The case of national currencies in the former Soviet Union

Crowning the Estonian Kroon

In June 1991, Estonia carried out a monetary reform to replace the Soviet ruble with a new national currency, the kroon (krown). In doing so, Estonia became the first country of the former Soviet Union (FSU) to achieve monetary independence. Estonia's example is important not only because several other republics plan to introduce their own currencies, but also because Estonia adopted a specific monetary mechanism—a currency board—that is designed to make the kroon a stable and convertible currency from the start.

Monetary Chaos

The background to Estonia's monetary reform is the monetary chaos that emerged in the final years of the Soviet Union. During 1990 and 1991 each of the republics of the Soviet Union established a separate central bank, operating alongside the Soviet-wide Gosbank. By late 1991 sixteen separate central banks were issuing ruble credits with no overall coordination. Gosbank has taken care of the Soviet Union's huge budget deficit (exceeding 20 percent of the GNP), financing it through money creation. In addition, central banks of the republics were financing their enterprises and governments. It all added up to hyperinflation, socialist-style: the enormous monetary overhang, combined with price controls, produced severe shortages in the official supply networks and hyperinflationary conditions on the black markets.

When Gosbank was disbanded at the end of 1991 (together with the Soviet Union), the number of ruble issuers fell to a "mere" fifteen, and the problem of uncoordinated inflationary finance continued. The monetary overhang was eliminated by the rise in prices that followed the Russian price liberalization at the start of 1992. The overall inflation rate, however, remained high as a result of continuing rapid increases in the total ruble money supply throughout the former Soviet Union.

Viewed from Estonia's perspective, the case for introducing a national currency seemed overwhelming. The general view was that an independent
nation required an independent currency; moreover, it was also thought that monetary independence was needed to escape from the continuing inflationary pressures and monetary instability in the rest of the FSU. The Estonians recognized that even if Russia were to try to stabilize the ruble, other republics could undermine it by continuing an easy monetary policy of their own. In fact, domestic credit expansion in Russia remained high, and political pressures for further credits to heavy industry remained strong.

Inflation was not the only problem. Trade was becoming bogged down by large delays in clearing payments between Estonian and Russian enterprises. Moreover, an excess of bank credits relative to currency notes in the ruble area led to a severe shortage of cash in the first half of 1992. Even when enterprises had money in their bank accounts, they could not draw on them to pay wages because of a shortage of cash. As Russia controlled the printing presses, and therefore the distribution of notes, many republics responded to the cash shortage by issuing their own “coupon” moneys or other money substitutes, thus adding to the chaotic monetary conditions.

Russia also hoped for the rapid introduction of new currencies in the new states of the FSU. Cooperative arrangements, in which several central banks had the authority to issue rubles, were bound to be inflationary, considering the strong political pressures for monetary expansion and the institutional weaknesses of the republican central banks. Russia understood that the only effective means of establishing currency stability was to make the Russian Central Bank the sole entity authorized to extend ruble credits.

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

**Smooth Conversion**

The Estonian strategy of monetary reform—with its aim of achieving the immediate current account convertibility of the kroon—seemed vital in view of the country’s high trade dependence, its urgent need to develop new exports in Western markets, and its need to generate competition on the domestic market. The Central Bank also aimed to insulate the monetary policy from intense lobbying pressures from industry and government. To achieve these goals, the Estonian government and Central Bank settled on the idea of a currency board (see box).

The kroon was to be introduced at a fixed exchange rate vis-à-vis the deutsche mark (DM), and with full backing of gold and foreign exchange reserves. All future emissions of high-powered money would have to be backed by foreign exchange receipts of the Central Bank. In essence, the Central Bank would swear off domestic credit expansion; the kroon’s monetary base would rise or fall only as the Central Bank bought or sold foreign exchange in return for kroons. To avoid an unnecessary trade collapse with the ruble zone, Estonia and Russia agreed to maintain trade financing in rubles, with a floating exchange rate between the two currencies.

The monetary conversion was undertaken during June 20-22, at a conversion rate of 10 rubles per kroon for bank balances, wages, prices, and other contracts. Residents could convert up to 1,500 rubles into kroons at the 10:1 rate, and rubles in excess of that sum at a 50:1 rate. About 2.2 billion rubles in cash were exchanged, and these will be returned to Russia.

At the time of the conversion, the market exchange rate was about 75 rubles per DM, or 7.5 kroon per DM. The new fixed rate was set at a slightly more depreciated rate, 8 kroon per DM. At this rate, the initial holdings of Central Bank reserves, made up mostly of monetary gold held in the West since 1939, more than equalled the total stock of the broadly understood kroon supply (M2). Thus, at the start, the entire money supply, not just the high-powered money (as in

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**What is a currency board?**

A currency board’s only purpose is to issue notes (paper currency) and coins convertible on demand into a foreign asset at a fixed rate of exchange. The foreign asset can be a foreign currency, gold, or some other commodity, or a currency or commodity basket. A currency board does not grant loans (except in serving as a clearinghouse for bank checks) or accept deposits. As reserves it holds high-quality, interest-bearing securities, denominated in the foreign asset. Its reserves must be at least 100 percent of its notes and coins in circulation. A currency board makes profits from the difference between the interest on the securities that it holds and the expense of maintaining its notes and coins in circulation. It remits to the government all profits beyond what it needs to pay its expenses and to maintain its reserves at the level set by law.

In an economy where capital flows can occur (any economy with a convertible currency that has few barriers to foreign investments), the balance of trade does not impose any strict limits on a currency board system’s ability to expand the money supply. Instead, a more complex but still market-based form of limitation, based on people’s estimates of profitability, applies. Hong Kong and Singapore experienced trade deficits for decades under their currency board systems, yet their money supplies expanded all the while.

From related studies by Steve H. Hanke and Kurt Schuler

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October 1992
The mODE!tary "eform has given fresh
appreciated to around 20 rubles per
change market in Tallinn for convert­
is that ruble-ba sed trade with Russia
impetus
in late June, the Estonian currency
kroon by late Beptember. The main
newed discipline. Privatization is
has yet to develop effectively; there is

The post-conversion monetary policy
 guarantees the convertibility of kroon
into DM at the fixed 8:1 rate for all
current account transactions. Profits
and capital arising from foreign in­
vestment can be freely repatriated.
Estonian residents are not, however,
allowed to open foreign currency bank
accounts abroad except with special
permission, nor can they establishe new
foreign currency accounts in domest­
ic banks. Domestic credit expansion
by the Central Bank is generally pro­
hibited, and the Central Bank's op­
erations are largely restricted to for­
eign exchange operations at the
official exchange rate. In particular,
the currency board precludes central
bank credits to finance the budget. 
Therefore, the government of Estonia
undertook several strong fiscal ac­
tions, including tax increases, to
undergird the new monetary policy.
New bank supervision procedures are
also being put into place to strengthen
the banking system.

Good Results

The results of the first three months
are extremely positive. The currency
has been stable and convertible, while
the ruble has continued to depreciate
sharply. Indeed, monetary policy in
the ruble area turned out to be much
worse than expected, with the ruble
money supply nearly doubling over
the summer months. After an initial
exchange rate of 10 rubles per kroon
in late June, the Estonian currency
appreciated to around 20 rubles per
kroon by late September. The main
shortcoming of the new system to date
is that ruble-based trade with Russia
has yet to develop effectively: there is
as yet no well-functioning foreign ex­
change market in Tallinn for converting
rubles and kroon.

The monetary reform has given fresh
impetus to other areas of reform. Fis­
cal policy has been subjected to re­
newed discipline. Privatization is
moving forward more rapidly, with a
sounder base for auctioning state
property. There is a new attention to
financial reform, because banks and
other intermediaries must now sur­

drive by their profitability rather than
through cheap credits from the Cen­
tral Bank. Major policy initiatives in
several of these areas will be backed
by an IMF standby loan concluded in
September. Estonia is also seeking
other balance of payments support to
help cushion the move to energy prices
at world levels and the restructuring of
the industrial sector.

The Estonian monetary reform clearly
points the way for the new states of
the FSU. Most, or all, will have their
own national currencies. Estonia's
experience demonstrates that it is
possible to move to a stable and con­
vertible currency right from the start,
if the policies are supported by a sound
institutional bulwark (such as a cur­
rency board arrangement) and by
sound fiscal policy.

It is time to move rapidly to create
national currencies in the FSU, linked
by floating exchange rates, and backed
by ample and timely international fi­
nancial assistance.

Ardo Hansson and Jeffrey Sachs

The authors advised the government
of Estonia and the Central Bank of
Estonia on the monetary conversion.
Ardo Hansson is Research Fellow,
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the Prime Minister of Estonia. Jeffrey
Sachs is Galen L. Stone Professor of
International Trade at Harvard Univer­
sity.

Lit, lat, manat, manat, rubel...

Among the Baltic states Lithuania re­
placed the ruble on October 1 with tem­
porary coupons that will be used until
the new Lithuanian currency, the lit,
is introduced. Latvia issued the Latvian
ruble in July and postponed introd­
tion of the lat.

Ukraine has put off the debut of its
gryvna; the government will instead in­
troduce the carbovanets by the end of
the year for accounting purposes and
link it to the ruble, said the deputy head
of the country's central bank. In the
meantime coupons—monetary surro­
gates since 1991—should take on all
aspects of a currency (for example, since
January salaries have been paid only in
coupons).

Belarus has withdrawn the ruble from
 circulation in areas bordering
Lithuania and Ukraine. The
rubel ("bel" stands for Belarus),
introduced last June to circu­
late alongside old Soviet
banknotes, would now be the
only legal tender for all types of
transactions in those border
areas. (A National Bank official
explained that the Bank wants
to prevent an influx of rubles
into Belarus from Lithuania
and Ukraine where non-ruble curren­
cies have been introduced.)

Other ex-Soviet states also announced
intentions to replace the ruble with
their own currencies: for example Geor­
gia ("manet"), Azerbaijan ("manat"),
Uzbekistan, Armenia, Kazakhstan,
and Kyrgyzstan. Moldovan Econom­
ics Minister Sergiu Certan said in early
October that "it would be a mistake to
introduce a national currency now
when Moldova is in an economic crisis."

Those states that rename their curren­
cies would not necessarily leave the
ruble zone. At the CIS summit in
Bishkek in late September, Armenia,
Belarus, Kazakhstan, Kyrgyzstan,
Russia, and Uzbekistan signed an
agreement to maintain the ruble zone.

One Belarus ruble.
No October Surprise in Beijing
The buzzword: Socialist market economy

The recent Congress of the Chinese Communist Party (Beijing, October 12-18) has been hailed as a major victory for the reform forces in China—and a major personal victory for senior leader Deng Xiaoping who has seen his reform proposals adopted as the guiding principles for the coming period and reform-minded candidates appointed to the leading positions in the Party. The Congress saw the elevation of what is called "Deng Xiaoping Thought" to the same standing as Marxism-Leninism and Mao Zedong Thought.

Deng's Thinking Prevails

Deng's approach to policymaking, which is essentially the art of pragmatism, has now been enshrined in the "theory of building socialism with Chinese characteristics." The Constitution of the Party was amended at the Congress to include this theory. The Work Report (the basic document presented to the Congress for approval) emphasizes economics development as a central task. The report also asserts: "We must not get bogged down in an abstract debate over what is socialist and what is capitalist." This is a more explicit version of Deng's often repeated, and more colorful aphorism "it doesn't matter if a cat is black or white, as long as it catches mice."

The emphasis on economic development also signals an abandonment of the very cautious targets of the 8th Five-Year Plan. Instead of the 6 percent per year growth target of the Plan, the work report calls for 8-9 percent economic growth. (In the Bank's recent economic report on China, it was also estimated that with faster reform, growth could rise to an average of 8.5 percent.) The report placed particular emphasis on the growth of the service sector and explicitly called for an early start to the famous Three Gorges project.

Ownership Targets

The Congress has made it clear that reform policies are to remain at the heart of policymaking and that the reform era is regarded as China's second revolution. The Chinese economy is now a socialist market economy, and where previous reports all used the word "planning," the current Work Report gives the strongest endorsement to the role of the market in China—and by implication criticizes planning. The Report notes that practice in China has proved that where market forces are given full play, the economy exhibits vigorous and sound development.

The Congress reaffirmed that the household responsibility system (in other words private farming) will be retained as the basic rural policy and that the Special Economic Zones policy will be extended to many parts of China, including border areas and the Yangtze valley (see box, page 5). The Congress reaffirmed multiple forms of ownership, "so long as the public sector remains dominant." However, public sector is defined as embracing not only collective enterprises, but also locally owned Township and Village Enterprises (TVE) and the Chinese share in joint ventures. This broad definition gives great scope for the continued decline in the share of state-owned enterprises in total output.

The Party now seems poised for a major rationalization of the state-owned enterprises. The Work Report underlines the need for price reforms and new incentives so that "efficient enterprises will prosper and the inefficient ones will disappear."

One of the main initiatives launched by the Congress is a program of government reform, to be completed over a three-year period. A major rationalization of the central government and the abolition of several ministries and agencies are expected, with the goal of creating a government organization that is more in line with the reform objectives and that exercises only indirect control of the economy.

The One-Party System Remains

The Congress reaffirmed Deng Xiaoping's long-held view on political
reform. Despite the debate about reforming the system of People's Congresses, a very clear statement emphasized: “the [political] goal of the reform is to build a socialist democracy suited to Chinese conditions and absolutely not a western, multiparty parliamentary system.”

The new Central Committee has appointed a Political Bureau expanded to twenty persons, with much stronger representation of reform-minded leaders from such cities and provinces as Shanghai, Tianjin, and Guangdong. The Standing Committee of the Politburo—the most powerful group in China—now has seven members, and two of its older members have retired. Among the three new members are Vice-Premier Zhu Rongji, the former mayor of Shanghai, and an economist who has contributed to several World Bank studies on China.

The strong official backing for continued reforms in China is not an unexpected development; nonetheless it is of major importance. There is widespread expectation that the rest of this decade will witness an economic performance every bit as spectacular and enviable as was observed during the first decade of reform.

Peter Harrold, EA2CO, The World Bank

Coastal winds blow inward

China's rapid growth is expected to continue over the next decade or more, based on two fundamental conditions: high savings and investment rates and a work force that is relatively skilled and healthy for a low-income country.

During the 1980s, economic liberalization proceeded at similar rates in the country. As a result, growth was fairly evenly spread nationwide. However, in the late 1980s coastal regions began to develop much faster than inland regions. Following 1989 the "coastal development strategy" was criticized and an "industrial policy" that would apply impartially to the whole nation was advocated. During the bitter ideological battle, however, foreign trade reforms were moving ahead, facilitated by the fact that elements of decentralization were already built into the system and driven by the need to export and the fact that local leaders could reap benefits from attracting foreign trade and investment.

The economies of the coastal provinces, which were better placed to take advantage of trading opportunities, grew more rapidly. In late 1991, and particularly with Deng Xiaoping's southern tour in early 1992, the emphasis was again on opening the economy to foreign participation—a far easier task than framing coherent reform policies for the domestic economy. As a result, there has been increasing differentiation between coastal and inland China. This is likely to continue to shape development in the 1990s for the following reasons:

• Because of poor communications and less skilled workforces, inland factories are not as efficient as coastal factories—producing between 15 percent and 40 percent less per unit of input.

• Transport costs for inland producers to access world markets are significantly higher than costs for coastal producers. And information about world market opportunities is less available.

• Inland regions are relatively concentrated in the energy and raw materials sectors, which are the least reformed part of the state economy. State price controls on these items act like an additional tax on inland regions.

• Foreign investors have been unwilling to invest in the interior's abundant natural resources because of depressed global commodity markets. With China's still underdeveloped capital markets, it falls to the central government to mobilize the large sums of capital necessary for resource development, leaving the interior highly dependent on the state economy.

Coastal regions, by contrast, are poised to grow rapidly as they are further integrated into the East Asian and world economies. Thus far, only the provinces of Guangdong and Fujian have experienced integration into the global markets. Successful reform policies have been a precondition for this development. However, transfer of low technology, labor-intensive manufacturing from adjacent Hong Kong (China) and Taiwan (China) played a crucial part.

This integration process has not exhausted its potential. Transnational manufacturing is spreading rapidly throughout Southeast Asia, and southern China is becoming increasingly integrated into these networks. Although the region as a whole remains dependent on the U.S. market, demand for final goods within the region is also growing—slightly faster than U.S. demand.

The economic regions of northern and southern coastal China are expected to expand and meet in the Lower Yangtze region around Shanghai and then extend up the Yangtze valley. By 2000, the entire coastal area will be integrated into international trading relationships, with the "accelerated growth area" also incorporating selected inland provinces, such as Hubei and Hunan.

(Based on Oxford Analytica)
The Challenge of Legal Reform in Hungary
An assessment and some proposals

Property Rights

In Hungary—as in other CEE countries—clarifying property rights is perhaps the most difficult and slow-moving area of legal reform. Not only does it require confronting the vested interests of former owners, existing users, and newly emerging business interests, but it must be carried out in a setting plagued by poor records, struggling institutions, and a legacy of distorted public policies.

In late 1989 and 1990 Hungary passed extensive amendments to the socialist constitution, which now asserts a commitment to a market economy and encourages entrepreneurship and competition. It establishes protection of private property, including compensation in the event of expropriation, and assures the right to freedom of association. The most important provisions on property in the Civil Code have also been amended. Private ownership is now fully accepted in Hungary, and the privatization program is attempting to transfer the bulk of state assets into private hands.

For real estate, Act I of 1987 on Land has been instrumental in freeing up the private market. A private citizen (either natural or legal) may now acquire real estate in Hungary without any legal limitation. However, other practical impediments, such as ambiguity in title to property and difficult access to credit, continue to retard the development of a real estate market. Foreigners are prohibited from owning agricultural land (unless specifically permitted by another law), but may own non-agricultural land and immovable real property after receiving permission from the Ministry of Finance. In contrast, Hungarian corporate entities that are partly or wholly foreign-owned are entitled to own real property related to the company's objectives.

Title to both publicly and privately held real estate is not likely to be complicated by restitution (or "reprivatization") in Hungary as it is in Poland, Romania, East Germany, Czechoslovakia, or Slovenia. Hungary's solution to the perceived injustices caused by socialist expropriations is the Compensation Act of 1991. This law partially compensates both Hungarians and foreigners whose property was expropriated through regulations enacted after 1939. Compensation coupons (embodying lump-sum settlements but not exceeding 5 million forints) may be used as full or partial payment for property sold by the state, including apartments, shares in privatized state-owned industries, and farmland. Only former land owners may use their coupons to purchase farmland.

Although rules on real property ownership are now firmly market-oriented, much more work is needed in reforming the regulation and financing of property development and use. In the regulatory area, reforms are needed in rent control, zoning, and construction standards. With regard to financing, reforms are needed in collateral and foreclosure laws and institutions. Mortgages on real estate have long been legally possible but rare. Interest and availability of financing is now growing in the case of commercial property, although direct foreign financing of commercial property development is prohibited by the inability of foreigners to register mortgage liens on Hungarian real estate. In the case of housing, lenders have been discouraged from making substantial mortgages because of the lack of effective legal mechanisms to repossess the collateral in case of default. Tenant protection laws, grounded in the still-applicable 1971 Housing Act, make foreclosure and eviction a cumbersome and futile endeavor. Collateral other than real estate is not used at all because of legal and institutional shortcomings that need to be resolved.

For intellectual property rights, protection has generally been considered better in Hungary than in other CEE countries. However, inadequate means for investigation and enforcement remain a problem, resulting in widespread piracy, mainly of software, music, and pharmaceuticals. As Hungary begins to recognize and protect private property rights generally, intellectual property may also begin to be better protected. This will, however, require stronger investigative and enforcement policies, without which infringements will be difficult to curb.

Company Law

In the late 1980s Hungary implemented a series of reforms designed to further its transformation to a...
market economy. Unlike Poland, it did not revive its prewar company law. Rather, Hungary used the opportunity to draft an entirely new code, the Act on Economic Associations, based on German and Austrian models. The law recognizes various forms of business organization, including the joint-stock company, the limited liability company, and general and limited partnerships.

Since Hungary opened its doors to foreign investment in 1988, the country has enjoyed a level of foreign investment unmatched by any other CEE country. This was initially because Hungary’s original foreign investment law, Act XXIV of 1988, was the most liberal investment law in the region. The law has been modified periodically since then, but it still retains the basic features that are attractive to foreign investors. The law allows foreign individuals and entities to own up to 100 percent of a Hungarian investment, including the real property associated with it. No special permission is needed. In the event of expropriation, the law guarantees foreign investors full compensation in the currency of the original investment.

Although the Hungarian forint is not yet formally convertible, the foreign investment law does allow foreign investors to repatriate their forint profits in the currency of the original investment (at the official exchange rate), “provided the company has the equivalent amount in forint on reserve.” Foreign individuals and companies with foreign participation are permitted to maintain hard currency accounts in any Hungarian commercial bank. The foreign investment law also offers generous industry-specific tax incentives to foreign investors. However, these have been widely criticized by economists and tax policy experts, both because they discriminate against domestic investment and because they cause tremendous revenue loss and complicate tax administration. Recognizing these problems, Hungary has moved recently to eliminate special tax incentives on foreign investments made after 1993 (see box on page 8).

Contracts

In Hungary two distinct spheres of contractual relations existed during the socialist period: private transactions among individuals, usually for small monetary amounts or equivalents, for which the Civil Code was (and still is) adequate to set a framework for bargaining and to resolve any disputes that may arise; and commercial contracts between state enterprises, which were instruments of the state economic plan. But now commercial transactions in the economy are increasingly being conducted according to the Civil Code (originally designed for the small, noncommercial private transactions). The applicable sections of the Code embody standard western contract concepts. Because courts have little experience with commercial contract cases, court interpretations and decisions over the coming years will determine just how far “freedom of contract” extends, particularly when it collides with other social concerns.

Bankruptcy Law

Hungary’s Law on Bankruptcy Procedures, Liquidation Procedures, and Final Settlement was passed by parliament in September 1991. The law differs from the previous one in several important respects. It encourages reorganization in lieu of liquidation when feasible, and it tries to encourage real as well as financial restructuring to make surviving firms more competitive in the longer run. It tries to balance the distribution of control over assets and bargaining power between debtor and creditors. And it establishes time limits on the different stages of the bankruptcy and liquidation procedure in order to speed up the process.

The number of bankruptcy filings has skyrocketed in the first few months under the new law. Although data is somewhat sketchy, the number of filings appears to have increased from 528 in 1991 to 3,403 (786 as reorganizations and 2,617 as liquidations) in the first quarter of 1992 alone. Because the law came into effect January 1, 1992 and requires reporting after ninety days in default, there was an even greater surge of 3,540 filings in April—including 2,259 reorganization filings and 1,281 liquidation filings. This surge in cases demonstrates the difficulty of applying the traditional solution—judicial bankruptcy proceedings—to the systemic problems of enterprise insolvency in CEE countries. It is highly improbable that any judicial system—much less one with relatively little exposure to economic matters—could handle such a surge in caseload efficiently and effectively.

Competition Law

Competition law can be an important tool to prevent abusive monopolistic behavior. In Hungary a new competition law, Act LXXXVI of 1990 on the Prohibition of Unfair Market Practices, took effect on January 1, 1991. The law deals with the traditional areas of antimonopoly enforcement, including horizontal and vertical agreements among firms, abuse by a single firm of a dominant position, and merger control, and it sets up a specialized antimonopoly office, the Office of Economic Competition, to enforce these provisions (subject to review upon appeal by the Budapest district court).

The law also covers unfair competition and prohibits such activities as misleading advertising or “unfair” acquisition and use of business secrets. One important element missing from the law is authority of the antimonopoly office to order the breakup of large monopolistic firms prior to privatization. Such a link between antimonopoly policy and privatization exists in Poland and Czechoslovakia and is a useful tool to prevent the privatization of public monopolies into private ones (which are certainly much harder to control or break up once in private hands). The Office of Economic Competition, in addition to
handling individual complaints, should educate the public about the distortions caused by monopoly behavior and lobby the government and parliament to minimize barriers to international trade—the most powerful antimonopoly force of all.

**Judicial Institutions**

Over the past few years the judiciary's workload in Hungary has more than doubled because of the registration of new private companies, the rapid rise in the number of commercial disputes, the rash of new compensation claims, and growing criminal activity. In order to accommodate private sector activities, the judicial infrastructure will need to be upgraded through training, staffing, and equipment. An area needing particular attention is debt collection. Of 700,000 lawsuits filed nationwide last year (a 60 percent increase from the previous year), two-thirds involved uncollectible debts. Streamlining debt collection, perhaps by allowing private debt collection in uncontested cases or reducing procedural requirements in judicial cases, could relieve much of the current strain on the courts. Also, arbitration could be a useful alternative to court procedures as a means to resolve commercial disputes among private parties.

In sum, Hungary has been at the forefront of CEE countries in reforming its legal framework to promote private sector development. Yet in the face of numerous legal and institutional difficulties, the challenge of implementing all of this new legislation is truly daunting.

Cheryl W. Gray  
**CECTM, the World Bank**


### Capitalism already? A variety of Hungarian taxes

**Corporate Tax.** The general rate for the entrepreneurial profit tax (corporate tax) is 40 percent. The following tax incentives will apply to foreign investments made before the end of 1993:

- Joint ventures with founding assets worth more than 50 million forints and a foreign stake of at least 30 percent are eligible for a 60 percent profit tax concession in the first five years of operation and for a 40 percent concession in the next five years— as long as at least 50 percent of their activity can be defined as material production.
- If a joint venture satisfies the above requirements and its activity is classified as being of special interest to the country (such as electronics; the manufacture of vehicle parts and components, machine tools, and agricultural, food-processing, and forestry machinery; medicine; the production of vegetable protein; packaging technology; and tourism-related operations), a full tax holiday is granted for the first five years, followed by a 60 percent reduction for the subsequent five years.
- If a joint venture ploughs in its profits or reinvests them elsewhere in Hungary, a tax reduction—identical to the amount of reinvested profits in the same year—applies.

After December 31, 1993, the above incentives will be eliminated, but a “grandfather law” will remain in effect for joint ventures set up before that date.

**Value Added Tax (VAT).** The system copies a common European type. It must be fully borne by the end-user or final consumer, unless the product or service in question is destined for export, in which case a full refund of the VAT can be claimed. Until the end of 1992 most basic products and services are tax-exempt or carry an “0” VAT rate. Other services are subject to a 15 percent rate, and for some products a 25 percent rate applies. The rates are the same for imported goods. (To increase tax revenues, the 1993 budget draft proposes a two-tier 25 percent and 8 percent rate and the elimination of the O rate and exemptions.)

**Personal Income Tax.** Residents are taxed on their total income—both within and outside Hungary. Nonresidents are taxed on their in-country income. (A person is a Hungarian resident if he or she has a permanent home there or is present for 183 days in a calendar year.) For tax rates, no distinction is drawn between foreign source and local source income. The personal income tax rate has ranged between 0 and 40 percent in 1992 (compared with 0-60 percent in 1989 and 0-50 percent in 1990-91):

<table>
<thead>
<tr>
<th>Income brackets</th>
<th>forints</th>
<th>tax rate (percent)</th>
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<tbody>
<tr>
<td>Up to 100,000</td>
<td>0</td>
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<tr>
<td>100,000-200,000</td>
<td>25</td>
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<tr>
<td>200,000-500,000</td>
<td>35 percent on income exceeding 200,000</td>
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<tr>
<td>more than 500,000</td>
<td>40 percent on income exceeding 500,000</td>
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The budget draft for 1993 (still awaiting parliamentary approval) stipulates that the tax rate for the top income bracket increases to 50 percent. Accordingly, an income of 1,000,000 forints would be taxed at a rate of 330,000 forints + 50 percent of income exceeding 1,000,000 forints.

**Social Insurance.** Based on employees' gross wages, employers pay 44 percent and employees 10 percent in contributions to social insurance. Additionally an unemployment contribution was introduced last year to help fund retraining programs and unemployment benefits. Employers' contributions to this fund are 5 percent and employees' 1 percent— again, based on employees' gross wages.

**TDC.** A technical development contribution (TDC) of 4.5 percent is paid from companies' profits. TDC payments are put in a special state-handled fund for technical development, which is allocated by tendering or by individual application. Joint ventures can apply.

**Local Taxes.** Building, real estate, business, communal, and tourist taxes can be levied. The basis and level of taxation depend on the needs of the communities in question, within limits determined by the law.
A new World Bank research project, "Services as a Growth-Promoting Sector in the Former Soviet States," will analyze services in the new states of the FSU, study the gap between anticipated and actual services, and chart the experience with growth in services of other (post)socialist countries in transition.

Neglected Sector

For a combination of reasons—the system of central planning, a bias against consumption, Marxism's doctrinal bias against "nonproductive" services, the monopoly position of providers, and the abolition of private production—the service sector assumed over the years a rather limited role in the Soviet economy (and Soviet-type economies). The Soviet economic structure, compared with similarly developed countries, was uniquely lopsided, with a large industrial base and a small service sector. Besides being small, the service sector was inefficient and client-"unfriendly." The high cost of transactions and lack of services were partially offset over the years by the second economy, which toward the end of the old regime might have accounted for up to 20 percent of all transactions in the household sector—and probably an even higher proportion of many individual services.

The lack of privately owned, small-scale services and the almost total absence of small-scale production in the "official economy" had dire consequences for both quality of life and economic efficiency. Inadequate consumer services imposed a heavy burden on the time management of household members, especially in view of the almost full participation of working age women in the labor force. (It has been estimated that the time people spent standing in line equaled full-time employment for 11 million people.)

On the eve of Gorbachev's perestroika, in 1985, only 39 percent of the Soviet labor force was employed in services, and a mere 40 percent of gross national product came from the service industries. The Soviet Union trailed far behind the middle- and upper-income countries, where 53 percent of the labor force was employed in services, accounting for 50 percent of gross national product. In five less-developed industrial countries (Greece, Ireland, Portugal, Spain, and Turkey), the respective figures were 43.1 and 55 percent. In the industrialized countries as a whole, the percentages of labor force in and gross national product from services were each 61 percent. The United States' service sector led the statistics with 69 percent and 67 percent respectively.

New states of the FSU can benefit from the dynamism of the service sector, especially of business and consumer services. The latter is a major factor in increasing static and dynamic efficiency, improving quality of life, generating jobs, and providing ample opportunities for the expansion of the private sector—through joint ventures and locally owned companies.

Comparative Analysis

Drawing on international, cross-country time series data sets, the research will first undertake a comparative analysis of the importance of services at different levels of development. Services will be measured by value added, employment, compensation of employees, investment, and household consumption; various proxy indicators, as well as per capita gross national product, will be used for the level of development. Services will be broken down into three subsectors: infrastructure services (housing, transportation, and communication), public services (health, education, and public administration), and business and consumer services (all other services). Particular emphasis will be given to the last category.

Historical data on services in the former Soviet Union will then be used to explore differences in the level of services among the former Soviet states in recent years. This quantitative analysis will be complemented by a qualitative analysis of the evolution of services, especially business and consumer services, since 1985 in the former Soviet states and in other economies in transition such as China, Czechoslovakia, Eastern Germany, Hungary, and Poland.

With a look toward the future, the study will simulate the potential contribution of services to future value added, employment, and household consumption and identify a policy agenda to facilitate the rapid expansion of services.

Data Sources

Information on the characteristics of the service sectors in Western countries and in some Central and Eastern European countries are available from various data bases, including those of the World Bank and OECD. Certain data on the Soviet Union and partial information for some of the former republics for previous years are available in official statistical reports of Goskomstat. Data also are being provided by the Center for Technology of Social Policy in Moscow, and by Genadii Zoteev. Other data sources include the IMF, the CIA, and the U.S. Census Bureau.

The project was begun in April 1992 and will be completed in April 1993. It is managed by Martha de Melo, William Easterly, and Gur Ofer, CECTM, the World Bank. (For additional information contact Martha de Melo, tel: (202) 473-9073, or William Easterly, tel: (202) 473-8965, or Gur Ofer, tel: (202) 473-8970.)
Quotation of the Month: “What Is the Market Value of Anything in Russia after All?”

Skeptical views of the chairman of the Russian Central Bank

Victor Gerashenko, chairman of the Russian Central Bank, believes that the state needs to interfere more in the running of the economy until market reforms take root. He explained his views in an interview published in the September issue of the London-based Euromoney. Excerpts from the interview follow:

Q. How bad is the economic situation?
A. The situation is quite serious. The main task is to create conditions that will enable us to produce more and to do so at reasonable prices and that will create competition between different sorts of enterprises. It will be two years before real progress toward a market economy can be made. Under these conditions [we must] maintain production of necessary items—using profitable or even unprofitable methods, because the state is the main owner of production capacity and we have made little progress in privatization. For the time being it is the responsibility of the government to manage state firms to ensure maximum use of productive assets as long as firms are producing goods in demand in the market.

Q. What should be the priorities for reform?
A. Under the Soviet system the cost of labor was low and basic goods and services were either free or cheap. With salaries low, the tax system had to depend on the pricing of retail goods. We had massive distortion and the value of money was artificial. It wasn’t a unit of value but simply a unit of accounting. So we must first of all find a proper price structure to move to a market economy. The older generation, which grew up under the state-administered economy, prefers an evolutionary approach to price reform using administered price rises.

Q. You are saying that privatization should come before price reform?
A. It’s a chicken-and-egg question—what comes first? [But] how can we go through privatization now when we have distorted prices and values? Should we sell shares in state enterprises or should we distribute them? I think distribution is wrong because people will take less care of what’s been given to them than they will of what they have earned. Property should be earned.

Q. But is there any alternative to the government’s share give-away program?
A. No population, whether here or in Britain or in the United States, is the prime mover of its economy acting solely through ownership of businesses and factories. It’s difficult to guess how successful the government’s privatization plans will be. Even discussion of the value of the vouchers is becoming more and more acute. The bulk of the people will not turn their vouchers into shares but will instead try to convert them into cash. We will end up with only a certain number of proprietors ready to take risks through the vouchers program and with their own capital. We will need to create investment funds similar to those in Czechoslovakia to help them to become share-owners.

Q. The central bank has decided to guarantee debts between state enterprises. Won’t this send a signal that the state will bail out firms that refuse to respond to market signals?
A. I disagree with the assessment. When the decision was published, the privatization Chief, Anatoly Chubais, felt that the central bank was interfering with his responsibility to compel firms to pay their debts or face liquidation by his committee. In the past six months interenterprise debts—99 billion rubles at the beginning of the year—have begun to snowball and have now reached 3.2 trillion rubles. We were headed for a liquidity and bankruptcy crisis for a simple and obvious reason: the wholesale price index increased sixteenfold in the first six months of the year and firms simply couldn’t afford to buy anything. It is just like what happened to ordinary Russians when retail prices were liberalized. The state gave them a helping hand by raising wages and pensions. The same approach is valid in boosting the working capital of enterprises. Commercial banks will evaluate enterprises’ requests for loans and their ability to repay. But with such high interest rates as we have now, enterprises can’t afford the interest [payments] and they have no possibility of raising money in the stock market because we haven’t got one. I admit that some managers were raising prices in an abuse of their monopoly position but anyone would behave like this under our conditions. In such cases the state should again regulate prices.

Q. Some people think your credit decision was highly inflationary. Isn’t inflation a major problem?
A. Inflation is a problem, I agree. We discussed the debt problem with [prime minister] Gaidar and with Chubais. The credits from the central bank will be used to repay interenterprise debts at levels as of the middle of September and to supplement the finance ministry’s credits, which were insufficient and inadequate. Any money left over will be used to increase the working capital of enterprises.

Q. But won’t that boost the money supply?

October 1992
A. Wholesale prices have increased sixteenfold while money supply has only a factor of 2.2—do you really think that the money supply is big enough? I don't think so. Yes, credits between enterprises are quasi-money and are a component of the money supply. But when the state commercial banks pass on the credits of the central bank to enterprises, bank and enterprise relations will become more businesslike.

Q. If the budget deficit is the main cause of inflation, can't the central bank refuse to finance the budget in its fight against inflation?

A. We have no laws like this.... Because the government has low tax revenues as a result of declining production, we would lose social support for reform if the central bank refused to provide credits because of some anti-inflation principles.

Q. You have said the value of the ruble on the currency exchange is far too low. Why is it so low?

A. The volume of transactions on the currency exchange is not representative. In the past eight months only $1.3 billion was sold. But half of it was central bank intervention. The foreign trade ministry says that export receipts should be $2 billion to $2.5 billion per month. So where's the money? The turnover is much too small. The retention allowance is wrong. Our balance of payments difficulties don't give us the ability to maintain the current system whereby exporters can retain 30 or 40 percent of their export receipts. One hundred percent of export receipts should be sold to the central bank and then anybody who wants to import can come to the bank for hard currency—probably with some restrictions on luxury goods and so on. We need a foreign law compelling enterprises to bring their foreign exchange into Russia from foreign banks.

Q. How are the IMF talks going? You previously criticized the conditions the IMF has set for providing credits.

A. I was not criticizing the IMF; I was just being skeptical about our ability to negotiate with the Fund and explain (to them) what's going on. The credit ceiling of 700 billion rubles is partly economic, but mostly it is a political requirement. (Achieving) single-digit inflation in December is the same. The essential economic aims should be amended to (take into account) realities in Russia. If we liberalize energy prices, we will go full circle and have high inflation as a result. We are not in the position of western economies of being able to apply proper monetary policies.

Q. How troublesome are the differences of views on policy between the government, the central bank, and the parliament?

Parliament chairman Ruslan Khasbulatov was right when he said that we all want to reform the economy. Either the government is always right as was the reality in the past, or we, the public and the mass media, should have the right to analyze and give our own opinion. The press tends to ignore this and support only one view—the government's. There are real differences about method and speed of reform. Decisions cannot be made if the population is not ready for them.

Q. How long will it take before reform goals are reached?

A. To create competition we need investment, whether local or foreign. We need to improve tax legislation. It's too rigid. We need a land law, a mortgage law. But the foreign investor will move rapidly only when our own investment reaches a certain level. He won't climb into the cage until there's already a similar sort of animal there. For this we need privatization. This will give everyone a chance. The main aim of privatization should be the creation of a private housing sector.... Then we'll have labor mobility. We asked the IMF how we could assess the values of enterprises when our pricing system is in such disarray. They said it would be very difficult. We'll probably end up basing evaluations on replacement value. What is the market value of anything in Russia after all? The government's present reform efforts are not correcting the price structure.... I'm always afraid when people start trying to find the final solution.

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**Conference diary**

**Market Economy and Business—Belarus'93**

*January 18-24, 1993, Minsk, Belarus*

Brown University's Center for Foreign Policy Development (CFPD) is co-sponsoring its third conference in Minsk, Belarus together with BelASBI, the Belarusian Computer-Aided Business Information system. The conference aims to develop business between Western and Belarusian participants and make recommendations on improving the legal, financial, and business infrastructures in Belarus.

Western participants are expected to be practitioners and experts of relevant business, financial and legal issues. Belarusian participants represent a wide cross-section of government institutions and private enterprises interested in cooperation with foreign firms and experts. The conference will include plenary sessions and presentations, as well as individual meetings with potential partners. Factory tours can be organized upon request of Western participants.

CFPD is organizing similar conferences in Ukraine (March 22-29) and tentatively in Uzbekistan (late spring). More information: Tania Lozansky, Center for Foreign Policy Development, Brown University, Box 1948, Providence, RI 02912, tel: (401) 863-3465, fax: (401) 274-8440.

*Editor's note: To enable us to inform our readers on forthcoming conferences, please send us the necessary details at least three months ahead of the scheduled date.*
Milestones of Transition

In late October Czech and Slovak leaders agreed on a customs union between the two republics after Czechoslovakia splits on January 1, 1993 (duty-free exchange of goods and services, common trade and customs policies toward third countries). A joint council and a permanent secretariat will coordinate these policies. Slovak Premier Vladimir Meciar said that the Czechoslovak koruna will remain the common currency indefinitely, but that either side could pull out of the arrangement at any time. The next round of pre-breakup talks is expected to cover financial issues, including taxation and protection of investments and the division of federal property.

Bulgaria's Prime Minister Filip Dimitrov resigned on October 28 after losing a parliamentary vote of confidence called over the economy and alleged arms sales to former Yugoslavia. Earlier, the government approved a 30 percent price increase for electricity starting in November. It has also announced plans to use 5 billion leva ($215 million) of state funds in a one-off action to assume responsibility for nearly all investment credits granted before 1991 and to help resolve the problem of overdue debts between state firms and banks. Total inter-enterprise debt in Bulgaria is estimated at more than 60 billion leva ($2.55 billion). The government also wanted to begin privatization of at least ninety-two companies before 1993. The Agency on Privatization, which prepared the plan, was to deal with eleven companies worth more than 10 million leva.

Russian First Deputy Premier Vladimir Shumeiko has said that energy supplies to other members of the CIS might be reduced by 60 to 63 percent in 1993. He justified this on the grounds that the former Soviet republics and East European countries were re-exporting Russian fuel and raw materials. As an example, he named Hungary, which, he claimed, had earned $1 billion this year by re-exporting Russian oil, fertilizers, and metals. It is thought that Russia has recently cut back on oil supplies to CIS members who were in arrears.

Industrial production in Russia fell by 18 percent in the first nine months of 1992 compared with the same period last year, the government reported. The production slump intensified in August, reaching a low of 27 percent as compared with August 1991. The October rate of inflation (CPI) is expected to increase to 25 percent, the highest since the price liberalization in January. The ruble fell to 398 per dollar on October 29 in trading on the Moscow Interbank Currency Exchange (from 393 on October 27).

Hungarian and Czechoslovak officials had agreed in principle on a four-point plan as the basis for settling their dispute over the Gabicikovo hydroelectric dam project on the Danube. According to Hungarian Secretary of State Janos Martonyi the four points include an immediate halt to work on the dam by Czechoslovakia; the acceptance of binding international arbitration; a commitment to maintain the normal volume of water in the original riverbed; and the creation of a small group to examine the immediate consequences of the Danube damming.

The Polish cabinet approved in late October a deficit of 85 trillion zlotys, or 5.3 to 5.5 percent of GNP, in a draft budget that projects 2 percent GNP growth and a fall in inflation to 38 percent for 1993 from a current rate of more than 40 percent. The budget, which is to go to parliament for approval before mid-November, foresees a 2 percent drop in real wages next year, after a fall of up to 7 percent in the first half of 1992. Taxes would account for almost 80 percent of revenue, while social outlays and debt servicing would be the biggest items on the spending side.

Mongolia's government has warned that living standards will collapse this winter if foreign donors do not step up aid. Chultemiin Ulaan, chairman of Mongolia's National Development Board, told delegates at an international aid conference in Ulan Bator that economic output was plunging at a rate of almost 20 percent per year. The conference, organized by the United Nations Development Program, was primarily focused on Mongolia's long-term needs.

Tanzania's President Ali Hassan Mwinyi says that privatization is the only way to revive state-run corporations whose debt is estimated at $3.1 billion, AFP reports. International donors try to persuade the country to dismantle or sell 400 unprofitable state-run firms to private investors.
World Bank/IMF Agenda

World Bank and IMF Support to Lithuania

A $60 million World Bank loan to Lithuania (approved on October 22) will help the country to maintain essential services in energy and health care and help sustain adequate agricultural production. (Badly needed imports include vaccines, drugs, and blood-control supplies; feed grain, protein meal, and veterinary medicines; lubricants; and fire-resistant cable.) Of the $60 million, $45 million will finance imports directly, and $15 million will be made available for purchase with local currency in commercial banks to meet the import needs of local enterprises. The Fund has approved an $82 million stand-by credit for Lithuania, to support the country’s economic reform program. The credit (the first since the Baltic state joined the Fund in April 1992), can be drawn over the next eleven months. The economic program is designed to bring down inflation to a monthly rate of 2 percent by next summer, and to limit the fall in real GDP to about 22 percent for the program year. (Consumer prices increased by about 2,200 percent from January 1991 to July 1992, and GDP fell more than 30 percent since early 1990.) Envisaged structural reforms include further price liberalization, privatization, creating a government securities market, financial sector reform, and designing and implementing a social safety net.

World Bank Helps Latvia Keep Warm

A $45 million World Bank loan to Latvia will provide foreign currency to buy critical imports in the energy, agriculture, and health sectors. Imports include heavy fuel oil (to assure adequate heat and electrical power this winter); agrochemicals, veterinary medicines, and machinery for food production, and drugs, vaccines, and supplies for local production of pharmaceuticals. (All three Baltic states joined the Bank this year; Estonia on June 23, Lithuania on July 6, and Latvia on August 11.)

IDA Brings Good Things to Laos...

With the support of a new $36 million International Development Association (IDA) credit to Laos, 14,500 households in the southern and central parts of the country will be able to switch on the lights—300 villages will be linked to the national power grids. (IDA is the World Bank’s affiliate for concessional lending.) At present only a sixth of the 4.1 million population has access to electricity. The funds will also finance training for staff of the country’s power utility and steps to improve network efficiency by reducing losses and improving billing methods. Part of the money will pay for a study on expanding the country’s first and largest dam, the Nam Ngum, where electricity is produced for domestic use and for export to neighboring Thailand. (The World Bank has approved lending totaling $227 million to Laos since its government launched economic reforms in 1985.)

... and Helps China’s Financial Reforms

A $60 million IDA credit will contribute to a more efficient mobilization of savings and their allocation to high-priority productive investments in China. Projects include establishing a sound payments and clearing system in the central bank for settlement of monetary transactions, bringing the country’s accounting standards in line with international standards, and strengthening the role of the Finance Ministry in debt management.

Vienna Institute for Human Investment

In Vienna six international institutions inaugurated the Joint Vienna Institute, which offers courses in economic and financial management and public administration for officials and private sector executives of Central and Eastern Europe and the former Soviet Union. The Institute is sponsored by the World Bank, the IMF, the EBRD, the BIS, the OECD, and the European Commission.

Hungary to Chair 1993 Annual Meetings

Hungary’s Finance Minister Mihaly Kupa has been named Chairman of the Annual Meetings for 1993. Mexico and Zimbabwe will name Vice-Chairmen.

World Bank Opens Hungarian Office

The World Bank opened its Budapest office on October 26 with Andrew P. Rogerson as Resident Representative. Address: World Bank Field Office, Suba Trade Center, 4th Floor, Nagymezo utca 44, Budapest 1065, Hungary. Tel: (361) 269-0389 or 269-0393.

Consultative Groups to Coordinate FSU Aid?

Japanese Prime Minister Kiichi Miyazawa, hosting the end-October Conference on Assistance to States of the Former Soviet Union, called for the World Bank to be put in charge of overseeing long-term assistance to those countries. Russian Deputy Premier Aleksander Shokhin said that while Russia welcomed the idea of consultative groups, it wanted authority shared between the World Bank and Russia’s Agency for International Cooperation and Development. British Overseas Development Minister Linda Chalker, speaking on behalf of the European Community, told the conference it would be helpful if all countries were to call upon the World Bank to convene consultative groups.
New Books and Working Papers *

World Bank publications:

Poland—Health System Reform

Since the 1970s, health indicators in Poland have plummeted. Life expectancy is down and postneonatal mortality is worse than in other European countries. Polish men die prematurely from cardiovascular disease, cancer, and accidents and injuries. The health system suffers from ineffective service delivery and a heavy reliance on public funds. Basic medical supplies are scarce, facilities are inadequate, and health workers are demoralized by hard work and low pay. As a result, health care is poor in quality and hard to obtain. The government pays most costs and confines private services to diagnostic tests and ambulatory care for acute illnesses.

A government health care task force worked with the Bank in June 1990 to draft reforms. In the short term, reforms aim to protect past achievements, prevent a worsening of health status in vulnerable groups, and balance care between public and market control. In the medium term, the system must cope with the rising burden of chronic, noncommunicable diseases; upgrade technology; and adjust the mix of chronic and acute care. The drastic changes ahead will not be easy, the study says. "Even with the most favorable possible increase in spending on health—which would come at the cost of much-needed investment in other sectors—Poland would have to face the trade-off between equity and efficient delivery of health services.

China—Long-Term Issues and Options in the Health Transition

Cornelis de Haan, Tjaart Schilhorn van Veen, and Karen Brooks

The Livestock Sector in Eastern Europe—Constraints and Opportunities

Ramgopal Agarwala
China: Reforming Intergovernmental Fiscal Relations

Available from the World Bank bookstore or to order: World Bank Publications, tel: (908) 225-2165 or P.O. Box 7247-8619, Philadelphia, PA 19170-8619.

IMF publications:

M.I. Blejer, M. Mecagni, R. Sahay, R. Hides, B. Johnston, P. Nagy, R. Peper
Albania: From Isolation to Reform

E.R. Borensztein, D.G. Demekas, and J.D. Ostry
The Output Decline in the Aftermath of Reform: The Cases of Bulgaria, Czechoslovakia, and Romania

Guillermo A. Calvo and Fabrizio Coricelli
Output Collapse in Eastern Europe: The Role of Credit

Adam Bennett and Susan Schadler
Interest Rate Policies in CEE: The Influence of Monetary Overhang and Weak Enterprise Discipline

Shoukang Lin
A Simple Monetary Model of a Shortage Economy

[Theoretical explanation of macroeconomic instability during transition.]


Henry Y. Wan, Jr.
The Market Transition in Taiwan [China]: Any Relevance for PRC?
To order: Cornell University, M. Einaudi Center, Ithaca, NY.

Chinese entrepreneurs still make decisions in an environment different from their counterparts elsewhere. The wage contract still borders on exploitation. The criterion for success is the ability to navigate the sociopolitical milieu and not the ability to solve technological and marketing problems. The latter function is exercised by foreign partners, either in a joint venture, or in a trading relationship like international subcontracting. And it is the foreign partners who retain the initiative in business dealings and earn the lion’s share of profits, according to this paper.

The Chinese economy has every opportunity to perform at least as well as the Taiwanese economy. The obstacle is not the socialist bias against monopolistic capitalism but bureaucratic institutions that prevent competition, claims the author. Instead of keeping inefficient firms alive, priority should be given to management reform and inefficient businesses should be exposed to competitive forces.

Other papers in this series:


October 1992
Is Bigger Better? The Economics of EC Enlargement

Key observations of the 1992 Annual Report on further enlargement of the Community:

- The Central and East European Countries (CEECs) would be expensive entrants, with current EC "cohesion" policies entailing annual transfers from current members of 8 billion ECU to Czechoslovakia, Hungary, and Poland and 5 billion to Bulgaria and Romania.
- Immediate free trade should be introduced between the CEECs and the EC for all goods and services, including agriculture and other sensitive sectors; high capital mobility should be formalized in a new European Economic Space (EES).
- Although current income disparities probably will not generate migration in excess of 5 percent of CEEC population over twenty years, free labor mobility should not be introduced now.

At present the Czech republic and Hungary appear the most plausible candidates for admission with the highest incomes, the most favorable location, the fewest agricultural problems, booming trade with the EC, the best record of transition, and the least threatening migratory pressures. [Editor's note: The newly independent Slovenia is not included in the authors' assessment.] Poland comes next, and the Baltic states might be ready as soon as Poland. Bulgaria and Romania are further behind economically and politically and are more likely to generate major migration flows, contends the CEPR report.

To order: CEPR, 25-28 Old Burlington St., London W1X 1LB. Tel.: (4471) 734-9110, fax: (4471) 734-8760.

CERGE, Charles University, Prague, Faculty of Social Sciences

Working papers:
- Katherine Terell. Productivity of Western and Domestic Capital in Polish Industry. WPS 8.
- Zdenek Drabek. Convertibility or Payment Union? Convertibility! WPS 12.

Lecture transcripts:

To order: CERGE, Taboritska 23, CS-130 87 Prague, Czechoslovakia. Tel: (422) 277-251, fax: (422) 277-249.

Recent working papers of the Warsaw Institute of Finance, Poland:

- Izabela Bolkowiak and Andrzej Wernik. Problems of Fiscal Policy in Poland. WP No. 28.

Information: IF, Information and Publication Section, Warsaw, Swietokrzyska 12.

New books:
- Robert W. Cambell
  The Failure of Soviet Economic Planning

- V. Samonis and C. Hunyadi
  Big Bang and Acceleration: Models for the Postcommunist Economic Transformation

Information: NSP, tel: (516) 499-3103, fax: (516) 499-3146.
Bibliography of Selected Articles

Staff may contact the Joint Bank-Fund Library, (202) 623-7064.

Post-socialist Economies


Information: ICPE, Ljubljana, Slovenia, tel: (3861) 182-331, fax: (3861) 346-389.


Central and Eastern Europe


Gati, C. From Sarajevo to Sarajevo. Foreign Affairs (U.S.) 71(64):78, Fall 1992.


CIS and the Baltics


Asia


Africa
