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The World Bank Streamlines Its Strategy for Transition Economies

Interview with Vice President Johannes F. Linn

The Europe and Central Asia (ECA) Region at the World Bank is in charge of providing; loans, guarantees, technical advice, and other services to the transition economies of Central and Eastern Europe and the former Soviet Union. It comprises four country departments, dozens of divisions, and hundreds of employees. Vice President Johannes Linn manages this Bank unit, which has thus far committed $20 billion to the countries of the region. In an interview with *Transition* editor Richard Hirschler, Linn explained major elements of the ECA Region's new approach, including fostering closer partnerships with borrowers, paying more attention to poverty issues, and sending country managers from their Washington offices to the field.

Q. What is your assessment of the region's economic and social performance?

A. A number of countries in Central and Eastern Europe, including the Czech Republic, Poland, Slovakia, and Slovenia, have made sustained economic turnarounds and enjoyed growing economies for at least two years. Slow, but stable growth has also characterized the Baltic states. These countries have managed to sharply reduce their inflation rates and bring fiscal deficits under control. But, on the less sunny side, the high tax burden in these economies still induces businesses to hide in the shadow (underground) economy. Two countries, Albania and Bulgaria, sank into deep economic and political crisis. Of the Commonwealth of Independent States (CIS) countries, Armenia, Georgia, Kazakstan, Kyrgyzstan, and Uzbekistan had positive GDP growth in 1996. Inflation and fiscal deficits have been sharply reduced throughout the region. CIS countries have made a strong recovery in trade, which has been reoriented toward the industrial countries. Others, including the two largest economies, Russia and Ukraine, haven't turned the corner yet. Last year Russian GDP shrank by about 6 percent, and gross fixed investment contracted by 15 percent. In Ukraine GDP might have fallen by as much as 10 percent. These potentially powerful economies are restrained in part by

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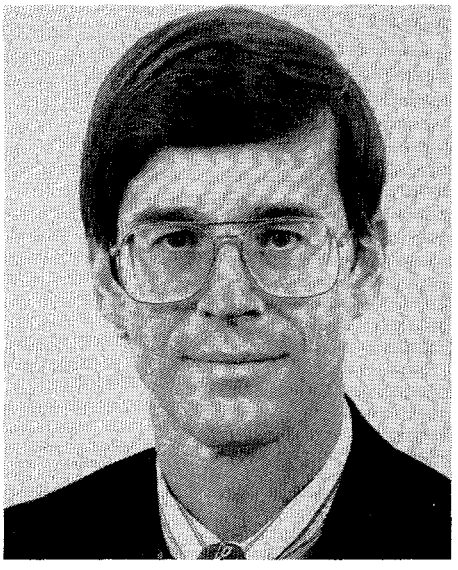


their government's poor fiscal performance. While budget deficits shrank, arrears accumulated. Although tax rates have increased, the tax base is still too narrow, and tax revenues are volatile. The continued ambivalent treatment of both domestic and foreign private businesses is also counterproductive.

Q. One would assume that in Russia the private sector has a much better chance now because the government—many claim—is run by influential groups of private bankers and industrialists.

A. But the climate is not conducive to private investment and efficient business activities. Property rights are still not established; the playing field is still not even across activities. In the Russian Duma attempts to adopt laws on private land ownership have been delayed. A high degree of uncertainty surrounds private businesses. Annual foreign direct investment is declining, although the potential is tremendous in areas such as the oil sector. Russia has a long way to go if it wants to grow 5 to 7 percent per year, provide adequate social services, and recover its initial GDP position in 1990, even if one allows for huge unrecorded activity in the shadow economy and the different valuation under the totalitarian system. The World Bank can help accelerate the transition by bringing to bear the experience of other countries and by providing technical assistance, advice, and sizable financial support.

Q. Poverty is still on the rise in most transition countries, and income differences among regions have increased. These could destabilize the political situation and endanger the reform course...

A. First of all, governments should support needy households, particularly poorer pensioners, rather than transfer subsidies to money-losing enterprises to sustain output. Delaying reforms is not the answer. While Ukraine delayed its reform process the share of poor households in the population increased from 12 percent to 25 percent in 1992-94. And in Russia the past practice of using inflation to finance subsidized credit to loss-making enterprises hit the poor hardest. Sharp erosion of minimum pensions and increasing layoffs in cities where a single dominant enterprise provides most jobs call for a more targeted approach to public spending.

Q. What are the major elements of the World Bank's future strategy in the transition economies?

A. In the Central European countries and the Baltics a major issue will be the accession to the European Union (EU). The applicant countries must adapt to EU standards in a number of areas, such as agriculture, the environment, industry, and social sectors. Once in the EU, countries like

Economies in Transition: Growth of Real GDP, 1992-97

(annual percentage change[a])

Country	*1992*	*1993*	*1994*	*1995*	*1996[b]*	*1997[c]*
Economies in transition	-12.0	-7.1	-9.0	-1.8	-1.3	1.5
Central and Eastern Europe	-3.0	0.2	4.0	5.8	3.9	4.3
Albania	-6.0	11.0	7.4	6.0	6.5	6.0
Bulgaria	-5.7	-3.7	2.2	2.5	-4.0	0.0
Former Czechoslovakia	-6.4					
Czech Republic		-0.9	2.6	4.8	4.7	5.0
Slovakia		-4.1	4.8	7.3	6.0	5.0
Hungary	-3.0	-0.8	2.9	1.5	1.0	2.0
Poland	2.6	3.8	5.0	7.3	5.3	5.2
Romania	-8.8	-3.0	4.0	6.9	4.5	4.0
Baltic states	-31.6	-14.4	1.5	1.3	1.7	2.0
Estonia	-14.8	-7.8	4.0	3.0	3.3	3.0
Latvia	-34.9	-14.9	0.6	-1.6	1.5	1.8
Lithuania	-35.0	-17.0	1.0	2.7	1.0	1.5
Commonwealth of Independent States	-14.1	-9.6	-14.6	-5.7	-4.4	-0.3
Kazakstan	-13.0	-12.9	-24.6	-8.9	0.7	1.5
Russia	-14.5	-8.7	-12.6	-4.0	-5.0	-1.0
Ukraine	-13.7	-14.2	-23.0	-11.8	-9.2	-2.3

a. Country group aggregates are averages weighted by GDP in 1988 dollars; for methodology, see World Economic Survey, 1992 (United Nations publication, Sales No. E.92.II.C.1 and corrigenda), annex, introductory text.
b. Partly estimated.
c. Forecast, based in part on Project LINK.
Sources: UN/DESIPA and ECE.

Lending Operations in Europe and Central Asia
(commitments in millions of U.S. dollar by fiscal year)

Country	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*	*Total*
ECA region (Turkey included)	3,837	2,111	3,849	3,756	4,533	4,376	22,462
Central Europe and the Baltics	2,937	1,777	1,790	1,480	891	1,222	1,097
Albania		41	44	47	67	73	273
Bosnia						160	160
Bulgaria	17	250	178	148	125	121	839
Croatia				128	120	32	280
Czech Republic	450	246		82	2		780
Estonia			30	50	30	15	126
Hungary	550	200	413	129	38		1,330
Latvia			45	25	53	27	150
Lithuania			60	26	32	42	161
FYR Macedonia				80	123	37	240
Poland	1,440	390	900	146	240	181	3,297
Romania	180	650	120	401	60	510	1,921
Slovak Republic				137			137
Slovenia				80		24	104
Former Yugoslavia	300						300
Eastern Europe and the Caucasus			1,435	1,803	2,781	2,479	8,499
Armenia			12	28	117	92	249
Azerbaijan					82	83	165
Belarus				170			170
Georgia					103	91	194
Moldova			26	60	90	55	231
Russia			1,370	1,520	1,740	1,816	6,447
Ukraine			27	25	648	343	1,043
Central Asia			60	373	611	363	1,407
Kazakstan				274	283	260	817
Kyrgyz Republic			60	78	77	98	313
Tajikistan						5	5
Turkmenistan					25		25
Uzbekistan				21	226		247

Source: World Bank.

Poland, Hungary, and Slovenia will be entitled to substantial financial support from Brussels. (They already receive loans from the European Investment Bank and grants through the PHARE program.) But in the short run there are plenty of opportunities for World Bank involvement—in economic and sector work, lending, and providing guarantees, particularly in infrastructure. Helping prepare the ground for access to the EU, (in close collaboration with the Union and the EBRD), dealing with continuing needs for infrastructure and social sector reform, and helping clean the environment are all major challenges for us. Our financial support will involve less adjustment lending and more investment loans and guarantees.

The less-advanced transition economies have a tremendous need for reconstruction after the collapse of their social safety nets and infrastructure systems. That need will not be fully met in the next ten years through private sector inflows or domestic resources. Therefore, the Bank will have a role to play in supporting their market-building efforts and access to foreign finance, until their economies can finally be propelled onto a growth path.

Q. How will structural changes within the Bank affect the loan operations in the transition countries?

A. The Bank will be able to focus better on individual countries because it will have ten to eleven country departments (instead of the current four) each handling six to seven countries. Country directors will be responsible for a minimum of one country and a maximum of four countries. The new design will enable the directors to focus more on the countries they are responsible for and develop clear, articulated strategies, in collaboration with governments, stakeholders, and other partners.

Country directors will have budget authority over the allocated funds to finance the Bank's lending operations, and economic sector work in the country they are responsible for. The directors and their country teams will work with six new sector management units operating in such areas as poverty reduction, human development, private and finance sector development, infrastructure, energy, as well as rural development and environment.

A country director will assign clusters of tasks to a matching sector unit, in line with their agreed country strategy, and will fund the job from the respective country budget, on a case-by-case basis. This new arrangement, based on direct motivation, will certainly improve the quality of the Bank's advice and financial support, making it more professional, more flexible, and more responsive.

Initially, two to four country directors will move from the World Bank's Washington headquarters to the resident office in the respective countries. Over time, others will follow, and functions such as procurement and disbursement can increasingly be carried out from the "field." This decentralization will proceed carefully; otherwise, it could be quite costly.

FSU Enterprises Keep on Providing Social Services

by Scott Thomas

State enterprises provided a broad array of social benefits for free or at highly subsidized prices under communism, including health care, child care, education, housing, home heating, and electrical, telephone, and water services. Huge enterprises granted extensive benefits not only to employees and their families, but also to the local community. With privatization and the development of a market economy, this residual from central planning has become a serious loss-making liability. Nevertheless, following mass privatization, the divestiture of enterprises' social assets has been slow in the former Soviet Union.

To give an idea of the magnitude of the problem, consider that in 1992, at the outset of the economic transformation, Russia's regional and local governments were responsible for 70 percent of all expenditures from the consolidated national budget for health, education, and other social services. But enterprises' annual spending on social services accounted for half as much as that of regional and local governments. In 1992 enterprise expenditures on social services accounted for 17 percent of total enterprise revenues (on average across eighty-five oblasts), and, partly as a result of price liberalization, this proportion rose substantially in 1993. In addition, state subsidies, in the form of public credits and budget transfers, also contributed to enterprise financing of social benefits.

To deal with the problem of social assets, enterprises have been advised to:

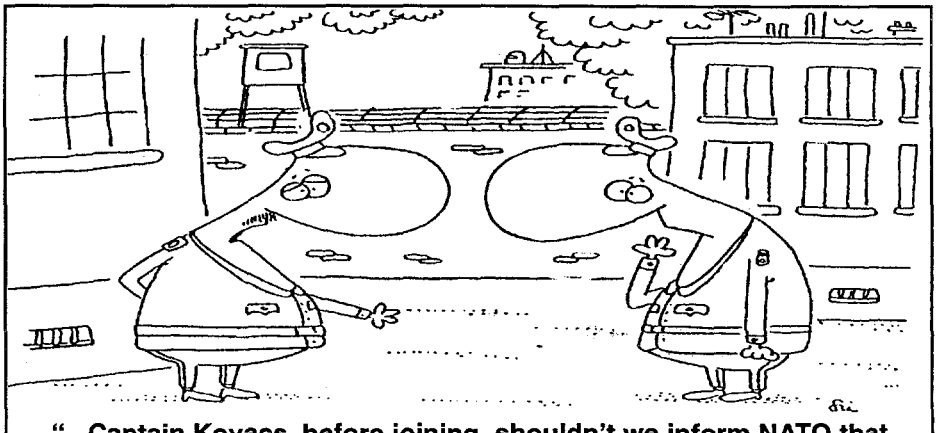
- Eliminate production, delivery, and maintenance of services that are best left to the private sector, such as housing.
- Pass on to municipalities, autonomous public utilities, or regulated private monopolies such services as residential heating and water and sewerage.
- Assign municipal financing or fee-for-service delivery to such services as child care and sports facilities.

But, frequently, the transfer of fiscal authority to regional and local governments has been inadequate. Although in Russia, for example, responsibility for a wide variety of social services has, by presidential decree, been shifted to regional and local authorities, additional revenues to finance that burden have not been forthcoming; nor has the authority to tax and spend. (A similar situation prevails in other republics of the former Soviet Union and in Central and East European countries like Poland.)

This situation does not explain why mass-privatized enterprises, particularly in the former Soviet Union, have remained impervious to market pressures to divest social assets. For example, most of Russian mass privatization was completed in 1993-94. But by 1995, 12 percent of all employees continued to work in jobs considered "non-industrial," an accounting category closely associated with the provision of social services.

The method of mass privatization in Russia and the other republics of the former Soviet Union has been dominated by insider buyouts or giveaways. In the vast majority of cases in Russia, management and workers in effect became the controlling shareholders of the 20,000 large enterprises that were divested. These new owners—including the management—continue to provide social services to both the employees and the surrounding communities. Needless to say, for the new employee-owners, reducing social services and subsidies in health care, housing, residential heating, and the like does not go down well when the purchasing power of pensions and wages is falling; or worse, when wages are simply not paid for months at a time.

The author is a senior economist with Louis Berger International, Inc. This article is excerpted from his contribution to M. Mandelbaum and E. Kapstein, eds., ***Social Policy and Social Safety Nets in the Post-Communist Economies,*** *Council on Foreign Relations: M.E. Sharpe, 1997.*



"...Captain Kovacs, before joining, shouldn't we inform NATO that Hungary hasn't won a war in the last 500 years?"

From the *Hungarian Economy.*

Quote-Unquote: "1996 was a year consumed less by policy than by politics and cardiology."

Larry Summers Prods Russia to Resume Its Reform Agenda

Since embarking on economic reform, Russia has shifted 70 percent of its enterprises to a private form of ownership; and laid to rest the risk of hyperinflation. Last year Russian inflation dropped to 22 percent—below Mexico's 27 percent, and near the 19 percent recorded by Hungary and Poland. Yet in applauding what Russia has achieved, we must also recognize that 1996 was a year consumed less by policy than by politics and cardiology.

The Russian government drew and defended a line on macroeconomic policy in 1996, but the rest of the economic reform process stalled. Privatization of large firms proceeded at a snail's pace amid serious questions about the fairness of the process. Key structural measures dropped off the reform agenda. Other reforms slowed as well, including efforts to audit and tax major state enterprises, adjust pension fund benefits, and make "strategic customers" pay for energy purchases. The Russian tax system was essentially missing in action in 1996, at least for domestic firms, threatening macroeconomic stability and even the minimal core functions of the government.

Russia's Potential

Whether Russia ends up trapped in a cycle of instability and despair, or graduates to become a strong economy, has tremendous implications not only for Russia but for the world. In Russia today:

- At current exchange rates, per capita GNP is about $3,400, or only one-sixth of the EU average.
- Only 25 companies' shares trade actively in Russia, and the top 200 firms (excluding Gazprom) are capitalized at less than $40 billion—roughly equal to the capitalization of Gillette or Motorola.
- A barrel of oil reserves in Russia is capitalized at under 5 cents, versus about $2.50 anywhere else.

Russia imports half the food [that consumers require] and pays for it with oil, timber, and aluminum. Russians buy more consumer goods in Istanbul than they do in St. Petersburg.

What could Russia look like in the year 2020 if it accomplished goals already met by other emerging countries? Were Russia able to attain the same depth of capital markets as other emerging economies, the capitalization of the Russian stock market would grow to thirty-five times what it is today—or over $1,000 billion—as a result of combination of increased capital issuance and share appreciation. If Russian economic growth were to average 6 percent a year to the year 2020, per capita income in dollars would be four times what it is now—or $14,000 (in real terms)—on a par with that of Spain.

Sustained growth in Russia would lead to huge demand for consumer durables—automobiles, appliances, and electronic equipment—as it has already in Eastern Europe. If Russian domestic demand reached current Spanish levels, this would mean 55 million passenger cars on the roads as against 13 million today; and 60 million telephone lines versus 25 million today. The list of reforms Russia needs to rediscover if it is to join the highly successful market economies is extensive and detailed. But if enacted, these measures will improve Russia's hospitality to capital.

The Two Evils

Two things in particular keep capital at arms-length: the tax system and crime and corruption.

- *Tax system.* Despite some of the highest tax rates in the world, Russia has one of the lowest rates of overall tax collections. The high rates, complexity, and arbitrariness of the tax system lead far too many investors—actual as well as potential—to throw up their hands in despair. Tax rates should be low and applied to as wide a base as possible. And taxes should be paid by all. Only about 17 percent of firms pay taxes regularly and in full, while at least a third publish no accounts and make no tax payments at all. With a federal tax system that now collects only 9 percent of GDP in taxes, Russia has room to boost its revenues and still remain one of the world's lowest tax environments.
- *Crime and corruption.* By some estimates 80 percent of businesses make payments to criminal organizations to provide a "roof" over their heads. A successful campaign against crime and corruption must begin with a commitment at the very top. The leadership of the government must say flatly that there is no longer impunity in Russia. And that statement must be followed by action—prosecutions and imprisonment—demonstrating that the rule of law will be applied evenly and universally and that even prominent and powerful people will be called to account.

Capital market development is necessary in order to channel funds from savers to investors, discipline management to ensure good performance, meet individual needs such as housing and

retirement finance, and provide citizens with a financial stake in the success of Russian capitalism. Almost all former communist countries have set up securities markets, but capital markets are much more than a stock exchange and a group of listings. The equity markets in Russia, the rest of the NIS, and all of Eastern Europe raised less than $1 billion in new capital from 1991 to 1995. This is about equal to net inflows into U.S. mutual funds per day in 1996.

Capital Market Woes

What is lacking is the **basic infrastructure** for participation in the capital markets, principally mechanisms that confirm, facilitate, and legitimize securities ownership and transactions. With equity shares in Russia largely paperless, ownership is recorded in the ledgers of share registries. Hundreds of registries exist in Russia, most of them outside of Moscow and most representing a single company. If you buy shares in a Siberian company, your broker has to travel there to transfer the shares and verify that the registry entry is accurately made in your name.

If the fact that companies often own the registrars of their shares makes you suspicious, it should. There have been cases where registry entries have been "erased" and shares assigned to someone else. In one notable case two years ago, U.K.-based Transworld bought a 20 percent stake in Krasnoyarsk Aluminum Smelter, only to find that the enterprise had unilaterally decertified its holdings. Concepts of minority shareholders' rights have not yet taken hold, and both managements and controlling shareholders regularly abuse the smaller holder.

The Russian **tax system** is also an obstacle to development of smoothly functioning securities markets. Broker/dealers pay taxes of 43 percent on their share-trading profits. Moreover, their capital losses cannot be used to offset capital gains, and there is no allowance for inflation. As a result of the difficulties in settlement and the tax system, nine out of ten Russian securities transactions are settled offshore. One of the sharpest paradoxes of Russian stock trading is that, with more than fifty stock exchanges and over 2,000 banks, **virtually all stock trading is nonetheless done over-the-counter and settled offshore.**

Yet another obstacle to fair and efficient markets is the absence of appropriate mechanisms for **corporate governance**. Russian privatization resulted in a concentration of ownership in the hands of company insiders. In well over half of privatized firms, insiders hold a majority stake. **Accurate and accessible information**—through accounting standards of value to investors, auditing, and rules on disclosure—drives the development of markets.

Secretary Rubin and SEC Chairman Levitt have agreed to cochair the U.S.-Russia Capital Markets Forum, designed to marshal the expertise of the U.S. private sector to help support and guide the development of Russia's capital markets. Four working groups are working on capital markets infrastructure, investor protection, accounting and tax issues, as well as mutual funds. (One area of great potential is the development of mutual funds in Russia to tap the estimated $20-$30 billion in mattress savings. Nine funds are now operating in Russia.) Although foreign direct investment will play a vital role in supplying technology and managerial expertise, and in supplementing domestic capital, Russia will finance its investment needs largely from its own resources.

Deputy U.S. Treasury Secretary Lawrence Summers spoke to a conference of U.S. and Russian businessmen at the Kennedy School of Governmentt at Harvard University, Massachusetts, on January 9. The Russian delegation was led by Boris Berezovskii, Deputy Secretary of the Security Council.

From the Ukrainian magazine *Ukrainian Finance*.

The Price Tag of Russia's Organized Crime

by Louise I. Shelley

Organized crime has a devastating impact on Russia's economy. It discourages foreign investment, deprives the country of its tax base, dominates the banking sector and financial markets, and exacerbates the already widespread problem of corruption. But probably the most damaging aspect of Russian organized crime activity is its contribution to large-scale capital flight.

Why Is Russia's Organized Crime Special?

Colombian drug traffickers repatriate most of their profits. Italian authorities were able to freeze $3 billion of mafia assets in the mid-1990s because much of the profits of Italian organized crime were invested domestically. In contrast, Russian organized crime groups repatriate little of their profits, instead depositing their proceeds in foreign countries, establishing banks in offshore havens. A specialist on capital flight reported at a recent Ministry of Interior conference in Moscow that $150 billion had been exported from Russia since 1991. This figure may be high but conservative estimates are still more than $50 billion. A minimum of 40 percent of the estimated $2 billion in monthly capital flight is attributable to organized crime groups. The problem of capital flight dwarfs the lamented absence of foreign investment (a figure estimated at approximately $6 billion since 1991).

Russian organized crime groups do more damage to their country's tax base than do their compatriots in other countries. Apart from not paying taxes, organized crime groups, by usurping the state's tax collection role, often deprive the state of needed resources. Recent research on the Russian customs service revealed that duties are paid on only 35 of every 1,000 cars imported into the country. Regional crime bosses control customs warehouses in many parts of the country. Many customs officials, who are on the payroll of crime groups, collude to divert customs duties to the crime organizations.

Russian organized crime has also infiltrated the domestic banking sector and financial markets more deeply than have their counterparts in other countries. Millions of citizens have lost their limited savings in pyramid schemes and in banking institutions that have collapsed. Hundreds of banks are owned or controlled by organized crime groups that are laundering money (abroad by Russian organized crime groups and within Russia by foreign organized crime groups). Bankers who refuse to launder money cannot compete with banks that provide such services. This criminalization of the banking sector and financial institutions has boosted capital flight.

Russian organized crime groups secured a massive transfer of state property because the privatization occurred rapidly, on a huge scale, without legal safeguards, and without transparency. These groups used force, if necessary, but relied mainly on their large financial assets and their close ties to the former Communist Party elite, the military, and the banking sector. (Colombian, Italian, and Mexican organized crime groups have also benefited from the privatization of state resources, but on a much more modest scale.) Amassing privatized property even before the collapse of the Soviet state, the Russian mafia now controls more than 40 percent of the total economy. In some sectors, such as consumer markets, real estate, and banking, their role is even greater. In other countries crime organizations also diversify from the illicit sector to the legitimate economy. But in Russia, organized crime groups are dominating both legitimate and illegitimate economic sectors simultaneously. The new owners, often uninterested in making their enterprises function, drain the resources and transfer the proceeds abroad, exacerbating the problems of both capital flight and nonpayment of wages.

Fighting on the Ground

The cancer of organized crime cannot be addressed solely of the national level or through officials in Moscow. There are significant geographic variations. For example, organized crime is based in the shipping industry in the Far East, in the appropriation and export of natural resources in the Urals, and in banking and real estate in Moscow. The weakness of the central Russian state and the rise of regional power means that assistance programs must involve a variety of individuals and groups apart from state institutions. A multipronged strategy is called for:

- Economic and legal assistance programs must be targeted to the most criminalized sectors of individual regions.
- Programs must seek to build civil society and help secure citizens' property rights. International programs to fight organized crime must work with groups like the Association of Russian Bankers, workers groups addressing issues of illegal privatization, and consumers groups educating citizens on the risks of investing in the largely unregulated banking sector, commodity markets, and stock exchanges.
- An integrated strategy of economic,

social, civil, and criminal legal assistance is needed. Reform of the banking sector, assistance in privatization, and maintenance of a free press must be implemented along with legal assistance to fight organized crime. Also required is coordinated legal reform in the criminal and civil areas, including enforcement measures; banking, tax, and regulatory reform; protection and education of journalists; and the empowerment of citizens to fight organized crime.

- Individual countries and international organizations assisting in the privatization process, such as the World Bank and the EU, must pay more attention to corruption. They must work to ensure that citizens have more access to the property now being privatized and to legal assistance in this area.
- More attention must be paid to ensuring the openness of the privatization process. Citizens must have better access to information about the integrity and viability of the institutions in which they may invest.
- Building integrity in the banking sector and in financial markets must be a key objective of any assistance program to combat Russian organized crime. Civil and criminal legal assistance must proceed in tandem to ensure that new economic institutions can be defended against further criminalization.

To sum up, efforts to decriminalize the Russian economy must define the problem more broadly than simply as money laundering. Donor nations and institutions must better coordinate their help in establishing the regulation and enforcement mechanisms for effective governing of financial institutions and markets. Assistance programs must identify areas of the economy that have managed to avoid massive criminalization.

The author is professor at the American University, Department of Justice, Law, and Society, Washington D.C. This article is based on her forthcoming book" Stealing the Russian State."

New Currency Boards Come to the Balkans

by Steve H. Hanke

If all goes according to plan, the monetary authorities in Bosnia and Bulgaria will soon have their hands firmly tied. This Herculean task of hand-tying will probably be completed when they dump their central banks and replace them with currency board systems. These new systems will put a stop to the monetary shenanigans that have characterized central banking in the Balkans.

With an orthodox currency board system, base money—domestic notes and coins, as well as any deposit liabilities—must be fully covered (usually at 100 percent to 115 percent) by foreign reserves denominated in a foreign anchor currency, and the domestic currency must trade, without restrictions, at an absolutely fixed exchange rate with the anchor currency. The system runs on automatic pilot, with changes in the monetary base determined solely by changes in the demand for domestic base money—the balance of payments.

Consequently, a currency board system cannot earn seigniorage (extra revenue from printing money) by creating credit and inflation. Instead, it generates profits because its liabilities (notes and coins) pay no interest, while its assets (foreign reserves) earn interest. Moreover, an orthodox currency board cannot operate as a lender of last resort. Thus, every financial institution is responsible for its own balance sheet, even in a pinch. Since the fiscal authorities and state-owned enterprises cannot obtain credit from the monetary authorities in countries with currency boards, discipline is imposed on governments, too. This feature of currency boards is particularly important. It not only provides an element of stability but also motivates liberal economic reforms.

Why have Bosnia and Bulgaria finally come to their respective monetary senses? After all, we developed detailed currency board blueprints for each country back in 1990. (S. H. Hanke and K. Schuler, **Monetary Reform and the Development of a Yugoslav Market Economy**, London: Center for Research into Communist Economics, 1991; and S. H. Hanke and K. Schuler, **Teeth for the Bulgarian Lev: A Currency Board Solution**, Washington, DC: International Freedom Foundation, 1991.) In both cases, however, the national authorities, at the urging of the IMF, rejected our proposals.

How times have changed! Article VII of the Dayton/Paris Treaty of 1996, which was drafted by the IMF, mandates that Bosnia establish and operate a currency board for at least six years. And the IMF has told the Bulgarians, "No currency board, no IMF credits." The IMF's insistence on currency boards for Bosnia and Bulgaria is a far cry from the response to our 1990 proposals and the cool reception the Fund gave to Argentina (1991), Estonia (1992), and Lithuania (1994), when those countries gave up on central banking and established currency board-like systems. Indeed, it represents a historic deviation from IMF orthodoxy.

Central banks have been the centerpieces of that orthodoxy. In the past, the IMF has asserted that central banks, with their power to create credit,

were engines for economic development. Not surprisingly, whenever a newly independent state was formed, the IMF applied its orthodoxy and mandated the establishment of a central bank. In turn, this required loads of technical assistance from the IMF. With the new central banks creating a lot of credit and inflation, the next step was a balance of payments crisis and a currency devaluation. This never seemed to bother the "airy-fairy devaluationists" (as Sir Roy Harrod, leading figure in the development of Keynesian Economics and Dynamic Theory, referred to them) at the IMF. They seemed to regard devaluation as a certain and swift remedy for a country's economic ills, one that would lead to a rapid, export-led recovery.

The IMF orthodoxy became etched in stone in the 1950s and early 1960s, when many African states became independent. At that time the IMF went head-to-head with the Bank of England over the desirability of retaining currency boards in Africa. The IMF won the battle, and instead of a "dash for growth," the African countries that embraced central banking made a "dash for inflation and instability."

The battle between central banking and currency boards was joined once again after the fall of communism and the establishment of newly independent states. At first the old orthodoxy held, as the IMF circled the wagons around central banking. But by late 1994 the IMF orthodoxy developed cracks, as the Fund began to defend the new currency board systems in Argentina, Estonia, and Lithuania. Then, in 1995, the IMF orthodoxy was shattered, when the Fund advocated a currency board mandate for Bosnia. Its no-nonsense advocacy in Bulgaria followed in 1996.

The IMF's deviation from its old orthodoxy is welcome, particularly in the Balkans. The former Yugoslavia has suffered a history of unstable money. In the period 1971-91, the average annual inflation rate was 69 percent, with hyperinflation of more than 50 percent per month in 1989 and again in 1991-92. According to many observers, hyperinflation was set off in 1991, as Slobodan Milosevic on December 28, 1990, ordered the National Bank of Yugoslavia to grant $1.8 billion in unauthorized credits to Serbian-owned enterprises. By January 1994 the rump Yugoslavia was suffering from a monthly inflation rate of 313 million percent, breaking the world records set by Weimar Germany and post-World War II Hungary. At present, the Yugoslav dinar is once again falling like a stone, and Montenegro, Serbia's junior partner in the rump Yugoslavia, is threatening to distance itself from the plague of hyperinflation by issuing its own money.

Bulgaria's story is much the same as Bosnia's. Since the fall of communism in 1989, Bulgaria has been racked by bouts of high inflation and political unrest. When we first proposed a currency board for Bulgaria, in 1990, its currency was trading at 10 lev per dollar. Now it takes 2,600 lev to fetch a dollar, and annual inflation is more than 300 percent and rising. It's no wonder that the protests in Sofia have turned ugly.

The monetary history of the Balkans is important. Most people in Bosnia, Bulgaria, and the rump Yugoslavia don't trust central banking. They believe that the central banks are instruments of strong sectoral and political interests, and that the money produced by these banks should be avoided. It is no surprise, then, that the unit of account and the preferred currency in the Balkans is the German mark. Both Bosnia and Bulgaria are operating at fractions of their 1989 economic performance, with unemployment rates of about 50 percent in both countries. Most banks and enterprises are insolvent. The rule of law and clear property rights are virtually nonexistent. Economic structures, to the extent they exist, are those inherited from the communist era. Governmental institutions are in their infancy and shaky.

Currency boards will satisfy two necessary, though not sufficient, conditions for jump-starting the Bosnian and Bulgarian economies and clearing the road to reform: they will produce stable money and monetary stability in both countries, and they will unleash $1.8 billion in foreign aid to Bosnia and a still undisclosed amount of IMF credits to Bulgaria. [In Bulgaria, under a currency board system, the lev would be pegged to the dollar or deutsche mark, convertibility would be guaranteed, and the Bulgarian National Bank (BNB) would be prohibited from buying government securities or lending directly to commercial banks. This would end the BNB's practice of refinancing troubled commercial banks and buying government securities—namely, printing money. In theory, this should force loss-making enterprises to restructure or close; any banks that persisted in lending to loss-making enterprises would be bankrupted. The successful implementation of a currency board might thus cause a further—if temporary—decline in output, following a fall in GDP of an estimated 8 to 10 percent in 1996. The Editor.]

Will Bosnia and Bulgaria be able to make their way down this reform road? In both cases, the best that we can hope for is that some visionary leaders and technically capable administrators will appear after discipline and stability have been established.

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Bulgaria in Crisis

Bulgaria's interim Prime Minister Stefan Sofianski has formed a caretaker government that will remain in office until the scheduled parliamentary elections on April 19. The caretaker cabinet on February 14 unveiled proposals aimed at rescuing the country from economic chaos. Mr. Sofianski set the following priorities: coping with crippling fuel shortages, stopping runs on banks, speeding up state sell-offs, closing loss-making state firms, cracking down on corruption and the gray economy, encouraging investment, and resuming talks with multilateral lenders.

Sofianski's government was sworn in mid-February 1997, just before the economy started to break down. In 1996 the GDP fell by some 8 to 9 percent, inflation soared to 310 percent, and the budget deficit reached about 12 percent of GDP. Cumulative inflation from 1991 to the end of 1996 was 24,000 percent, and wages fell sevenfold (in dollar terms) over the same period, revealed President Petar Stoyanov.

In early February the currency (leva) exchange rate was set at 2,608 to the dollar, from 500 leva to the dollar in early January. Basic staples have disappeared from the shelves. Many retail stores have closed down. Restaurants, shops, and wholesale suppliers still in business have been accepting payment in dollars only, despite an official ban of trading in hard currency. The fuel shortage has paralyzed public transport and road traffic in large parts of the country. Grain supplies have been depleted; the minister of agriculture has warned that the prices of a loaf of bread may rise from 250 leva to 2,000 leva if grain must be imported at market conditions. Ninety percent of the population is already living below the World Bank poverty level of $4 a day; in fact, due to raging hyperinflation, many pensioners now receive less than $4 a *month*, according to a recent *Washington Post* editorial.

The government, on February 18 almost tripled fuel prices to bring them closer to the world market level and cut down on the losses suffered by Bulgaria's biggest oil refinery, Neftochim in Burgas. Drastic hikes were the only way to stabilize the economy, Prime Minister Sofianski said. Officially, fuel will sell for 850-1,130 leva per liter ($0.30- $0.40), while the black market price is 10 percent to 30 percent higher. Another hike might come soon.

Finance Minister Svetoslav Gavriiski confirmed that Bulgaria must rely entirely on external loans to repay a foreign debt of nearly $1 billion due this year. Without financial support from the EU and international lending institutions, the country would not be able to service its obligations. Bulgaria must repay $992 million to foreign creditors this year, but has only $415 million in reserves. (National Bank figures showed Bulgaria's foreign debt totaled $9.86 billion at the end of September 1996, up from $9.31 billion at end-June.)

Central Bank Governor Lyubomir Filipov said that the currency board proposed by the IMF to stabilize the Bulgarian economy can be introduced in June. He told reporters that stabilization measures, which could include a fixed exchange rate, could be introduced before the implementation of the currency board if the financial resources needed to do so were available. The IMF, however, has hinted that before disbursing any funds it will require the government to complete previously agreed measures, such as closing sixty-four large, loss-making state enterprises; curbing loans to another seventy inefficient but essential state firms like the state railways, and power and heating plants; and speeding up privatization. One of the toughest tasks for a new government will be to tell workers at loss-making companies that they no longer have jobs. But the tough measure has to be taken since a currency board regime allows no scope for government bailouts of such businesses. The IMF earlier has frozen a $582 million loan pending implementation of these measures.

The World Bank has also linked its funding to Bulgaria's ability to speed up reforms needed to hasten economic stabilization "The priorities are to try to stabilize the economy, to restore some confidence and growth in the medium term," Alberto Musalem of the World Bank's Sofia office told reporters after meeting with interim Prime Minister Sofiansky. "We also discussed some projects for adjustment in the infrastructure sector and [the possibility of providing] some support for the social sector," Musalem said. Musalem also warned that Bulgaria's plans for a fixed exchange rate regime to stabilize the leva would not solve the problems of illiquid banks and that more failures could follow. Unless Bulgarian commercial banks are stabilized by the time the currency board is introduced, they will face a new crisis. If interest rates do not fall, banks' portfolios will be seriously unbalanced, according to Musalem. The central bank has sought insolvency for fifteen local banks since May 1996, but there has been no final court ruling on any of them so far.

Based on reports from news agencies, OMRI's Daily Digest, and Oxford Analytica

Bosnia Priority List 1997

Pushing ahead with Bosnia's reconstruction programs and setting up a market economy were crucial to reviving Bosnia's economy, officials of the World Bank, the EU, and Bosnia's two entities agreed during their January meeting in Brussels. Donors are interested in helping to sustain long-term recovery but not in financing short-term aid projects, cautioned an observer.

Last year Bosnia's economy grew by 40 percent; industrial output recovered to some 10 percent of its 1991 level; real wages grew about threefold, to an average of DM 270 ($170) per month; and the unemployment rate fell to some 50 to 60 percent of the labor force from its postwar high of 90 percent, as more than 200,000 jobs were created through reconstruction assistance. Trains are running on the rehabilitated Sarajevo-Ploce rail lines; the Sarajevo airport has opened to commercial air traffic; and district heat installations in 20,000 apartments in Sarajevo have been fixed before the winter. Key bridges are being repaired and rehabilitation of three principal power plants and four main transmission lines is proceeding. Foreign trade turnover has increased severalfold. Prices have been stabilized. The EU-World Bank donor conferences in December 1995 and April 1996 raised $1.8 billion. Of the total pledged, 90 percent had been committed to specific programs and projects by the end of October 1996. Close to $1.2 billion in civil works, services, and equipment contracts—as well as in orders of critical imports—are being implemented, and of this, $720 million has actually been disbursed.

But the country's GDP (adding up the figures of the two entities, the Muslim-Croat Federation and the Serb Republic) is still only one-third of its prewar level. Per capita GDP is estimated at $500 compared with the $1,900 seen in 1991. Economic revival so far has been limited: most of the country's industrial capacity is still waiting to be brought back into operation, and adequate infrastructure is still lacking. (Industry was key to the country's prewar economic structure, generating 38.8 percent of GDP, employing 43.7 percent of the labor force, and accounting for 99.0 percent of exports. Ten large industrial enterprises accounted for 50 percent of both GDP and employment.) Physical destruction, the technological obsolescence of much of the equipment that survived, and the lack of working capital and adequate skills are the industrial sector's most serious immediate problems.

The lack of an industrial revival has also meant continued high unemployment. According to government estimates, around 850,000 people are looking for work in the country as a whole. Among job-seekers, there are some 290,000 skilled and 350,000 unskilled workers. Due in part to the lack of adequate housing and job opportunities, refugee return has fallen far short of expectations. (Some 1.8 million displaced Bosnians and refugees are in Western Europe or in regions of the former Yugoslavia; several hundred-thousand of them were expected to return late last year or early this year.)

It is estimated that in Bosnia's Croat territory, industrial output has recovered to 85 percent of its prewar level, while the average monthly wage is more than DM 350. The Serb Republic has so far received only 2 percent of donor support. Economic growth there has been close to zero, wages are one-third of the level in the Federation, and inflation is high.

The country's investment needs are huge, since the task is not only to reconstruct an economy destroyed by war (the World Bank has estimated war damage in Bosnia at between $20 and $40 billion), but simultaneously to effect a transition from a communist to a market economy. There is hardly any potential for generating investment locally:

- A countrywide, coherent, well-defined institutional and legal framework is still lacking. Four currencies are in use (the Bosnian dinar, the Croatian kuna, the Yugoslav dinar, and the German deutsche mark), and different trade and tariff regimes apply both between the two entities and within the Federation. Obstacles to the free flow of goods and persons remain.
- Enterprises face numerous financial problems in their operations, a situation aggravated by a heavy tax burden. In the area under Bosnian Muslim control, the total taxes and contributions paid by employers amount to 110 percent of wages.
- Forty-two banks operate in the Federation, of which twenty-seven are in private ownership; and seven banks operate in the Serb Republic. State-owned banks have inherited nonperforming assets and foreign currency-denominated liabilities toward individuals and enterprises from before the war, and are in major need of restructuring. Private banks are too small and lack the experience needed to become major creditors for development projects.

Bosnia badly needs commercial legislation that clarifies company ownership, corporate governance, and financial markets if Bosnian companies are to attract foreign capital. The central government has already established a risk guarantee scheme in cooperation with the World Bank to promote foreign investments. Analysts from USAID have singled out the country's most promising assets, which include the forestry

and wood products industry, metal industries, construction materials and components sectors, electric products, and mineral processing. So far, relatively few of the country's former foreign partners—mainly in textiles and the automobile industry—have expressed an interest in returning and restarting their activities. However, this may change when privatization gets under way. The two entities have adopted different privatization models: a privatization law that is based on case-by-case sales has been in operation in the Serb Republic since August 1995; the Federation's privatization law, which envisions a mass program, is still in draft form.

Reconstruction efforts are now focused on pushing for economic reforms that would pave the way for long-term employment. Rory O'Sullivan, head of the World Bank's Sarajevo office, has said that Bosnia urgently needs to reform its steep payroll tax to encourage job growth.

Bosnian authorities have pledged to get the central government functioning and to start serious economic reforms, including adopting laws on a single central bank (to operate as a currency board for at least six years) and a single currency; adapting foreign investment regulations unifying customs tariff rates and payments systems, and harmonizing tax rates between entities. Other measures high on the agenda include:

- Return of refugees
- Infrastructure development (transport, power, and telecommunications).
- Community support (housing, district heat and gas, water and sewerage; landmine hazard reduction).
- Job creation through private sector and financial sector reforms (political risk insurance schemes, including investor guarantees, venture capital funds; technical assistance for privatization of state enterprises; credit lines to restructured and privatized banks).
- Establishment of a social safety net (school and hospital repairs, rehabilitation of primary care facilities, supply of critical medicines).

At the January joint World Bank-EU meeting, it was decided that donors meeting in Brussels in early April would be asked to pledge a total of $1.4 billion to Bosnia for 1997. (Around sixty nations will attend the conference, which will also include the IMF, the European Investment Bank, the Islamic Development Bank, the OECD, WHO, and planners from NATO.) With an estimated $2.5 billion needed in 1997-98, the $1.4 billion would keep the four-year goal of $5.1 billion on track and allow for some catch-up support for the Serb Republic.

Early agreement with the IMF on a macroeconomic stabilization program should pave the way for a substantial debt reduction by the Paris and London Club creditors. This in turn, would help Bosnia to achieve creditworthiness and access to private capital. The World Bank alone plans to approve some $160 million in new low-cost loans.

Based on reports from news agencies, OMRI's Daily Digest, and Oxford Analytica

From the *World Press Review*.

Vox Populi—What Do People in Central and Eastern Europe Think of Their Reforms?

by Jiri Vecernik

This article describes the level of satisfaction with and political support for the economic reforms in the Czech Republic, Hungary, Poland, and Slovakia, using a combination of economic and political microindicators. Since a person's sense of "well-being" is largely a subjective matter, opinion surveys have been used, rather than a strict assessment of incomes. This seemed particularly appropriate in a period of broad social and economic change.

In 1990 an overwhelming majority of the people in the four Central and East European countries welcomed profound economic reform: 78 percent of Poles and 67 percent of Hungarians fiercely supported fundamental changes; 60 percent of Czechs (but only 40 percent of Slovaks) saw capitalism as the only alternative for the future. Since 1990, however, support for a market economy has gradually slipped in the CEE countries, except in Poland. Whereas in 1991, roughly 49 percent of men in the CEE countries (average not weighted by population size) saw the new regime as better and 28 percent as worse (compared with the old regime), the satisfaction rate dropped in 1995 to around 40 percent, and the dissatisfaction rate increased to the same, 40 percent level (table 1).

Table 1. Opinion of Current Regime
(as a percentage of male respondents)

	1989-19				1992-95			
Country	*Worse*	*Same*	*Better*	*Total*	*Worse*	*Same*	*Better*	*Total*
CzechRep.	16	14	70	100	23	20	57	100
Hungary	39	30	31	100	52	26	22	100
Poland	23	26	51	100	38	19	43	100
Slovakia	25	22	53	100	50	17	33	100

Source: "Dismantling of the Safety Net," SOCO survey 1995.

Opinions vary between population categories: the current regime is more positively evaluated by men than women, by the young than the elderly, by the higher-educated than the less-educated, and by the well-to-do than the have-not. However, these sociodemographic characteristics tell only part of the story; for example, risk-taking, entrepreneurial individuals are much more in favor of changes than those less endowed with these characteristics.

Table 2. Ability of Households to Make Ends Meet
(percent)

	1989[a]				1995			
Country	*Bad*	*So-so*	*Good*	*Total*	*Bad*	*So-so*	*Good*	*Total*
Czech Republic	13	38	49	100	24	40	36	100
Hungary	21	35	44	100	47	41	12	100
Poland	25	43	32	100	60	27	13	100
Slovakia	7	39	54	100	33	44	23	100

a. Retrospective observation.
Source: SOCO survey 1995.

In 1995, 60 percent of Polish households and 47 percent of Hungarian households admitted financial distress as opposed to only 33 percent of Slovak and 24 percent of Czech households (table 2). The perceived deterioration during the transformation period 1989-95 is most pronounced in Hungary (60 percent of households declaring they are worse off), in the middle ("so-so") range in Poland and Slovakia (54 and 52 percent), and least notable in the Czech Republic (35 percent).

The correlation between households' ability to make ends meet and leftist preferences is significant only in the Czech Republic (quite strong) and Poland (rather weak). This suggests that in the Czech Republic more individuals are likely to join opposition parties in reaction to the declining living standard and dissatisfaction with the regime. Indeed, leftist and rightist parties are more visible in the Czech Republic than in the other CEE countries. The 1996 Czech elections signaled a weakening of the public's previously strong commitment to the market, and as a result, Prime Minister Klaus's party lost its absolute majority in Parliament. (In Hungary it fell to the ruling, Socialist-dominated coalition government to

implement a belt-tightening austerity program; in Slovakia, Prime Minister Meciar's party adheres to a populist-nationalist program.)

Citizens in all the CEE countries expect their governments to focus more attention on the social, ecological, and moral dimensions of reform and, specifically, to protect equality of opportunity, which is threatened by hidden monopolies and the excessive power of the banks, big corporations, and the expanding state bureaucracy.

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Surveys used: "Dismantling of the Safety Net and Its Political Consequences"—October 1991, Institute of East West Security Studies, New York; "The Social Consequences of Transition"—early 1995, Social Costs of Economic Transformation (SOCO) and Institute for Human Sciences, Vienna.

Adapted from the author's book, **Markets and People: The Czech Reform Experience in a Comparative Perspective** *(Avebury Publisher, Aldershot, United Kingdom, and Brookfield, Virginia, United States, 1996, 294 p.)*

Letters to the Editor

Lessons from the Hungarian Energy Sector Sell-Out

Our data on energy intensity in Central and Eastern Europe (CEE) are quite different from those shown in the chart "Electricity Intensity of Output 1994" ("Rebuilding Postsocialist Infrastructure," ***Transition***, vol. 7, no. 11-12, p. 13). Your data severely underestimate energy intensity in some countries. For example, for Estonia, our figure is 1,300 gigajoules while your chart shows 750. Despite earlier expectations, energy intensities are still on the rise in this region.

I agree that creating market conditions in the electricity sector will address several of the problems these economies face, such as energy waste, liquidity constraints, obsolete technologies, and the like. However, the large capital requirements in the electricity sector have been met mainly by foreign investors. Since selling off a significant share of the energy sector—an important base of the economy—to foreign owners has never been done elsewhere, such sales should proceed cautiously.

To illustrate the potential dangers, consider several examples from Hungary, where citizens are already paying the price for fast and careless privatization of the energy sector. By the end of 1996, following the accelerated sell-off of the energy sector in 1995, a significant portion (40 to 80 percent) of Hungarian utilities was in foreign hands. According to the State Auditing Agency, the accelerated privatization went forward without any overall analysis of the Hungarian energy sector and without individual impact assessments. The primary goal was to raise capital quickly to reduce the public debt and improve foreign reserves.

Since this shortsighted political goal was the primary engine of the fast privatization, several national, social, and environmental considerations were ignored. For instance, the government agreed to raise electricity tariffs to the level that would guarantee an (excessive) 8 percent profit margin for foreign investors. Achieving this level would have required a 40 percent tariff increase in January 1997. Since this increase would have presented an intolerable social burden, tariffs were raised only an average of 24.9 percent. Understandably, foreign investors considered this shortfall to be an unacceptable deviation from the government's commitments. As a consequence, tension levels rose in countries whose industries had a high stake in the Hungarian energy sector, such as France and Germany.

Another undesirable consequence of the aggressive sell-off has been the protection of foreign investors relative to local and government owners. For example, locally owned utilities usually do not have an 8 percent profit margin written into their tariff formulas. As a result, the additional revenue from the January tariff increases disproportionally benefits the foreign owners: only 15 percent of the extra revenue goes to Hungarian owners.

Also, to accelerate capital inflows, lower efficiency standards were set for foreign-owned utilities than for Hungarian-owned utilities. Other national interests, including technical improvements, retrofitting investments, and pollution controls, were not regulated in the contracts. And since the investors have acquired full control and rights in their enterprises, almost no government influence can be exerted for the protection of national, social, and environmental interests.

Thus, the selling off of the energy sector, a sector that is so important to the national economy and to environmental and social well-being, is a risky business. International financial institutions, while promoting the establishment of market conditions in the energy sector, should also work to ensure that national, social, and environmental interests are represented during the privatization process in transition economies and that shortsighted political interests do not jeopardize decades of development.

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Increased Ownership of Consumer Durables Does Not Necessarily Indicate Higher Real Incomes

Professor Jan Winiecki was one of the most perspicacious critics of (what he also termed) the Soviet-type economies. He indeed retains some of his unique style in the recent rejoinder (*Transition*, vol. 7, no. 11-12) to an article in *Transition* by Professors Kubaj and Kawalik (vol. 6, no. 7-8). Professor Winiecki's discussion deals with the social costs of transition, and, more specifically, with the extent to which GDP and living standards have declined during the transition. There are many arguments why GDP, and possibly population income, declines have been overstated. Some of them are eloquently exposed by Winiecki in his *Transition* piece and elsewhere.

This discussion is becoming somewhat irrelevant for countries like Poland, where incomes and GDP, according to any reckoning, are back where they were before the transition, and the economy is recording healthy, fast growth. But these issues are still relevant for other transition economies—many of them, especially Russia and Ukraine, still mired in depression.

As significantly more households own a greater amount of durable consumer goods (VCRs, cars, computers, dishwashers) than they did before the transition, Professor Winiecki and others see evidence of rising real incomes. Some critics, while admitting that ownership of durable goods has increased, try to reconcile that increase with the real income decline, contending that "only the rich were able to buy the durable goods." But ownership of durables increased across the board: in Poland between 1989 and 1994 the share of households owning a VCR increased by almost twenty times—from about 2.5 percent to 48.0 percent.

These arguments disregard a huge relative price change that occurred in the transition economies. In 1988 a worker in Poland who earned the average $30 monthly wage (at the official exchange rate) had to earn ten times that amount to buy a simple VCR ($300) or some 100 kilos of pork. During 1993-94 in Poland and 1996-97 in Russia, incomes did not necessarily return to their pretransition levels, but relative prices changed massively, and, most important, the exchange rate was allowed to float freely. After a short, and sharp devaluation that brought the official exchange rate almost to the level of the parallel (market) rate, a sustained period of real exchange rate appreciation followed.

The real exchange rate of the zloty is now higher than the zloty's official exchange rate in 1988. In Russia between January 1992 and September 1996, following the price and exchange rate liberalization, the cost of living increased 670 times, and the nominal ruble-dollar exchange rate increased only twenty-six times; the real exchange rate of the ruble thus rose more than twenty times. As a result the real wage that was worth $7 in January 1992 is now worth $160.

In Poland the average wage is now $300 per month. Our worker needs only one month's salary to buy the VCR. Note the truly astonishing decline in wage-prices of imported consumer durables: the new wage-price is one-tenth of the old. But the purchasing power of the worker's salary, in terms of domestic goods, has decreased, as statistics show—the nominal wage is deflated by the cost of living index. (Durable goods of course figure into the cost of living index, but their weight is appropriately small.) Our worker now purchases less food (in Poland in 1994, only 70 kilos of pork) but more durables.

To conclude, the increased consumption of durables is not necessarily indicative of an increase in real incomes. But even if real incomes, measured in domestic goods, have declined, the ownership of durable consumer goods is certainly a gain brought about by economic liberalization.

Branko Milanovic
World Bank
Washington, D.C.

Foreign Investment Brings a Clash of Cultures —The Story of GE Lighting Tungsram

by Paul Marer and Vincent Mabert

General Electric, in 1990, acquired majority share in one of Hungary's largest, oldest, and internationally most prestigious firms, the light-source manufacturer Tungsram. In 1903 engineers at the Hungarian company developed an incandescent lamp, using for the first time tungsten filament. Their remarkable invention was patented in 1904. (The word "Tungsram" is a combination of "tungsten" and the German equivalent, "wolfram".) In 1994 GE fully bought out the company, which in 1996 was renamed GE Lighting Tungsram. Over the past six years GE has invested $600 million in the venture and thoroughly restructured every aspect of its operations. It is the largest U.S. manufacturing investment in Central and Eastern Europe to date.

Sale of the Century

Even under the communist system, Tungsram was able to sell its lighting products in more than 100 countries, maintaining a 5 to 6 percent market share in Western Europe and 2 to 3 percent globally. The company's other main assets included its traditionally strong scientific and technology capability and a skilled and relatively low-cost labor force. Nonetheless, it had a weak financial position, a mixed product structure, many run-down physical facilities, technology that was not uniformly state of the art, and a breakage and wastage (toss and throw) rate that was several times above industry standards in the West. Tungsram had problems with accumulated hazardous waste and other weaknesses in its environmental performance, struggled with an antiquated internal communication and management information system, and followed management practices that could at best be characterized as lax.

The company thus needed substantial new investments and comprehensive restructuring—things only a foreign strategic investor was able to provide. When the opportunity presented itself in 1989, GE made a quick strategic decision to acquire Tungsram, with an eye to strengthening its own operations in Western Europe where, in 1985, its market share was just about a third of Tungsram's 5 to 6 percent. A large part of GE's capital expenditures in the next years went into capacity improvements, upgrading of the physical infrastructure, acquisition of hardware for a new system of telecommunications and a new management information system, and installation of equipment to improve environment and safety. Capital outlays during 1990-94 represented about 10 percent of sales, as compared with an average of 1 to 2 percent during the 1980s.

Following the sale, Tungsram came under the management of General Electric Lighting (GEL), one of GE's twelve major business units and a giant global corporation in itself, with annual sales of $3 billion. Choosing a "regional-global" approach, GE decided to make a substantial integration along functional lines. In 1992 General Electric Lighting Europe (GELE) was established, headquartered in London. Corporate strategy, research and development, manufacturing technology, finance and accounting, and many aspects of marketing and distribution became regionally or globally managed.

Regional-Global Approach

All of GE's light source research has been done in Hungary since 1994. The Budapest-based Brody Institute became GEL's only global R&D Center of Excellence. Of the eight major research programs that GEL sponsors worldwide, four are at the headquarters at Nela Park and the other four are located in Hungary (research on tungsten, glass composition, and phosphorous synthesis and coating, as well as on high-temperature chemistry and discharge modeling). About half of GEL's approximately 750 professional research and development personnel reside in Hungary. GEL now spends 5 to 6 percent of its revenues on research and development, more than the industry standard. Whereas in 1989 the average product development cycle at Tungsram was three years, by 1994 it was reduced to less than a year.

By 1995 some 90 percent of GEL European production was located in Hungary, as several newly acquired West European facilities were closed down and their machinery was transferred to Tungsram. The Nagykanizsa factory has become the world's largest and most outstanding producer of light sources. Several Tungsram facilities have been designated as Centers of Manufacturing Excellence (in other words, they have become the sole suppliers of certain GE product families).

General Electric Lighting Tungsram increased its turnover by 10 percent in 1996, to $35 million, primarily as a result of expanding its exports. The same year, the company invested $40 million. Investment has been funneled

into manufacturing new products and building productivity. In 1996 a special compact lamp production line was installed in the Vac-based factory, while automation and factory capacity were both enhanced. GE Lighting Tungsram currently manufactures all of GE's energy-saving lighting sources. GE Lighting, with a 16 to 17 percent share of the West European lighting market, ranks a close third after Philips and Osram. GE Lighting Tungsram also has a 16 to 17 percent share of the East European market, ranking as market leader among international companies. The company hopes to raise its average market share in Europe to more than 20 percent over the next few years.

GE Brings Good Things to Life?

GE's efforts to bind together separate national and corporate cultures have resembled the practices of many multinationals in some respects: providing extensive training in language and business skills and offering opportunities for talented younger employees to rotate to different businesses and geographic locations. But GE's corporate culture also incorporates the views of its dominant leader, Welch, CEO since the early 1980s. Jack Welch has made it standard company practice that every business unit conduct continuous campaigns to become the lowest-cost producer in its area. One approach to reducing costs and improving productivity is work-outs, which are multi-day retreats. After the boss and outside consultants lay out the unit's achievements, problems, and business environment, the participants—representing every layer and type of employee of the unit—brainstorm to come up with recommendations for improving operations. They receive on-the-spot responses and pledges that what is agreed upon will be implemented quickly.

Jack Welch also pioneered the best-practices program. Its objective is to seek from outside GE practical ideas for improving operations—to break with the "not invented here and therefore not considered" syndrome that permeates many large organizations. GE's corporate culture also includes empowerment: delegating down the chain of command as many decisions as possible and encouraging individual initiative. Employees are encouraged to communicate and to act across hierarchies. GE's culture sets ambitious targets for continuous improvement, consistent with Welch's notions of stretch: achieve large results, not small, incremental ones; make things happen quickly because speed is a competitive advantage. Under Welch's leadership GE has made massive layoffs at many of its units and has quickly sold businesses that do not perform up to expectations. There is no long-term job guarantee at GE.

The corporate culture of GE embodies such typical American traits as individualism, universalism, and self-confidence. GE offers scope and rewards for individual initiatives, making performance evaluations and offering incentives that are more individual-than team-based. American culture generally, and GE's corporate culture specifically, are strongly universalist: rules are more important than relationships, "what is good and right can be defined and always applies." A GE publication, "Integrity: Code of Conduct at the Workplace," is issued to all company employees in the local language, and workers must pledge to observe its covenants. The fifty-page book prescribes behavior to try to eliminate corruption. It instructs that one must deal fairly with one's coworkers, regardless of nationality, sex, or creed. It requires absolute fairness in dealing with competitors and suppliers. It insists on integrity in all aspects of conduct involving the workplace. In the family, at school, and through the media, Americans are taught to approach tasks with confidence and to seek the most practical solutions to problems. They believe that it is up to each individual to succeed, that nature can be subdued and other outside constraints overcome if only one tries hard enough.

Corporate Culture

Culture refers to the fundamental values and norms that a group of people—such as an ethnic group, a nation, a corporation, or some other organization or profession—holds or aspires to hold. Every culture distinguishes itself from others by the specific ways it prefers to solve certain problems, such as those that arise from relationships with other people, from the passage of time, and in dealing with the external environment. Groups of people have "typical" cultural traits that can be identified by observing situational behaviors and predominant tendencies in problem solving. Recognizing that a group exhibits certain "typical" cultural traits does not mean that every person in that group has precisely those characteristics. That would be stereotyping. The way in which attitudes are expressed in a business organization and the way employees are evaluated and rewarded are labeled "corporate culture." The culture of an organization is shaped by the national traits of its employees, by the personality and ideas of the corporation's dominant leader (if there is one), and by the nature of the industry.

Hungarian society in general, and Tungsram workers in particular, are individualistic in certain respects, such as preferring to attack problems alone rather than in teams; and community-oriented in others, such as being less willing to accept individual responsibility. Community orientation is partly a legacy of the previous economic system, when neither ownership nor control over the means of production was clearly defined. There is a tendency to blame others for problems. The first reaction to a difficult task is usually to dwell on why it cannot be solved, although Hungarian pride and ingenuity eventually do find a way to solve it. Hungarian culture is strongly particularist: "circumstances and particular relationships influence how I act." Hungarian employees have been socialized—by the many vestiges of the old feudal system and by the hierarchy of central planning—to act only in their areas of authority, and they are reluctant to step beyond those boundaries.

Since its establishment in 1896, Tungsram's culture was cradle-to-grave. Employees lived in housing provided and financed by Tungsram. Their children went to Tungsram kindergartens and schools. They vacationed in Tungsram's vacation facilities. On weekends they rooted for Tungsram sports teams. They played soccer or tennis or basketball in Tungsram's sport facilities. The only way to get a job was to be recommended by a current Tungsram employee. Many families had three or four generations of Tungsram employees. This community-oriented ethos was reinforced during the socialist era by practically no layoffs. Even after five years under GE, the leader

GE Surges Further

General Electric posted a record $7.3 billion profit in 1996, up 11 percent from $6.6 billion the previous year, and preserved its position as the world's most profitable enterprise. Revenue for the full year was a record $79.2 billion, up 13 percent from $70.0 billion in 1995. Revenues rose at nine of its twelve major businesses, led by double-digit growth at NBC television, GE's Capital Services unit and its power systems division. GE's operating profit improved to a record 14.8 percent of sales in 1996, up from 14.4 percent the previous year. To keep GE ahead, the management has devised the following corporate strategy:

• Heavy reliance on a quality control program, involving four months of training during which young managers become "Black Belts." The Black Belts then spend their full time roaming GE plants and setting up quality improvement projects. The company already has trained 2,000 Black Belts and plans to increase that number to 4,000 by year-end and to 10,000 by 2000. The program can be applied to financial services—for example, making sure that bills GE sends to customers are correct. (Forty percent of GE executive bonuses, which run as high as $1 million, will now depend on implementation of this program. Earlier, bonuses were based only on profit and cash flow.)

• A shift in GE's sales emphasis from manufacturing products to supplying services. This tactic is largely a response to the heavy pressure on prices that is eroding profits on some products. (In the United States, for example, cost-cutting hospitals have tried to limit price increases on GE-made X-ray machines and scanning devices. So GE has developed a highly profitable online diagnostic service linked to 11,000 scanning machines in hospitals worldwide.)

• A push for profitable niche acquisitions. GE Capital, principally, has followed this route, buying about thirty insurance, credit card processing, and other financial companies annually. The unit's assets totaled $186 billion at end-1995, a gain of 46 percent in two years; if it were a bank, it would have been the third-biggest in the United States. Last January GE Capital's aircraft-leasing unit ordered seventy-seven Boeing jets, mostly 737s, valued at $4 billion.

• Rapid expansion abroad. GE's revenue is growing three times as fast in foreign countries as in the United States. Foreign revenue will account for 50 percent of GE's total revenue by 2000, up from 40 percent in 1996.

Sum of Its Parts: General Electric Units, 1995
(US $ billions)

Business units	*Revenue*	*Operating profit*
Aircraft engines	6.10	1.18
Appliances	0.70	5.93
Broadcasting (NBC)	3.92	0.74
Industrial (e.g., lighting, locomotives)	10.19	1.52
Materials (GE Plastics)	6.65	1.47
Power generation	6.55	0.77
Technical (e.g., medical)	4.42	0.80
GE Capital	26.49	3.52
Other	2.71	2.68

Source: General Electric.

of the Independent Union of Tungsram Workers made the following statement: "GE's corporate strategy is to make everyone insecure. The owner assesses us from the United States, where the structure of the economy and industrial relations are different. GE tries to employ here overseas methods, which causes conflicts."

American business culture emphasizes that the prime duty of management is to serve the stockholders' interest. GE under Jack Welch has prided itself on continuously increased profits and the stellar performance of GE shares on the stock market. European and Japanese business cultures lean more toward the view that employee interests should be on or near par with owner interests. Such cultural differences can give rise to conflicts and misunderstandings in particular situations.

For example, GE at Tungsram has followed its universal practice of establishing a confidential telephone line for reports of ethics violations by its employees. Reports of any kind can be made and the caller need not give a name; all charges are investigated. For many Tungsram employees this practice recalls the hated political "snitching" that Hungarians were compelled (and later, encouraged) to do in the postwar decades. The confidential phone line was introduced over the strenuous objections of the union and the work councils, and it remains in place. Another example: In 1995 GE announced that it will end a seventy-five-year-old corporate tradition of financial support for the Tungsram Sports Club, which sponsored Hungary's leading professional teams in men's and women's basketball, volleyball, and water polo. Thus the title of one Hungarian editorial: "GE Brings a Good Thing to an End."

In addition to regretting the withdrawn GE sponsorship of Tungsram's professional sports teams, the Hungarian public has been equally disturbed by reports of substantial downsizing of the workforce, decline of real wages even though productivity has improved strongly, and depreciation of the well-known Tungsram name. But the fact is that Tungsram—a large, state-owned enterprise in a small country, manufacturing a standard product for export—could survive only through being internationally competitive. GE has made impressive strides toward that goal through restructuring. Thus, Tungsram's privatization under GE—besides being an excellent strategic investment for the multinational—was, on balance, in Hungary's national interest, too.

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From the *Hungarian Economy.*

The World Bank's Multilayer Partnership Program

President Wolfensohn on New Relationship with Aid Donors, NGOs, Businesses, and Member Countries

A first level of partnership is with the other bilateral and international organizations. The regional banks, the World Trade Organization, the European Union—all constitute a major force in terms of development. The UN institutions, for example, are active in many of the same areas as the Bank, from health to education to conflict resolution.

Earlier we did not have a systematic relationship with regional banks such as the Inter-American Development Bank and the African Development Bank. We have successfully initiated regular regional bank summits, and just had the third such meeting in London, under the chairmanship of European Bank for Reconstruction and Development (EBRD) President Jacques de Larosiere. The atmosphere has changed from one of sensitivity and competition to one of cooperation. We are continuously building our links with the European Union, too, and have established an office in Brussels.

A second level of partnership is with NGOs and civil society. With freedom and greater democratization comes a greater voice for civil society. And so we have seen an explosion of nongovernmental organizations around the world, in support of both special and more general issues and interests—be they women's issues, environmental issues, educational issues, or health issues; be they the interests of a village, a region, or a country. These voices are real, and they are central to the development process.

We are making efforts to engage NGOs in substantive studies and work on critical issues, whether it be environment or structural adjustment. This relationship with NGOs is part of the Bank's new, more broadly based approach to social structure and poverty assessment.

A third level of partnership is with the private sector. Over the past years there has been a dramatic change in the pattern of investment flow. Ten years ago private sector investments in the developing world came to about half the amount of the World Bank's and other partners' official transfers. This year the private sector will invest about $250 billion in developing countries, that is, five times the amount of official assistance. Though it is true that 80 percent of that will go to just twelve countries, and Sub-Saharan Africa, will get less than 2 percent.

For power and electricity, for water and toll roads, for ports and communications—to achieve development in these crucial areas, the Bank must work in partnership with the private sector: that is where money is most vigorously and readily available.

We need to assist those countries that are not yet ready to absorb development investment, that need help with their judicial systems and regulations, with education, with communications, with their tax systems, and with their financial and banking sectors—all the things that will create a favorable environment for investment. The new private sector bureaus are linking the activities of the Bank, the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA). We are beginning to develop a centralized information base on tendering or procurement to do business.

A fourth, and the most significant level of partnership is the Bank's relationships with the governments and the peoples of our member countries. At present almost two-thirds of these nations function under some form of democracy, as against 41 percent five years ago. Five billion people now live in market economies, whereas seven years ago the number was just 1 billion. And moves toward decentralization are part of this trend, with more regional and local governments entrusted with financial resources and responsibilities.

We at the World Bank are looking at ways we can develop into a knowledge bank, to take advantage of the experience that we have gained over fifty years. Can you imagine putting online all the experience we have had in preschool education, to allow an education minister or a researcher in a distant country to have direct access to the Bank, without waiting for various documents? Or just think: through our satellite system, interactive, thirty-person classrooms around the world can participate in direct teaching. Bank offices can provide classes and discussions with developing countries throughout the world, in whatever language necessary. This is not science fiction; this is today. So we will take advantage of technology, and we will take advantage of the new opportunities we are finding.

Excerpted from Mr. Wolfenson's speech at his meeting with senior managers in December 1996, and his keynote address at the International Development Conference in Washington on January 13, 1997.

Milestones of Transition

Albania

President Sali Berisha promised Albanian citizens that the government will seek to repay "quickly and fairly" the money that has been "stolen" from them. Hundreds of thousands of Albanians have lost their savings in the recent collapse of pyramid schemes, which was followed by nationwide demonstrations and riots. At least five leading pyramid schemes have collapsed since last fall. Others are still operating and paying out interest but are not returning capital. Zef Preci, director of the Albania Center for Economic Research, estimates that the 25.5 billion leks ($255 million) seized from two schemes would cover only one-third of total investments. World Bank representative Carlos Elbirt said that any further surge in prices could be ruinous for Albania's economy. The budget deficit in the first eleven months of 1996 reached $260 million, or 11 percent of GDP, while the central bank has foreign exchange reserves totaling just $270 million. Moreover, much of the assets seized from the two schemes are held in the form of Albanian treasury bills.

Albanian Prime Minister Aleksander Meksi said that the government would try to increase revenues in 1997 by launching a major drive against tax evasion. The latest central bank figures, from October, showed that the deficit was equivalent to 10 percent of GDP. Meksi also said the government was in the process of concluding an agreement with the International Monetary Fund and would strive for an association agreement with the European Union (EU).

Belarus

The Belarusian economy grew by 2.6 percent in 1996, the first increase since the Soviet Union collapsed in 1991, First Deputy Prime Minister Piotr Prakapovich announced on January 20. The opposition Belarusian Popular Front issued a report the same day claiming that the economy had actually shrunk by 4 to 5 percent and that about 1.5 million people, one-third of the workforce, are unemployed. Prakapovich acknowledged that the country's foreign trade deficit in 1996 was $1.4 billion and that industrial goods worth $633 million are languishing in warehouses.

The National Assembly passed the draft state budget for 1997 on January 11. The budget sets expenditures at 43.3 trillion Belarusian rubles (BR) and revenues at BR 35.8 trillion. The deficit is equivalent to 3.3 percent of GDP. Most of the deficit will be covered by issues of government securities, privatization of state property, and foreign loans. The rest will be covered with loans from the National Bank of Belarus. The budget was described by deputies as "socially oriented," with 55 percent of expenditures going to the social and cultural spheres. Eight percent of the budget will be used to deal with the ongoing consequences of the Chernobyl disaster. The agricultural sector will receive the lion's share—more than half of "social" expenditures. The draft 1997 budget predicts GDP and industrial output will grow by 5 percent and 6 percent, respectively, and projects a 10 percent growth in investment. The budget also forecasts monthly inflation of less than 2 percent.

Cambodia

Cambodia's National Assembly approved the 1997 budget, which cuts defense spending by 5 percent from the previous year, reflecting the country's easing political situation. The government lost income last year because of poor economic management, especially ineffective tax collection, admitted Finance Minister Keat Cheon. The unchecked harvesting of trees, which since 1970 has stripped Cambodia of half its forest cover has increased over the past few years, with proceeds used largely to finance both the government and the Khmer Rouge, the insurgency it is fighting, according to a *New York Times* report. The international financial institutions that support half the government's annual budget, about $650 million, are warning that illegal logging could jeopardize continued financing. Last May, the IMF suspended a $20 million installment of a $120 million three-year loan. At a July meeting in Tokyo with the World Bank and other international donors, the Cambodian leaders pledged again to implement measures to halt illegal logging. These new measures include closing Cambodia's borders to logging exports; calling on neighbors Thailand, Laos, and Viet Nam to help stop illegal exports; empowering the ministry of agriculture to take necessary enforcement measures; and removing private security forces hired by logging companies.

China

China's GDP grew by 9.7 percent in 1996 compared with 10.2 percent in 1995, the State Statistical Bureau reported on December 30. The consumer price index was up 8.3 percent during the same period. The Institute of Economy, a research body under the State Planning Commission, forecasts that China's economy will grow 10.5 percent in 1997, with inflation held to less than 6 percent. China has

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Domestic Consumption Drives Economic Growth in Poland

Poland remains the fastest-growing of any major European economy, even if growth has slowed somewhat in comparison with 1995 performance, when GDP rose 7 percent. The Polish economy grew by at least 6 percent in 1996 largely owing to a 9 to 10 percent growth in consumption and 18 to 19 percent growth in investment spending.

According to a recent OECD report, Poland's real GDP now far exceeds its pretransition peak. The structure of Poland's economy has changed considerably over the past seven years. The share of services in the economy has risen from 35 percent to 53 percent, while that of industry and construction has shrunk from 52 percent to 39 percent. Agriculture's contribution to GDP has fallen from 13 percent to 8 percent. But farm employment still represents one-quarter of total employment, reflecting low productivity. Other sectors where adjustments still have a long way to go include heavy industry, particularly coal mining, the report points out.

Observers note that Poland has managed a "soft landing" from its reliance on exports as the primary growth factor in 1994 and into 1995 to a reliance on domestic demand to sustain GDP growth in 1996. Exports in 1996 have felt the impact of the 1995 real zloty appreciation (see box). But domestic economic developments have helped in 1996 to compensate for the shortfall in export demand. Investment in the first eight months of the year increased by around 25 percent in real terms, with the bulk of this coming from the private sector. Wages and earnings also increased fast. Over the first three quarters of 1996, the average real increase in monthly take-home pay was 6.2 percent greater than in the same 1995 period. Another demand-supporting feature of 1996 was an explosion in consumer borrowing: over the first ten months of the year, growth in household credit amounted to 78.6 percent. Unemployment has edged slightly downward in 1996, falling from 14.9 percent of the civilian labor force in December 1995 to 13.5 percent in September 1996.

Prospects for continued economic growth in 1997 appear good:

- Most observers expect the EU

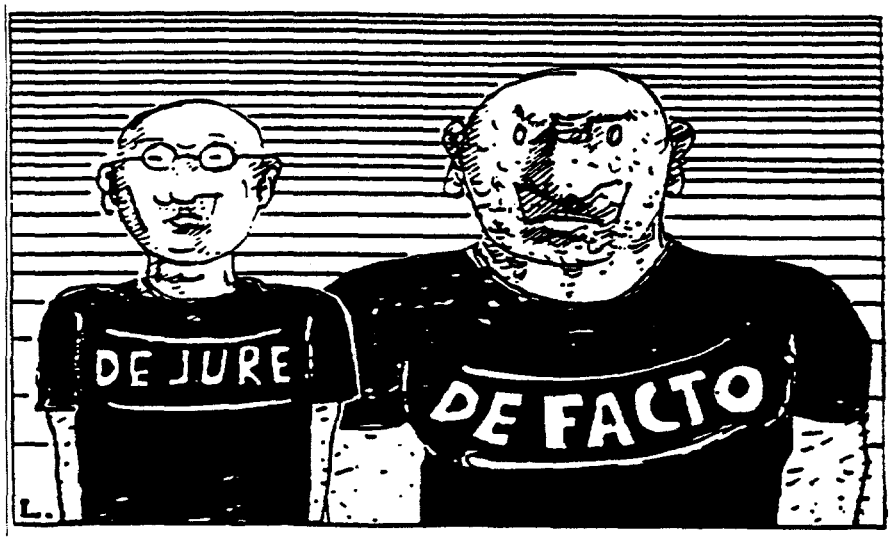
The Headaches Managing Poland's Exchange Rate Policy

by Adam Koronowski

Poland's foreign exchange reserves have shown extreme oscillation during the past three years: in December 1993 they amounted to $4.3 billion; two years later they more than tripled, to almost $15 billion. Last year, however, the reserves increased by only $3.5 billion, to $18.5 billion.

At present, official reserves represent about six months' imports. It is not the level of foreign reserves, but the extreme speed of their growth in 1995 that has generated anxiety. (The rapid growth has been caused primarily by the inflow of foreign currency through spending by foreign, predominately German shoppers in Poland. This "unofficial" or "crossborder" trade surplus came to about $7 billion in 1995. This revenue was not registered in the trade account, but showed up as "purchases of foreign exchange at bank cash desks," or "private transfers," in the capital account.)

In 1995 and 1996 anti-inflationary policy was directed primarily against the large inflows of foreign exchange reserves and the excessive money supply growth they threatened to produce. Monetary authorities, however, were unable to reduce the inflation rate to less than 20 percent. (Average year-on-year inflation in 1996 is likely to be around 20 percent, compared with the 1995 rate of 27.2 percent.) As reduction of inflation has remained a major goal, policy has taken the form of real zloty appreciation. According to Narodowy Bank Polski, Poland's national bank, the zloty's real value in 1995 rose by 10 percent (6.5 percent using the producers' prices index as deflator). Crawling peg rates remained below the inflation rate and were reduced even faster than inflation. In December 1995 the zloty was formally revalued upward by 6 percent. In addition, to sterilize the huge amount of capital inflow, the central bank resorted to open market operations. By



From Serb magazine *Nin*.

economies to grow at a faster rate in 1997. Moreover, although world trade growth is projected to slow, it will remain buoyant relative to global output growth, as further liberalization occurs. This will be supportive of Polish exports.

• Domestic investment and consumption will continue to grow rapidly in 1977. The former will be sustained in part by foreign inflows: foreign direct investment accelerated in 1996, and Poland's growth record, OECD membership, and EU accession prospects are likely to ensure no weakening of Western business interest. Furthermore, consumption growth is unlikely to slow substantially in an election year.

Other officials, primarily from the National Bank of Poland (NBP) and the Central Statistical Office (GUS), warn however, of the danger of overheating the economy. National Bank President Hanna Gronkiewicz-Waltz views Poland's ballooning trade deficit ($6.4 billion in November) as a sign that the consumption boom is unsustainable, not least because household indebtedness has doubled. She has said that the bank might raise interest rates this year. (See also Professor Winiecki's study on the institutional barriers to Poland's development, page 38).

Based on news agency reports, and analysis of Oxford Analytica, the U.K.-based research group.

the end of 1995 it sold almost all the treasury bills in its portfolio and issued, on a large scale, its own bonds.

By 1996 import growth had slowed to 28 percent (after expanding 39 percent in 1995), but exports—in the face of the considerable real appreciation of the zloty—increased by only 9.5 percent (compared with 35 percent growth in 1995). The trade balance closed with a $6.6 billion deficit, compared with $1.8 billion in 1995. However, these data do not take into account the surplus from the unofficial or cross-border trade, which over the first nine months of 1996 again amounted to about $5.5 billion, according to the national bank. The unofficial trade surplus was recognized—for the first tim—in the current account calculation for 1996: as a result, the 1995 current account deficit of $2.1 billion was cut to a mere $0.3 billion in 1996. The capital account surplus amounted to $4.0 billion, of which portfolio investment constituted $0.5 billion.

Zloty appreciation was successful in anti-inflation terms. However, as a result of its impact on exports, concern arose that appreciation had gone too far. Over the first nine months of 1996 the real value of the zloty rose by only around 3 percent, and the national bank made it known at year-end that it would not permit any further significant real zloty appreciation in 1997. Concerns over the deteriorating trade balance are being heightened by the prospect of further trade liberalization measures due in 1997 under Poland's EU, OECD, and Central European Free Trade Agreement commitments. The trade deficit could increase still further and the current account could show a deficit of about $3.9 billion if the zloty's real exchange rate remains stable this year, according to estimates. If capital inflow is lower than expected, real depreciation will be required to preserve foreign reserves and revitalize exports. It is clear that exchange rate policy—which successfully slowed the growth of foreign reserves, but also hampered exports and worsened the current account balance—will have to be very flexible in 1997.

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emerged as the world's eighth largest provider of capital, committing about $18 billion in officially approved direct and portfolio investment abroad between 1989 and 1995.

Czech Republic

In the Czech Republic annual inflation is likely to remain around 9 percent for all of 1997—higher than the 8.8 percent in 1996. Last year household consumption grew by 5.5 percent, and investment by almost 18 percent. In response to the rise in domestic demand, imports grew by an estimated 11 percent. With exports of goods and services growing by only 5 percent, slower than in 1995, the trade deficit rose to 150 billion crowns ($5.5 billion) in 1996. The government confirmed that it will not devalue the crown in response to the rapidly growing trade deficit. Rather, it plans to implement measures to boost exports, including tax breaks for exporters. In 1997 the government expects recovery in the major export markets along with strong domestic demand to fuel growth, which could reach 4.5 to 5.0 percent. The unemployment rate is likely to increase slightly from the current 3.4 percent to 3.5 to 4.0 percent. Real wages will continue to grow at 8 percent, whereas labor productivity will grow by only 3 percent. The trade deficit is expected to ease slightly in 1997, owing to increased exports. The current account is set to remain in deficit in 1997, by at least $2 billion. *(Sources: OECD Report, Oxford Analityca.)*

Estonia

Estonia's 1997 state budget of 12.5 billion kroons ($1 billion) has been approved by Parliament. The largest source of revenues is the value added tax, which should bring in 5.8 billion kroons, and a 44 percent personal income tax, with a revenue target of 2.3 billion. Taxes on corporate income, alcohol, tobacco, and gasoline should provide the rest. Social support and education will receive most of the budget: 4.3 billion kroons. The budget also includes expenditures to cover preparations for Estonia's entry into the EU.

Georgia

The government has raised electricity rates as of January 1. The move was prompted by an IMF request that power prices be brought closer to production costs. To compensate for the higher bills, the government increased salaries by an average of 15 percent. Georgia will start privatizing its power plants in April, another move recommended by the IMF.

Hungary

The ongoing investigation into last year's privatization scandal provides evidence that some of the controversial payment by the state privatization agency to an outside consultant was transferred to companies linked to the coalition parties, *Magyar Hirlap* reported on January 20. The paper cites a letter from the prosecutor-general saying that Laszlo Boldvai, the Socialist Party's treasurer and a deputy in Parliament, and Gyorgy Budai, an entrepreneur with links to the junior coalition party, the Alliance of Free Democrats, told consultant Marta Tocsik last May that she could keep her $5.1 million commission from the privatization agency only if she transferred 25 percent of that amount to two companies. According to the newspaper the prosecutor-general has evidence of a series of money transfers between Tocsik and the two companies, and requested that Parliament waive Budai's immunity from prosecution.

The Prague-based newspaper *Mlada Fronta* said in its weekend edition that Hungary is the only East European reformist country in which living standards dropped last year. Quoting international and national statistics, the paper said real wages in Hungary continued to drop by 4 to 5 percent because of the government's austerity measures, following a 12 percent nose-dive in 1995. The paper reported that Slovenia and the Czech Republic posted the highest living standards in the region, registering annual per capita GDP figures of $10,606 in Slovenia and $9,547 in the Czech Republic, as compared with $7,486 in Slovakia, $6,639 in Hungary, and $5,532 in Poland. As for average life expectancy, citizens of Slovenia and the Czech Republic have the highest at 70 years. This figure drops to 68.5 years in Slovakia, 68 years in Poland, and 65 years in Hungary. The purchasing power of wages is highest in Slovenia and the Czech Republic. The newspaper said that the average monthly salary in the Czech Republic buys 30 percent more products than the salaries in Hungary or Poland.

The Budapest Stock Exchange (BSE) ranked third in the world for increase in value in 1996, behind the Russian and Venezuelan exchanges, Morgan Stanley Capital International reports. The BSE posted revenue profits of 104.2 percent, compared with the 151.2 percent and 127.9 percent achieved by the Russian and Venezuelan bourses. The BSE's 1996 trading volume exceeded the total for the preceding five years. The share market volume grew fivefold from the 1995 figure. The BUX Index rose from 1,557.91 at the beginning of the year to close at 4,100 on December 31. The volume of trading on the futures market increased fifteenfold.

Most of Hungary's GDP is produced by private ventures, with capital movements expected to be fully liberalized in 2000, a recent government report indicates. The report, based on an EU questionnaire, observes that domestic

private businesses contributed 52 percent of GDP, private foreign firms 12 percent, and public firms 36 percent in 1995. The GDP share of collective property sank to less than 30 percent in 1996. EU membership will make differences in the level of development between Hungary and most of the single-market countries more palpable, and the full capital transaction liberalization may worsen the balance of payments temporarily. The government will rely on the EU to help handle these problems.

The independent Financial Research Institute (Penzugykutato Rt) forecasts a Hungarian trade deficit of $2.7-$2.9 billion in 1997 as a result of 8 percent increases in both exports and imports. Last year's trade deficit reached an estimated $2.2-$2.4 billion, with 10 percent growth in exports and 3 percent growth in imports. Despite the expected deterioration of the trade balance, Hungary's current account deficit can be financed from direct foreign capital investment in 1997. Infrastructure investment and consumer spending are expected to grow in 1997. Capital investment in plants and machinery is forecast to increase by 7 percent in 1997, compared with only 2 percent in 1996. As a result of higher domestic demand, Penzugykutato forecasts 4 to 5 percent growth in industrial production and a 1 to 2 percent increase in the output of the construction sector in 1997.

Poland

Marek Belka, a free-market economist who has served as President Aleksander Kwasniewski's economic adviser for the past year, was named Poland's new finance minister, an appointment widely seen as ensuring continuity in Polish reform policies. (Mr. Belka particiapted as Polish project director in the World Bank's research project Economic Reform and Enterprise Adjustment in CEE, managed by I.J. Singh of the former Transition Division). The new finance minister succeeds Grzegorz Kolodko, who resigned on February 4 after leading the country's economy through three years of high growth and falling inflation. Mr. Belka said transforming Poland's bloated Communist-era social security system and fighting inflation would be his top priorities. Inflation in 1996 stood at 18.5 percent, down from 21.6 percent in 1995, but still among the highest in Central Europe.

Poland's 1997 budget foresees 5.7 percent growth in GDP, compared with 6 percent in 1996, and 13 percent inflation (18.5 percent last year). It also expects a 2.8 percent budget deficit and a 5.5 percent increase in real public sector wages. Prime Minister Wlodzimierz Cimoszewicz said that with this budget, Poland will remain one of the fastest-developing countries in the world.

The cabinet has accepted a document outlining the principles for integration into the EU. The "National Integration Strategy" provides for the gradual elimination of trade barriers and protectionism. Poland expects negotiations on its admission to the EU to start in early 1998. Deputy Prime Minister Miroslaw Pietrewicz of the Polish Peasant Party (PSL) was the only cabinet member to vote against the document. Other PSL ministers had been expected to demand more protection for Polish agricultural products, but they refrained from doing so. The document must now be approved by the Sejm.

Although the plan to privatize 512 state enterprises was launched in July 1995, all of the companies and the fifteen funds set up to manage them are still owned by the government. The funds and their companies will become private only when they enter the Warsaw Stock Exchange. This milestone is set to occur "in spring," according to the Polish Securities Commission, which is now reviewing the funds' prospectuses, the *Wall Street Journal* reported. In mid-December prospectuses for the fifteen funds, which are managed by a consortium of Polish and international financiers and consultants, were approved by the treasury ministry and passed along to the securities commission. In the year ending November 22, more than 25 million Poles claimed privatization vouchers offered by the government.

Romania

Prime Minister Victor Ciorbea said inflation was about three times higher and the budget deficit five to six times higher than the figures agreed on with the IMF in 1996 as a performance criterion for the country to receive further disbursements from a standby loan. Ciorbea said the country was far behind in economic and social reforms and had to catch up if it did not want to miss the opportunity to join NATO and the EU. He blamed the previous government for delaying for electoral purposes the implementation of unpopular reforms, but said Romania had restored its international credibility. (Romanian Minister of Finance Mircea Ciumara has urged shock therapy because agriculture, the railways, and the oil industry have amassed huge debts, and the banking system is almost bankrupt. The current account deficit has reached $1.9 billion, or 5.6 percent of GDP in 1996.)

The Standing Bureau of the Chamber of Deputies decided to dismiss from the State Property Fund three members of Parliament appointed by the previous legislature and to replace them with members representing the new governing coalition. The fund has been accused of slowing privatization, mismanaging its assets, and selling undervalued state property to cronies, proteges, and supporters of the former government.

Russia

The Russian central bank announced on January 30 that it has eased rules for Russians wishing to take foreign currency across the country's borders. Vladimir Smirnov, head of the central bank's department for foreign currency supervision, said individuals are no longer required to have a special foreign-currency bank account or to obtain special permission to carry out crossborder cash transfers for noncommercial purposes. Russians can transfer up to $2,000 a day provided that they present either a foreign exchange transaction receipt or a customs declaration. Additional documentation is still required for larger transfers.

The Russian population fell by nearly half a million last year and stood at 147.5 million on January 1, continuing a precipitous drop accelerated by plummeting living standards and life expectancy. Statisticians say the 1996 decline of 475,000 was the sharpest in the past five years and hit hardest in economically struggling central regions where ethnic Russians are predominant. Across the country there were 1.6 times as many deaths as births. The population grew in ten regions, most of them Caucasus Mountain areas with large Muslim populations and Siberian districts with many indigenous people. About 97,500 people emigrated to nations outside the former Soviet Union, mostly to Germany, Israel and the United States. That number is 15,000 fewer than in 1995, but still many times more than the 2,500 people coming into Russia.

Russia's gas giant Gazprom is set to receive a $2.5 billion commercial credit from a consortium of major Western banks led by Dresdner Bank of Germany. The eight-year loan will not be guaranteed by the Russian government. The money will finance the construction of a 4,200-kilometer gas pipeline stretching from the Yamal Peninsula to Western Europe. The total cost of the project is estimated at $24 billion.

The inflow of foreign investments to Russia's economy is modest, Minister of Economics Yevgeny Yasin complained in his presentation at the session of the Russian government's Advisory Committee for Foreign Investments. In 1993 a total of $2.8 billion was invested in the Russian economy, which is "far below its potentialities." Yasin pointed out that China received $38.0 billion worth of foreign investment, Indonesia $4.5 billion, and Mexico $4.1 billion. In 1996 the inflow of foreign investments was approximated at $6 billion, with half invested in government securities, the proceeds of which are used to cover Russia's budget deficit, not channeled into domestic production.

The State Duma passed the 1997 budget on January 24. Budgetary spending is now set at 529.8 trillion rubles ($94.3 billion) and revenue at 434.4 trillion, leaving the budget deficit at 3.5 percent of GDP. Tax receipts are expected to reach 374.7 trillion rubles, up 25 percent from 1996 —an estimate considered unrealistic by many observers.

Real monthly wages grew 5 percent in 1996 although real income levels remained stable, Goskomstat (the State Statistics Committee) reported. The average monthly wage in November was 835,000 rubles plus an average of 29,800 rubles in social payments (approximately $150). These figures do not take into account delays in the payment of wages and benefits.) Goskomstat estimated the average December pension at 320,700 rubles, up from 246,700 at the beginning of 1996. The average subsistence minimum in December was 379,000 rubles a month; 22 percent of the population is living below the poverty line.

In 1996 Russia's GDP and industrial production fell by 6 percent and 5 percent, respectively, over the previous year, Goskomstat reported . The largest declines were recorded in light industry (28 percent), construction materials (25 percent), and the chemical and petrochemical industry (11 percent). Oil production dropped 2 percent to 293 million metric tons, and coal output fell 4 percent to 243 million tons. The production of natural gas rose 1 percent to 575 billion cubic meters. The volume of investment totaled 370 trillion rubles, down 18 percent since 1995. Housing construction shrank 10 percent to 37 million square meters.

In late December 1996, 9.3 percent of Russia's workforce was unemployed, up from 8.8 percent in early 1996, Goskomstat reported in mid-January. The figures were calculated on the basis of household survey data. About 2.5 million people, or 3.4 percent of the workforce, were registered as unemployed with the Federal Employment Service. The wage debt to Russian workers totaled 47.1 trillion rubles on December 23, up from 46.6 trillion on November 25. About one-fifth of total arrears—9.3 trillion—were in organizations funded by the federal or local budgets.

By the end of 1997 foreigners will be given full access to the government bond market on the same terms as Russian buyers, Central Bank First Deputy Chairman Sergei Aleksashenko told Reuters on January 17.

Slovakia

An IMF report warns Slovakia's economy is in danger of overheating and urges the introduction of stricter financial policies to curb domestic consumption. The report, made public on January 21, grew out of an IMF mission to Slovakia in October 1996, in which it was found that "after three

years of fast economic growth and decreasing inflation the Slovak economy shows signs of overheating." One such sign is the significant deterioration of the current account (essentially the foreign trade balance), which ran a $1.5 billion deficit in 1996 after a $648.8 million surplus in 1995. "A further signal of overheating is the fast growth of real wages, which increased by 12 percent over the past 12 months and to a high degree surpassed the growth of productivity," the report added.

Tajikistan

According to Tajikistan's National Custom's Committee and Statistics Services, the country had a foreign trade volume of $1.4 billion in 1996. Exports amounted to $768 million and imports to $657 million—for a surplus of $111 million. Prime Minister Yakhye Azimov, in an interview in the January 31 edition of *Nezavisimaya Gazeta*, claimed the country had not yet reached even half its economic potential. Azimov said that "internal conflict" had held the country back, but he also noted successes in the privatization of agriculture and small businesses. The prime minister said the establishment of peace following an agreement signed between the government and United Tajik Opposition in December would hopefully create the stability needed to attract foreign investment and raise wages, currently among the lowest in the CIS.

Turkmenistan

Turkmenistan's 1997 budget envisages a deficit of 1 percent of GDP. In his New Year's Day address, Turkmen President Saparmurad Niyazov said living standards were starting to improve although the country's agricultural output was below the desired level (the cotton and grain harvests were disastrous in 1996). Niyazov vowed to press on with economic reform and pledged to invest more than 2 trillion manats (about $400 million) in social programs.

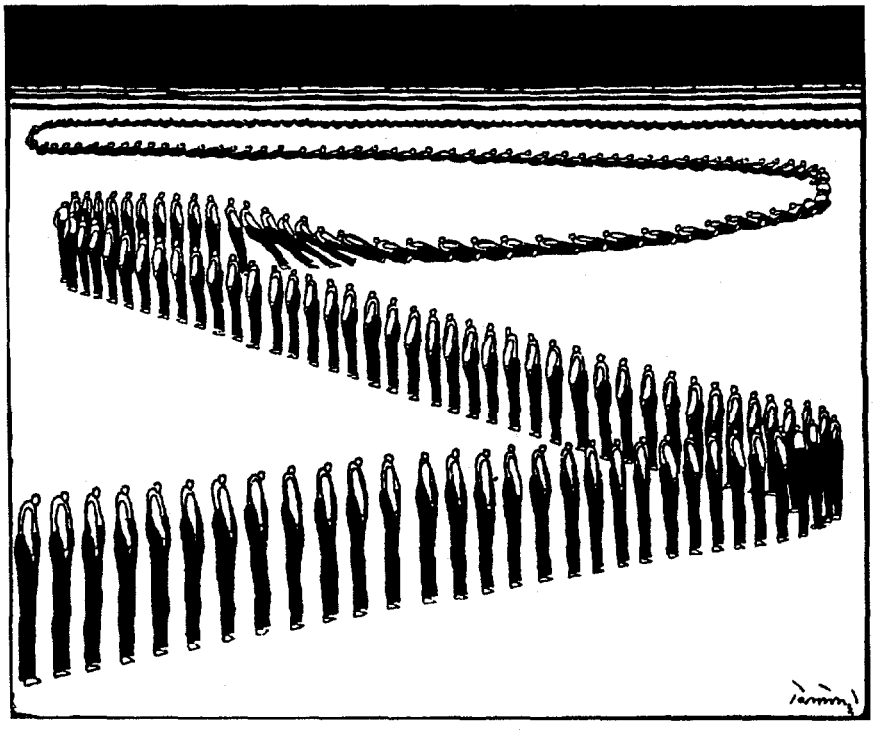
The oil ministers of Turkmenistan, Turkey, and Iran met in the Iranian capital, Tehran, on December 29 and agreed to bring Turkmen and Iranian gas to Europe through Turkey. The first gas transfer between Iran to Turkey is expected to flow in 1998.

Ukraine

Ukraine's budget deficit in 1996 totaled 8.6 billion hryvnyas ($4.57 billion)—double the figure forecast when the budget was drawn up. Prime Minister Pavlo Lazarenko said that GDP fell for the fifth consecutive year and that, according to the most optimistic forecasts, it is not expected to reach the 1990 level for another eleven years. Lazarenko said wage arrears have not been paid because of "other commitments." On a more positive note, he added that Ukraine has paid off all its accumulated gas debts to Russia and Turkmenistan.

Parliamentary Chairman Oleksander Moroz has expressed displeasure at the "new anti-Parliament campaign" over the passage of the 1997 budget, Ukrainian TV reported on January 16. Moroz complained that the government has ignored the legislature's December 19 resolution instructing the executive to revise the 1997 budget draft within two weeks, adding that legislators would not approve half-finished documents. But the Parliament has not yet passed the tax reform package necessary for the government to revise the budget draft. U.S. economist Jeffrey Sachs, following a meeting with President Leonid Kuchma on January 13, said the Parliament's repeated delays over adopting tax reform legislation were "dangerous," *Ukraina Moloda* reported on January 15. The

Working Class



From the Hungarian magazine *Hócipö*.

parliamentary budget commission said a second reading of the draft will take place in late February or early March.

Energy Minister Yurii Bochkarov made a special appeal to the Ukrainian public on January 13, Ukrainian Radio reported. He warned that energy supplies are at a critical level and called on everyone to lower their consumption of energy by 20 percent. The energy production potential of the Dnipropetrovsh hydroelectric station, which supplies water to one-third of Ukraine's territory, has been almost completely exhausted. Bochakov said one of the biggest problems has been the indebtedness of consumers. Ukrainians owe 2.5-2.7 billion hryvnyas ($1.4 billion) for energy, and Bochakov warned that those who do not pay will not receive energy supplies.

Ukraine has abandoned its plan to raise natural gas and electricity prices in 1997, Prime Minister Pavlo Lazarenko said. The government plans to take steps to overhaul its energy sector. Residential customers pay only 80 percent of energy costs.

Uzbekistan

Uzbekistan's 1997 budget sets a deficit of 26.8 billion som ($515 million), or 3 percent of GDP. Revenue will be 124 billion som and expenditures 150 billion. Uzbek President Islam Karimov claims annual inflation will drop from 60 percent in 1996 to less than 27 percent in 1997. Karimov observed that industrial output had risen by 6 percent, while foreign trade turnover was $8.3 billion, an increase of 40 percent from 1995. (See also "Agenda.")

We appreciate the contributions from the Open Media Research Institute's Daily Digest.

Conference Diary

Justice and Solidarity in Post-Communist Societies of Central and Eastern Europe
April 11-13, 1997, Bremen, Germany

Organizer: the Bremen University Center for European Legal Policy, Volkswagen Foundation.
Information: Armin Hoeland, Zentrum fuer Europaeische Rechtspolitik, Universitaet Bremen, Universitaetsallee, GW1, 28203, Bremen, Germany, tel. 49-0421-218-2247, fax 49-0421-218-3403, E-mail: arminius@zerp.uni-bremen.de

The Monetization of the Economies of Eastern Europe
April 17-19, 1997, Wittenberg/Elbe, Germany

Organizer: the German Association for Eastern European Studies.
Topics include economic transformation, increasing importance of money, financial categories, and monetary processes.
Information: Thomas Bremer, Deutsche Gesellschaft fuer Osteuropakunde, Schaperstr. 30, 10719 Berlin, Germany, tel. 49-30-478-412, fax 49-30-478-314.

Ninth Annual Bank Conference on Development Economics (ABCDE)
April 30-May 1, 1997, Washington, D.C., United States

Inaugurated by James D. Wolfensohn, President of the World Bank, and sponsored by Joseph E. Stiglitz, Chief Economist and Senior Vice President, Development Economics. Conference has sessions on Corruption: Catalysts and Constraints (Michael Johnston and Susan Rose-Ackerman), Incentives and Performance in Public Organizations (Sherwin Rosen and Dilip Mookherjee); Poverty and Environment (Karl Goran-Maler and Ramon Lopes); and Leaders in Growth: Can Others Follow? (Alberto Alesina, Takatoshi Ito). Participation by non-Bank and non-IMF staff is by invitation only.
Information: Boris Pleskovic or Gregory Ingram, Research Advisory Staff, World Bank, 1818 H Street, N.W., Room N7-031, Washington, D.C., 20433, tel. 202-473-1062, fax 202-522-0304.

International Symposium on Economic Informatics
May 7-10, 1997, Bucharest, Romania

Organizer: the Academy of Economic Studies, Department of Economic Informatics.
Information: Academy of Economic Studies, Department of Economic Informatics, Piata Romana, nr. 6, Sector 1, Bucharest, Romania, tel. 401-311-2066, E-mail: velicanu@infocib@infocib.ase.ro

The Importance of the Unofficial Economy in Economic Transition
May 16-17, 1997, Zagreb, Croatia

Organizer: the Institute of Public Finance and the Ministry of Finance of the Republic of Croatia, Ministry of Science of the Republic of Croatia, Open Society Institute, British Know How Fund, Friedrich Ebert Stiftung, USIS, and USAID. This international workshop will include 20-25 participants from Croatia, the West, and the economies in transition. The purpose will be to exchange ideas and prompt discussion among participants regarding the project "The Unofficial Economy in Croatia."
Deadlines: Papers must be submitted no later than June 15, 1997.
Information: E-mail: natalija@ijf.hr

The Enlargement of the European Union to the East
June 13-15, 1997, Luebeck, Germany

Organizer: Ostsee-Akademie Travemuende (Baltic Sea Academy).
Deadlines: Registration four to five weeks before conference.
Information: Ostsee-Akademie, Travemuende, Europaweg 3, 23570 Luebeck, Germany, tel. 49-4502-803-203/205, fax 49-4502-803-200, E-mail: ostseeakademie@t-online.de

Central and Eastern Europe in a Global Context
June 24-25, 1997, Birmingham, England

Organizer: the Buckinghamshire Business School.
Topics include integration of Central and East European countries into the European-global economy, foreign direct investment, alternative models of transformation and their relevance to countries of Central and Eastern Europe.
Deadlines: Papers for conference proceedings by May 19, 1997.
Information: Conference Support International Limited, The Old Granary, 27-29 Chester Road, Castle Bromwich, Birmingham, B36 9DA, United Kingdom, tel. 44121-776-7799, fax 44121-776-7447.

Marketing Challenges in Transition Economies
July 1-4, 1997, Mangalia, Romania

Organizer: the Black Sea University.
Topics include the changing markets of East European countries, the former Soviet republics, and other developing nations; government policy and legislation; technology in marketing and development; sectoral and regional strategies; foreign direct investment.
Deadlines: Registration by April 1, 1997.
Information: Nik Dholskia, College of Business Administration, University of Rhode Island, 7 Lippitt Road, Bal 209C, Kingston, Rhode Island, 02881-0802, United States, tel. 401-874-4172, fax 401-874-4312, E-mail: nikhil@uriacc.uri.edu

Sasakawa Forum: Transition in Central and Eastern Europe
July 1-5, 1997, Belgrade, Serbia

Organizer: the Yugoslav Association of Sasakawa Fellows (YASF) in cooperation with the Rectorate of the University of Belgrade, the Balkan Center for Public Policy Research, and the Ryoichi Sasakawa Young Leaders Fellowship Fund (Tokyo). The Forum will evaluate transition results, including political, legal, economic, and cultural issues.
Information: Mihajlo D. Rabrenovic, Executive Vice-President and Secretary-General, Yugoslav Association of Sasakawa Fellows, Ul. Susedgradska 4-a/6 YU-11090, Belgrade, Serbia.

International Conference on the Economies of Greater China
July 7-8, 1997, Perth, Australia

Information: CESAA Conference Covenor, Department of Economics, University of Western Australia, Nedlands, WA 6907, Australia, tel. 619-380-3964, fax 619-380-1016, E-mail: ywu@ecel.uwa.edu.au

Central Banking in Post-Soviet Economies
July 10-11, 1997, Reading, United Kingdom

Organizer: the Centre for Post-Soviet Studies, Reading University, in association with the Centre for Central Banking Studies, Bank of England.
Information: Dr. Yelena Kalyuzhnova, Coordinator, Centre for Post-Soviet Studies, University of Reading Whiteknights, PO Box 218, Reading RG6 6AA, United Kingdom, tel. 44118-931-6637, fax 44118-975-5442.

Cuba in Transition: The Seventh Annual Meeting of the Association for the Study of the Cuban Economy
August 7-9, 1997, Knight Center, University of Miami, Miami, Florida

Organizer: Association for the Study of the Cuban Economy (ASCE).
Topics include: macroecononomics, banking and finance, fiscal policy, agriculture and sugar industry, social and political aspects of economic development, education and health, environmental policy, law and legal institutions, and international relations.
Deadline: Abstracts due May 1, 1997.
Information: Persons interested in presenting papers or being discussants should contact Jorge Perez-Lopez, 5881 6th Street, Falls Church, Virginia 22041, United States, tel. 703-379-8812, E-mail: perezlop@erols.com. For conference information contact Juan Carlos Espinosa, tel. 305-284-4303, E-mail: csaum@umiami.ir.miami.edu

Fourth International Congress of the International Society for Intercommunication of New Ideas (ISINI)
August 21-23, 1997, Maastricht, the Netherlands

Organizer: ISINI, a society composed of scholars from more than sixty countries, with expertise in economics, finance, and the social sciences.
Topics include new approaches to economic research, policy analysis, and implementation; issues in transition economies.
Deadlines: Proposals for sessions and papers must be received by January 31, 1997.
Information: Gerrit Meijer, Department of General Economics, University of Maastricht, Tongersestraat 53, P.O.

Box 616, 6200 MD Maastricht, the Netherlands, tel. 3143-388-3649, fax 3143-325-8440, E-mail: g.meijer@ algec.rulimburg.nl, Internet: http:// serpiente.dgsca. unam.mx/siini

Fifty-third Congress of the International Institute of Public Finance
August 25-28, 1997, Kyoto, Japan

Organizer: the International Institute of Public Finance.
Topics include public finance and investment in transition economies.
Deadlines: Abstracts should be submitted by the end of January 1997.
Information: Professor Bruno S. Sergi, Strada Statale 106-km 27, 89060 Saline Joniche, Reggio Calabria, Italy, tel. 39965-787-066, fax 39965-487-798.

1997 European Conference of the European Urban and Regional Research Network: Regional Frontiers
September 20-23, 1997, Frankfurt-Oder, Germany

Organizer: the Regional Studies Association.
Deadlines: Abstracts must be submitted by the end of April 1997.
Information: Sally Hardy, Director, Regional Studies Association, 15 Micawber Street, London N1 7TB, United Kingdom, tel. 44171-490-1128, fax 44171-253-0095, E-mail: rsa@mail box. ulcc.ac.uk

Social and Economic Aspects of Aging Societies: An Important Social Development Issue
September 25-28, 1997, Ljubljana, Slovenia

Organizer: the Institute for Economic Research.
Deadlines: Abstracts (1 to 2 pages) must be submitted by the end of February 1997.
Information: Nada Stropnik, Ph.D., Institute for Economic Research, Kardeljeva ploscad 17, 1000 Ljubljana, Slovenia, tel. 38661-345-787, fax 38661-342-760, E-mail: stropnikn@i er.si

Entrepreneurship in Central and Eastern Europe
November 6-7, 1997, New York, United States

Organized by the Institute for EastWest Studies and the Berkley Center for Entrepreneurial Studies at the Stern School of Business, New York University.
Information: call for papers: Professor Paul Wachtel, Institute for EastWest Studies, 700 Broadway, New York, NY 10003, United States, tel. 212-998-0874, fax 212-995-4218, E-mail: pwachtel@stern.nyu.edu.

Bosnia: Road to Recovery?
March 1-2, 1998, Amherst College, Amherst, Massachusetts, United States

Organizer: Friends of Bosnia, the Amherst College Political Science Department, and the Five-College Program in Peace and World Security Studies. A national grassroots conference for activists, scholars, human rights and aid professionals, journalists, students, and others concerned about the future of Bosnia and Herzegovina.
Information: Friends of Bosnia, 47 East Street, Hadley, Massachusetts 01035, United States, tel. 413-586-6450, fax 413-586-2415, E-mail: fob@crocker. com, Internet: http:// www.crocker.com/~fob

We appreciate the contributions of the Cooperation Bureau for Economic Research on Eastern Europe, Koenigin-Luise-Str. 5, D 14195, Berlin, Germany, tel. 4930-897708-68, fax 4930-897708-99, E-mail: tribakova @diw-berlin.de, or dbowen@diw-berlin.de.

World Bank/ IMF Agenda

Romania Seeks World Bank, IMF Funds

The new government of Romania has begun talks on terms and conditions for new IMF and World Bank support. This support would constitute only a third of an estimated $3 billion Bucharest is trying to generate in 1997 from a pool of sources. Romania is hoping to receive between $400 and $500 million of new IMF standby credits, plus a further $500 million from the World Bank. Romania's President Constantinescu met with World Bank President James Wolfensohn in Davos. In an interview Wolfensohn said that the Bank looks forward to working with the Romanian government in a supportive way. Prime Minister Victor Ciorbea is putting together a tight reform package drafted with help from IMF and World Bank experts.

Caio Koch-Weser: We Could Lend Russia More

The World Bank is prepared to make new loans to Russia to support economic reform and social protection, but more must be done to implement existing programs, Managing Director Caio Koch-Weser said in Moscow. The Bank is willing to expand its activities, through lending and other services, to areas such as the social sector, agriculture, and the environment. The Bank has commitments of $6.4 billion in Russia and has paid out $2.2 billion. Implementation of programs lagged seriously earlier in 1996, but it has improved and disbursement is now running at $70 million a month, instead of the $25 million a month in 1996. The Bank can help reinforce Russia's social safety net. And it can make structural adjustment loans for sectors such as agriculture

(similar, for example, to a $500 million credit it has agreed to provide to help restructure the coal industry).

Coal Loan Tranche Released

The World Bank in late December approved the release of a second and final tranche (equivalent to $250 million) of the $525 million Coal Sector Adjustment Loan to Russia. Earlier, the Bank's verification missions, sent to three major coal basins—Kuzbass, Rostov, and Tula—reported that not all the funds trickled down through the bureaucracy to reach the intended recipients, housing and public utilities of the coal communities. Subsequently, the Russian government announced plans to transfer the management of more than one-quarter of the troubled coal industry into private hands. The decision followed prolonged strikes by unpaid coal miners.

IMF-Russia Loan Talks

International Monetary Fund (IMF) First Deputy Managing Director Stanley Fischer told an investment meeting hosted by Harvard's John F. Kennedy School of Government that Russia made substantial progress in cutting inflation and achieving stabilization in 1996. But he added that progress was slow in meeting an ambitious structural agenda, and that the IMF and the authorities agreed that further structural change was critical for sustained, healthy growth. Fischer also cited setbacks in Russia's program to reduce state ownership of industry. He said a lack of transparency in the privatization of large enterprises had tainted the reform process, and that the remaining businesses should either be divested, closed, rehabilitated, or restructured in a manner seen to be fair.

The IMF has informed Russian officials that for 1997 it will insist that the government include federal wage and pension arrears and interest on government borrowing in federal-deficit calculations, *Segodnya* reported on December 28. That will make it more difficult for the government to keep the deficit within the agreed 3.85 percent limit, since those two items will widen the gap by an estimated 18 trillion (federal wage) and 87 trillion rubles (pension arrears) in 1997.

World Bank Lends China $3 Billion in FY97

The World Bank will extend about $3 billion in loans to China in the 1997 financial year, which started last July, China's *Economic Daily* reported. The paper cited Pieter Bottelier of the Bank's Beijing office as saying that the loans would be used to support China's market-oriented economic reforms, infrastructure projects, and agriculture, adding that poverty relief work would also be a focus of the Bank's activities in China.

Tarim Basin Project Goes Ahead

The World Bank has approved a $150 million loan for the second phase of a controversial agricultural project in the northwest region of Xinjiang, the Chinese news agency *Xinhua* reported. The World Bank launched an inquiry into the first phase of the project in late 1995 after human rights activist Harry Wu charged that tens of thousands of prison laborers were working on an irrigation scheme that made up most of the project. After a six-week probe, the Bank said it had found no evidence to back up Wu's claims, adding that activities of prison camps in the region were separate from the Tarim Basin project.

$400 Million for China's Highways

The World Bank agreed in mid-December 1996 to lend China $400 million to build a stretch of highway linking the country north and south. The project is the second in a series of four national highway projects aimed at improving China's highway system—a network of aging roads that lacks the capacity and strength to support the traffic demand fueled by economic growth. As part of the Beijing-Zhuhai Expressway (JingZhu), connecting northern and southern China, the new construction will link the inland province of Hunan and its capital city, Changsha, with Guangdong's capital, Guangzhou, and its fast-growing Pearl River Delta, as well as with Hong Kong.

Burgeoning Demand for Infrastructure in China

There is an urgent need for a new partnership between the Chinese government and the private investors who will be expected to contribute the bulk of the $600 billion required to fund infrastructure projects in China, World Bank Senior Operations Adviser Harinder Kohli said at a recent Hong Kong infrastructure conference. Other speakers at the conference, organized by the Hong Kong Trade Development Council and the Massachusetts Institute of Technology, also warned that new strategies need to be devised to cope with the burgeoning Chinese demand for infrastructure. Kohli said that governments must look at these projects more as a "business" than as just a set of services (such as transport or communications) to be provided to the public. Investors are looking for "bankable" projects that will provide them with a return on their investment and where the investment rules are clear.

IFC Breakthrough in China's Financial Services

The World Bank's International Finance Corporation (IFC) announced in mid-January a pathbreaking cooperative

project between international and non-State Chinese financial institutions. The deal—submitted to the IFC's Board of Executive Directors for approval—involves a $30 million IFC loan to be relent to non-State companies through Orient Finance Co., one of the first non-State finance houses in China.

New Role Urged for World Bank

The World Bank should abandon its role as a lender of development funds to relatively rich countries in Latin America and Asia, and allow resources to be shifted to those countries too poor to tap the free market, Professor Christopher Gilbert of London University's Queen Mary & Westfield College explained during a lunchtime meeting organized by the Center for Economic Policy Research on January 23. The World Bank has evolved over its fifty years of operation so that it simultaneously exercises a number of different functions: it combines the functions of bank, development agency, credit-ranking agency, and development research institution. In its role of a development agency, the World Bank provides finance for development purposes, often on concessional terms and combined with conditionality. Conditionality gives it a comparative advantage over private sector banks both in enforcement of debt service and in its ability to insist on policy reforms before offering financial assistance. Thus, private sector banks benefit from World Bank conditionality. This externality justifies the existence of a strong multilateral institution, and would be lost if the Bank were privatized. Gilbert and his colleagues argue for a shift from lending to guaranteeing, and for diverting resources to support the institution's private sector role. He recommends switching IBRD funds to the Bank's Multilateral Investment Guarantee Agency (MIGA) and inviting private banks to become shareholders in the IFC.

EU, World Bank Strengthen Relationship

The European Union (EU) and the World Bank agreed to bolster cooperation on a wide range of issues, including aid to the former Yugoslavia and the emerging economies of Central and Eastern Europe. After a meeting between World Bank President James Wolfensohn and European Commission President Jacques Santer in Brussels, the two institutions said the rapidly increasing scale of private capital flows had made closer links necessary. For the Bosnia reconstruction, there was agreement to prepare for the next meeting of international donors, planned for April 1997. Together, the Bank and the Commission have prepared a three- to four-year, $5.1 billion reconstruction program as a framework for donor support. For Central and Eastern Europe, further help was pledged in easing the transition toward market-based economies.

IMF Commitments Drop

The IMF's financial commitments in 1996 fell sharply compared with the previous year because no large loans like those to Mexico and Russia in 1995 were approved in the past year. Credit commitments fell to near 6 billion SDRs compared with 18.3 billion in 1995. (At the present rate, about 1.4 SDRs equal a dollar.) The Fund's concessional ESAF (enhanced structural adjustment facility) commitments dropped to 708 million SDRs from 1.4 billion the year before. But the ESAF could be revived in the context of the IMF-World Bank debt initiative for the world's poorest countries because it represents the Fund's contribution to the program.

IMF's A+ to Azerbaijan

The IMF approved two credits worth $219 million, in support of Azerbaijan's economic stabilization program over the next three years. The funds would be used to build on improvements implemented in 1995-96 by reforming the banking system, promoting privatization, and ending government involvement in production and trade. The medium-term strategy was designed to prepare the country for a prospective oil boom, as oil production was projected to double by 2000 and to quadruple shortly thereafter. The government is scheduled to hold its first voucher privatization auction by end-March, selling medium and large-scale enterprises. On January 16 the World Bank approved a $14.7 million International Development Association (IDA) credit to Azerbaijan to help finance a farm privatization project.

U.S. Pays Asian Development Bank Arrears to Avoid Procurement Sanctions

Japan has agreed to push for the removal of procurement sanctions against the United States relating to a $7.7 billion World Bank IDA fund. In return, the United States has agreed to boost its offer for the replenishment of the ADB's Asian Development Fund from $340 million to its full share of $400 million, the Australian *Financial Review* reports. The United States faced sanctions because, instead of paying its full three-year share of the World Bank's IDA-11 fund, it had only made a contribution for the second and third years. World Bank rules triggered sanctions that would have excluded U.S. consultants and companies from participating in procurement tenders for IDA-11 in 1997. Japan will put the case for the United States at the forthcoming Paris meeting on World Bank development assistance.

Life Saving Loans to Ukraine

Donor countries and international organizations meeting at the IMF in mid-December pledged $3.5 billion in balance

of payments support to back Ukraine's economic program in 1997. The package includes a loan of $1.1 billion from the IMF, $1 billion from the World Bank, and the remainder from other multinational organizations and donor countries. Ukraine will reform its tax and pension systems, improve its social safety net, strengthen its banking sector and monetary policy, and further liberalize its economy. In a statement after the meeting donors noted that the components of the program were interdependent and that the program would not succeed if implemented piecemeal. They therefore urged Ukraine to carry out the adjustment program in its entirety as soon as possible.

The World Bank in December 1996 approved a $300 million loan to Ukraine for its coal sector reforms. The loan, to be dispersed in two equal tranches, has a seventeen-year maturity and a five-year grace period. Ukraine's coal sector reform program spans eight years. The IMF, meanwhile, approved the release of about $200 million in credits for Ukraine, made available under an $867 million standby loan agreement reached in 1996.

IMF Postpones Disbursements to Uzbekistan

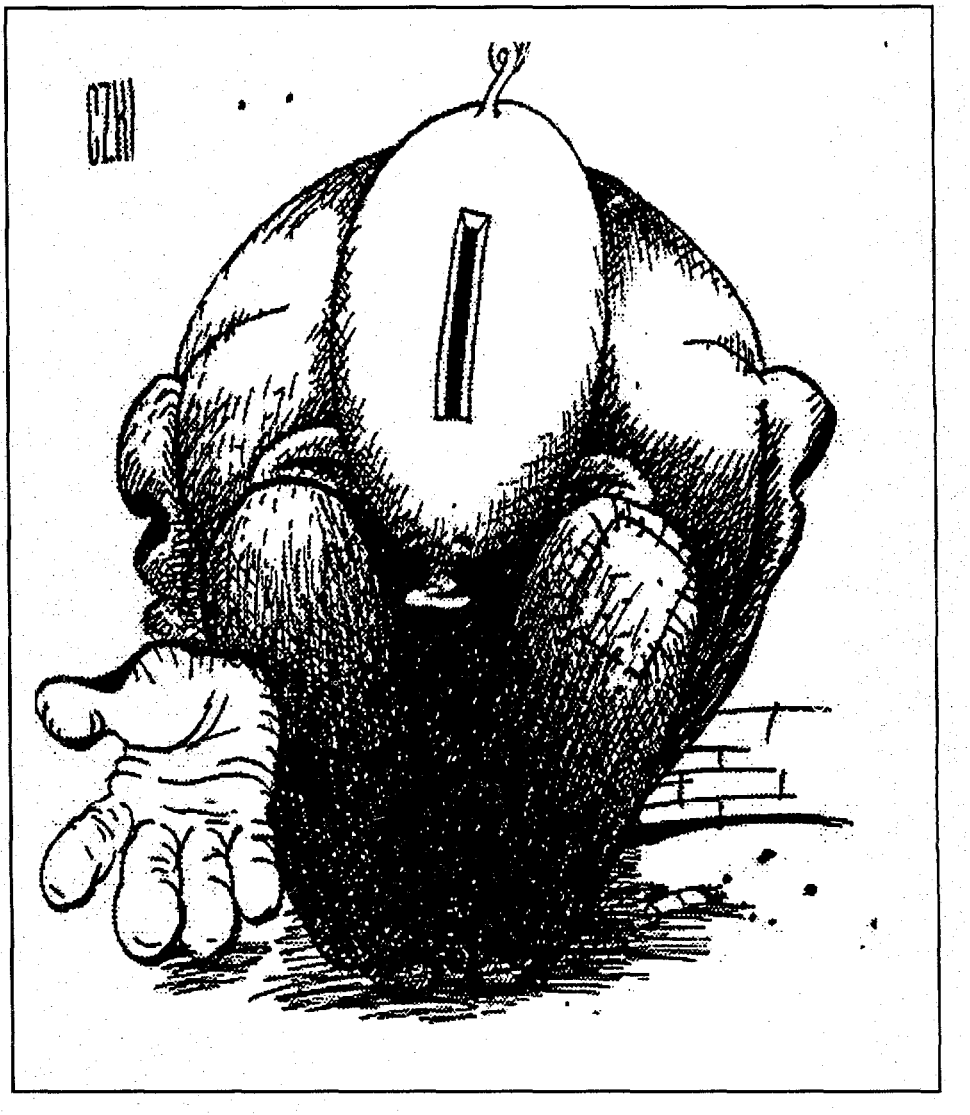
The IMF in mid-December postponed disbursements of a $185 million standby loan to Uzbekistan, IMF Resident Representative Mark O'Brien announced in Tashkent. O'Brien told a news conference that Uzbekistan's external trade account was hit in 1996 by lower international prices for cotton exports and a poorer-than-expected grain harvest. The government had responded by increasing credits to agriculture. Inflationary pressures had then intensified—inflation is estimated to have exceeded 40 percent in 1996. Another factor in the loan delay was Uzbekistan's introduction of draconian foreign exchange controls in October. Exchange rates for the sum (the local currency) in the interbank auction, exchange bureaus, and the curb market have diverged widely. Further loan payments have been conditioned on a "very tight financial policy...combined with a full liberalization of access to foreign exchange."

World Bank Loans in a Nutshell

Kazakstan: A $7 million loan was approved on December 23 to purchase goods and materials needed to rebuild the Aralsk-Sarbulak pipeline near the Aral Sea disaster zone and to support related consultant services.

Latvia: A $60 million loan was approved on December 19 to refinance the country's high debt service payments (due in 1997) and to support the government as it reduces and reforms the public sector and expands the private sector.

Viet Nam: A $37.8 million IDA credit was approved on December 23 to purchase vehicles, equipment, and materials to maintain and improve roads and bridges in fifteen provinces. The credit will also provide consultant services and training for provincial government officials and finance a study on demand and investment in the rural transport sector.



From the Hungarian daily *Népszava*.

New Books and Working Papers

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Working Papers

Susmita Dasgupta and David Wheeler, **Citizen Complaints as Environmental Indicators: Evidence from China,** Policy Research Working Paper 1704, January 1997, 24 p.

China's environmental regulators respond to more than 100,000 citizen complaints a year. Analyzing provincial data for 1987-93, the authors find that relying on complaints alone would result in few inspection resources being allocated to the less-educated, relatively "silent" regions. Citizens' incomplete information creates the biggest problem for regulators who rely on complaints for guidance. Therefore, agencies should invest in public environmental education and explore targeted outreach programs.
To order: Evelyn de Castro, Room N10-019, tel. 202-458-9121, fax 202-522-3230, E-mail: edecastro@world bank.org

Fernando Montes-Negret and Luca Papi, **The Polish Experience with Bank and Enterprise Restructuring,** Policy Research Working Paper 1705, January 1997, 43 p.
To order: Tomoko Ishibe, Room G8-136, tel. 202-473-8968, fax 202-522-3199, E-mail: fmontesnegret@world bank.org

Martha de Melo and Cevdet Denizer, **Monetary Policy during Transition: An Overview,** Policy Research Working Paper 1706, January 1997, 75 p.

The authors examine monetary policy in twenty-six transition countries in Europe and Central Asia from 1989 to 1995. They classify these countries by the extent of market orientation in terms of use of monetary policy instruments, by indicators of policy stance, and by broad measures of effectiveness. They evaluate these three dimensions by cross-country comparisons over the transition period and at the time of stabilization. The use of credit ceilings was helpful during stabilization, especially in the Central and Eastern European countries.

Subsidies and central bank support of public enterprises to help maintain employment and output are ultimately financed by creating money, thereby reducing the options for market-based monetary policy regardless of how market-oriented the monetary system is.
To order: Cynthia Bernardo, Room N10-049, tel. 202-473-7699, fax 202- 522-1154, E-mail: prdpe@world bank.org

Technical Papers

Syed Kirmani and Guy Le Moigne, **Fostering Triparian Cooperation in International River Basins: The World Bank at Its Best in Development Diplomacy,** World Bank Technical Paper 335, January 1997, 32 p.

Jeni G. Klugman and George Schieber, **A Survey of Health Reform in Central Asia,** World Bank Technical Paper 344, January 1997, 68 p.

The paper presents and analyzes data on health status, delivery of services, and financing in each of the former Soviet states of Central Asia. It examines health care reform from the perspectives of macroeconomic constraints, demographic and epidemiological transitions, the underlying structure and financing of health care systems, and the systems inherited from the former Soviet Union.

Gnanaraj Chellaraj, Olusoji Adeyi, Alexander S. Preker, and Ellen Goldstein, **Trends in Health Status, Services, and Finance: The Transition in Central and Eastern Europe,** Volume II, Statistical Annex, World Bank Technical Paper 348, January 1997, 152 p.

This is the second of a two-volume report on trends in health and health care in Central and Eastern Europe. This volume is a statistical annex to the first volume, which carried the main report, (see *Transition*, Vol. 7, no. 11-12, November-December, 1996, page 35). The annex contains comprehensive charts and tables of epidemiological, demographic, and health financing indicators for 1987-95.

Discussion Papers

Stephen Stares and Zhi Liu, **China's Urban Transport Development Strategy: Proceedings of a Symposium in Beijing,** November 8-10, 1995, World Bank Discussion Paper 352, January 1997, 530 p.

Topics of the symposium include motor vehicle pollution, urban transport management and planning, bicycles in cities, mass rapid transit,

public transit reform, and the role of the private sector.

Klaus Schmidt-Hebbel and Luis Serven, Saving across the World: Puzzles and Policies, World Bank Discussion Paper 354, January 1997, 176 p.

High savings rates enable high GNP growth. This study surveys broad saving trends worldwide, summarizes current knowledge about saving and consumption, and outlines the major policy questions to be researched. The paper includes a case study from China.

Other Publications

Michael Bruno and Boris Pleskovic, eds., **Annual World Bank Conference on Development Economics 1996.**

The articles in this volume were initially presented as papers at the Eighth Annual World Bank Conference on Development Economics, held in Washington, D.C., April 25-26, 1996. The articles focus on banking reform, poverty reduction, legal systems, and labor and environmental standards in international trade. The authors include Joseph Stiglitz, Frederic S. Mishkin, Gerard Caprio Jr., and Daniela Klingebiel. Stock no. 13786.

Kathy Megyery and Frank Sader, **Facilitating Foreign Participation in Privatization,** Foreign Investment Advisory Service Occasional Paper 8, January 1997, 50 p.

This paper presents best practices in successfully structuring and managing privatization with foreign investment, describing the full cycle from the development of a general policy framework to the actual divestiture procedure. The study analyzes the privatization programs of Hungary and Poland, among others.

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David K. H. Begg, **Monetary Policy in Central and Eastern Europe: Lessons after Half a Decade of Transition,** Working Paper 96/108, September 1996, 91 p.

John R. Dodsworth, Ajai Chopra, Chi D. Pham, and Hisanobu Shishido, **Macroeconomic Experiences of the Transition Economies in Indochina,** Working Paper 96/112, October 1996, 28 p.

This paper examines stabilization policies in Cambodia, and Laos , and Viet Nam, since the late 1980s. The Indochinese countries moved quickly to strong GDP growth and low inflation. Each adopted a similar mix of policies centered on flexible exchange rates, high real interest rates, fiscal adjustment through expenditure cuts, and the imposition of hard budget constraints on public enterprises. An exchange rate anchor was not considered feasible in any of the countries, and despite evident instability in the demand for money, money-supply-based stabilization proved effective.

László Halpern and Charles Wyplosz, **Equilibrium Exchange Rates in Transition Economies,** Working Paper 96/125, November 1996, 39 p.

Policy implications of the analysis include:

• Present purchasing power parity in transformation economies is not an appropriate benchmark against which to measure exchange rate policies. Real appreciation is the sign of a successful transition: transition will be complete once the real appreciation stops. By then, price and wage levels in Central and Eastern Europe will have converged to levels not too different from those in Western Europe.

• If the exchange rate is pegged to a Western currency (the dollar, deutsch mark, European Currency Unit, or any basket of currencies), the real appreciation will come through inflation that is higher than that in the country to whose currency the peg is established. If the nominal exchange rate is allowed to float and appreciate, inflation can be brought down.

• The choice of an exchange rate policy is linked to the desired level of inflation. Some argue that countries should aim for moderate inflation in the early years of transition because an "inflation tax" (seigniorage) could be useful until a broad and fair tax base is created through tax reform; nominal exchange rate appreciation can be risky, given the uncertainty over the desired rate and the volatility of flexible rates; moderate inflation allows for relative price changes without actually forcing some wages and prices to decline; and continuous appreciation of a currency with respect to strong currencies such as the deutsche mark could hit snags.

Mark A. Horton, **Health and Education Expenditures in Russia, the Baltic States, and the Other Countries of the Former Soviet Union,** Working Paper 96/126, November 1996, 25 p.

Russia, the Baltic states, and the other countries of the former Soviet Union inherited health and education systems that were in need of substantial structural and financial reform. In spite of a sharp decline in real resources, this reform has barely begun. Health and education have not suffered disproportionate cuts and employment has been maintained, but real wages have been sharply compressed, purchases of materials have been reduced, and energy-related spending takes a greater share of resources in many countries. Structural and financial reform would include reducing staffing and physical capacity, while increasing expenditures for materials and wages for the more highly qualified.

V. Sundararajan, **The Role of Prudential Supervision and Financial Restructuring of Banks during Transition to Indirect Instruments of Monetary Control,** Working Paper 96/128, November 1996, 30 p.

Ales Bulir, **Business Cycle in Czechoslovakia under Central Planning: Were Credit Shocks Causing It?** Working Paper 96/129, November 1996, 19 p.

Adriaan M. Bloem, Paul Cotterell, and Terry Gigantes, **National Accounts in Transition Countries: Distortions and Biases,** Working Paper 96/130, November 1996, 43 p.

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The Changing Social Benefits in Russian Enterprises, ISBN 92-64-15282-2, September 1996, 148 p.

Worker compensation in the Russian Federation has traditionally included a large package of social benefits. But these are decreasing, even if they continue to be important in certain industries and regions. This book looks at the restructuring of the ownership, management, and function of enterprise-based social assets and how employer-provided services are granted in light of potentially desirable changes in the social protection system in the Russian Federation.

OECD Economic Surveys: Poland 1997, ISBN 92-64-15359-4, November 1996, 179 p.

Regional Integration and Transition Economies: The Case of the Baltic Rim, ISBN 92-64-14929-5, November 1996, 209 p.

Trends and Policies in Privatization—Performance of Privatized Enterprises: Corporate Governance, Restructuring, and Profitability, ISBN 92-64-04856-1, vol. 3, no. 1, October 1996, 202 p.

This publication provides biannual reviews of recent developments in privatization and a comparative analysis of experiences in transition economies. It is designed to alert decisionmakers to policy alternatives and inform them of analytical foundations, as well as lessons of implementation.

The Centre for European Economic Studies (CEES) Publications

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Robert Ackrill and Dean Garratt, **Political Business Cycles and Economic and Monetary Union in the European Union,** no. 96/6, November 1996, 29 p.

Janusz Maciaszek, Katarzyna Mikolajczyk, and Barbara M. Roberts, **Unprofitability in the Polish Enterprise Sector, 1988-93,** no. 96/5, Oct. 1996, 33 p.

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Beyond Cuba, ISBN 1-55183-284-4, June 1996, 557 p.

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János Kornai, **Adjustment without Recession: A Case Study of the Hungarian Stabilization,** Discussion Papers 33, August 1996, 48 p.

Other Publications

Kevin F. F. Quigley, **For Democracy's Sake: Foundations and Democracy Assistance in Central Europe,** Woodrow Wilson Center Press, Washington, D.C., February 1997.

Promoting democracy has become a major concern of the international

community since the end of the cold war. Private actors—foundations and other nongovernmental organizations—are playing a growing role in these efforts, rivaling that of governments and international institutions. This study examines the democracy assistance programs of foundations in Central Europe during the years immediately following the fall of the Berlin Wall.

The author backs up his findings with extensive field research, recounting a series of workshops in which Central Europeans knowledgeable about democracy efforts participated, and with his own experience as a foundation executive. The book includes chapters on foundations' efforts in the Czech Republic, Hungary, Poland, and Slovakia; on regional initiatives; and on the philanthropy of George Soros.
To order: The Johns Hopkins University Press, Hampden Station, Baltimore, Maryland 21211, United States, tel. 1-800-537-5487.

George Soros, **The Capitalist Threat** in *The Atlantic Monthly* (United States), February 1997, 279(2): 45-58.

The main enemy of the open society is no longer the communist but the capitalist threat. Too much competition and too little cooperation can cause intolerable inequities and instability. Insofar as there is a dominant belief in our society today, it is a belief in the magic of the marketplace. The doctrine of laissez-faire capitalism holds that the common good is best served by the uninhibited pursuit of self-interest. Unless it is tempered by the recognition of a common interest that ought to take precedence over particular interests, our present system—which, however imperfect, qualifies as an open society—is liable to break down.

The main scientific underpinning of the laissez-faire ideology is the theory that free and competitive markets bring supply and demand into equilibrium and thereby ensure the best allocation of resources. This is widely accepted as an eternal verity, and in a sense it is one. As originally formulated, the theory of perfect competition—of the natural equilibrium of supply and demand—assumed perfect knowledge, homogeneous and easily divisible products, and a large enough number of market participants that no single participant could influence the market price. The assumption of perfect knowledge proved unsustainable.

Buyers and sellers in financial markets seek to discount a future that depends on their own decisions. Instead of tending toward equilibrium, prices continue to fluctuate relative to the expectations of buyers and sellers. There are prolonged periods when prices are moving away from any theoretical equilibrium. Yet the concept of equilibrium endures. It is easy to see why: without it, economics could not say how prices are determined. In the absence of equilibrium, the contention that free markets lead to the optimum allocation of resources loses its justification. The assertion of perfect knowledge stands in contradiction to the concept of the open society (which recognizes that our understanding of our situation is inherently imperfect). Laissez-faire ideas can pose a threat to the open society:

Economic stability. History has shown that financial markets do break down, causing economic depression and social unrest. The breakdowns have led to the evolution of central banking and other forms of regulation. Instability extends well beyond financial markets: it affects the values that guide people in their actions. Advertising, marketing, even packaging aim at shaping people's preferences. People increasingly rely on money as the criterion of value. What is more expensive is considered better. The value of a work of art can be judged by the price it fetches. People deserve respect and admiration because they are rich. What used to be a medium of exchange has usurped the place of fundamental values, reversing the relationship postulated by economic theory. What used to be professions have turned into businesses. The cult of success has replaced a belief in principles. Society has lost its anchor.

Social Darwinism. By taking the conditions of supply and demand as given and declaring government intervention the ultimate evil, laissez-faire ideology has effectively banished income or wealth redistribution. The laissez-faire argument against income redistribution invokes the doctrine of the survival of the fittest. This social Darwinism is based on an outmoded theory of evolution, just as the equilibrium theory in economics is taking its cue from Newtonian physics. The principle that guides the evolution of species is mutation, and mutation works in a much more sophisticated way. Species and their environment are interactive, and one species serves as part of the environment for the others.

International relations. States have no principles, only interests, geopoliticians argue, and those interests are determined by geographic location and other fundamentals. This deterministic approach is rooted in an outdated nineteenth-century view of scientific method, and it suffers from at least two glaring defects: it treats the state as the indivisible unit of analysis, just as economics treats the individual; and it does not recognize a common interest beyond the national interest. As things stand, it does not take very much imagination to realize that the global open society that prevails at present is likely to prove a temporary phenomenon.

Jan Winiecki, ed., **Institutional Barriers to Economic Development:**

Poland's Incomplete Transition, Adam Smith Research Centre, Poland, June 1996, 97 p.

In Poland, with privatization proceeding slowly, the stock market has remained little more than a marginal institution with a few dozen quoted companies. The uniqueness of Poland's transition, in comparison with that of other Central and East European countries, lies in the fact that political change has come through the Solidarity movement, which has been largely utopian socialist and syndicalist in nature. The Polish political spectrum is strongly anticapitalist at both ends, with an excommunist alliance (SLD) and its anachronistic peasant ally (PSL) at one end, and a strongly anticommunist, but utopian Christian-socialist Solidarity at the other. The imbalance between the power of labor and capital, to the distinct disadvantage of capital, is a fixed point of the political economy of Polish transition.

Polish wages are extremely sticky downward, and the willingness to accept wage cuts for higher employment is almost nonexistent. The result is high unemployment, underpinned by the rigid labor market, characterized by low occupational and territorial mobility. Also, the unemployed maintain a high reservation wage, approaching 95 percent of their previous wage (even after two years of unemployment). The high economic growth rate during 1993-95 barely dented the unemployment rate.

The share of pensions in Polish GDP has been about 15 percent in the past two to three years. The share of the next closest Eastern or Central European country, Hungary, is 11.0 to 11.5 percent of GDP (still substantially higher than the average share for countries of the European Union: 8.7 percent in 1992). And the growth of pensions' share during the transition period has been financed almost exclusively through increases in budgetary subsidies. Average pensions in Poland are much higher than those in other countries: 70 percent of average wages and salaries (rather than 40 to 50 percent, as in most European countries). Hidden social assistance is given to farmers under the guise of the pension system—farmers' contributions amount to barely 5 percent of total expenditures.

There has been a general rise in the level of tariff protection since 1991. Agriculture is in the lead with high nontariff and tariff barriers, though the whole range of consumer products—from cars and electronics to food—is being affected by import impediments. About one-fourth of Polish imports are now subject to nontariff barriers, such as quotas, exceptions from quotas, concessions, and so on. All the coal trusts, sugar trusts, encouragement of various holdings, and "consolidation" of state banks have two aims:

- To shield the inefficient state enterprise sector from the efficiency demands of the market, thereby earning the gratitude of its employees.
- To retain the state sector as an important spoils area for the old *nomenklatura* from both parties of the communist ancien regime.

Budding economic activity of the generic private sector, registered and unregistered alike, has put Poland in the forefront of transition. But without sufficient, well-proven institutional underpinnings, success can run out of steam.

To order: Adam Smith Research Centre, University of Warsaw, Bednarska St. 16, Warsaw, Poland 00321.

Willem H. Buiter, Ricardo Lago, and Nicholas Stern, **Promoting an Effective Market Economy in a Changing World,** CEPR 1468, October 1996, 55 p.

To order: Centre for Economic Policy Research, 25-28 Old Burlington Street, London W1X 1LB, United Kingdom, tel. 44171-878-2900, E-mail: cepr@cepr.org

China's Economic Future: Challenges to U.S. Policy, ISBN 0-16-053566-2, Study Papers for the Joint Economic Committee, Congress of the United States, Washington, D.C., August 1996, 530 p.

John P. Hardt and Robert N. Mottice, **Institutionalization—Establishment of Market-Friendly Institutions and Legal Framework.**

The legal and regulatory framework of a market system requires replacing the rule of the party bureaucracy (the rule of people) with the rule of law, necessary for the efficient and equitable operation of a democratic market system. In China an agenda of institutional change may include:

- An independent central bank or currency board with an efficient private commercial banking system to ensure a solid monetary environment. A stable currency free from political influence is critical.
- A federative, modern tax code, modeled in rate and structure after the Hong Kong system. Local and federal mandates and revenue-raising capabilities should be better correlated.
- A workable civil code to establish market rules and accountability.
- Regulatory agencies to set market rules in both the state and private sectors. Securities and exchange, consumer protection, and environmental protection are all rule-driven activities that affect the quality of life and act against crime, corruption, and inequality.
- Judicial review of rule of law in economic crime and civil actions to ensure that markets function effectively. Some degree of parliamentary oversight is also essential.

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Office, Superintendent of Documents, Congressional Sales Office, Washington, D.C. 20402, United States.

Competition Act of Hungary, Office of Economic Competition, Hungary, 1996, 46 p.

Die Lage der Weltwirtschaft und der Deutschen Wirtschaft, Working Paper 14, 1996, 42 p.
To order: Wirtschaft im Wandel, Delitzscher Strasse 118, 06116 Halle, Germany, tel. 0345-7753 701, fax 0345-7753 820.

Emilian Dobrescu, **Macromodels of the Romanian Transition Economy,** The National Institute of Economic Research, Romania, October 1996, 159 p.

From an institutional point of view the Romanian economy is weakly structured: ownership rights are poorly defined, new market mechanisms have only limited effectiveness, informal institutions play a significant role, economic agents behave unpredictably, and political factors exert great influence over resource allocation. Economic resources are wasted as a consequence of the fuzzy ownership structure, uncertainty, and high transaction costs. Only a thorough restructuring would enable the country to begin sustainable, long-term economic growth. Inflation must be kept under control through judicious monetary policy, the share of budget expenditures in GDP must be lowered, and a prudent fiscal policy must be promoted.

A new ownership structure would include a developed capital market, a drastic cut in inefficient activities subsidized by the state, improved corporate governance, and the progressive integration of Romania into the European and the world economy.

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Peter Havlik and Vladimir Vertlib, **Die wirtschaftliche Lage der zentralasiatischen Nachfolge-staaten der UdSSR,** WIIW Working Paper 165, October 1996, 239 p.
To order: The Vienna Institute for Comparative Economic Studies, Oppolzergasse 6, A-1010 Vienna, Austria, tel. 431-533-6610, fax 431-533-6610-50, Internet: http://www.wsr.ac.at/wiiw-html/

David Lane, **The Rise and Fall of State Socialism: Industrial Society and the Socialist State,** ISBN 0-7456-0742-X, Polity Press, United Kingdom, 1996, 233 p.
To order: Editorial Office, Polity Press, 65 Bridge Street, Cambridge, CB2 1UR, United Kingdom; or in the United States, Blackwell Publishers Inc., 238 Main Street, Cambridge, Massachusetts 02142.

Erik Mathijs and Johan F. M. Swinnen, **The Economics of Agricultural Decollectivization in Central and Eastern Europe,** Working Paper no. 3/1, Department of Agricultural Economics, K. U. Leuven, 1996, 27 p.

Negoslav P. Ostojic and Norman Scott, eds., **Privatization in the Economies in Transition,** European Center for Peace and Development (ECPD), Yugoslavia, 1996, 418 p.
To order: European Center for Peace and Development (ECPD), United Nations University for Peace, 11000 Beograd, Knez Mihailova 7/II, Yugoslavia, fax 011-623-169.

Mária Vanicsek, **Ownership and Operational Developments in the Hungarian Private Sector,** Property Foundation, Institute for Privatization Studies, Hungary, 27 p.
To order: Property Foundation, Institute for Privatization Studies, P.O. Box 44, 18 Gyori ut, 1123 Budapest, Hungary H-1387, tel. 361-202-5175, fax 361-202-1093, E-mail: property@odin.net

Yanrui Wu, **Trends and Opportunities in China's Health Care Sector,** Policy Paper 18, ISBN 0-86905-507-0, September 1996, 48 p.
To order: Asia Research Centre, Murdoch University, Western Australia, tel. (619) 360-2846, fax (619) 310-4944.

Milford Bateman, ed., **Business Cultures in Central and Eastern Europe,** University of Wolverhampton, United Kingdom, January 1997.

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