The phasing and politics of Eastern Europe's reforms

Transferring an economic system differs greatly from reforming policy in an established economic system. And the sequencing of individual reforms in a broad system transformation is open to considerable debate (see box).

Most analysts now agree that, although country-specific factors will influence the pattern of reforms, some components must precede others or occur in tandem with them. It has also become increasingly clear that the components are tightly interlinked — and that clearly articulating a long-term strategy and starting in many policy areas is important from the beginning. A stylized phasing of reforms shows that reforms need to be carried out simultaneously on many fronts (see chart on page 3).

Because some reforms take longer than others, tensions are inevitable. Some reforms are appropriate only late in the process, when market forces are developed well enough to replace administrative controls. In any case, although early reforms may yield some immediate benefits (such as an increase in the availability of goods), rapid and sustainable economic growth should not be expected until many reforms are implemented on a significant scale. And this is likely to take several years. All these propositions gain force from the indifferent performance of the Central and Eastern European countries in their earlier phases of partial reform.

Few disagree with the premise that macroeconomic stabilization is a prerequisite for structural reforms — and that it should be followed quickly (or concurrently) with price and trade reform (including the convertibility of the current account) to enhance competition and promote foreign investment (see the chart on phasing). Tax reform and public support. Restructuring should thus precede privatization, and firms should not be given away hastily.

Should trade liberalization come early and fast or later and slower?

Early: It supports price reform by importing the world price structure and heightens competitive forces.

Later: It shocks the economy, in the right directions but with excessive costs, and is risky until the economy is stabilized.

Must full-scale financial sector reform go hand-in-hand with enterprise reform, or can it come earlier?

Hand-in-hand: Competitive financial markets require clean loan portfolios, and enterprise reform and bank portfolio restructuring are best accomplished simultaneously.

Earlier: Only independent financial institutions and liberalized financial markets can play the critical role of allocating capital as enterprises are restructured.

The debate on phasing

Should price reform come before or after enterprise reform?

Before: Enterprise reform and privatization will not succeed if the market cannot judge efficiency and value because prices do not reflect true costs. Budgets cannot be "hardened" before introducing market prices.

After: Freeing prices in the presence of monopolies will lead to excessive prices and profits, undercutting the political consensus for reform. Domestic competition policy should be in place before price liberalization.

Should large-scale privatization be "quick and dirty" or slower and more careful?

Quick: Rapid privatization is of utmost importance. It raises efficiency, speeds restructuring, establishes a constituency for further reforms, and weakens the traditional power centers opposing reform.

Slow: Sales revenues are needed by the government, and preserving fairness in the process is vital for
In This Issue

1

The phasing and politics of Eastern Europe's reforms

5

New Research

Enterprise behavior and competitiveness

Credit programs for the poor: household and intrahousehold impacts and program sustainability

Equipment prices and trade policies for developing country manufacturing industries

Assessing the Mexico-United States free trade agreement

Do national policies affect long-run growth?

The international economic environment and productivity growth in industrial and developing countries

Housing indicators for policymaking: an extensive international survey

License prices and rent sharing in the Multi-Fibre Arrangement

9

Books


World Development Indicators

10

Journals

Volume 6, Number 2 issue of the World Bank Research Observer

12

Discussion, Technical, and Related Papers

13

Working Papers

16

Calendar

Martin Ravallion on reaching the rural poor through public employment: arguments, evidence and lessons from South Asia

John Wakeman-Linn on the mark for developing country debt and its nature and importance of its shortcomings

The World Bank Policy Research Bulletin is published five times a year by the Research Advisory Staff. Subscriptions to the Bulletin are complimentary and may be ordered by contacting Evelyn Alfaro at the Bank’s main address, room S10-062. The Bulletin’s purpose is to inform the development community of the Bank’s policy and research output. It includes description of Bank publications, research summaries, and updates of events in and outside the Bank. The views and interpretations in articles published are those of the authors and do not necessarily represent the views and policies of the World Bank or of its Executive Directors or the countries they represent. The Bulletin is not copyrighted, and it may be reproduced with the appropriate source attribution. For more information, contact Evelyn Alfaro, the production manager. Alison Strong is the editor.
Phasing reforms over 10 years

The chart shows that reforms need to be simultaneous on many fronts and suggests a stylized phasing over the long term.

<table>
<thead>
<tr>
<th>Macro stabilization</th>
<th>Intense</th>
<th>Continuing</th>
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</thead>
<tbody>
<tr>
<td>Price and market reform</td>
<td>Price reform</td>
<td>Most goods</td>
</tr>
<tr>
<td>Goods and services</td>
<td>Trade reform</td>
<td>Remove QRs</td>
</tr>
<tr>
<td>Price reform</td>
<td>Distribution</td>
<td>Privatization, demonopolization</td>
</tr>
<tr>
<td>Labor market</td>
<td>Deregulate hiring and firing</td>
<td>Liberalization of wage bargaining</td>
</tr>
<tr>
<td>Autonomous banking system</td>
<td>Preparation</td>
<td>Implementation</td>
</tr>
<tr>
<td>Other financial markets</td>
<td>Preparation</td>
<td>Implementation</td>
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<tr>
<td>Restructuring and privatization</td>
<td>Small-scale privatization and private sector development</td>
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<td></td>
<td>Revise regulations</td>
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<td>Foreign investment</td>
<td>Large-scale: Corporate governance</td>
<td></td>
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<tr>
<td>Restructuring and privatization</td>
<td>From evaluation to implementation</td>
<td></td>
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<tr>
<td>Redefining the role of state</td>
<td>Intensive (tax reform, basic property, and commercial law)</td>
<td>Continuing (other)</td>
</tr>
<tr>
<td>Legal reforms</td>
<td>Tax administration, budgeting, legal, regulatory institutions</td>
<td></td>
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<tr>
<td>Institutional reform</td>
<td>Emergency</td>
<td>Institutionalization</td>
</tr>
<tr>
<td>Unemployment insurance</td>
<td>Intensive</td>
<td>Continuing</td>
</tr>
<tr>
<td>Other social areas</td>
<td>Year</td>
<td>0 1 2 3 4 5 6 7 8 9 10</td>
</tr>
</tbody>
</table>

In this regard, there is a tension in Eastern Europe between the strong central leadership needed to push through difficult reforms and the compromise needed to ensure widespread...
support for the program. Central executive authority, discredited by past experience, has yet to be replaced by a new model of strong government with a legitimate role in supporting a market system. In fact, the pendulum is swinging in the opposite direction in several countries — toward greater decentralization and autonomy for provincial and local governments. This is likely to complicate reform efforts in the short run.

Regional disputes over power-sharing further threaten cohesion, compromise legitimacy, and impede economic reform. In the Czech and Slovak Federal Republic, the division of authority between the federation and the two republics over policymaking and budgetary control is still unclear. The problem is magnified in Yugoslavia and the Soviet Union, where reaching consensus on the political relations and distribution of power between the center and the republics is likely to be a prerequisite for large-scale reforms and macroeconomic stability. The regional disputes do not reflect lack of consensus on economic policy as much as long-simmering ethnic tensions unleashed with political liberalization.

Added to the difficulty of sustaining political and economic reform is a harsh international economy. Temporarily higher world oil prices, economic problems in the Soviet Union, the transformation of the CMEA trading system, and the disruption of trade with Iraq (a significant trading partner, especially for the Czech and Slovak Federal Republic and for Bulgaria) — all these place extra strain on economies already burdened with the short-term costs of reform. The public will find it difficult to separate the impact of reform from that of the external shocks. Proximity to Western Europe, and the prospect of joining it, are probably important in setting standards for reform.

The course of reform will not only depend on political developments — it will probably influence those developments. A crucial variable in all this may be the speed of reform. The political pressures that arise in a “go slow” approach argue for as rapid a reform as possible. Under “shock therapy,” like that in Poland, a large set of reforms is launched before strong opposition can coalesce (resistance to reform by the old guard of managers and bureaucrats is often cited as an argument for rapid enterprise reform).

Rapid adjustment may cause political instability if there is no quick and demonstrable payoff. But a slower approach also has political risks. Failure to pursue reforms vigorously will cost much, economically and politically. The reforms may be easier to undertake, the worse the prereform situation. Thus, short-run costs would be borne more readily in Poland than in, say, the Czech and Slovak Republic. But it is still too early to do more than speculate on these issues.

The growth prospects for the Central and Eastern European countries depend on the consistency with which they pursue their reform programs, the impact of outside developments, and the response of the industrial countries in providing technical assistance, finance, and an open trading environment. Recovery and growth are expected to be quite slow in the near term because of the fundamental systemic and institutional changes needed. Per capita output for the six Central and Eastern European countries over 1990-2000, following the sharp drop in 1990, is projected to decline further in 1991 and stay level in 1992 before the recovery begins in 1993. Growth in per capita output is expected to improve to 3-4 percent in the second half of the decade, as the countries recover from the disruptions of their current reform processes and as their economic efficiency and absorptive capacity rise with restructuring. Output per capita is not projected to attain its 1989 level until late in the decade. But that (market-determined) output should be achieved with greater efficiency and associated with a higher level of social welfare than the output of 1989. Despite unavoidable short-term costs, reforms set the stage for sustainable growth in the medium and long run. Without reform, these economies would continue to stagnate into the foreseeable future — and still bear the adjustment costs stemming from the trade shock.

Two important general points emerge from these projections. First, even under fairly favorable assumptions on external factors and domestic reforms, the period of catch-up toward market economies with levels of income comparable to those of the industrial countries will almost certainly be measured in decades rather than years.

Second, system reforms are unlikely to proceed smoothly, especially considering their complexity and highly political nature. Setbacks can be expected and should not be prematurely interpreted as failure of the entire reform process. It will be important in the years ahead to maintain political will, patience, and a long-term perspective.

New Research

The research projects described here have been approved by the Research Committee and are funded by the Bank’s Central Research Budget (RSB). Bank units contribute their staff time to these projects, and RSB funding complements this by providing for expenses such as consultants, data collection, and travel. For information on funding to prepare research proposals approved since May, see page 9.

For information about research projects listed here, contact the researchers at the Bank’s main address.

Research Starts

Enterprise Behavior and Competitiveness
Brian Pinto
Resident Mission in Poland
Ref. no. 676-58

The priority in Poland’s economic transformation program, which began in January 1990, has been to stabilize the economy and reduce inflation to less than 1 percent a month by May 1991. Another important goal has been to stimulate public enterprise reform by subjecting the sector to import competition through a fixed exchange rate combined with low tariffs. The two goals are interdependent. Enterprise taxes account for 70 percent of budgetary revenues. A serious disruption of the sector — a potential cost of adjustment — could therefore create a fiscal imbalance, affecting not only stabilization but income and employment throughout the economy. Likewise, if inflation is not brought under control, the relative price signals essential for restructuring are likely to be obscured.

This research project will explore such micro and macro links along two lines. First, what has been the enterprise-level response to macroeconomic reform? For example, has tight monetary policy been diluted by interfirm competition? Has the appreciating real exchange rate led to specific restructuring efforts at the enterprise level, and have different sectors responded differently? How has indexation affected wage-setting? Second, what are the prospects for enterprise performance, and thus export earnings and tax revenues? Were the high profits toward the end of 1989 and in 1990 transitory or permanent — that is, were they genuine gains or were they due to temporary factors? This component captures the tangible feedback from enterprise response to macroeconomic variables. The research will be conducted through a survey of the largest enterprises, mostly public enterprises, in the main manufacturing sectors.

The study will assess the immediate macroeconomic implications of the findings. For example, if profitability rates are likely to decline or if export performance was facilitated by temporary factors, this would have implications for fiscal revenues and export earnings beyond the possible effects on the labor market.

If the surprisingly good performance of public enterprises in 1990 is found to stem from temporary factors, which impeded true liberalization, this might illuminate the debate on the sequencing of liberalization and stabilization, especially if the disruption of the sector is large and costly. This would also raise questions about “big-bang” liberalization policies for other emerging post-communist economies. If the public sector is not showing a capacity to respond to the new economic environment (the test of which must follow the evaporation of the temporary factors postponing adjustment), this will suggest that “getting the prices right” is only a necessary and not a sufficient condition for adjustment. This raises a host of issues relating to economic coordination policies. Getting the prices right is usually equated with a stable exchange rate and trade liberalization. An important dimension that is missing is the incentive structure within the firm, not just clarification of the ownership/control structure, but profit-linked pay for managers. Thus, the prices may have to be right within the firm to elicit the desired response.

RSB support: $20,000
Staff weeks: 31

Credit Programs for the Poor: Household and Intrahousehold Impacts and Program Sustainability
Shahidur Khandker
Population and Human Resources Department, Women in Development Division
Ref. no. 676-59

For the rural poor in many developing countries lack of capital may be the only obstacle to starting income-earning activities — and thus to break out of the vicious circle of low capital, low productivity, low income, and low savings. Access to affordable credit for productive activities can remove this obstacle and lead, if the credit effects are sustainable, to improvements in income, welfare, and assets.

Although many governments in developing countries have promoted rural credit institutions, there are few good studies of their effects and sustainability. This project will analyze how group-based credit programs work and whether they are sustainable in imperfect credit
markets by examining their cost structures and estimating their effects on households and on members of households. It will pay particular attention to the distribution of the effects by gender. Bangladesh, because it has a number of different kinds of credit programs — including the well-known Grameen Bank — has been chosen as the project's focus.

The research has three main objectives. First, it will identify the effects of credit programs on the income, wealth, and asset accumulation — and thus, poverty reduction — of households and on the employment, education, health, and nutrition of individuals. Determining the results will help show whether a credit program produces the effects desired for households — that is, effects that help to reduce poverty and to increase the human capital of the rural poor.

Second, the research will examine the participation of women in the credit programs and the effects of their participation on such household and intrahousehold outcomes as decisionmaking, resource allocation, and productivity. The research will try to determine whether such effects vary according to the gender of the participant and whether a credit program designed for women increases the welfare of the family — and if so, how.

Third, the research will analyze the financial and economic efficiency of the credit programs and make comparative evaluations so as to estimate the cost structures of the programs and determine whether and under what conditions group credit programs are sustainable.

The findings of the research will provide both evidence on the viability of group-based credit schemes in Bank projects and a generally applicable framework for analyzing the relative costs and benefits of different kinds of credit programs elsewhere, including the measurement of the effects on households and the distribution of the effects by gender.

RSB support: $215,000
Staff weeks: 79

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**Equipment Prices and Trade Policies for Developing Country Manufacturing Industries**

Garry Pursell
Country Economics Department, Trade Policy Division
Ref. no. 676-61

Export unit values of certain kinds of machinery exported from such advanced industrial nations as Germany and Japan to India, China, and Brazil are substantially higher than the unit values of similar machinery exported to developed countries and to more successful export-oriented developing economies such as Hong Kong, Korea, and Taiwan, China. This pilot study will collect and analyze reliable data on machinery prices, specifications, and qualities in order to test the validity of the several possible hypotheses explaining this difference and determine whether the subject merits more extensive research.

The main reasons for the differences in export unit values seem to stem from nontariff interventions to promote import substitution in machinery or machinery component manufacturing. These barriers increase the costs and risks of machinery suppliers and may exclude some from competition, increasing the market power of those remaining. Rent-seeking activity aimed at circumventing "law of similars" import-licensing regulations may lead to the import of inappropriate (overspecified) machinery. And importing countries' creditworthiness could also play a role, because of the increased insurance costs credit risks represent for the exporter and the elimination of competitors unable to obtain insurance.

The study will conduct surveys of machinery exporters and other relevant firms and institutions in Germany and Switzerland; analyze data on Indonesia's machinery imports; analyze Bank project data and conduct a field survey in Brazil where the "law of similars" and creditworthiness are most prominent. The principal focus of the research will be on the machinery and equipment used by the textile and garment industries.

RSB support: $56,000
Staff weeks: 15

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**Assessing the Mexico-United States Free Trade Agreement**

Sweder van Wijnbergen
Latin America and the Caribbean Regional Office, Country Department II, Country Operations Division
Ref. no. 676-65

The free trade agreement (FTA) that Canada, Mexico, and the United States have agreed to negotiate is expected to go beyond reducing or removing trade barriers for agricultural and manufactured products, liberalizing such areas as direct foreign investment and key services — transport, communications, insurance, and banking. For Mexico the agreement can be expected effectively to cement the major structural reforms that it has undertaken over the last few years by increasing the difficulty of policy reversals. This will send a strong signal to potential foreign investor making increased direct foreign investment likely. For this and other reasons, the FTA will have broad implications for Mexico's economy and raises a number of policy issues.

This research project will examine the likely effects of the FTA on Mexico, focusing on three questions with a view toward policy. First,
what will trade liberalization in agriculture mean for the economy as a whole? Second, how will opening up the services sector affect both the sector itself and the sectors that use its outputs? Third, to what extent can we expect major changes in firms’ decisions on location and in trade patterns after a free trade agreement in industry? And if we can expect substantial foreign direct investment, what are the likely implications for Mexico’s aggregate productivity growth and hence for long-term growth prospects?

The research will have a two-track structure. First, it will look in detail at six sectors: sugar, maize, textiles and apparel, motor vehicles and parts, services, and maquiladoras (border industries that operate under a special tariff regime). The research will examine the potential effects for each sector of its inclusion in the free trade agreement — such as those on employment and trade. Second, the project will conduct an economy-wide analysis of the effects of the FTA that will focus on intersectoral linkages and spillovers, using the results of the sectoral studies, and on policy changes (regulation of foreign investment, for example) that affect the economy as a whole.

The results of the research could serve as an important input for formulating policy, both on which sectors the parties should bring into the agreement and on the design of adjustment policy packages, if any are required, to ease Mexico’s adjustment to the conditions created by the agreement. The results should also be of general policy interest, for several reasons: this is the first free trade agreement among developing and developed countries; the agreement is expected to cover new areas (services and direct foreign investment); and other Latin American countries may soon establish similar agreements with the United States.

RSB support: $249,060
Staff weeks: 20

Do National Policies Affect Long-Run Growth?

William Easterly
Country Economics Department, Macroeconomic Adjustment and Growth Division
Ref. no. 676-66

After a decade in which some developing countries showed outstanding growth and others stagnating growth, many are attempting to reestablish — or establish for the first time — conditions conducive to growth. Coming up with appropriate policies requires understanding the reasons behind the wide variance in growth.

A clear link has been drawn in empirical work between economic policy and economic growth. But which policies have a strong effect on long-run growth — and which have only a one-time effect on income? Do policies explain successive periods of rapid growth and stagnation in the same country? What are the effects of external factors on growth relative to those of national policies? And which policies are most critical for a country seeking to achieve decent long-run growth?

This project will examine the relation between growth and fiscal, monetary, trade, domestic financial, and foreign capital policies. It will use an analytical framework based on the simple idea that all factors of production can be increased through investment in human or physical capital. Economic growth will be related to policies that affect the incentive to invest in such capital and to policies that affect the efficiency of the use of capital and intermediate inputs. The frame- work enables researchers to consider which policies affect the long-run growth rate, not just the level of income for a one-time change, and to analyze complex interactions among policies and initial conditions. The project will rely on fairly aggregate indicators of national policies — for simplicity and to test relations that aggregate measures of national policies can be used to predict growth performance. The project will use the framework to derive testable predictions of the relation between the national policies and long-run growth and then use econometric and qualitative techniques to test the accuracy of the predictions and determine which policies are most important in promoting growth.

The research will also examine the relation between growth and broader measures of welfare such as social indicators and environmental measures. Evidence suggests high correlation between growth and other welfare measures; this research will try to identify factors that could cause them to diverge.

RSB support: $177,694
Staff weeks: 118

The International Economic Environment and Productivity Growth in Industrial and Developing Countries

Vikram Nehru
International Economics Department, Office of the Director
Ref. no. 676-67

Two recent research products of the World Bank, the World Development Report 1991 and Global Economic Prospects and the Developing Countries, have both observed that the GDP growth rate of developing countries as a group has tended to move closely with that of industrial countries as a group. This has been attributed mainly to greater world
economic integration. At the same time, individual developing economies and regions have shown wide variations in growth performance. This has been ascribed mainly, though not solely, to different factor endowments and domestic policies. There is thus a tension between whether the international or the domestic policy environment is more important in influencing long-term growth. This tension spills over into the Bank’s relations with its clients. While the Bank emphasizes the role of domestic policies, developing countries often cite the influence on growth of global variables — real commodity prices, international real rates of interest, industrial country protectionism. This project seeks to fill a perceived gap in analysis by examining the relative importance of the international and domestic policy environments in explaining growth in developing and industrial countries. It will also quantify the consequences of changes in international economic variables and in groups of variables for the growth rates of developing countries.

The project will first prepare a series on labor and capital stock (both physical and human) for a wide range of countries. It will then estimate aggregate production functions for industrial and developing countries and disaggregate the sources of output growth into contributions from production inputs and total factor productivity. The project will also use cross-section, time-series pooled regression equations to determine the effects of the international economic environment and of domestic policies on the long-term growth of output and of partial and total factor productivity. The research, to be carried out for analytically meaningful groups of countries, will produce results useful in analyzing both future global economic prospects and international linkages.

Housing Indicators for Policymaking: An Extensive International Survey
Stephen Mayo
Infrastructure and Urban Development Department, Urban Development Division
Ref. no. 676-68

Housing, although recognized as a basic need, is rarely recognized also as an important economic sector whose performance can make a critical difference for the performance of the overall economy. It comprises 20–50 percent of reproducible wealth in most countries, is a major incentive for household saving, and significantly influences household consumption.

Monitoring the performance of the housing sector and making informed policy decisions that affect the sector are made difficult by a lack of good data and of conceptual and analytical frameworks. If governments are to make a fundamental shift in their role in housing, as called for by the U.N.’s Global Shelter Strategy for the Year 2000, from attempting to supply housing directly, as most developing country governments do, toward supporting the private sector’s activities in developing housing, they will need a better understanding of the mechanisms that govern the sector.

This project, a new component in an ongoing program to develop housing indicators for policymaking, has three main objectives. First, it seeks to develop conceptual, analytical, and institutional frameworks for managing the housing sector. Second, it will create a basic set of 20–30 key housing indicators and obtain current estimates for the indicators through extensive surveys in 35–40 major cities in separate countries. The surveys will also obtain some 10 social and macroeconomic indicators thought to relate to the housing sector. Third, it will attempt to establish key relations among the housing indicators and between them and the social and economic development indicators, using cross-sectional data from the surveys.

The project should contribute to the development of operational tools necessary for measuring performance in the housing sector for understanding how difference in sectoral outcomes are influenced by socioeconomic conditions and policies, and for understanding in turn how the housing sector influences other social and economic outcomes. The project also seeks to contribute to the development of new institutional mechanisms for encouraging the use of such tools by governments of developing countries and by international donors.

License Prices and Rent Sharing in the Multi-Fibre Arrangement
Refik Erzan
International Economics Department, International Trade Division
Ref. no. 676-69

Estimates of tariff equivalents of quotas and welfare calculations on the costs of Multi-Fibre Arrangement quotas for developing countries are based on the premise of perfect competition in both the product and license markets. It is also assumed that the exporting countries subject to the MFA quota receive the scarcity rents. But if there is market power on the buyers’ side in the product marke
and concentration in the license markets, importing countries might retain part of the rents. Thus, if rent sharing does occur, the cost of the MFA quotas to exporting developing countries might be greater than the acknowledged costs of reduced export volumes.

A pilot study analyzed U.S. apparel imports from Hong Kong to test whether data conformed to all the relevant predictions of the competitive model. The test compared the license price inclusive Hong Kong price, adjusted for tariffs and transport costs, with the domestic U.S. price. Deviations between the two prices were assumed to indicate product market power on the buyers' side. The results produced strong evidence that importers retained a substantial share of the MFA quota rents.

The purpose of this research project is to provide a conclusive answer to the question of whether there is rent sharing in the MFA. The methodology and country coverage of the pilot study will be enhanced and extended. Data will again be tested against the competitive model, but alternative proxies for market power will be incorporated to allow a determination of the sources of the deviations from the model — whether from imperfections in the product markets or the license markets. Economies covered will include — besides Hong Kong — Bangladesh, India, Indonesia, Korea, Mexico, Sri Lanka, and Thailand. The U.S. market, the largest for apparel products, will remain the focus, but other industrial country importers will be added. Apparel imports from nonrestricted countries will also be studied, to see whether price differences exist that cannot be explained by quality differences.

A second part of the research will look at the path of license prices of MFA quotas over a year and develop a model on the option value component of the license price to test whether there is price-fixing — market power — in the license market. The results of this model will contribute to the analysis of rent sharing.

RSB support: $86,494
Staff weeks: 16

Research Proposals under Preparation

Financial Linkage Development under Liberalization in Sub-Saharan Africa
William Steel and Mala Hettige
Industry and Energy Department, Industry Development Division
Ref. no. 676-60
RSB support: $6,325

Import License Auctions in Trade Liberalization: An Empirical Study
Jaime de Melo and David Tarr
Country Economics Department, Trade Policy Division, and Technical Department, Europe, Middle East, and North Africa Regional Office, Trade, Finance, and Public Sector Division
Ref. no. 676-62
RSB support: $14,700

Labor Market Dynamics during the Transition of a Socialist Economy
Alan Gelb
Country Economics Department, Socialist Economies Reform Unit
Ref. no. 676-63
RSB support: $9,600

Operations and Maintenance in Developing Countries
Heywood Fleisig
Latin America and the Caribbean Regional Office, Chief Economist's Office
Ref. no. 676-64
RSB support: $10,500

Publications

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Books

World Development Indicators
Published for the World Bank by Oxford University Press
English hardback edition: 344 pages/
Order Stock #60869/$32.95
Paperback editions: $16.95
English: Order Stock #60868
French: Order Stock #11796
Spanish: Order Stock #11797

This fourteenth edition of the World Development Report draws together the lessons of 40 years of development experience. It shows how governments and markets can interact most effectively to promote rapid development that benefits all. While it acknowledges that no single development strategy has yet proved ideal, WDR 1991 explains the reliable principles that have emerged to guide policymakers.

WDR 1991 first reviews the world economy, assesses the effect of external factors on development, and considers alternative scenarios — optimistic and pessimistic — for the 1990s. To assess the prospects for development, the report then looks at how effective past strategies have been in promoting growth and how thinking on development is changing. The emphasis in the 1950s and 1960s on capital accumulation is giving way to a greater recognition of the importance of policies that can...
improve the quality of investments. Optimism about the ability of governments to direct development is giving way to a greater faith in markets.

The report identifies four aspects of strategies for development that are crucial for success:

1. **Invest in people.** Governments must spend more — and more efficiently — on human beings. This requires shifts in spending priorities, better targeting of expenditures, and in some cases greater resource mobilization.

2. **Improve the climate for enterprise.** Governments need to intervene less in pricing, to deregulate restrictions on entry and exit, and to focus instead on ensuring adequate infrastructure and institutions.

3. **Open the economy to international trade and investment.** This calls for greatly reducing the restrictions on trade and investment.

4. **Get macroeconomic policy right.** Macroeconomic policy needs to ensure low fiscal deficits and low inflation, and market-based incentives for saving and investment.

WDR 1991 recognizes that, for all four, there are ways in which governments can be either building blocks or stumbling blocks to development. For countries to develop, governments must complement markets. They should create institutions that enable the private sector to flourish in producing and marketing goods and services. And they should step in efficiently when markets prove inadequate or fail altogether.

The report elaborates on these strategies with a detailed discussion of 15 actions that have worked and that can be adapted to solve the problems of the 1990s. The report concludes that despite the challenges that remain, the opportunities for development are greater today than at any time in history.

As did previous editions, WDR 1991 contains the World Development Indicators, with comprehensive data on social and economic development for 124 countries.

**World Tables 1991**
Published for the World Bank by Johns Hopkins University Press
655 pages/Order Stock #44252/$34.95
This seventh edition of the World Tables gives economic, demographic, and social data for 139 countries and territories for 1969–89. Like its predecessors, it provides historical time series based on the World Bank’s ongoing collection and analysis of data on its member countries. The data, updated annually, focus on national accounts, international transactions, and other development indicators.

**Price Prospects for Major Primary Commodities, 1990–2005**
Volume I — Summary, Energy, Metals and Minerals/248 pages
Volume II — Agricultural Products, Fertilizers, Tropical Timber/371 pages
Order Stock #11794/$275.00 for a two-year subscription
These volumes provide the most up-to-date information on the market performances and forecasts for 44 commodities. The set examines prospects for energy, metals, minerals, food products, nonfood agricultural products, and fertilizers. For each commodity or group of commodities, it looks at production, consumption, exports, imports, and prices for 1970-89 and gives forecasts for the next five years, for 2000, and for 2005.

The set also analyzes the future directions for the world economy and world trade, and the most important economic regions and countries involved in the market for each commodity.

The information is available as a two-year subscription that comprises, besides the two volumes, occasional supplements describing recent market performance and a set of biannually updated price forecasts.

**Journals**

The articles summarized in this Journals section appear in the current issue of the World Bank Research Observer. Subscription to the Observer is available without charge to readers with mailing addresses in countries that are not members of the OECD but are members of the World Bank. Other subscription requests should be directed to the World Bank Publications Sales Unit, Department PR, 1818 H Street, NW, Washington DC 20433.

**World Bank Research Observer**
Volume 6, Number 2
July 1991

**The Relative Efficiency of Private and Public Schools in Developing Countries**
Emmanuel Jimenez, Marlaine E. Lockheed and Vicente Paqueo

Aside from revenue mobilization, one of the arguments for allowing the private sector to assume a large role in the provision of education is that it would increase efficiency, as administrators become more responsive to the needs of students and their parents. But what is the evidence? Based on case studies that compare private and public secondary education in Colombia, the Dominican Republic, the Philippines, Tanzania, and Thailand, private school students generally outperform public school students on standardized math and language tests. This finding holds even after holding constant for the fact that, on average, private school students in these countries come from more advantaged backgrounds than their public school counterparts. In addition, preliminary evidence shows that the unit costs of private schools are lower than those of public schools. Although these results cannot, in
 themselves, be used as arguments for massive privatization, they indicate that governments should reconsider policies that restrain private sector participation in education. Further research is needed to determine whether some teaching and administrative practices in private schools are applicable to public schools.

Cash Flow or Income? The Choice of Base for Company Taxation
Jack M. Mintz and Jesús Seade
Cash flow and equity income (or income) are two alternative bases advocated for taxes on businesses throughout the world. Although in practice most tax systems are hybrids with elements of both types of taxes, recent literature has stressed the merits of the cash flow tax because it is simple in concept and it does not distort decisions about capital expenditures and financing. But international issues and administrative complexities—particularly tax evasion—present problems that must be sorted out before a cash flow tax can be implemented.

Development, the Environment, and the Social Rate of Discount
Anil Markandya and David W. Pearce
This article examines the role of the discount rate in making decisions that will have significant implications for the environment. The authors begin by providing a rationale for discounting in general and by describing the main factors that determine the discount rate. These factors—the private and social rates of time preference, the opportunity cost of capital, risk and uncertainty, and the interests of future generations—all have an environmental dimension. The article goes on to examine that dimension and to explore the connections between the choice of the discount rate and environmental concerns, such as excessive exploitation of natural resources, inadequate investment in conservation, and insufficient attention to the irreversible loss of certain environmental resources.

The authors conclude that, in general, environmental concerns are not best addressed by lowering the discount rate—an action that might have both benefits and costs for the environment. A more promising course would be to incorporate a criterion of sustainability into certain aspects of decisionmaking. How such a criterion could be made operational is touched upon but not developed in this article.

Reform of Trade Policy: Recent Evidence from Theory and Practice
Vinod Thomas and John Nash
In the 1980s many developing countries began to recognize that restrictive trade policies can constrain growth. To facilitate trade and integration into the world economy, many countries have embarked on reform programs, often with World Bank support. This survey synthesizes the conclusions of the literature on trade policy reform with those of a recent study by the World Bank analyzing reforms in developing countries, particularly those supported by adjustment lending programs. Its objective is to shed light on some of the questions about these programs to guide policymakers in the future. The article reviews conditions in these countries before trade policy reforms were implemented and examines how much reform actually took place. It also examines the effects of the reforms on economic performance and reviews the factors that constrained the reform process. The survey considers the most important issues in designing and implementing trade policy reforms and concludes that although past reforms have had some impact, future programs should emphasize three elements: reducing the level of protection, maintaining macroeconomic stability, and considering the potential conflicts and complementarities with other policies.

Reaching the Rural Poor Through Public Employment: Arguments, Evidence, and Lessons from South Asia
Martin Ravallion
With the limited set of policy instruments typically available in the rural sectors of developing countries, imperfect coverage of the poor and leakage to the nonpoor must be expected from even the most well-intentioned poverty alleviation scheme. One way to reach the poor more effectively is to build incentives for self-selection into the scheme. Labor-intensive rural public works projects have the potential to reach and protect the poor, as well as to create and maintain rural infrastructure. The limited evidence for South Asia suggests that few nonpoor persons want to participate, and that both direct and indirect transfer and stabilization benefits to the poor can be sizable. These benefits can, however, be rapidly dissipated by a badly conceived and executed project; the details of how projects are selected, designed, and financed are crucial to success in both the short and the long run.

The Market for Developing Country Debt: The Nature and Importance of Its Shortcomings
John Wakeman-Linn
There are two problems in the market for developing country debt: one is the immediate crisis. What do we do about the large volume of outstanding debt? A more subtle but no less important...
problem is that because contracts are unenforceable and lenders have incomplete information about risk, capital is misallocated. This article examines the latter problem and reviews the nature and causes of the unenforceability. It shows that unenforceability results in higher interest rates on smaller and shorter-term loans than are otherwise available and discourages investment in developing countries. Similarly, unenforceability can explain the perverse timing of capital flows to developing countries, causing credit to flow into the country when income is high, and out when income is low. The article then analyzes the risk associated with three types of information asymmetries: information about the borrowers' ability to repay, willingness to repay, and use of the loan proceeds. These asymmetries, the author argues, reinforce the effects of unenforceability. The prospects for remediating the immediate crisis are discussed, as is the need to be certain that the proposed solutions do not aggravate these problems.

### Discussion, Technical, and Related Papers

**Developing Financial Institutions for the Poor and Reducing Barriers to Access for Women**  
Sharon L. Holt and Helena Ribe  
Discussion Paper 117  
60 pages/Order Stock #11775/$5.95

This study reviews experience with financial microcredit programs available to poor people, especially women. It analyzes the success of formal and informal programs and outlines what experience suggests are viable solutions to the problem of providing these groups with credit and savings facilities.

Poor people, especially poor women, commonly have limited access to financial services. Donors and national governments have invested substantially in large-scale, regulated, subsidized credit programs. But the low-interest credit from these programs often goes to wealthier people who know how the system works.

The study looks at the two most significant obstacles to credit for the poor. First, transaction costs are high for both the lender and the borrower. The lender incurs high unit costs in administering small loans. The low literacy and numeracy among poor people and their unfamiliarity with formal banking lead to high opportunity cost in dealing with a bank.

Second, most poor people, and especially women, cannot fulfill collateral requirements. The valuables to which women have access may be accepted by money-lenders and pawnbrokers, but not by formal institutions. Women also have trouble reaching formal sources of credit because it is often culturally inappropriate for them to travel alone the necessary distances. Women also tend not to belong to most organizations through which important contacts and sources of credit can be reached.

### The Social Dimensions of Adjustment Priority Survey: An Instrument for the Rapid Identification and Monitoring of Policy Target Groups

Christiaan Grooelaert and Tim Marchant  
Social Dimensions of Adjustment Working Paper 12  
192 pages/Order Stock #11720/$10.95

This report presents a simple household survey along with guidelines for using it. The survey has two primary objectives. First, it provides a quick socioeconomic profile of household groups that are targets of government interventions. Second, it provides a way to easily monitor the socioeconomic variables within these groups.

The authors put considerable effort into identifying the minimum information needed. As a result, the Priority Survey's questionnaire is short and easy to administer, and the data analysis is delivered through an efficient system.

### Improving the Performance of Soviet Enterprises

John Nellis  
Discussion Paper 118  
32 pages/Order Stock #11777/$5.95

Most productive capacity in the Soviet Union is the property of the state. Under perestroika, however, the Soviet government has begun to increase the autonomy of state enterprise managers and has allowed new forms of production emerge — such as cooperatives, leasing arrangements, and collectively owned firms.

This paper presents the history of Soviet state enterprises and compares their productivity with that of the new enterprises. It also discusses the problems in the "quasi-private" sector — called this because owners of private enterprises control them but only partially own them and rarely have personal capital at risk. The concept of ownership remains vague, and a private sector, in the capitalist sense, cannot emerge.
The paper examines the prospects for true privatization and presents detailed reforms to "corporatize" enterprises that are most likely to remain in state hands in the foreseeable future. It recommends actions to improve the awareness and skills of Soviet managers.

**PRE Working Papers**

**Working Papers disseminate the findings of work in progress and encourage the exchange of ideas among Bank staff and all others interested in development issues.**

**Fiscal Policy with Fixed Nominal Exchange Rates: Côte d'Ivoire**
Christophe Chamley and Hafez Ghanem
WPS658 • Contact R. Luz, room N11-059, extension 34303.

**Inflation and Growth in the Transition from Socialism: The Case of Bulgaria**
Andrés Solimano
WPS659 • Contact E. Khine, room N11-061, extension 39361.

**The Development of the Colombian Cut Flower Industry**
José A. Mendez
WPS660 • Contact N. Artis, room N10-013, extension 37947.

**The Bretton Woods Agencies and Sub-Saharan Africa in the 1990s: Facing the Tough Questions**
Richard E. Feinberg
WPS661 • Contact S. King-Watson, room S8-040, extension 33730.

**Trends in Social Indicators and Social Sector Financing**
Jacques van der Gaag, Elenen Makonnen, and Pierre Englebert
WPS662 • Contact B. Rosa, room S9-137, extension 33751.

**Bank Holding Companies: A Better Structure for Conducting Universal Banking?**
Samuel H. Talley
WPS663 • Contact Z. Seguis, room N9-005, extension 37665.

**Should Employee Participation Be Part of Privatization?**
Barbara W. Lee
WPS664 • Contact G. Orraca-Tetteh, room N9-069, extension 37646.

**Microeconomic Distortions: Static Losses and their Effect on the Efficiency of Investment**
Ramón López
WPS665 • Contact the World Development Report office, room P4-001, extension 38064.

**Agriculture and the Transition to the Market**
Karen M. Brooks, José Luis Guasch, Avishay Braverman, and Csaba Csaki
WPS666 • Contact C. Spooner, room N8-039, extension 30464.

**VERs Under Imperfect Competition and Foreign Direct Investment: A Case Study of the U.S.-Japan Auto VER**
Jaime de Melo and David Tarr
WPS667 • Contact D. Ballantyne, room N10-033, extension 37947.

**Inflation Tax and Deficit Financing in Egypt**
Hinh T. Dinh and Marcelo Giugale
WPS668 • Contact L. Santano, room D7-039, extension 80553.

**Are High Real Interest Rates Bad for World Economic Growth?**
Nemat Shafik and Jalaledin Jalali
WPS669 • Contact M. Divino, room S8-038, extension 33739.

**Inflation Adjustments of Financial Statements: Application of International Accounting Standard 29**
Yaaqov Goldschmidt and Jacob Yaron
WPS670 • Contact C. Spooner, room N8-039, extension 30464.

**Lessons from the Heterodox Stabilization Programs**
Miguel A. Kiguel and Nissan Liviatan
WPS671 • Contact E. Khine, room N11-067, extension 39361.

**The Macroeconomics of Public Sector Deficits: The Case of Ghana**
Roumeen Islam and Deborah L. Wetzel
WPS672 • Contact R. Luz, room N11-059, extension 34303.

**The Macroeconomics of Public Sector Deficits: The Case of Pakistan**
Nadeem U. Haque and Peter Montiel
WPS673 • Contact R. Luz, room N11-059, extension 34303.

**Distributional Effects of Adjustment Policies: Simulations for Two Archetypical Economies**
François Bourguignon, Jaime de Melo, and Akiko Suwa
WPS674 • Contact the World Development Report office, room P4-001, extension 38064.
Education and Adjustment: A Review of Literature
Andrew Noss
WPS701 • Contact C. Cristobal, room S6-035, extension 33640.

Should Price Reform Proceed Gradually or in a “Big Bang?”
Swee-Lyn Wijnbergen
WPS702 • Contact M. Stroude, room 18-159, extension 38831.

The Political Economy of Fiscal Policy and Inflation in Developing Countries: An Empirical Analysis
Sebastian Edwards and Guido Tabellini
WPS703 • Contact A. Bhalla, room N10-035, extension 37699.

Costs and Finance of Higher Education in Pakistan
Rosemary Bellew and Joseph DeStefano
WPS704 • Contact C. Cristobal, room S6-035, extension 33640.

What Causes Differences in Achievement in Zimbabwe’s Secondary Schools?
Abby Rubin Riddell and Levi Martin Ngwura
WPS705 • Contact C. Cristobal, room S6-035, extension 33640.

Successful Nutrition Programs in Africa: What Makes Them Work?
Eileen Kennedy
WPS706 • Contact O. Nadora, room S6-065, extension 31091.

Population, Health, and Nutrition Division, Population and Human Resources Department
WPS707 • Contact O. Nadora, room S6-065, extension 31091.

NGovernmental Organizations and Health Delivery in Sub-Saharan Africa
Jocelyn Delong
WPS708 • Contact O. Nadora, room S6-065, extension 31091.

An Empirical Macroeconomic Model for Policy Design: The Case of Chile
Luis Serven and Andrés Solimano
WPS709 • Contact S. Jonnakuty, room N11-039, extension 39074.

Urban Property Tax Reform: Guidelines and Recommendations
William Dillinger
WPS710 • Contact V. David, room S10-141, extension 33734.

Financial Reform in Socialist Economies in Transition
Millard Long and Silvia B. Sagari
WPS711 • Contact M. Raggambi, room N9-041, extension 37657.

Foreign Direct Investment in Developing Countries: Patterns, Policies, and Prospects
Thomas L. Brewer
WPS712 • Contact S. King-Watson, room S8-023, extension 31047.

The Determination of Wages in Socialist Economies: Some Microfoundations
Simon Commander and Karsten Staehr
WPS713 • Contact O. Del Cid, room M7-047, extension 39050.

Women in Forestry in India
Ravinder Kaur
WPS714 • Contact A. Sloan, room S9-121, extension 35108.

Promoting Girls’ and Women’s Education: Lessons from the Past
Rosemary Bellew and Elizabeth M. King
WPS715 • Contact C. Cristobal, room S6-214, extension 33640.

Financing Training: Issues and Options
Christopher Dougherty and Jee-Peng Tan
WPS716 • Contact C. Cristobal, room S6-214, extension 33640.

Does Financial Liberalization Really Improve Private Investment in Developing Countries?
Jacques Morisset
WPS717 • Contact S. King-Watson, room S8-043, extension 31047.

Impact of Investment Policies on German Direct Investment in Developing Countries: An Empirical Investigation
Andrea Gubitz
WPS718 • Contact S. King-Watson, room S8-043, extension 31047.

How Trade and Economic Policies Affect Agriculture: A Framework for Analysis Applied to Tanzania and Malawi
Ramon Lopez, Ridwan Ali, and Bjorn Larsen
WPS719 • Contact M. Gunasekara, room H5-053, extension 32261.

The Outlook for Commercial Bank Lending to Sub-Saharan Africa
Ellen Johnson Sirleaf and Francis Nyers
WPS720 • Contact Sheilah King-Watson, room S8-040, extension 31047.

The Demand for Money in Developing Countries: Assessing the Role of Financial Innovation
Patricio Arrau, José De Gregorio, Carmen Reinhart, and Peter Wickham
WPS721 • Contact S. King-Watson, room S8-040, extension 31047.

Is Rice Becoming an Inferior Good? Food Demand in the Philippines
Merlinda D. Ingco
WPS722 • Contact P. Kokila, room S7-040, extension 33716.

Improving Women’s and Children’s Nutrition in Sub-Saharan Africa: An Issues Paper
Carmen Reinhart and Peter Wickham
WPS723 • Contact S. King-Watson, room S8-040, extension 31047.

Fiscal Issues in Adjustment: An Introduction
Ricardo Faini and Jaime de Melo
WPS724 • Contact D. Ballantyne, room N10-019, extension 37947.

How Structure of Production Determines the Demand for Human Capital
Indermit S. Gill and Shahidur R. Khandker
WPS725 • Contact A. Sloan, room S9-121, extension 35108.

Perspectives on the Design of Intergovernmental Fiscal Relations
Anwar Shah
WPS726 • Contact A. Sloan, room S9-121, extension 35108.

Is Export Diversification the Best Way to Achieve Export Growth and Stability? A Look at Three African Countries
Ridwan Ali, Jeffrey Akeyong, and Paul B. Siegel
WPS729 • Contact M. Gunasekara, room H5-053, extension 32260.

Wage and Employment Policies in Czechoslovakia
Luis A. Rivas
WPS730 • Contact V. Charles, room S6-228, extension 33651.
August


22-29 — 21st International Conference of Agricultural Economists, Tokyo, Japan, on sustainable agricultural development: the role of international cooperation [Contact: R. J. Hildreth, IAAE, Farm Foundation, 1211 W. 22nd Street, Suite 216, Oak Brook, Illinois, 60521-2197]

September

7-14 — Seminar on Sustainable Development and the Future of Cities, Bauhaus, Dessau, Germany [Contact: European Centre for Future Studies, Prof. Dr. Bernd Hamm, Department of Social Sciences, University of Trier, P.O. Box 3825, D5500 Trier, Germany, fax (49) 651 23498]


16-27 — Workshop on Financial Sector Analysis and Policies, Prague, Czechoslovakia, on basic tools for analyzing and evaluating financial sector policies for the transition to a market economy and structural reforms for the financial sector and the economy [Contact: Hernan Cortes, Economic Development Institute, World Bank, 1818 H Street, NW, Washington, DC 20433, tel. 202-473-6456]

October

2 — Agricultural Prospects for Eastern Europe, Exeter, U.K. [Contact: K. S. Howe, Agricultural Economics Unit, University of Exeter, St. German’s Road, Exeter, EX4 6TL U.K.]

14-18 — International Conference on Ecologically Sustainable Industrial Development, Copenhagen, Denmark, [Contact: United Nations Industrial Development Organization, P.O. Box 300, Vienna International Centre, 1400 Vienna, Austria, tel. (43-1) 211 310]

17 — Senior Policy Seminar for Chief Executives of Development Banks, Bangkok, Thailand, to allow an exchange of experiences on development banking in developing countries [Contact: Nicholas Bruck, Economic Development Institute, World Bank, 1818 H Street, NW, Washington, DC 20433, tel. 202-473-6457]


November

11-16 — Seminar on Industrial Restructuring and Integration of Small and Medium Enterprises, Bangkok, Thailand, on how restructuring can affect the market structure, scale of enterprises, and opportunities for small- and medium-scale industries [Contact: Sahathavan Meyanathan, Economic Development Institute, World Bank, 1818 H Street, NW, Washington, DC 20433, tel. 202-473-6376]


20-24 — 3rd International Association on Water Pollution Research and Control Regional Conference on Development and Water Pollution Control — Asian Waterqual ’91, Shanghai, China [Contact: Li Xiaopin, Huangpu River Research Development No. 1 Nandan Road, Shanghai 200030, China]