Privatization in Post-Communist Societies

Eastern European countries are facing the most momentous economic and social change of the last 50 years. Since the late 1940s, when these countries adopted the central planning system, no other economic change has been as radical and thorough as the currently envisioned privatization of state-owned enterprises.

Previous market-oriented reforms in Eastern European countries never questioned the dominance of state (social) ownership over the means of production. But failure of the reforms ultimately led to the realization that a market economy assumes private ownership over capital and that this lack of ownership is the root cause of inefficiency in socialist economies.

Two approaches

From the legal viewpoint, before privatization can start, laws have to be introduced to alter the character of state-owned enterprises (SOEs) and allow for their transformation into joint-stockholding companies. The new companies may still be owned entirely by the state, but the notion that enterprise ownership must be unequivocal and unambiguous (which is what shareholding implies) opens the way for eventual privatization.

Transformation of state-owned enterprises into joint-stock companies is often referred to as commercialization (enterprises are to be autonomous and to maximize profits) or corporatization.

Corporatization laws in Eastern Europe have defined property claims to the newly invested capital relatively well (e.g., with the infusion of new private capital, the enterprise becomes a jointly owned company). The laws in Eastern Europe, however, have failed to identify unambiguously the owners of the existing assets and to prescribe the methods for privatization. This is, first, because privatization was not an important option when the laws were drafted. Second, in all socialist countries the ownership problem is extremely difficult to resolve as both the state and employees have strong claims to enterprise assets.

The legal dilemma about enterprise ownership has led to divergent approaches to privatization. The first

What's inside...

Will the Oil Shock Imperil Reform?

The Gulf crisis and the accompanying oil price explosion could not come at a worse time for the Central and Eastern European countries, already facing tremendous terms of trade loss from the shift in CMEA trade. How can the World Bank contribute to limiting the damages? We asked Ulrich Thumm, lead economist in EMENA. (page 4)

Tanzania: Analytical Lessons

Analyzing developments in Tanzania highlights the potential of the parallel and informal economies for unleashing economic activity at the outset of the transition phase. The author warns that the conventional motto, "deal with the macro-fundamentals first, worry about the sectors and institutions later," does not apply in settings like Tanzania. (page 5)

Quotation of the month

"Can you turn the fish soup back into an aquarium?" Timothy Garton Ash, the British historian quotes this Russian joke about the dilemma of systemic change in the former Communist countries. (page 8)

Disinflation in Yugoslavia

Sofar so good — the Yugoslav government has successfully tamed hyperinflation, which by the end of 1989 had reached 10,000%. How did rapid disinflation work? What are the major challenges? (page 10)

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The privatization approach — *private from above* — assumes the state as owner, with assets in the hands of the state, ultimately to be deposed through sale or free distribution to private individuals. Privatization from above presumes that ownership rights unambiguously belong to the state — a position contested by both management and workers.

The second approach — *private from below,* or *spontaneous privatization* — implies that the real owner of the assets (or at least part of the assets) is the enterprise itself (workers or management), and that they alone should decide to whom (including themselves) and how to sell the assets. Hungary and Poland, for example, have taken apparently contradictory positions over these issues. Both have tried to recentralize assets only a few years after some portion of capital was to become quasi-owned by workers. In about five years these countries had moved from partial central planning to a decentralized self-management system. To speed up privatization, both economies had to backtrack to state ownership — ironically, “privatizers” tried to undo what the original “nationalizers” did some forty years ago using the same instrument, the state.

Employees argue that through the decentralization that transferred to them many of management’s rights (including the right to invest retained profits), they could claim property rights over at least some assets. They pointed out that if an enterprise were indeed autonomous (as had previously been guaranteed), it could enter into any kind of legitimate contract and was authorized to issue its own shares. Using this rationale, workers and managers engaged in “wild” or spontaneous privatization, beginning in Hungary in 1988, spreading to Poland and Yugoslavia as well.

Spontaneous privatization provoked a public outcry against the intrinsic inequity of the process (used often by managers as a way to enrich themselves) and the squandering of national wealth, often to the advantage of foreigners. As a consequence, and because of recent political changes, privatization laws have been passed in Hungary, Poland, and Yugoslavia.

**Typology and country experience**

No serious privatization has yet occurred in Eastern Europe, however, although several large enterprises were sold to private investors in Hungary. In the post-communist countries, privatization of perhaps as much as 50% of each nation’s GDP is envisaged — an enormous undertaking in the absence of capital markets and after 40 years of actively discouraging entrepreneurship.

All privatization can be divided into three types, according to the “target group” of the privatization process: *internal privatization,* in which employees are eligible for shares; *external privatization,* which occurs when the shares are freely sold to anyone; and finally, *free distribution of shares,* another type of external privatization, which simply requires citizenship.

Experience in several Eastern European countries indicates that they are likely to follow different approaches, mostly reflecting differences in their initial conditions: the political and social strength of various groups, the existing degree of decentralization, the relative success or failure of socialist experiments, etc.

In Hungary the groundwork for privatization was laid down by the October 1988 Law on Economic Association, which allowed state enterprises to convert themselves into joint-stock companies. This led to a spurt of spontaneous privatization, often at advantageous terms. The decision to convert an enterprise into a joint-stock company rested with the enterprise councilors, frequently dominated by the management.

An interesting political coalition supported the process of spontaneous privatization. It consisted of economic liberals, who held that spontaneous privatization was the most natural and quickest way to dismantle the state sector, and parts of the old *nomenklatura* who saw in the process an opportunity to acquire wealth. The first group viewed social pathology in the process of spontaneous privatization as a necessary cost of the transition to a private-ownership economy. The second group expected to profit from such "social costs.”

Hungary’s Transformation Law of June 1989 addresses some of the abuses of spontaneous privatization and has established rigorous procedures for subsequent privatization. The privatization processes are at present overseen by the State Property Agency, in operation since March 1990.

Hungarian data on the extent of spontaneous privatization are scarce. It is estimated that assets worth US$1.6 billion were sold in 1989. This is roughly 2.8% of the total accounting value of state assets. The relative size of the state sector was reduced only through spontaneous privatization; more important, private sector activities expanded significantly. In the beginning of 1988, private sector employment (inclusive of the self-employed) accounted for 6.3% of the non-agricultural labor force; two years later that proportion was about 8%.

In Poland, after imposition of martial law, the role of workers councils was strengthened and, as in Hungary, steps were taken toward a self-managed system. It is only relatively recently that privatization has become the preferred solution. Some changes in this direction were taken.
by the last Communist government, partly for two reasons: first, the government was probably more aware than its predecessors that it needed social support and believed that the nascent private sector (which prefers stability to turmoil) could provide it. Second, when it became clear that, despite all efforts, loss of political power was indeed imminent, the nomenklatura, probably with tacit support of the government, engaged in spontaneous privatization.

The subsequent Mazowiecki government quickly realized that the existing arrangement, characterized by undefined property rights and workers councils' ur controlled management prerogatives, was probably the worst from which to start speedy privatization — since workers were loath to relinquish their managerial rights. Consequently, the state tried to lay claim to all assets through laws to establish external privatization via sales. It did not entirely succeed. The Law on Privatization of State-owned Enterprises (SOEs), which, after several months of parliamentary procedure, was adopted in July 1990, represents a compromise. It leaves intentionally vague the procedure for privatization, basically allowing practically all schemes: straight external privatization (the English model), free distribution (the voucher scheme), and holding companies. SOEs are to be first transformed into joint-stock companies 100% owned by the treasury. This is corporatization, which requires the consent of the founding organization (most often a ministry), the management, and the workers' council. Assent from the latter will probably be the most difficult to obtain, particularly since at the time of corporatization workers' contracts need to be renewed.

The Polish government has drawn up a list of a dozen profitable and relatively well known companies that would be offered for public sale first. Other than several thousand retail outlets, few enterprises have been privatized so far. On the other hand, growth of the private non-agricultural sector has been vigorous: in the last several years its employment has expanded by more than 10% yearly.

Yugoslavia's path to privatization, despite the country's many special characteristics, is similar to that of Hungary and Poland. The "battle lines" in Yugoslavia were more clearly drawn because of the strongly entrenched self-management system that has existed since the early 1950s.

The Enterprise Law of 1988 represented a breakthrough since it limited workers' self-management, allowed transformation of self-managed firms into joint-stock companies (accepting private capital, they became mixed companies), and formally equalized the treatment of all forms of property. A decisive move toward privatization came with the enactment of the Law on Social Capital (December 1989). The law attempted to define ownership of "social capital" and to establish procedures for the sale of assets, citing the so-called Development Funds as the owners.

The first results were disappointing. Lack of enthusiasm from workers for transforming their firms into privately-owned companies has been the main reason for the failure. In July 1990, the government proposed a more radical approach. It further curtailed workers' managerial rights, and a number of prerogatives (including hiring and dismissal) were passed back to management. Loss of these rights should make workers more amenable to privatization since there is little difference between their current position in a firm and what it would be in a privately-owned enterprise. The law is an attempt to start privatization from below by luring workers with a "carrot" of preferential shares: they will receive a discount of up to 70% of the accounting value of capital.

The relative success of the different privatization options will provide lessons for other countries that will take the same road. Privatization will also provide a unique testing ground for economics: can market institutions be created by design (human constructivism) rather than through evolution and slow process characterized by accumulation of knowledge and survival of more efficient forms of organization?

Branko Milanovic, CECSE

This is an overview from a longer paper of the same title, in the forthcoming book Socialist Economies in Transition.
Will the Oil Shock Imperil Reform?

The latest oil price explosion means that Central and Eastern Europe will have to import less, but more expensive, Soviet oil for hard currency, as the rouble settlement of CMEA trade will be abolished by January 1991. In response to increasing internal demand and deepening production difficulties, the Soviet Union already has cut back oil deliveries to its traditional East European partners. The shortfall has to be covered from other sources.

How will all these developments affect the countries involved? What specific assistance can be expected from the World Bank? We asked Ulrich Thumm, lead economist in the Europe, Middle East and North Africa Regional Office.

Q. How is the transformation process of the Eastern European countries influenced by recent developments?

A. According to our calculation, all the countries of the region will suffer considerable terms of trade losses due to the shift of the CMEA trade to convertible currencies. Their main exports to the Soviet Union, mainly manufactured goods and agricultural products, were overpriced relative to world market prices, whereas they paid below world market prices for the primary products imported from their big partner. Estimates are that the terms of trade loss for the area adds up to $5-7 billion a year. In relative terms, the worst hit country will probably be Bulgaria, and the least affected one Yugoslavia.

Moreover, much depends on how long the crisis drags on. The World Bank's moderately pessimistic scenario estimates an additional yearly oil bill of about $5 billion for the region. The worst affected countries are Czechoslovakia and Poland.

In addition, these economies will also feel the heat of the impact on the world economy, such as the increase of interest rates. (This is partly due to the process of German unification.) Out of that we would estimate a roughly $1 billion additional cost for the whole region. Combined, the effects add up to something on the order of $12-13 billion, which would be about 5% of the region's combined GDP. That could provoke a major shock and wipe out 2 to 3 years of economic growth.

Q. In these circumstances what are the chances of the continued reform effort?

A. Though most of those governments have been politically legitimized and enjoy strong popular support, it does not necessarily mean equally strong support for the economic transformation process, at least in the short run.

In that sense, external support is even more urgent. The resources of the multinational financial institutions have to be combined with those of the international banking community, the Common Market, and individual donor governments. In the case of Poland, for example, the bulk of the support could be provided through debt relief. Negotiations are under way with commercial banks, and consultations are going on with the Paris Club to provide debt relief beyond the traditional rescheduling arrangements.

Q. What can the World Bank undertake to ease the burden?

A. The World Bank has an active lending program for the whole region for 1990-92 on the order of US$7 billion; about 25% could be allocated for balance of payments financing in support of broad reform programs. One might envisage an increase in the lending program in response to the faster than expected dismantling of the CMEA and also to the impact of the oil crisis. For the time being, three Bank member countries are involved. Yugoslavia, as a non-member of CMEA, can relatively easily absorb the initial shock of the dismantling of the organization. For Hungary and Poland, this is a major additional shock. Originally we had assumed in our balance of payment scenarios that this process would take three years, but now we have to work on the assumption that this is going to happen all at once next year. For Poland, which is not servicing its debt anyway, it would mean just continued debt rescheduling. There may be no need for any additional emergency assistance. Hungary will require additional financing to be able to continue servicing its debt.

Q. Czechoslovakia and Bulgaria are newcomers. Have they started discussing structural adjustment loans or other loans from the World Bank? Is the Romanian government ready to resume relations with the Bank?

A. A possible lending program for Czechoslovakia was discussed in early September, and more formal discussions took place during the annual meeting. Discussions with Bulgaria are less advanced. However, Bulgaria's creditworthiness is doubtful — the government suspended servicing its commercial debts. Bulgaria is the country most dependent on the CMEA and badly affected by the oil crisis. Romania, although a member since the 70s, stopped borrowing from us and prepaid its debt. Preliminary discussions about the reform program and possible Bank support have taken place. The next step should be an economic mission to Romania, possibly in October or a little later. Right now I think the reform process is at a very early stage in Romania.

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**WORLD BANK COMMITMENTS IN EASTERN EUROPE**

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*Estimated. Country-specific allocation to be determined.
†Admitted as new members in September 1990.
‡Resumes borrowing after several years' absence.
Tanzania: Analytical Lessons from an Economy in Transition

From the early 1970s until the mid-1980s, the Tanzanian economy was subject to state control over virtually all realms of activity. Furthermore, the lion's share of the assets in industry, banking and public utilities was in the hands of the state, as was all land. Private sector activity, while accounting for a significant share of production in industry and agriculture, was discouraged by the generally adverse attitude toward private initiative, lack of price incentives, strict controls over trade, and administrative allocation of foreign exchange and other inputs.

The restrictiveness of the trade and exchange rate regime increased significantly during the early 80s, in the aftermath of the large fiscal deficits induced by the war with Uganda and the ensuing balance of payment crisis. This latter occurred as the coffee boom subsided and the passive exchange rate regime was maintained, while inflation accelerated. The economic decline was dramatic.

Overall production and consumption per capita contracted significantly, while real incomes in rural areas are estimated to have declined by about 50% between 1977 and 1983. By early 1984, basic commodities were all but absent, much of agriculture had reverted to subsistence production, and industry was operating at less than 25% capacity.

Transition away from controls

Faced with such decline in economic activity, the Tanzanian Government embarked on a major reform program in the mid-80s. It began by lifting restrictions on imports financed by importers' own foreign exchange — the "own funds" scheme — which de facto sanctioned many parallel market transactions. This trade liberalization measure resulted in significant improvement in the availability of goods and in improved incentives for production. The more comprehensive Economic Recovery Program (ERP) of 1986 included a major — but gradual — adjustment of the exchange rate. The parallel exchange rate was more than eight times the official rate in 1985; today it is about 50% higher. Reform also included broadening the "own funds" import scheme, gradual liberalization of foreign exchange allocation and internal trade, and decontrol of prices. The private sector environment improved significantly. These reforms, complemented with programs of fiscal and monetary restraint, have been supported by the World Bank and the IMF and by substantial aid inflows.

Peasant response

In Tanzania, contrary to what would have been expected from textbook economics, exchange rate alignment did not lead to improved terms of trade for the producer of agricultural exports, a key tradable. This is because for most traditional crops the agricultural marketing system continued operating in a non-competitive and inefficient environment. Thus, gains in improved rural terms of trade accrued to inefficient marketing intermediaries and also financed higher transport and processing costs — instead of benefitting the farmer, who faced higher input costs and consumer prices. Real prices paid to farmers hardly increased, in spite of the large devaluations.

Even without improved pricing incentives in most crops, peasants increased production significantly. Why? Because they responded to the improved availability of consumer goods as the economy made the transition to a liberalized economic regime. In turn, the combination of higher sales and improved availability of goods has resulted in improved living standards for the rural population.

Two conclusions about this type of controlled economy in transition emerge:

- Exchange rate reform can be translated into significantly higher price incentives to producers of tradables only when accompanied by critical institutional changes, in this case in agricultural marketing.

- However, during the transition from a rationed to an uncontrolled regime, it is possible to generate supply response in the absence of higher price incentives. But this is not sustainable in the long run. Once the trade regime is no longer "rationed," all goods are available at market-clearing prices, and improved producer prices become critical to generating production increases.

The institutional factor

The improved performance in sectoral production and GDP growth (4% each year) has not been matched by the performance in financial aggregates — particularly in the monetary, fiscal and balance of payments accounts. Inflation, which has remained around 25%-30% since the late 70s, and the balance of payments situation underscore the fragility of the ongoing recovery. In fact, the contrast between the performance of financial aggregates and the recovery on the real side of the economy reflects a complex set of achievements and constraints in the ERP's implementation.

Implementation has been successful where the limited institutional and administrative capacity has not been overtaxed by reform, or where reform has reduced these institutional demands. Notable examples are the internal and external trade and pricing liberalization measures and the more realistic exchange rate regime. In contrast, the main problems and delays encountered in implementing the programs have been in areas where the institutional demands im-
posed by the required reforms have been high, such as in the financial system and in the rest of the public sector, or where liberalization measures to relieve institutional inefficiencies have yet to take place, such as in agricultural export marketing.

In particular, the non-competitive agricultural export marketing system, comprising parastatals and cooperatives, has been partly responsible for agricultural export growth's being less than expected, and thus jeopardizing progress in balance of payments. Further, the excessive credit requirements of the agricultural institutions have been readily met without adequate financial review by a state-controlled banking sector, resulting in high monetary growth. In practice, a true separation between the fiscal side of the central government, on the one hand, and the financial system, on the other, does not exist in Tanzania. Hence, a large fraction of public expenditures has been channeled through the banking system. Higher than anticipated inflation, in turn, has necessitated larger and politically more painful nominal devaluations of the currency. The link from agricultural institutions to macro-stability and the exchange rate, via the financial sector conduit, is therefore critical in Tanzania.

Finally, but equally important, weaknesses in public sector management, partly brought about by an inadequate structure of compensation, have impaired discipline and productivity. This has had a detrimental impact on the delivery of social services and on the ability of the public sector to carry out urgently needed improvements in transport infrastructure.

Challenges ahead

The second phase of the adjustment program, unveiled by the government in December 1989 (the Economic and Social Action Program - ESAP), will thus require complex structural and institutional changes. These will be aimed at sustaining the economic recovery and restructuring process, attaining macroeconomic balance, improving the external situation, and addressing urgent social issues.

The design and phasing of these second-phase measures require taking into account the existing institutional constraints (e.g., implications of limited implementation capacity on parastatal restructuring), the identification of additional areas where institutional pressures can be relieved (e.g., agriculture marketing), and the support for institution-building, such as reforming the civil service to improve its productivity. Also, ESAP requires taking into consideration critical links between the real sectors and the institutional side of the economy, on the one hand, and macro-financial variables, on the other. Resolution of fiscal, monetary, and balance of payments instability can come only once sectoral and institutional weaknesses are addressed.

Concluding lessons

The case of Tanzania highlights the potential of the parallel and informal economies in unleashing economic activity at the outset of the transition phase. The "own funds" scheme, in one stroke liberalized much of the trade regime de facto and allowed a market-determined rate—the parallel exchange rate—to play a key allocative role. And the relaxation of constraints on domestic informal activities demonstrated the large potential of the indigenous entrepreneur. In turn, the resulting market-based pricing and the large supply response facilitated the introduction of difficult structural adjustment measures, particularly in the exchange rate regime.

Clearly, respecting certain "fundamentals," such as minimizing distortions and avoiding macro-imbalances, is as relevant in Tanzania as elsewhere. But its analysis requires a less conventional framework during the transition. Both the characteristics of the evolving trade regime and the sectoral and institutional constraints need to be incorporated into analysis of macro-imbalances and aggregate supply response. Similarly, the effectiveness of key pricing variables, such as the exchange rate, will depend on institutional and sectoral features. The conventional motto, "deal with the macro-fundamentals first, worry about the sectors and institutions later," does not apply in settings like Tanzania, since all are clearly intertwined. Recognizing this, ESAP programs either are being prepared or are underway already in most structural areas.

In particular, it will be critical to liberalize agricultural marketing further, create a truly independent and competitive financial system, restructure parastatals, the budget and the civil service, and rehabilitate the road network.

Daniel Kaufmann, AF6CO

From the collection of Yugoslav cartoonist Felix
Milestones of Transition

The Czechoslovak Government plans to unify more than 1,600 separate tax rates under three new rates: 12%, 22% and 32%. The tax unification plan is part of a broader tax reform package establishing a value-added tax (VAT), an excise tax on alcohol, tobacco, and other products, a personal income tax, and a new corporate tax structure. Road, real estate, gift and inheritance taxes will also be introduced. The package is expected to be in effect by January 1993.

In addition, Prague unveiled privatization plans, to start on January 1, 1991. The new Czech and Slovak privatization ministries will implement the legislation. Small properties nationalized in 1959 will be reprivatized first. An estimated 70,000 people will regain expropriated workshops, retail outlets, and apartment blocks. Land and large industrial plants seized under the 1948 legislation will not be returned.

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In the Soviet Union, the Group of 13, under the chairmanship of economist Stanislav Shatalin, has called for absolute freedom of economic activity for all Soviet citizens and massive privatization of state ownership throughout the economy. "Property in the hands of each individual is a guarantee of stability in society," stresses the document. It calls for the free transfer of ownership of small apartments and private plots, and the mass privatization of state property through leaseholds, loans, and other means. The plan also utilizes economic sovereignty to the republics, which also will be responsible for ensuring the maintenance of a single market. Shatalin was also the head of "Yeltsin's team," a group of experts that designed the plan to transform the Russian Republic to a market economy in 500 days. The 500-days program, which has been approved by the Russian legislature provides for the following:

- The first 100 days. A new legislative structure, guaranteeing private ownership of land, factories, and other means of production; laws regulating taxation, banking, stock markets, and social security enacted.
- Days 100 to 250: The economy fully privatized, all subsidies abolished, inefficient enterprises merged or sold to foreign investors, or closed. Export licensing to be abolished.
- Days 250 to 400: Full market mechanisms, including decontrolled prices and competition policies.
- Days 400 to 500: Major public investment programs to begin to stimulate economic growth and stabilize the economy. To offset any inflationary impact, the government to release imported consumer goods and food reserves.

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According to a three-year program announced by Poland's central planning agency, the following steps are required from the government to speed the shift to a market economy:

- Removal of remaining barriers to foreign investment, particularly the limits on profit transfers and property ownership.
- Assistance to help restructure the coal mines, steel mills, chemical factories, machine tool plants, and other industries unable to respond promptly to new market mechanisms.
- Phase out the least effective factors and support companies with good prospects.
- Guarantee of minimum prices for key agricultural products, low-cost credits, and tax breaks to farmers.
- Low interest rates to stimulate the economy.
- Full convertibility of the zloty by the end of 1993.
- Retaining price controls on electricity, heating, basic transportation, medicine, alcohol, and tobacco.
- Comprehensive tax reform by 1991-92, including introduction of a personal income tax and value-added tax (VAT).
- Implementation of retraining programs to reduce unemployment (expected to reach 1.3 million by the end of 1990).

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Albania has issued new decrees aimed at encouraging the expansion of foreign trade. Foreign investments and joint ventures will now enjoy the same rights as Albanian enterprises. Foreign partners can repatriate profits and apply for credit from Albanian and foreign banks. The liberalization program's several key elements: relaxation of strict central planning, replacement of financial allocation with bank credits, legalization of the private sector, licensing of privately owned small-scale workshops, and expansion of private agricultural plots. The convertibility of the lek is envisaged.

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The Romanian parliament enacted a privatization law in early August requiring most state-owned companies and farms to transfer 30% of their assessed value to the new National Privatization Agency. The agency will allocate 20% of the value of the companies to the population by distributing vouchers worth 5,000 lei (about US$100) to every citizen. Foreigners will be permitted to own enterprises. According to a recent interview with Mugur Isarescu, the head of the Central Bank, the privatization law will be followed by the liberalization of foreign investment laws. (At present, foreign investors can transfer abroad only 8% of earnings in convertible currency.) In addition, the government intends to establish a foreign investment agency, restructure the banking system, based on the West German or U.S. model, and plan for the internal convertibility of the lei in two or three years.

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China is making new efforts to stimulate foreign investments in the country. According to a regulation issued in late August in Beijing, overseas Chinese and "compatriots" from Hong Kong and Macao will be able to set up 100% privately owned ventures. They can also invest in joint ventures and cooperatives and buy the shares and bonds of enterprises in China. The government guarantees the companies managerial autonomy, unrestricted transfer of profits, and exemption of these transfers from import duties and taxes. (According to official Chinese statistics, authorities have approved more than 25,000 foreign-funded enterprises in China, 11,000 of which are in operation. Ninety percent of these are in the coastal area of eastern China. Foreign investors have committed US$36.6 billion in the last 11 years; US$17 billion actually has been invested. In 1989, 6,500 foreign-funded enterprises exported goods worth US$4.92 billion, approximately one-tenth of the nation's total exports.)
"...The system of late communism may not have qualified for the label "totalitarianism," but it was certainly post-totalitarian.

"...A Russian joke about the transition from communism makes the point better than any learned disquisition: we know that you can turn an aquarium into fish soup; the question is, can you turn the fish soup back into an aquarium?

"...In East Central Europe things are not quite so hopeless. Here one has something more like a goulash than a fish soup. Large lumps of civil society [float] around like meat in the goulash: private farmers, churches, universities, small-scale entrepreneurs. But it is still a very long way from the regular meat and two vegetables of developed West European societies, with relatively durable political parties.

"In East Central Europe today there are a few elements of political differentiation according to socio-economic positions. For example, ever since the formation of the Mazowiecki government, private farmers have been the clearest and most determined interest group in Polish politics. But it is still very difficult to imagine a class-based politics. Walesa and his political allies may sometimes speak in the name of "the workers," but in reality the working class is almost as divided as the intelligentsia, between those who stand to gain from this or that measure favoring a market economy, and those who stand to lose by it. In Poland there is still no significant property-owning middle class. In Hungary, the sociologist Elemer Hankiss argues that one can already identify a grande bourgeoisie (including the "red barons," who exploited their Party positions to take large stakes in new private companies, and the "green barons" of the agricultural cooperatives), and a larger petite bourgeoisie, numbering perhaps as many as two million. But he cannot yet offer any significant correlation between these new classes and particular political parties.

"Indeed in both Poland and Hungary the more important divide may be between those who believe that parliamentary politics can change something in their everyday lives and those who do not.

"...It would be wrong to say that there are no ideological divides....They emerge, for example, in one of the most important debates in all contemporary East Central European politics: how to proceed with privatization. What, if any, should be the limitations on foreign ownership? Should the present management of state enterprises be allowed to turn them into joint-stock companies? Should ownership be given to the workers? Or should shares be distributed to the whole population?

"...If the basis of post-Communist politics is neither class nor ideology, what is it? At the moment the answer would seem to be: history and the West. Western models play a major part, both in the design of the new political institutions of East Central Europe and in the formation of parties. Everywhere, teams of Western experts have been called in to give their advice. In domestic debates about the new constitution, the "French model," the "Italian model," and the "German model" are basic terms of reference. The last-mentioned is particularly noteworthy.... The German model of democracy is arguably the most relevant of all, because it is a model built on the rubble of a totalitarian dictatorship and very deliberately designed to prevent the return of such a dictatorship. It is, one might say, a Western system built on Central European experience.

"...It is a commonplace to say that the chances for the political transition from dictatorship to democracy depend to a very large degree on the transition from a planned to a market economy. But it is also true that the chances for the economic transition depend on the politics of transition. The transition is, as Ralf Dahrendorf has written, unavoidably a valley of tears. Even the Germans, with far better starting conditions in 1948, got poorer before they got richer. (There is of course a problem of unrealistic popular expectations in East Central Europe, based on a mental elision of the idea of the 1950s Wirtschaftswunder with the visible reality of West German prosperity in the 1990s. Perhaps the Goethe Institute should organize a traveling exhibition showing everyday life in Germany in the early 1950s.) In Czechoslovakia, there is talk of achieving a "soft landing." But the real issue is whether you can achieve a soft take-off. Even East Germany is not going to have that.

"The immediate question is: What variant of democratic politics can provide sufficiently strong, stable, consistent government to sustain the necessary rigors of fiscal, monetary, and economic policy over a period of several years, while being sufficiently flexible and responsive to absorb the larger part of the inevitable popular discontents through parliamentary or, at least, legal channels, thus preventing the resort to extraparliamentary, illegal, and ultimately antidemocratic means?

"...The political key to creating such a consensus must be the formation of strong, freely elected coalitions. Hungary has a freely elected [though weak] coalition government. Czechoslovakia has a freely elected government...but it is not a coalition, in the sense of a government constructed as a negotiated deal between distinct parliamentary parties.

"...As for Poland, from the formation of the Mazowiecki government in September 1989 until the early summer of this year, Poland had some-
thing that it has not often had in its history: a strong coalition government... The trouble is, it was not a freely elected coalition government.

"...If there is a threat to democracy in East Central Europe it will probably come through a period of, so to speak, excessive democracy. In Czechoslovakia and Hungary, as well as in Poland, one can see three major elements that give cause for concern. First, there is popular disgruntlement, not only about the costs of economic transition but also about the processes of parliamentary democracy, which are themselves held to be responsible for the slowness of change.

"...Second, the processes of the fledgling democracy are, indeed, often slow, ramshackle, and flawed. There is also an abnormally high level of political conflict inside the new political elites: because there are no clear dividing lines, no proper parties, and few "rules of the game."

"Third, the inevitable dislocation and distress associated with the conversion to a market economy could increase both the fissiparousness of the elite and the disillusionment of the population.

"...The responsibility of the West in general, and Western Europe in particular, is therefore immense. A cartoon on the front page of the leading Czech independent daily, Lidove Noviny, expressed a sentiment about the West that can be encountered in Budapest and Warsaw as well as Prague. It showed a rather gloomy man saying: "The European home is shut. If we want to get in we have first to solve all our key problems." At times the attitude of some Western leaders does still recall Dr. Johnson's famous definition of a patron: "Is not a Patron, my Lord, one who looks with unconcern on a man struggling for life in the water, and, when he has reached ground, encumbers him with help?" Of course, Western investors have no moral obligation at all to invest unless the conditions are right. But Western democracies do have a moral obligation to help, and, what is more, they have a hard political interest in helping the man while he is struggling in the water. Provided, of course, he is really trying to swim.

"...The West, if it is to help, has a right to ask for certain rigorous, consistent economic policies - let us call them, in shorthand, a Balcerowicz or Klaus Plan - and the kind of government that will be able to sustain such policies. If the countries of East Central Europe produce such governments, then they must be confident that the help will really be there. For without it, such policies are simply unsustainable.

"There is, to be sure, a general consensus among Western governments and political elites that "we should help" the transition to democracy in East Central Europe. But how many politicians are prepared to even contemplate action on a scale comparable to that which West Germany, after a very sober examination, considers to be necessary for East Germany? Above all, how many politicians are prepared seriously to make the case for such help to their own electors? Ironically, the kind of Western European consumer democracy to which East Central Europeans so passionately aspire may be the kind least likely to help them.

"Nonetheless, the challenge of democratic leadership would be precisely to make this unpopular case as eloquently and convincingly as possible, stating plainly that this is a moment when short-term personal and material interests should be sacrificed to long-term national and European ones.

"Finally, my exclusive emphasis on just three countries of East Central Europe may raise an objection: What about all those other Europeans, to the east and to the southeast, who are also crying out for democracy? My answer is a purely pragmatic one. Poland, Hungary, and Czechoslovakia are the countries where the fate of democracy hangs in the balance today, and where the weight of the West can make the difference between success and failure. You cannot do everything at once. With German unification, the eastern frontier of democratic Europe has already moved from the Elbe to the Oder. I sincerely hope that in ten or fifteen years the frontier of democratic Europe will be at the Urals and the Black Sea. But the question for today is: Will democratic Europe end on the Oder or on the Bug?"

From Timothy Garton Ash's recent article in The New York Review of Books. The author lives in Oxford, England, and has written books and essays on Central and Eastern Europe; he also leads a research project at St Antony's College.
Disinflation Program in Yugoslavia

Contrary to the initial diagnosis, which pointed to disequilibrium in the domestic goods and services market, the Yugoslav inflation tax, which was essentially the origin of inflation, was not sufficiently contained. Consequently, since 1983 the net value-added (after-wage) in the enterprise sector dwindled rapidly. Since 1987 the enterprise sector as a whole has been registering net financial operating losses annually.

Detailed analysis revealed that monetary policy had been accommodating and expansionary rather than contractionary. Most of the expanded credits were directed to the enterprise sector through a banking system essentially controlled by enterprises. In addition, in the face of rising interest costs and import charges, the wage bill was not sufficiently contained. Consequently, since 1983, the net value-added (after-wage) in the enterprise sector dwindled rapidly. Since 1987 the enterprise sector as a whole has been registering net financial operating losses annually.

Studies reveal that real resources generated by the inflation "tax" were transferred primarily to the enterprise sector through negative real interest rates on the accumulated stock of credits and the capitalization of interest. This was made all the more convenient by the foreign exchange insurance scheme provided by the central bank, which, on the basis of these deposits, provided cheap dinar credits to the commercial banks—foreign exchange risks associated with these deposits were entirely absorbed by the central bank. In addition, the central bank also provided subsidized credits to the export and agricultural sectors.

As inflation continued, the base for the inflation tax, which was essentially the dinar-denominated monetary assets, eroded constantly. Thus the inflation tax rate had to be raised continually to generate sufficient resources to cover the enterprise deficits. The process of price increases was further accelerated by the general application of comprehensive indexing schemes.

The Package

The 1990 program for rapid disinflation was formulated on two premises: First, nominal "anchors" had to be provided to break inflation inertia in the economy; second, monetary authorities needed sufficient freedom to pursue a tight monetary policy independently. Appropriate fiscal and income policies would be needed to support the objectives of the monetary policy.

The most important nominal anchor was the pegging of the new dinar to the D Mark at the ratio of 7:1. Authorities reckoned this rate would be sufficient to maintain the level of the real exchange rate on January 1, 1990, and provide for the adequate competitiveness of the dinar. The new dinar was also made internally convertible. At the time, over three-quarters of total bank deposits were already in foreign exchange; the foreign exchange reserves of the banking system were around US$5 billion.

Contractionary monetary policy, essentially prescribing a gradually declining level of the central bank's net domestic assets, was the center of the program. Average monthly inflation was projected to be only 1% when targets for monetary aggregates in 1990 were formulated. To ensure attainability of the monetary targets, the central bank was relieved of most of its quasi-fiscal operations (foreign exchange insurance scheme, and subsidies to agriculture and export activities); the outstanding stock of uncovered foreign exchange differentials, because of accumulated foreign exchange deposits at the central bank, was converted into public debt with a fixed rate of return. This was to be serviced periodically by the government federation; special measures were adopted to limit the surplus from trade in non-convertible currencies and its monetary consequences. The National Bank of Yugoslavia discount rate was fixed at 23.4% per annum, compared to the projected monthly inflation of 1%. Short-term borrowing by the public sector was strictly regulated.
Fiscal efforts targeted an overall surplus of 0.7% of national output, with increased expenditures for unburdening the central bank operations, a social safety net, and restructuring the banking and enterprise sectors. Sales taxes and customs tariffs were increased. To further ensure the viability of the monetary program, a comprehensive wage freeze and a partial price freeze were imposed (20% of retail prices) for the period January-June 1990.

Outcome and lessons

As of April 1990, inflation was near 0%. Accompanying this rapid disinflation is the continued buoyancy of exports, leading to the current account surplus and increased foreign exchange reserves, amounting to US$8.7 billion near the end of June; the signing of over 1,300 foreign investment contracts amounting to DM1 billion; and an explosive growth of small and medium enterprises (over 15,000 enterprises, 28,000 retail shops). Social tension arising from the measures of the program has been remarkably confined.

The government credits the success of the rapid disinflation program to three measures: very tight monetary policy, convertibility of the new dinar and its pegging to the D-Mark, and increased supplies of inputs as a result of import liberalization.

On the negative side, industrial production declined by over 10% from the previous year; interest rates reached exorbitant levels in real terms (as high as 50% in some instances); the expenditures of the overall public sector substantially increased; and wage payments went beyond what was envisaged in the program.

Incomes policy has failed to stabilize nominal wages because of loopholes in the legislation, however. Fiscal policy has been undermined mainly by the systemic problems associated with excessive decentralization of the public sector. Substantial real appreciation of the dinar also has occurred because of the persistence of inflation during the first quarter of 1990. Although export activities continue to be vigorous, the dinar's competitiveness in the medium term appears less certain.

The outcome of the disinflation program reflects both the strong and the weak aspects of the government's ability in handling macroeconomic policies. Monetary, foreign trade, and foreign exchange policies were primarily the realm of the federal government and thus were more forcefully and exactly implemented. The weakest area has been fiscal policy, in which the federal government has only limited authority. Therefore, the government was not able to implement the overall objectives of the program. Inability to carry out tight incomes policies was another major weakness.

Structural reform has been much more difficult and less forthcoming. The only substantive progress has been in the goods and services market, where deregulation of the domestic economy, combined with import liberalization since March 1989, has substantially enhanced competition. Growth has been remarkable for small and medium enterprises and in foreign investments. However, overall reform of the social enterprise sector has been slow. In the financial market, despite the creation of institutional prerequisites (one money market and three stock exchanges), no serious headway has been made in the development of new financial services. In fact, competition in the financial market remains weak. Meanwhile, the market for labor allocation and wage determination has yet to be established.

Tasks ahead

Notwithstanding short-term achievements, the inherent risks of the program have not diminished. Tight monetary policy has to be maintained to consolidate the hard-won price stability. In addition, fiscal spending, greatly inflated during the first semester, has to be lowered at the republic and provincial level — which may prove to be an extremely difficult task for the government. Wage stability is critical to the success of the program. The government intends to pass legislation to limit wage distributions in both loss-making and temporarily insolvent enterprises and to limit the cash payment of wages for profitable enterprises.

The dinar exchange rate, although appreciated in real terms, can remain at the current level. Nevertheless, the development of external sector accounts should be carefully monitored.

Within the range of monetary targets, mechanisms have to be found to reduce the cost of financial intermediation. The program in the second half of 1990 may be considerably more costly in terms of unemployment and lower output. It is therefore of utmost importance to accelerate reform in the real sector and establish a viable social safety net.

Wei Ding, EM4CO

From the Yugoslav magazine Osten
TAX SYSTEMS IN THE REFORMING SOCIALIST ECONOMIES OF EUROPE
Cheryl Gray

Although the fiscal system of every socialist country has unique characteristics, these systems must pass through distinct stages on the way from full central planning to the free market.

The first stage, classical socialism, prevailed in the first two to three decades after World War II. Tax systems in this stage tended to be very rudimentary tools to capture economic surplus and transfer revenues to the state.

In the second stage, reform socialism, the traditional sources of revenues—turnover, company profits, and payroll taxes—remain the most important taxes but become more fine-tuned. They are often joined by new and unique taxes that attempt to mimic market forces, such as a levy on fixed assets and an excess wage tax.

Several Eastern European countries now are moving into the third stage, post-socialist transition. The tax changes needed to adapt to a market economy are fundamental and systemic. But three sets of problems—related to macroeconomic concerns, enterprise ownership, and structural, and institutional weakness—impose constraints on the design of tax policy during the transition. Maintaining revenues to insure a balanced budget is crucial for macroeconomic stabilization. However, institutional weakness, combined with the demands of rapid privatization, threatens to erode the traditional revenue base.

The most obvious recommendation for the medium term is to adopt a fairly traditional, yet relatively simple, low-rate tax system along the lines of some Western market economies. Such a system would include a standard company income tax (with a maximum rate in the range of 30%-50%), a global personal income tax (with a maximum rate no higher than 50%, and preferably lower), and a comprehensive retail VAT of the standard European type, with as few rates as possible (preferably only one). Alternative approaches would include a more complex system such as that existing in Hungary (not recommended by the author), or an innovative approach that taxes only consumption.

Ronald I. McKinnon

STABILIZING THE RUBLE: THE PROBLEM OF INTERNAL CURRENCY CONVERTIBILITY
OECD Development Center, July 9, 1990, 30p.

In principle, all firms with a positive cash flow should switch to the status of “liberalized enterprise” (LE). LEs are free to make all short- and long-run decisions—including investment—autonomously. Their financial means are internally convertible, i.e., they can be freely used to purchase domestic goods and services, can be converted into cash for income payments, and can be deposited at positive real interest rates; but LEs would operate under a strict hard budget constraint. “Traditional enterprises” (TEs) not yet ready for LE status would remain under tightened central control.

The convertibility restrictions among various monies and the credit restrictions can be relaxed gradually as more TEs either switch to LE status or are liquidated, and as budget constraints harden, the new financial system accumulates operational experience, and inflationary pressures subside. Once consolidation is complete and all fiscal and financial constraints removed, complete price decontrol can be initiated. Introduction of an appropriate and unified exchange rate could follow price decontrol. Introduction of convertibility for current account transactions would be a gradual process, starting after exchange rate reform.

The continuing lack of a hard budget constraint and the still passive monetary policy induce firms to borrow madly to pay higher wages with reduced output while “hoarding” intermediary goods and equipment; inventories have reached 82% of the national income. This syndrome makes the transition to market clearing prices in the “wholesale trade” (inter-firm transactions) impossible and drives up both shortages and inflation. It also destroys the monetary equilibrium that was tightly controlled under central planning through the control of financial macro- and micro-balances. The monetary overhang of the household sector is of secondary importance.

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What are the initial macroeconomic conditions in socialist economies in which the reform process is taking place? High inflation has been a major problem in Poland and Yugoslavia and to a lesser extent in Hungary; on the other hand, in Czechoslovakia, East Germany, and the Soviet Union, open inflation has not been a serious problem until now. Some common macroeconomic imbalances in traditional socialist economies refer to: chronic excess demand for goods, foreign exchange, and labor markets; the existence of money overhang; and the divergence between real wages and the marginal productivity of labor. Those macro imbalances are, in general, produced by:

- An excessive investment drive by enterprise managers, accommodated by central planners;
- Relative prices (including the real exchange rate) that do not reflect the relative scarcities in the economy; and
- Money overhang.

Three measures can be taken to eliminate the latter: (i) monetary reform, (ii) price deregulation to allow prices to reach market clearing levels, and (iii) financial deepening. Another way to restore balance in the money market is to allow price deregulation at a given level of the nominal money supply. Poland and Yugoslavia, which have experienced hyperinflation recently, provide an example of how very high inflation tends to wipe out excessive real money balances; furthermore, hyperinflation is likely to have led these economies to the opposite of money overhang—demonetization—as national money started to be heavily taxed by inflation.

A third avenue to reduce money overhang is to introduce other assets into the system: through creation of a domestic capital market, selling off shares of public enterprises, or auctioning state-owned housing. The correction of fiscal deficits that need to be monetized is also a key policy measure to avoid resurgence of the money overhang problem.

The resumption of growth in the Eastern European economies hinges on three crucial elements: (i) mobilize domestic savings into productive investment, make available additional external savings—both in the form of foreign credits and direct foreign investment—and manage adequately the real exchange rate and the real interest rate; (ii) induce firms to commit real resources and effort toward new profitable investment and export opportunities in spite of the inherent systematic uncertainty of the reform process; (iii) develop a sizeable and experienced private sector—"the Schumpeterian entrepreneurs" who invest and innovate—that can carry out the required supply response to the new incentive structure.

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Milan Vodopivec HOW REDISTRIBUTION HURTS PRODUCTIVITY IN A SOCIALIST ECONOMY (YUGOSLAVIA)

Socialism as practiced in Eastern Europe is characterized by massive income redistribution. The paper focuses on inter-firm redistribution—consisting of taxing profitable firms in order to subsidize the unprofitable ones—and intra-firm redistribution—consisting of the compression of personal income differentials within a firm. The author constructs a theoretical model of redistribution of income as practiced in Yugoslav firms. Empirical results lead him to conclude that efficiency in production could be improved at no cost if such redistribution were abolished. That call for introducing new mechanisms to: (i) provide alternative services on the basis of impersonal (market) decisionmaking, thus supplanting bargaining between interest groups where feasible; and (ii) where impersonal decisionmaking is not feasible, as in fiscal and monetary policy, supplement current institutions by providing checks and balances in political decisionmaking.

Paul R. Gregory RESTRUCTURING THE SOVIET ECONOMIC BUREAUCRACY

The book reveals Soviet bureaucratic practices to be a response to an inherently complex resource-allocation problem that defies easy solutions. The often criticized irrationalities of the Soviet bureaucracy have their own internal logic and consistency. Dealing with such topics as plant negotiation, party-planner relationships and bureaucratic reform, the author analyzes the practices perestroika seeks to change and the resistance Soviet reformers will inevitably face. Inefficient, overstaffed and indifferent to the public needs, the Soviet economic bureaucracy operates today much as it did in the 1930s. The book is based on Soviet and Western published accounts as well as interviews with former members of the middle elite. Most of these individuals were located by the Soviet Interview Project, which conducted a census of adults who emigrated to the U.S. in the early 80s.

Paul R. Gregory is a Humboldt Fellow and a Volkswagen Advanced Fellow in Soviet Studies at the University of Houston.

New Books and Working Papers

Biberaj, Elez. Albania: a socialist maverick

Craig, Paul and LaFolette, Karen. Meltdown: Inside the Soviet economy

Aslund, Anders. Systemic change in Eastern Europe and East-West trade

Fitzgerald, Frank T. Managing socialism: from old cadres to new professionals in revolutionary Cuba
Technical assistance to Moscow

A Soviet delegation, headed by Soviet State Bank chairman Victor Gerashenko, participated as "special invitees" at the World Bank-IMF annual meeting. The special status created for the Soviet Union allowed its representatives to take part in all plenary sessions but not to sit in on the policymaking IMF Interim Committee or the joint Bank-IMF Development Committee. After the meetings, Gerashenko said that Soviet application can be expected soon. Both the IMF and World Bank gave assurances that they ready to begin immediate technical assistance to reorganize the Soviet economy.

IMF Support to Mozambique

Mozambique's main economic and financial objectives for 1990 are to raise the real rate of economic growth to about 6% from an estimated 3.2% in 1989 and contain the current account deficit of the balance of payments at about 30% of GDP. To support these efforts the International Monetary Fund has approved $112.8 million for three years under the enhanced structural adjustment facility (ESAF) and the first annual arrangement thereunder. Mozambique will need substantial and highly concessional foreign assistance, including exceptional treatment of its external debt-service burden.

ECO Program

The World Bank has approved the first Eurodollar transaction under its Expanded Co-financing Operations (ECO) program. The Bank has guaranteed scheduled repayment of a $200 million, fixed-rate Eurobond for Hungary's State Development Institute. The proceeds of the 10-year bond issue will support three ongoing projects in Hungary: to develop the infrastructure and the energy sector and support industrial restructuring, with a total cost of $1.3 billion. Direct World Bank funding for these projects totals $345 million. ECO is intended to provide flexible support for transactions undertaken by eligible borrowers in a broad range of markets.

Poland's Anti-Inflation Drive

According to a letter to IMF Managing Director Michel Camdessus from Poland's Finance Minister, L. Balcerowicz, and National Bank President W. Baka, the inflation rate will have declined from 6% in July to 2.5% in September, and will decline to 1%-2% a month in the reminder of the year. If the monthly rate is one percentage point above this level, the government would be prepared to consult with the IMF on raising the refinancing and other interest rates, and would be ready to tighten the credit policy.

Comment on Yugoslavia

Eugenio Lari, Director of EMENA in the World Bank, commented on the current Yugoslav economic reform program: "...the rate of inflation has gone down dramatically, and foreign exchange reserves have increased beyond expectations. The country needs three or four months to apply recently adopted laws, introduce financial discipline, and provide credit financing on the basis of technical and economic criteria."

IFC's Expanded Role

The International Finance Corporation is stepping up efforts to help the Eastern European governments create market-oriented economies. IFC plans to manage a new Polish entity for promoting small business and is about to help open a commercial bank in Poland with the participation of several Western European banks. IFC has opened temporary missions in Czechoslovakia and Bulgaria, anticipating that the two countries will soon be IFC members. So far the agency has provided roughly $130 million to Hungary and Poland for 10 projects (seven in Hungary and three in Poland) in addition to providing policy guidance.

MIGA Guarantee

The Multilateral Investment Guarantee Agency (MIGA), part of the World Bank Group, has signed a $30 million political risk reinsurance contract with the U.S. Overseas Private Investment Corporation. MIGA reinsured a portion of OPIC's $130 million insurance for the New York-based General Electric Co. investment project in Hungary. The project covers acquisition, modernization and expansion of Tungsram Co., Ltd., Hungary's largest manufacturer of lighting products. MIGA's term of coverage is 20 years. (MIGA promotes private foreign investment in developing member states; besides advisory and consultative services, guarantees are provided to investors against losses caused by currency inconvertibility, expropriation, civil disturbances, and breach of contract.)

New Loan Requests

Czechoslovakia has announced plans for major borrowing from the World Bank and the IMF to support its economic reform program. Hungary plans to apply for between $300-500 million a year of financial aid from the IMF for its projected 1991-93 financial requirements, officials of the National Bank of Hungary said. Poland and Bulgaria are seeking additional help to offset losses due to the Gulf crisis. "Romania viewed the annual meetings as crucial test for opening credit lines to the nation's shattered economy," said Mugur Isarescu, governor of the National Bank of Rumania. World Bank President Barber Conable indicated that if the crisis is protracted, a new pool of financial aid for Eastern European nations and other severely affected countries may have to be created by the Bank. The IMF does not plan a new fund but is exploring ways to assist countries "usually not eligible for IMF subsidized loans," announced Managing Director Michel Camdessus.
Conference Diary

Financial Sector Reform
September 10-12, Paris, France

Conference on “Financial Sector Reform in Transitional Socialist Economies,” organized by the World Bank (EDI). Participants: Senior policymakers from Eastern Europe and Algiers and leading experts from the World Bank. The seminar was in three parts:

- Part one discussed the economic policy environment and the conditions necessary to allow the functioning of the financial system.
- Part two dealt with the transition process. There is a link between the financial sector’s reform and the restructuring of enterprises. To function as a market-based system, the financial sector requires important preconditions, such as appropriate price signals in the economy, mechanisms to lead agents to react to market signals, macroeconomic stability, and a lesser state role in the economy. Restructuring of banks and their clients is interrelated and needs to be considered altogether. Once restructured, the financial system must be properly regulated and supervised to avoid relapses of portfolio problems. Regulatory changes, institutional development, changes in credit and interest rate policies, and monetary control are at the heart of reform at this stage.
- Part three centered on constructing a blueprint of the reformed financial sector. A guide for institutional reforms and legislation would come through learning from the experiences of the industrialized and developing countries.

Implications for Western Business
September 9-12, Middlebury, VT

Fall 1990 Seminar on “German Reunification and the Privatization of Czechoslovakia, Hungary and Poland: Implications for Western Business.” Organized by the Geonomics Institute. (The institute, established in 1987 as a private nonprofit organization, seeks solutions to international economic problems.) Three working groups involving 40 Western and Eastern economists, government officials, and business experts developed broad-based policy recommendations on business and investment strategies dealing with Poland, Hungary, Czechoslovakia and Germany. Some of the suggestions and conclusions:

(i) decentralized, flexible, multichannel approaches are essential to give enterprises considerable autonomy if privatization is not to become bogged down in government regulations; and (ii) a consortium of Western colleges and private development institutions should be created as a clearinghouse for information and to work with the business sector in developing management training programs. Seminar papers are available from George Bellerose, Director, Geonomics Institute, 14 Hillcrest Avenue, Middlebury, Vermont 05753. Telephone: (802) 388-9619.

Forthcoming Conferences

Adjustment Lending
October 4-5, Pultusk, Poland

Seminar on “The World Bank’s Experience with Adjustment Lending: Lessons for Eastern Europe.” The organizers are the World Bank (CECMG) and the World Economy Research Institute of the Warsaw School of Economics. The conference will also focus on the comparative evaluation of the stabilization programs, sequencing of policy changes, adaptation to the new economic environment and constraints, and privatization strategies. Participants will include senior officials of the World Bank and IMF, scholars, and leading economists and government representatives from Poland, Hungary, Czechoslovakia, Yugoslavia, the Soviet Union, Romania, and Bulgaria.

Technology, Culture and Development
October 26-27, Columbus, OH

International Conference on “Technology, Culture and Development: The Experience of the Soviet Model.” Organized by the Ohio State University Center for Slavic and East European Studies and the University Learning Guild, Office of Continuing Education. The conference will explore the present condition and future prospects of technological development in the Soviet Union and Eastern Europe, and the impact of social and cultural influences on technology. Papers will be presented by senior scholars and economists from the U.S. and overseas. For more information, contact: James P. Scanlan, Director, Center for Slavic and East European Studies, 344 Dulles Hall, 230 W. 17th Ave., Columbus, OH 43210-1311. Telephone: (614) 292-8770.

Economic Revolutions
October 29-31, Waco, TX

At Baylor University, conference on “Economic Revolutions in the Soviet Union and East Central Europe.” Will focus on the expected pace and sequence of institutional changes; from the Eastern perspective, the intended role of Western trade, aid and investments; and from the American perspective, how Eastern Europe fits into U.S. corporate and governmental strategies. Participants will include Soviet, East European and U.S. experts. For information, contact: Steve Gardner, Baylor University. Fax: (817) 755-2421.
Bibliography of Selected Articles

Socialist Economies


Klaus, Vaclav. Policy positions towards the International Monetary Fund and the World Bank by centrally planned economies that are not members of the organization. JOURNAL OF DEVELOPMENT PLANNING, United Nations Department of International Economic and Social Affairs, No. 20:315-27, 1990.


Eastern Europe


Lipton, David and Sachs, Jeffrey. Creating a market economy in Eastern Europe: the case of Poland. BROOKINGS PAPERS ON ECONOMIC ACTIVITY (U.S.) No. 1:75-147, 1990.


USSR

Belykh, A. Bogdanov's theory of equilibrium and the economic discussions of the 1920s. SOVIET STUDIES (U.K.) 42:52-1, July 1990.


Asia

