as much to lose. Pensioners, for example, tend to be pessimistic in their assessment of transition. People who held well-paying jobs in 1991 also tend to assess the transition negatively. Individuals' initial position clearly influence survey results, because their responses reflect their perceptions of reality.

Younger generations and families with children—identified as highly vulnerable groups, both in the poverty profile for Latvia and in the literature on other transition economies in the region—tend to be more positive. These people are more likely focused on the future and expect their situation to improve. Their assessment of their current situation could be an expression of their hopes that current low living standards are only transitory.

A main conclusion from the survey is that life in Latvia has become more difficult and insecure and that the future is uncertain. The fact that most Latvians feel they have lost in the transition and are worse off today than they were 10 years ago should cause concern. People in Latvia did not just get poorer, they became more pessimistic. This political reality cannot be ignored, even with economic growth rates that appear to have recovered.

Franziska Gassmann is an economist at BOFIT. An earlier version of this article appeared in Baltic Economies: The Quarter in Review *(April, 2000).*

BOFIT's Latest Discussion Papers

Laura Solanko and Merja Tekoniemi, **A Tale of Two City-States: Novgorod and Pskov in the 1990s**, DP 14/2000.

Despite common histories, geography, and natural resources, the Russian cities of Novgorod and Pskov chose different paths during transition. Novgorod committed early on to policies that would attract foreign investments in production; Pskov adopted protectionist policies until it was clear that efforts to increase domestic and foreign investment levels were needed. The differences between the two cities show that policies at the regional level matter.

Sandra Dvorsky, **Measuring Central Bank Independence in Selected Transition Countries and the Disinflation Process,** DP 13/2000.

This study measures the degree of legal and actual central bank independence (CBI) in five Central and Eastern European transition economies striving for EU accession (the Czech Republic, Hungary, Poland, Slovakia, and Slovenia). It finds that that the level of legal central bank independence is high in all five countries and that the level of actual central bank independence, measured by the turnover rate of central bank governors, is used as a proxy to measure actual CBI. The paper concludes that the overall degree of legal CBI is comparatively high in all countries examined.

Vadims Sarajevs, **Money Shocks in a Small Open Economy with Dollarization, Factor Price Rigidities, and Nontradeables,** DP 12/2000.

Tuomas Komulainen and Jukka Pirttilä, **Fiscal Explanations for Inflation: Any Evidence from Transition Economies?** DP 11/2000.

R. E. Ericson and B. W. Ickes, **A Model of Russia's "Virtual Economy,"** DP 10/2000.

Oil Price Dependency of the Russian Economy

The ruble's crash shrank the Russian economy drastically in dollar terms. As world oil prices climbed, the share of export earnings in GDP increased from 20–25 percent in 1994–97 to 50 percent in 2000. The share of fuel exports (oil and gas) rose from 9–10 percent in 1994–98 to almost 25 percent of GDP (although the fuel industry employs only about 1 percent of the workforce).

At the 1999–2000 exchange rate, the Russian GDP changes about 0.5 percent for every dollar-a-barrel change in the oil world market price. In the first half of last year the increase in Russia's oil and gas export income alone accounted for 50 percent of the rise in the GDP. A dollar-per-barrel change in the oil price causes a 4 percent change in the economy's ruble money supply, M2 (cash in circulation and deposits), or about a 1.5 percent change in the broader money supply, M2XX (ruble money plus foreign currency deposits plus estimated foreign cash in Russia). The current shift of lower oil prices and growing imports may help monetary policy in checking liquidity and can also help exchange rate policy keep the ruble stable—unless, of course, this shift continues.

In the first half of 2000, Russia produced a current account surplus of $23 billion, or 22 percent of GDP. Gold and foreign currency reserves rose from $12 billion at the end of 1998 to $27 billion in November 2000. Correspondingly, the monetary base also rose, which in turn has boosted the larger monetary aggregates. The year-on-year changes in M2 have been at least 50 percent since June 1999.

In contrast with the past, rapid money growth has not been reflected in consumer prices. However, increases in producer prices are clearly higher (by about 50 percent). The main reason for the discrepancy between money growth and inflation is the rapid decrease in the velocity of money.

What can the Russian authorities do to keep inflation at reasonable levels? If large current account surpluses persist, the increased liquidity in the economy must be sterilized or the monetary aggregates will grow. Sterilization of large capital flows is costly and cannot be a long-term strategy of a central bank. Moreover, the Central Bank of Russia currently lacks the tools to control money growth. To attain further monetization of the economy, a properly functioning financial sector is imperative—and reforms of the Russian banking sector have barely begun.

Excerpted from Vesa Korhonen, "Swings over Russian Economic Transition" (Russian Economy: The Month in Review *December 2000) and Tuomas Komulainen and Iikka Korhonen, "The Dilemmas of Russian Monetary Policy"* (Russian Economy: The Month in Review *November 2000). The authors are economists at BOFIT.*

Conference Diary

For the Record

2000 Asian Venture Forum
November 8–10, 2000, Hong Kong J.W. Marriott Hotel

Sponsors: Prudential Asset Management Asia Ltd.; GE Equity; Newbridge Capital Ltd.; Clifford Chance; Baker & McKenzie; Baring Private Equity Partners Asia; Bain & Company; Crimson Ventures Ltd.; Coller Capital Ltd.; Walden International Investment Group.

Global sponsors: H&Q Asia Pacific; Venture Quest: KLM Capital Group; AsiaTech Web site Group.
Information: Tel.: 852 2838-9626, fax: 852 2891-9659 (Hong Kong), or tel.: 650-232-2709, fax: 650 –75-0181 (United States), Email: Conference@asiaventure.com, Web site: www.asiaventure.com/conference.html.

Forthcoming

European Bank for Reconstruction and Development Annual Meeting
April 22–24, 2001, Hilton London Metropole Hotel and Conference Centre, London

The 2001 Annual Meeting of the Board of Governors of the European Bank for Reconstruction and Development (EBRD) and the associated Business Forum will mark the 10th anniversary of the start of the EBRD's operations.
Registration: http://www.ebrd.com/english/meet/index.htm.

European Summer Symposium in Labour Economics
April 24, 2001, Ammersee, Germany

This symposium is designed to bring together labor economists from across Europe and key researchers from outside the region. It provides the opportunity for researchers from different universities and countries to discuss their work in a relaxed atmosphere and to develop long-term collaborative relationships. The conference also aims to provide young researchers with the opportunity to meet and discuss their work with senior economists.
Information: Monique Muldoon, Meetings Manager, tel.: 4420-7878-2907, fax: 4420-7878-2999, *Email: mmuldoon@cepr.org, Web site: http://www.cepr.org/home_ie.asp.*

World Bank's Thirteenth Annual Bank Conference On Development Economics (ABCDE)
May 1–2, 2001, Washington, D.C., United States

Opening Address by World Bank President, James D. Wolfensohn, Keynote Address by World Bank Senior Vice President and Chief Economist Nicholas H. Stern.
Session One: *Globalization and Inequality* (Kevin O'Rourke, Daniel Cohen, Richard N. Cooper, and Anthony Venables).
Session Two: *Health and Development* (representing Medecins sans Frontieres—Doctors Without Borders: Jean O. Lanjouw, Anne Case, and Tomas J. Philipson). Four parallel workshop sessions will be held each afternoon. Participation by non-Bank and non-IMF staff by invitation only.
Information: Boris Pleskovic (e-mail: bpleskovic@worldbank.org), Research Administrator, Development Economics Vice Presidency, World Bank, 1818 H Street, N.W., Room MC 4-402, Washington DC 20433, tel. 202-473-1062, fax 202-522-0304., Web site: http://www.worldbank.org/research/abcde/

Product Markets, Financial Markets, and the Pace of Innovation in Europe
May 25, 2001, Brussels, Belgium

Considerable progress has been made in the past 10 years, but researchers and policymakers have still not fully identified the main sources of and obstacles to innovation or how those obstacles can be overcome through policy or institutional design. This workshop will look at the environment facing firms—particularly product markets and financial markets—to achieve a better understanding of the relations between innovation and institutions. Papers will focus on four themes: innovation and the structure of product markets, innovation and the structure of financial markets, innovation and the policy environment, and measuring the impact of institutions on innovation and productivity growth.
Information: Monique Muldoon, Meetings Manager, tel.: 4420-7878-2907, fax: 4420-7878-2999, *Email: mmuldoon@cepr.org, Web site: http://www.cepr.org/home_ie.asp.*

The Second International Conference on PR's Contribution to Transition in Central and Eastern Europe Research and Practice
June 8–9, 2001, Poznan, Poland

Poland and the other countries of Central and Eastern Europe, as well as those of the former Soviet Union are going through this unique historical process of transition. It is difficult and for some social groups proves to be also painful. The key factor for its success are changes in social consciousness. Public relations have already in many cases proved to be a new—in this unique environment—and usefull instrument for achieving such desirable changes in the former "socialist" thinking, and helping in introducing the principles of market economy and of democratic political system.

The aims of the conference are to:
- Identify the main areas of "transition PR" activities such as: PR of state enterprises, with primary goal to gain the acceptance for possible privatisation; PR in privately-owned businesses, to gain the acceptance for private property; PR of the "new" market economy institutions such as the stock exchange, investment and pension funds etc, to encourage the

public to use their services; PR in foreign companies—to remove the predjudicies toward foreign capital and foreign ownership.

- Help the western practitioners to understand, that their strategies and instruments, to be successful in the new enviroment, have to be properly adjusted.

Deadlines: March 1, 2001—for registration and submission of abstracts.
Information: Dr. Jacek Trbecki, email: jacak@nl.pl.

Sexualities in Transition: International Social Science Conference
June 12–16, 2001, Dubrovnik, Croatia

Despite the profusion of research on the political, economic, and sociocultural aspects of the postcommunist transition in Central and Eastern Europe, little has been written about the effect of rapid economic and social transformation on sexuality. This conference aims to fill this gap by addressing the important question of whether in addition to reflecting the new societal reality, sexuality can also generate the social tolerance and social capital necessary for a well-rooted democracy. A book consisting of selected conference proceedings, to be published following the conference, will provide the first theoretical and empirical body of work that explores various aspects of human sexuality in posttransition economies.

The conference also hopes to establish a wider sexuality research network by bringing together experts from Central and Eastern Europe, the European Union, and the United States. Topics to be addressed at the conference include Postcommunist Sexual Politics; Sexuality Research in Transitional Countries: Tradition and New Winds; Gender Roles and Sex Norms in Transition; Sexual Representations in the Postcommunist Media; Aporiae of Sex Education: New Solutions for New Health Risks?; Sexual Minorities: New Social Movements and the Old Homophobia; Toward New Sexual Lifestyles: Patterns of Adult Sexual Behavior; and Commercial Sex in Transitional Countries.
Information: SITconference@yahoo.com, fax: 1-818-677-2059.

Competition Policy in the Transition: Theory, Implementation, and Challenges
July 9–27, 2001, Budapest, Hungary

This three-week course is intended to equip participants with the economic tools needed to assess the welfare effects of competition, competition legislation, and alternative competition policy decisions. It aims to support those who contribute to the growing political debate, legal disputes, and administrative decisionmaking processes on competition policy in transition. Particularly welcome are Ph.D. students with teaching experience, junior faculty, and competition analysts in NGOs, business, and government.

The course, directed by Todor Gradev, includes six modules. After a brief review of the basic concepts of oligopoly theory, the first module will set up the subsequent discussion by addressing competition and efficiency. The next four modules will address the theoretical concepts and inferences for public policy design of controversial competition-related issues, including the permissible levels of market power and market concentration, the role of the market as a selection mechanism, the evolution of market structure, and the controversies over international trade and domestic competition. One module will be devoted to the European Union. The last module, a simulated competition adjudication, will make participants explore the practical applicability of the theory of competition.

Fully funded places are available for 28 participants from Central and Eastern Europe, the former Soviet Union, and other new democracies. Applicants must apply by January 15, 2001.
Information and downloadable application forms: http://www.ceu.hu/sun/sunindx.html. Inquiries: CEU Summer University Office, 1051 Budapest, Nádor u 9 Hungary; tel: 36-1 327-3811, fax: 36-1 327-3124, Email sunreq@ceu.hu.

Location of Economic Activity, Regional Development, and the Global Economy: The European and East Asian Experiences
September 26–27, 2001, University of Le Havre, France

This conference, organized jointly by the the University of Le Havre and Inha University (Republic of Korea), aims to bring together theoretical and applied research work on the importance of spatial factors in addressing regional economic development. Papers are invited on the following topics:

- *International trade and location of economic activities.*
- *Spatial factors in the strategy of economic actors.*
- *Logistics and transportation issues.*
- *Regional development and urban economics.*

Empirical papers should draw on evidence from Europe or East Asia. Case studies comparing East Asia and Europe and papers drawing on the recent rediscovery of economic geography are particularly welcome.

Papers will be selected and the final program drawn up by May 15, 2001. Final versions of selected papers should be submitted by September 1, 2001. The proceedings of the conference will be published. Travel, hotel, and meal expenses will be covered for all conference participants.
Submission: To submit a paper, send a one- to two-page proposal to either of the conference organizers by March 31, 2001. Prof. P.B. Ruffini, University of Le Havre, Faculté des Affaires Internationales, 25, rue Philippe Lebon, BP.420-76057 Le Havre CEDEX-FRANCE. Tel. 332-3274-4054, fax: 332-3521-4959, E-mail: pierre-bruno.ruffini@univ-lehavre.fr; Prof. S.G. Lee, Inha University, Division of International Trade, 253 Yonghyun-Dong, Nam-Ku, Inchom, 402 751, Republic of Korea, Tel.: 8232-860-7778, fax: 8232-868-5373, Email: sanglee@inha.ac.kr.

New Books and Working Papers

The Macroeconomics and Growth Group regrets that it is unable to provide the publications listed.

World Bank Publications

To receive ordering and price information for World Bank publications, contact the World Bank, P.O. Box 960, Herndon, VA 20172, United States, tel.: 703-661-1580, fax: 703-661-1501, Email: books@worldbank.org, Web site: http://www.worldbank.org/publications, or visit the World Bank InfoShop in the United States, at 701 18th Street, NW, Washington, DC (tel.: 202-458-5454).

Carlos B. Cavalcanti and Zhicheng Li, **Reforming Tax Expenditure Programs in Poland,** WPS 2465, 2000, 23 pp.

Tax expenditures are reductions in tax liabilities that result from preferential provisions, such as deductions, exemptions, credits, deferrals, preferential tax rates, and exclusions from taxation. They are an effective form of government spending channeled through the tax system, usually as a substitute for direct government spending to achieve fiscal and political objectives.

Poland introduced tax expenditure programs in 1992 to compensate lower-income taxpayers for the withdrawal of subsidies. But the tax system is difficult for the average taxpayer to understand, it reduced the tax base, and most of the programs, which are extremely regressive, benefit higher-income taxpayers more than the taxpayers they were originally designed to help. Currently, these programs are not subject to systematic review. To limit their expansion, their administration should be strengthened, "sunset dates" established, and their economic effectiveness reviewed.

To order: Anita Correa, Room H4-318, tel.: 202-473-8949, fax: 202-522-2755, Email: acorrea@worldbank.org. The authors may be contacted at ccavalcanti@worldbank.org or zli@worldbank.org.

Michael Lokshin and Martin Ravallion, **Short-Lived Shocks with Long-Lived Impacts? Household Income Dynamics in a Transition Economy,** WPS 2459, 2000, 26 pp.

Persistent poverty has emerged in many transition economies, as vulnerable households have been unable to recover from large shocks to their income. In Hungary households were able to bounce back from transient shocks.

To order: Patricia Sader, Room MC3-556, tel.: 202-473-3902, fax: 202-522-1153, Email: psader@worldbank.org. The authors may be contacted at mlokshin @worldbank.org or mravallion@worldbank.org.

Uwe Deichmann and Vernon Henderson, **Urban and Regional Dynamics in Poland,** WPS 2457, 2000, 40 pp.

Poland's continuing housing shortage reduces labor mobility, which reduces potential growth. Urbanization remains low in Poland. Internal migration decreased significantly in the 1990s, with rural-to-urban migration declining dramatically. Housing construction, which was already low, fell by half in the 1990s and has only recently begun to recover. A significant number of mostly young and educated temporary migrants leave Poland annually, many to find employment abroad.

To order: Roula Yazigi, Room MC2-533, tel.: 202-473-7176, fax: 202-522-0056, Email: ryazigi@worldbank.org. The authors may be contacted at udeichmann @worldbank.org or vernon_henderson@ brown.edu.

Jo Ritzen, William Easterly, and Michael Woolcock, **On "Good" Politicians and "Bad" Policies: Social Cohesion, Institutions, and Growth,** WPS 2448, 2000 35 pp.

Bold, civic-minded, well-informed politicians (or interest groups) can face severe constraints in bringing about policy reform that force them to enact bad policies. These constraints are shaped by the degree of social cohesion in a country (that is, the inclusiveness of a country's communities) and the quality of its institutions. Social cohesion is essential for generating the trust needed to implement reforms. Citizens must believe that short-term losses will be more than offset by long-term gains. In countries in which institutions are weak and that are divided along class and ethnic lines, cohesion is weak.

Joel S. Hellman, Geraint Jones, and Daniel Kaufmann, **"Seize the State, Seize the Day": State Capture, Corruption, and Influence in Transition,** WPS 2444, 2000, 44 pp.

To order: Diane Billups, Room J3-131, tel.: 202-473-5818, fax: 202-334-8350, Email: governancewbi@worldbank.org. For an electronic version of this paper and related research papers and governance data, visit www.worldbank/wbi/governance. The authors may be contacted at jhellman @worldbank.org or dkaufmann@world bank.org.

Richard H. Adams, Jr., **The Politics of Economic Policy Reform in Developing Countries,** WPS 2443, 2000, 44 pp.

To order: Moira Coleridge-Taylor, Room MC4-554, tel.: 202-473-3704, fax: 202-522-3283, Email: mcoleridgetaylor @worldbank.org. The author may be contacted at radams@worldbank.org.

Patrick Honohan and Daniela Klingebiel, **Controlling the Fiscal Costs of Banking Crises**, WPS 2441, 2000, 35 pp.

Crisis management strategies such as unlimited deposit guarantees, open-ended liquidity support, repeated recapitalization, debtor bail-outs, and regulatory forbearance appear to add greatly to fiscal costs. The authors argue for a strict rather than an accommodating approach to crisis resolution.

To order: Agnes Yaptenco, Room MC3-446, tel.: 202-473-8526, fax: 202-522-1155, Email: ayaptenco@worldbank.org. The authors may be contacted at phono han@worldbank.org or dklingebiel@ worldbank.org.

Shang-Jin Wei, **Corruption, Composition of Capital Flows, and Currency Crises,** WPS 2429 2000, 26 pp.

To order: Hedy Sladovich, Room MC2-609, tel.: 202-473-7698, fax: 202-522-1154, Email: hsladovich@worldbank.org. The author may be contacted at swei @worldbank.org.

Dominique van de Walle, **Are Returns to Investment Lower for the Poor? Human and Physical Capital Interactions in Rural Vietnam,** WPS 2425, 2000, 28 pp.

To order: Hedy Sladovich, Room MC2-609, tel.: 202-473-7698, fax: 202-522-1154, Email: hsladovich@worldbank.org. The author may be contacted at dvan dewalle@worldbank.org.

Other World Bank Publications

Christof Ruhl and Daniel Daianu, **Economic Transition in Romania: Past, Present, and Future (Proceedings of the Conference "Romania 2000: Ten Years of Transition" (October 1999),** The World Bank/Romanian Center for Economic Policies, 2000, 608 pp.

Global Economic Prospects and Developing Countries 2001, December 2000, 180 pp.

Average GDP in Eastern Europe and Central Asia reached 5.2 percent in 2000, significantly above the 1 percent advance of 1999. For the first time since the break-up of the Soviet Union, almost all countries in the region recorded positive growth. Exports picked up, in large part due to rising import demand from the Euro Area. The World Bank expects relatively strong growth for the region through 2002. GDP for the region is projected to expand 4.1 percent a year through 2010—up from a decline of 1.9 percent during the 1990s. The principal weakness is the low level of investment. The expected rapid growth in electronic commerce could impair the competitive position of countries that lack the technical skills and infrastructure necessary to participate effectively.

David Lindeman, Michal Rutkowski, and Oleksiy Sluchynsky, **Dilemmas and Emerging Best Practices—The Evolution of Pension Systems in Eastern Europe and Central Asia: Opportunities, Constraints, Practices,** 2000, 56 pp.

Since the early 1990s the transition economies of Eastern Europe and Central Asia have had to adapt their pension systems. Some changes relate to the fact that contribution bases are shrinking and governments are unable to finance prior commitments and protect pensioners from poverty. Others reflect the need to make pension systems more sustainable in light of forthcoming demographic changes. Reform entails a move away from a single-pillar pay-as-you-go defined-benefit system toward a multipillar system that includes a funded defined-contribution component and makes the remaining pay-as-you-go components more self-sustaining and transparent. This study examines various aspects of moving to a new pension system, including organization, administration, guarantees, transition arrangements, participation requirements, the role of the government, and annuitization.

M. Kojima, R.W. Bacon, M. Lovei, and M. Fodor, **Cleaner Transport Fuels for Cleaner Air in Central Asia and the Caucasus**, 2000, 40 pp.

Urban air pollution is a matter of increasing concern in many of the newly independent states. Traffic is burgeoning in cities, but vehicle registration, inspection, and maintenance are inadequate to support efforts to improve air quality. Poor fuel quality exacerbates emissions problems. Although certain emissions, such as greenhouse gases, are of global concern, the greatest costs of air pollution at the local level are to human health.

Technical Papers

Tim Schwarz and David Satola, **Telecommunications Legislation in Transitional and Developing Economies,** TP 489, 2000, 86 pp.

Nina B. Bubnova, **Governance Impact on Private Investment: Evidence from the International Patterns of Infrastructure Bond Risk Pricing**, TP 488, 2000, 96 pp.

Capital markets have become the main funding source for infrastructure projects worldwide, including in developing and transition economies, where infrastructure still falls considerably short of meeting needs. Infrastructure bonds served as the most popular method of oil, gas, electricity, telecommunications, and transport project financing in these countries throughout 1990–99, substituting for government funding. This study identifies the political and regulatory risks that most concern investors. It provides a comparative analysis of developed and emerging infrastructure bond markets and identifies factors that drive infrastructure finance in each group of countries.

Mrak Mojmir, **Communal Infrastructure in Slovenia: Survey of Investment Needs and Policies Aimed at Encouraging Private Sector Participation**, TP 483, 2001, 80 pp.

This study provides an overview of the institutional, legal, and regulatory environment for communal infrastructure development; provides a detailed analysis of communal infrastructure investment; and discusses policy measures for increasing the volume of communal infrastructure investment. It provides information for those seeking sources of financing other than the government budget to support and expand the communal infrastructure essential to Slovenia's economic development.

Peter Havlik, **Trade and Cost Competitiveness in the Czech Republic, Hungary, Poland, and Slovenia,** TP 482, 2000, 80 pp.

Although the four countries considered in this study are the most developed transition countries in Europe, their average wages are only a fraction of those in Western Europe. Theoretically, low labor costs should give the Central and Eastern European countries an advantage, but capital shortages and the lack of skills required by a market economy prevent them from doing so. This report—prepared under the auspices of the World Bank by Peter Havlik, Deputy Director of the Vienna Institute for International Economic Studies (WIIW)—reviews wage and labor productivity developments and examines the evolution of export competitiveness. It also summarizes the main findings from the ongoing research by WIIW on the impact of foreign direct investment on restructuring and provides some policy recommendations.

Other World Bank Publications

Czech Republic: Completing the Transformation of Banks and Enterprises, Country Studies, 2000, 88 pp.

The Czech Republic reached the end of the 1990s with an unfinished transformation agenda. Especially apparent were the lingering problems in the major banks and in large segments of the corporate sector, which led to unsatisfactory economic performance. The root cause for the poor performance stems from weak internal and external mechanisms of corporate governance. This report aims to assist the Czech authorities in their ongoing efforts to improve the overall institutional and legal framework for restructuring distressed enterprises and for providing new lending as well.

World Bank Atlas 2000, 32nd edition, 2000.

The World Bank Atlas 2000 provides easy-to-read maps, tables, and graphs highlighting key social, economic, and environment data for 206 economies. The 32nd edition has been updated and improved with new material taken from the *World Development Indicators 2000*. It includes six sections, including sections on global links and world view drawn from the corresponding sections in the *World Development Indicators*. Also included are new estimates of purchasing power parities and data on relative prices for countries that participated in the most recent round of the International Comparison Program. Data on GNP, the shares of exports and agriculture and investment in GDP, private investment, energy consumption, and population growth are also included.

Opportunities and Risks in Central European Finances: European Union Accession, 2000, 380 pp.

IMF Publications

To order: IMF Publication Services, 700 19th Street, NW, Washington, DC 20431, United States, tel.: 202-623-7430, fax: 202-623-7201, E-mail: publications@imf.org, Web site: http://www.imf.org.

Working Papers

Simon Commander, Irina Dolinskaya, and Christian Mumssen, **Determinants of Barter in Russia: An Empirical Analysis,** WP/00/155, 2000.

Vivek B. Arora and Martin Cerisola, **How Does U.S. Monetary Policy Influence Economic Conditions in Emerging Markets?** WP/00/148, 2000.

Paulo Drummond, **Former Yugoslav Republic of Macedonia Banking Soundness and Recent Lessons,** WP/00/145, 2000.

George T. Abed and Hamid Davoodi, **Corruption, Structural Reforms, and Economic Performance in the Transition Economies,** WP/00/132, 2000.

Other IMF Publications

Romania: Selected Issues and Statistical Appendix, Country Report No. 01/16, 2001, 223 pp.

Estonia: Second Review Under the Stand-By Arrangement: Staff Report, News Brief by the Deputy Managing Director, and Statement by Authorities of Estonia, Country Report No. 01/14, 2001, 42 pp.

Andrea Schaechter, Mark R. Stone, and Mark Zelmer, **Adopting Inflation Targeting: Practical Issues for Emerging Market Countries**, Occasional Paper No. 202, December, 2000, 62 pp.

The experience of the industrial countries suggests that the foundations for successful, full-fledged inflation targeting are a strong fiscal position and entrenched macroeconomic stability, a well-developed financial system, central bank independence and a mandate to achieve price stability, a reasonably well-understood transmission mechanism between monetary policy actions and inflation, a sound methodology for constructing inflation forecasts, and transparency of monetary policy to build accountability and credibility. Experience in Chile, Israel, and Poland suggests that a gradual shift from a crawling exchange rate regime to an inflation targeting framework is feasible.

George Kopits, **How Can Fiscal Policy Help Avert Currency Crises?** WP/00/185, November, 2000.

CASE Publications

To order: CASE, Sienkiewicza 12, 00-944 Warsaw, Poland, tel.: 4822-622-6627, fax: 4822-828-6069, Email: case @case.com.pl, Web site: http://www.case.com.pl.

A. Radziwill, **Poland's Accession to the EMU,** No. 212, 2000, 23 pp.

R. Antczak, **Theoretical Aspects of Currency Crises,** No. 211, 2000, 34 pp.

E. Jarocinska, **Labour Developments in Moldova,** No. 210, 2000, 26 pp.

M. Blaszkiewicz, **What Factors Led to the Asian Financial Crisis: Were or Were Not Asian Economics Sound?** No. 209, 2000, 57 pp.

M. Tomczynska, **Early Indicators of Currency Crises: Review of Some Literature,** No. 208, 2000.

Y. Kuzmyn, **Ukraine's Foreign Trade Developments and Forecasts,** No. 207, 2000.

R. Antczak, S. Bogdankiewich, P. Daneiko, K. Polomski, and V. Usowski, **Impact of the Russian Crisis on the Belarussian Economy,** No. 206, 2000, 40 pp.

The Russian financial crisis of August 1998 seriously damaged President Lukashenko's domestic and foreign policy. But the crisis in Belarus—caused by maintenance of a command economy—began in the first quarter of 1998. The Russian crisis merely aggravated the economic situation.

M. Jarocinski, **Moldova in 1995–1999: Macroeconomic and Monetary Consequences of Fiscal Imbalances,** No. 205, 2000.

P. Kovatchevska, **The Banking and Currency Crises in Bulgaria: 1996–1997,** No. 204, 2000, 31 pp.

The banking crisis in Bulgaria was caused by slow structural reforms, inefficient prudential regulation, and prolonged unsound lending practices. Excessive credit, a large interest rate spread, and an overvalued exchange rate exacerbated the banks' liquidity position. The currency crisis was a consequence of expansionary monetary policy, which led to irreversible depletion of Bulgaria's international reserves and caused the eventual collapse of the exchange rate. At the same time, the balance of payments deteriorated. The causal link between the two crises is explained through expansionary monetary policy that came in response to the banking crisis. The central bank was unable to sustain the exchange rate when it faced a run on its reserves.

A. Kudina, **An Approach to Forecasting Ukrainian GDP from the Supply Side,** No. 196, 2000, 20 pp.

J. Cukrowski and M.M. Fischer, **European Integration: Strategic Market Research and Industry Structures,** CASE-CEU Working Papers Series, No. 36, 2000, 24 pp.

Center for East European Studies (CEES) Publications

To order: CEES, Howitzvej 60, DK-2000, Frederiksberg, Denmark, tel.: 45-3815-3030, fax: 45-3815-3037, Email: me.cees@cbs.dk, Web site :http://www.econ.cbs.dk/institutes/cees.

Klaus E. Meyer, Ane Tind, and Mår K. Jacobsen, **National Internationalization Processes: SME on the Way to Eastern Europe,** No. 37, 2000.

Enese E. Lieb-Doczy and Klaus E. Meyer, **Context Sensitivity of Post-Acquisition Restructuring: An Evolutionary Perspective,** No. 36, 2000.

Klaus Uhlenbruck, Klaus Meyer, and Michael A. Hitt, **Organizational Transformation in Transitional Economies: Resource-Based and Organizational Learning Perspectives,** No. 35, 2000.

Many former state-owned firms in the transition economies of Central and Eastern Europe failed because they pursued primarily defensive downsizing rather than forward-looking strategic restructuring.

Klaus Meyer, **Institutions, Transaction Costs, and Entry Mode Choice in Eastern Europe,** No. 34, 2000.

Klaus Meyer, **International Business Research on Transition Economies,** No. 32, 2000.

This working paper reviews the literature on business in the transition economies of Eastern Europe.

Kenneth Husted and Snejina Michailova, **Knowledge Sharing in Russian Companies with Foreign Participation,** No. 31, January 2000.

Centre for Economic Policy Research (CEPR) Publications

To order: CEPR, 90-98 Goswell Road, London EC1V 7RR, United Kingdom, tel.: 4420-7878-2900, fax: 4420-7878-2999, Web site: http://www.cepr.org.

Paul C. De Grauwe, **Exchange Rates in Search of Fundamentals: The Case of the Euro-Dollar Rate,** DP 2575, October 2000.

Dalia Marin, **Trust versus Illusion: What Is Driving Demonetization in Russia?** DP 2570, 2000.

European Bank for Reconstruction and Development (EBRD) Publications

To order: EBRD, One Exchange Square, London EC2A 2JN, United Kingdom, tel.:

4420-7338-6227, fax: 4420-7338-6110, E-mail: sanfeyp@ebrd.com, Web site: http://www.ebrd.com.

Working Paper

Daniel Gros and Marc Suhrcke, **Ten Years After: What Is Special about Transition Countries?,** WP 56, August 2000, 21 pp.

Discussion Papers

Saul Estrin and Alan Bevan, **The Determinants of Foreign Direct Investment in Transition Economies,** DP 2638, December 2000.

Using a panel data set on foreign direct investment (FDI) flows from market to transition economies, this study finds that country risk, unit labor costs, host market size, and gravity factors determine FDI flows into Central and Eastern Europe. Country risk is influenced by private sector development, industrial development, the government balance, reserves, and corruption. Progress toward EU accession has the potential to induce virtuous cycles for frontrunners but may have serious consequences for laggards.

Francesco Giavazzi, Richard Baldwin, Erik Berglöf, and Mika Widgrén, **EU Reforms for Tomorrow's Europe,** DP 2623, November 2000.

Damien J. Neven and Petros C. Mavroidis, **Antitrust Practice in Poland, Hungary, and the Czech Republic,** DP 2601, November 2000.

Anti-trust agencies in all Poland, Hungary, and the Czech Republic have advocated for competition in the formulation of trade policy. The Polish agency has become less independent over time, whereas the Hungarian agency has probably become more independent.

Jozef Konings, **The Effects of Direct Foreign Investment on Domestic Firms: Evidence from Firm-Level Panel Data in Emerging Economies,** DP 2586, October 2000.

Do foreign firms perform better than their domestic counterparts? Do foreign firms generate spillovers to domestic firms? Using a firm-level panel data set that includes detailed information on foreign ownership at the firm level, the author finds that only in Poland do foreign firms perform better than firms that do not involve foreign participation. No evidence of net positive spillovers to domestic firms was found in any of the three countries. In contrast, net negative spillovers to domestic firms were found in Bulgaria and Romania. No net spillovers to domestic firms were found in Poland. The results suggests a negative competition effect that dominates a positive technology effect.

Gérard Roland and Thierry Verdier, **Law Enforcement and Transition,** DP 2501, July 2000.

Law enforcement implies coordination problems and multiple equilibria due to a law abidance and a fiscal externality. This study analyzes two institutional mechanisms for solving the coordination problem. The first mechanism, called "dualism," follows the scenario of transition in China, where the government retains direct control over economic resources and a liberalized nonstate sector follows market rules. The second mechanism is accession to the European Union.

Economic Education and Research Program (EERC) Publications

To order: EERC, 3 Kochnovsky proezd Suite 418, 125319 Moscow, Russian Federation, tel./fax: 7095-152-0121, Email: eerc@eerc.ru, Web site: http://www.eerc.ru.

Yuri Perevalov, Ilya Gimadi, and Vladimir Dobrodey, **The Impact of Privatisation on the Performance of Medium and Large Industrial Enterprises,** K/01E, 2000.

This study, based on panel data from 198 industrial enterprises in the Sverdlovsk Oblast during 1992–96, provides empirical evidence on the impact of privatization on the performance of medium, large, and extra-large industrial enterprises. Both full privatization and majority state ownership are preferable to the state retaining a minority share. The state should retain majority control over privatized enterprises or reduce its stake to less than 5 percent in order to avoid the drop in performance caused by the absence of a monitoring shareholder.

Constantin Sonin, **Inequality, Property Rights, and Economic Growth in Transition Economies: Theory and Russian Evidence,** No. 2K/02E, 2000.

Evgeny Dorofeev, **Economic Factors' Influence on the Russian Capital Market,** No. 2K/03E, 2000.

This study analyzes the price dynamics of shares listed on the Russian Trading System (RTS). Preferences for speculative versus strategic investments in the Russian capital market are studied by dividing the risk associated with each share into a general component, which depends on economic fundamentals, and an individual (speculative) component, which is associated with holding a particular asset.

Evgenia Kolomak, **Sub-Federal Tax Exemptions in Russia: Less Taxes, More Investment,** No. 2K/07E, 2000.

Sergey Levendorsky and Svetlana Boyarchenko, **Money Substitutes in the Russian Virtual Economy: Why They Appear and What Is Their Impact on the Economy?** No. 2K/08E, 2000.

Edward Edgar Publishing

To order: EE Publishing Limited, Glensanda House, Montpellier Parade, Cheltenham, Glos GL50 IUA, United Kingdom, tel.. 44-1242-226-934, fax: 44-1242-262-111,

Email: info@e-elgar.co.uk, Web site: http://www.e-elgar.co.uk/.

Ole Norgaard, **Economic Institutions and Democratic Reform: A Comparative Analysis of Post-Communist Countries,** 2000, 272 pp.

This book systematically explores the political effects and consequences of economic reform in more than 20 postcommunist countries, using primary quantitative data and stringent statistical analysis. The author argues that there is no universally applicable economic reform strategy and that popular democracy is a more stable foundation of a successful economy than a powerful executive or president. The book also shows that generalized models are not useful in studying the complexity of postcommunist transformation.

Tomasz Zylicz, **Costing Nature in a Transition Economy,** Case Studies in Poland, 2000, 200 pp.

Other Publications

Roy W. Bahl, Jr., **Fiscal Policy in China: Taxation and Intergovernmental Fiscal Relations,** University of Michigan Press, 1999, 224 pp.
(To order: http://www.press.umich.edu/Ordering/OrderInfo.html)

China's 1994 tax reform is noteworthy because it was the most systematic and comprehensive restructuring of China's revenue system since the start of economic reform in 1979. In addition to adapting the tax structure and tax administration to the needs of a rapidly rising market economy, the major thrust of the reform was to redefine intergovernmental fiscal relations. Although the reform clearly propelled the nation's fiscal system toward centralization, it put in place the structure necessary to pursue true fiscal decentralization in the future.

Claudia M. Buch and Daniel Piazolo, **Capital and Trade Flows in Europe and the Impact of Enlargement,** Kiel Working Paper No. 1001, Kiel Institute of World Economics, 2000.

Eastern enlargement of the European Union is likely to boost trade and capital flows. But empirical evidence on the possible magnitudes remains scant. This study uses four different data sets to estimate the determinants of international asset holdings and trade flows.

To order: Daniel Piazolo, Kiel Institute of World Economics, Duesternbrooker Weg 120, 24105 Kiel, Germany, fax: (49)-431-8814-500, Email: dpiazolo@ifw.uni-kiel.de, Web site: http://www.uni-kiel.de/IfW/pub/kap/2000/kap1001.htm.

Robert W. Compton, **East Asian Democratization: Impact of Globalization, Culture, and Economy,** Praeger Publishers, 2000, 224 pp.

To order: http://info.greenwood.com/cgibin/eupdget.pl?S=RV&I=0275964469.

David Cox, **Close Protection: The Politics of Guarding Russia's Rulers,** Praeger Publishers, October 2000, 184 pp.

This book examines the "close protection" units that guard Russia's leaders, including elite from outside the government and outside the Russian Federation.

To order: http://info.greenwood.com/cgibin/eupdget.pl?S=RV&I=0275966887.

Jan Delhey and Verena Tobsch, **Understanding Regime Support in New Democracies: Does Politics Really Matter More Than Economics?** DP FS III 00-403, Social Science Research Center Berlin, 2000, 31 pp.

Using the 1991–98 New Democracies Barometer, the 1999 Hungarian Euromodule, and the 1998 German Welfare Survey, this study examines citizen satisfaction with democracy in 12 economies. The results do not support the common view that in all postcommunist societies political output is more important than economic output for generating support for the new system. In explaining support for postcommunist regimes, other aspects, such as social security, social justice, and public safety, should also be taken into account.

To order: Social Science Research Center Berlin (WZB), Presse- und Information sreferat, Reichpietschufer 50, 10785 Berlin, Germany, Email: delhey@medea.wz-berlin.de, Web site: http://www.wz-berlin.de/sb/pub/pub.de.htm#2000.

Jean-Jacques Dethier (editor), **Governance, Decentralization, and Reform in China, India, and Russia,** Kluwer Academic Publishers, 2000

Distorted economic and political incentive structures, capture of the state by powerful elites, and inoperative legal systems have greatly complicated the political economy of reform in China, India, and the Russian Federation, all countries with heterogeneous populations. This volume studies three aspects of reform: fiscal federalism; decentralization and provision of local public goods; and legal reforms.

Part I examines the role of incentives in fiscal federalism. It analyzes the effects of different revenue-sharing mechanisms between different levels of government, studying in particular the effects on regional growth and inequality and the incentives that local politicians may have to provide public goods depending on the fiscal arrangements with the central government. All three countries have been striving for increased decentralization. But the theoretical literature suggests that, in a decentralized setting, second-best solutions must prevail: it is not possible to ensure incentive compatibility simultaneously with optimal allocation of resources and a balanced budget in providing public goods.

Part II discusses taxation and public expenditure management, both as a political and as a budgetary process. Two questions are addressed: Does participa-

tion of stakeholders and accountability of public authorities improve economic and social outcomes? Does better governance in the provision of basic goods, such as health care and education, improve equity? While decentralization is often seen as a way to improve the quality of public services, rule-based governance is viewed as a safeguard against the arbitrariness of public officials and weakness in law enforcement.

Part III focuses on the rule of law, the role of the judicial system in establishing a rule-based economy, and the effectiveness of legal institutions during the transition from socialism to a market economy. It also discusses various conceptual approaches to addressing legal reform issues.

Kristin J. Forbes, **The Asian Flu and Russian Virus: Firm-Level Evidence on How Crises Are Transmitted Internationally,** MIT-Sloan School of Management and NBER, 2000, 58 pp.
To order: kjforbes@mit.edu.

Bartolomiej Kaminski, **NATO and Europe in the Twenty-First Century: New Roles for a Changing Partnership,** Conference Proceedings, Woodrow Wilson Center, 2000.
To order: http://wwics.si.edu/ees/special/2000/apr00.htm

Grzegorz W. Kolodko, Post-Communist Transition: The Thorny Road, University of Rochester Press, Rochester Studies in Central Europe, 2000, 200 pp.

This volume examines the transformation of state-controlled economies into free market economies, an ongoing transition that is an indispensable part of globalization. The recession created by the transition has lasted much longer than expected, contraction was deeper than expected, and the recovery was not—and in some cases still is not—as smooth as envisaged by both governments and international organizations. Instead of recovery and robust growth, the lasting recession has turned out to be the Great Transitional Depression, continuing in several countries over the entire decade of the 1990s. The effects have been most severe in the two countries with the largest economies—the Russian Federation and Ukraine. This study examines the underlying roots of these processes, especially from the viewpoint of policy options for the future and their political and technical constraints.

Russell R. Miller, **Doing Business in Newly Privatized Markets: Global Opportunities and Challenges Quorum Books,** 2000, 344 pp.

During the past decade thousands of state-controlled companies in more than 100 different countries have entered the private sector. These firms range in size and commercial significance from small family-owned kiosks in the Russian Federation to some of the largest, most influential corporations in Western and Central Europe, Latin America, and Asia. This book provides a comprehensive, business-oriented perspective on the origin and geographic expansion of the privatization movement and describes the methods that governments use and the objectives they hope to achieve in divesting state assets. It identifies the formative influences on these new companies, as well as the operating needs created by the privatization process. The book also discusses alternate methods of expanding markets, such as reaching newly privatized firms through a strategic marketing program by creating strategic alliances, restructuring enterprise, expanding technical relationships, and developing export markets.
To order: Greenwood Publishing Group, 88 Post Road West, Westport, CT 06881, tel.: 203 226-3571, Email: webmaster@greenwood.com, *Web site: http://info.greenwood.com/books/1567202/1567202608.html.*

Marc Suhrcke, **Are Reforms from a Centrally Planned to a Market System Bad for Health?** HWWA Discussion Paper 105, 2000, 38 pp.
To order: UNICEF Innocenti Research Centre, Piazza SS. Annunziata, 12, 50122 Florence, Italy, Switchboard: 39 055 2033 0, direct line: 39 055 2033 345, fax: 39 055 244817, Email: msuhrcke@unicef.org, Web site: www.unicef-icdc.org.

Peter H. Solomon and Todd S.Foglesong, **Courts and Transition in Russia: The Challenge of Judicial Reform,** Westview Press, 2000.

This book analyzes the state and operation of the courts in the Russian Federation, paying particular attention to the struggles of reformers to develop judicial independence and extend the jurisdiction of the courts to include constitutional and administrative disputes as well as supervision of pretrial investigations. It outlines what can and should be done to make courts in Russia autonomous, powerful, reliable, efficient, accessible, and fair. The book draws on extensive field research in Russia, including the results of a lengthy questionnaire distributed to district court judges throughout the country.
To order: Westview Press, 5500 Central Avenue, Boulder, CO 80301, tel.: 800-386-5656, fax: 303-449-3356, Email: westview.orders@perseusbooks.com, Web site: http://www.westviewpress.com.

Janusz M. Szyrmer (editor), **The Barter Economy: Non-Monetary Transactions in Ukraine's Budget Sector,** Harvard University Ukraine Project, Kyiv, 2000, 207 pp.

Janusz M. Szyrmer and Khvaja M.Sultan, **Ukraine through Transition, Challenges, and Strategies, Harvard University Ukraine Project**, CASE, Kyiv, 2000, 205 pp.

Special Publication

Public Management Forum (a bimonthly newsletter for public administration practitioners in Central and Eastern Europe), published by SIGMA (Support for Improvement in Governance and Management in Central and Eastern European Countries), a joint initiative of the OECD and the European Union Web site: http://www.oecd.org/puma/sigma web/.

Bibliography of Selected Articles

Postsocialist Economies

Lerrick, A. **A Better Way to Lend A Hand: The World Bank Should Convert Its Lending Program for the Poorest Countries to Outright Grants.** *The International Economy* (United States) 14(6): 36–39, November–December 2000.

Winiecki, J. **Solving Foreign Trade Puzzles in Post-Communist Transition.** *Post-Communist Economies* (United States) 12(3): 261–278, September 2000.

Asia

Banking in Asia: Delusions of Adequacy—Far Eastern Economic Review Focus. *Far Eastern Economic Review* (Hong Kong) 163(39): 59–76, September 28, 2000.

China

Chen, W. **Village Elections in China: Cooperation between the State and the Peasantry.** *Journal of Chinese Political Science* (United States) 5(2): 63–81, 1999.

Sachs, J., X. Yang, and D. Zhang. **Globalization, Dual Economy, and Economic Development**.*China Economic Review* (United States) 11(2): 189–209, 2000.

Xu, L. C., and H. Zou. **Explaining the Changes of Income Distribution in China.** *China Economic Review* (United States) 11(2): 149–170, December 2000.

Yu, Q., and A. K. Tsui. **Monetary Services and Money Demand in China.** *China Economic Review* (United States) 11(2): 134–148, December 2000.

Central and Eastern Europe

Feldman, R., and M. C. Watson. **Central Europe, from Transition to EU Membership.** *Finance and Development (a quarterly publication of the International Monetary Fund)* (International) 37(3): 25–27, September 2000.

Hungary: Financial Times Survey. *Financial Times* (United Kingdom) Suppl.: i–iv, November 22, 2000.

Macek, J. **Banking Legislation of the Czech Republic.** *Journal of International Banking Law* (United Kingdom) 15(10): 257–259, October 2000.

Nord, R. **Central and Eastern Europe and the New Financial Architecture**. *Finance and Development (a quarterly publication of the International Monetary Fund)* (International) 37(3): 32–35, September 2000.

O'Rourke, P.J. **The Godfather Decade: An Encounter with Post-Soviet Corruption.** *Foreign Policy* (United States), pp. 74-81, November-December 2000.

Bush, J. **Poland—Running Out of Steam.** *Business Central Europe* (United Kingdom) pp. 16-19, December 2000-January 2001.

Repse, E. **Latvia: Focus on Country Development.** *Finance and Development (a quarterly publication of the International Monetary Fund)* (International) 37(3):17–19, September 2000.

State-Building in South-East Europe—Survey. *Public Management Forum* (France) 6(3): 3–13, 2000.

Tucker, A. **Reproducing Incompe-tence: The Constitution of Czech Higher Education.** *East European Constitutional Review* (United States) 9(3): 94–104, 2000.

UNCTAD: Hungary in the Lead. *The Hungarian Economy* 29(4): 3–4, 2000.

Weber, R., and G. Taube. **Estonia Moves toward EU Accession.** *Finance and Development (a quarterly publication of the International Monetary Fund)* (International) 37(3): 28–31, September 2000.

CIS

Cochrane I., V. Gidirim, T. Carty, and Z. Dobritskaya. **The Russian Tax System: Achievements in 2000 and the Possible Agenda for 2001.** *Russian Economic Trends* (United States) 9(3): 17–21, September 2000.

Dudarev G., and H. Hernesniemi. **Competitive Edge of the Russian Economy.** *Russian Economic Trends* (United States) 9(3): 6–16, September 2000.

Gürgen, E. **Central Asia: Achievements and Prospects.** *Finance and Development (a quarterly publication of the International Monetary Fund)* (International) 37(3): 40–43, September 2000.

Hillion, C. **Institutional Aspects of the Partnership between the European Union and the Newly Independent States of the Former Soviet Union: Case Studies of Russia and Ukraine**. *Common Market Law Review* (Netherlands) 37(5): 1211–1235, October 2000.

Kazakhstan: Financial Times Survey. *Financial Times* (United Kingdom) Suppl.: i–iv, December 11, 2000.

Perevalov Y., I. Gimadii, and V.Dobrodei. **Does Privatisation Improve Performance of Industrial Enterprises? Empirical Evidence from Russia.** *Post- Communist Economies* (United States) 12(3): 337–364, September 2000.

Subscribe to *Transition* (English Version)

If you are not currently on our subscription list, beginning in calendar year 1999 you may receive *Transition* on a complimentary basis by writing to:

Jennifer Prochnow
The World Bank,
1818 H Street, N.W.
Room MC3-374
Washington, D.C. 20433, USA
telephone: 202-473-7466
fax: 202-522-1152

Email: jprochnow@worldbank.org

Or if you would like to receive the *Transition* Newsletter electronically, please notify Jennifer Prochnow at the above email address.

ТРАНСФОРМАЦИЯ

For a free subscription to the Russian language version of *Transition*, write to:

International Centre for Policy Studies
8/5, Voloska St.
Kyiv, Ukraine 254070
telephone: +380 44 4636337
fax: +380 44 462 4937, 38
Email: marketing@icps.kiev.ua
Website: http://www.icps.kiev.ua

If you would like to receive the Chinese version of the *Transition Newsletter* please write to:

Center for International Reform and Development (CIRD),
57 Renmin Rd., Haikou City,
Hainan, China

We appreciate the continuing support of:

Bank of Finland
Institute for Economies in Transition

P.O. Box 160, FIN-0010 Helsinki
tel: 3589-183-2268, fax: 3589-183-2294
email: bofit@bof.fi
Internet: http://www.bof.fi/bofit

SITE
Stockholm Institute of Transition Economics and East European Economics
STOCKHOLM SCHOOL OF ECONOMICS

Box 6501, SE-113 83 Stockholm,
Sweden, Sveavägen 65, 9th floor
tel: 468-736-9670, fax: 468-316-422
email: SITE@hhs.se
Internet: http://www.hhs.se/site

Local Government and Public Service Reform Initiative

Open Society Institute

P.O. Box 519
H-1397 Budapest, Hungary
Phone: (36-1) 327-3104
Fax: (36-1) 327-3105
E-mail: lgprog@osilhu
Website: http://www.osi.hu/lgi

We look forward to establishing similar agreements with other sponsors—whether individuals or companies. Please contact the editor for more details.

For Distribution Use Only

TRANSITION

Senior Editor: Richard Hirschler
Room MC3-374
Telephone: 202-473-6982
Fax: 202-522-1152
Email: rhirschler@worldbank.org

Production Manager:
Jennifer Prochnow
Telephone: 202-473-7466
Fax: 202-522-1152
Email: jprochnow@worldbank.org

The World Bank
1818 H Street, N.W.
Washington D.C. 20433
Telephone: 202-477-1234
Fax: 202-477-6391
World Wide Web:
http://www.worldbank.org/

THE WILLIAM DAVIDSON INSTITUTE
AT THE UNIVERSITY OF MICHIGAN BUSINESS SCHOOL

724 East University
Wyly Hall 1st floor
Ann Arbor, MI 48109-1234, U.S.A.
tel. 734-763-5020
fax 734-763-5850
http://www.wdi.bus.umich.edu

Editor: Anna Meyendorff
Email: Ameyen@umich.edu
Associate Editor: Deborah Jahn
Email: Djahn@umich.edu

Transition is a publication of the World Bank, in collaboration with the William Davidson Institute, and is produced by the Development Research Group. The opinions expressed are those of the authors and should not be attributed in any manner to the World Bank, to its Board of Executive Directors, or to the countries they represent.

Volume 11, Number 6
Nov.-Dec. 2000/Jan. 2001

Printed on recycled paper