Welfare or Economic Growth

We are certain that the following articles will generate animated discussion about the costs and benefits of fast growth. What is the role of traditional institutions in a radically changing society that tries to overcome a historical lag to become a member of the European Union (EU) on an equal footing with other members? Is there a real tradeoff between social expenditures and faster economic growth, or can the two be targeted at the same time? Jeffrey D. Sachs and Andrew M. Warner from Harvard University argue for accelerating growth in order to overcome the historical legacy in Central and Eastern Europe. Jose Tavares and Romain Wacziarg, also from Harvard University, analyze the positive effect of democracy on growth but also argue that more equality, though important for holding the social fabric together, hinders growth. Michael Bruno and Lyn Squire of the World Bank disagree, arguing that new World Bank research reveals that more equality in asset (land) distribution and equal opportunities in health care and education boost economic growth.

How to Catch Up with the Industrial World—Achieving Rapid Growth in Europe’s Transition Economies
by Jeffrey D. Sachs and Andrew M. Warner

The preeminent economic challenge for the Central European Economies in transition (CEEs) is to grow rapidly over a sustained period in order to narrow the economic gap with Western Europe. If the CEEs grow only slightly faster than the EU, convergence will take several decades (see Transition, vol. 7, no. 1, January-February 1996, p. 6). Poland’s income level today is 36 percent of average income in the EU. Assuming that per capita income grows an average of 1 percent a year in the EU and 3 percent a year in Poland, it would take forty-six years for Poland to reach 90 percent of the average per capita income of the EU. But if Poland manages to boost growth to 5 percent per capita a year, the time it takes Poland to reach 90 percent of EU per capita income would be cut in half, to twenty-three years. The key issue for Poland and the other CEEs, therefore, is how to achieve high rates of economic growth in the next decades.

To do this, the CEEs will have to do better in the coming years than the recent performance of the less advanced EU economies—Greece, Ireland, Portugal, and Spain. Although Ireland, Portugal, and Spain each grew rapidly in the last five years of the 1980s, that proved to be a short phase—only Ireland has achieved rapid growth in the 1990s. Greece has never achieved sustained rapid growth in the past fifteen years, and Spain and Portugal grew very slowly in the early 1980s and the early 1990s. For the fifteen-years during 1980-95, all four countries fell short of 5 percent per capita
growth. Therefore, instead of being satisfied with these growth rates, the CEEs should instead try to match the performance of the countries that have a proven record of sustained rapid growth.

Our list of very fast growing economies (VFGEs) includes Chile, Hong Kong, Republic of Korea, Malaysia, Mauritius, Singapore, Taiwan (China), and Thailand. All are middle-income developing countries with populations (in 1989) of more than 1 million. They achieved a per capita annual growth rate of at least 4 percent during 1985-94.

These countries all share important characteristics of economic strategy. Their outstanding success is based on four clusters of factors:

1. Allocative efficiency (the efficiency with which resources are allocated among the various sectors of the economy at a point in time) is especially high. They rely mainly on market forces in the allocation of resources and have kept government intervention to relatively low levels. These countries are further characterized by a high degree of market competition, open trade, flexible labor markets, and low taxes, especially on labor income.

2. Savings and investment rates are high, as a result of high government saving and investment, high private saving, and high foreign direct investment. The VFGEs invest considerably in infrastructure (energy, communications, and transport), often in support of international trade activities. In turn, high private saving seems to be related mainly to a combination of demographic characteristics, overall fiscal and regulatory policies, and national pension (retirement) policy, based on individual saving accounts run by private pension funds.

3. The VFGEs have quickly absorbed new technologies from abroad (acquired through promoting foreign direct investments and licensing) and have adapted them in domestic production (technological upgrading). None of the VFGEs is a major innovator in technology, but all have been effective in using world-class technologies to upgrade domestic production and infrastructure. The VFGEs have established special economic zones to encourage new export-oriented industries and science parks for high-tech industries. These economic zones are often supported by tax holidays and government provision of infrastructure (such as land, energy, communications, warehousing, expedited customs processing, and improved transport links to nearby airports and seaports). The government’s education policy also helped to achieve high growth rates.

4. The VFGEs also have some natural advantages that have enabled them to pursue rapid export-led growth. They are all coastal economies with natural seaports that could be equipped with modern container port facilities. On the whole, these are abundant labor economies and relatively scarce in natural resources (Chile and Malaysia are the two exceptions in this regard).

The abundance of labor meant low initial wages and the ability to compete internationally on the basis of labor-intensive manufactures (footwear, apparel, textiles, and electronics assembly operations). These manufactures provided the starting point for export-led industrialization in these economies, except for Chile, where the recent export-led growth has come mainly in agriculture and resource-based industries. A scarcity of natural resources has been an advantage to economies seeking to establish export-led growth in manufactures—in the past twenty-five years such economies have tended to grow more rapidly than resource-rich economies.

If the CEEs adopt the policies of the VFGEs, the time needed to reach 90 percent of EU per capita income can be cut from 120 to 23 years for Hungary, and from 141 to 31 years for Poland. Similarly, the time needed to reach 70 percent of the EU average can be cut from 36 to 10 years for the Czech Republic, from 45 to 13 years for Hungary, and

<table>
<thead>
<tr>
<th>Type of Economy</th>
<th>Growth of real GDP per person (PPP adjusted)</th>
<th>Savings of GDP as a share (1994)</th>
<th>Investment of GDP as a share (1994)</th>
<th>Real GDP per person (1994)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very fast growing economies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td>5.1</td>
<td>4.8</td>
<td>25.9</td>
<td>24.9</td>
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<tr>
<td>Hong Kong</td>
<td>6.4</td>
<td>6.4</td>
<td>n.a.</td>
<td>28.8</td>
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<tr>
<td>South Korea</td>
<td>9.2</td>
<td>8.3</td>
<td>35.8</td>
<td>33.5</td>
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<tr>
<td>Malaysia</td>
<td>5.1</td>
<td>4.8</td>
<td>33.7</td>
<td>27.9</td>
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<tr>
<td>Mauritius</td>
<td>5.7</td>
<td>5.5</td>
<td>24.8</td>
<td>27.8</td>
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<tr>
<td>Singapore</td>
<td>5.7</td>
<td>5.7</td>
<td>42.3</td>
<td>33.1</td>
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<tr>
<td>Taiwan (China)</td>
<td>7.7</td>
<td>7.3</td>
<td>32.1</td>
<td>22.6</td>
</tr>
<tr>
<td>Thailand</td>
<td>7.4</td>
<td>5.9</td>
<td>28.8</td>
<td>33.8</td>
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<tr>
<td>Slow growing economies</td>
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<td></td>
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<tr>
<td>Argentina</td>
<td>2.1</td>
<td>2.3</td>
<td>19.1</td>
<td>16.6</td>
</tr>
<tr>
<td>Brazil</td>
<td>-0.5</td>
<td>-1.1</td>
<td>24.0</td>
<td>21.0</td>
</tr>
<tr>
<td>Mexico</td>
<td>1.6</td>
<td>0.3</td>
<td>19.7</td>
<td>21.1</td>
</tr>
<tr>
<td>Turkey</td>
<td>3.1</td>
<td>2.4</td>
<td>21.5</td>
<td>23.2</td>
</tr>
<tr>
<td>Poor European Union economies</td>
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</tr>
<tr>
<td>Greece</td>
<td>1.4</td>
<td>1.0</td>
<td>15.2</td>
<td>19.2</td>
</tr>
<tr>
<td>Ireland</td>
<td>4.1</td>
<td>4.1</td>
<td>20.7</td>
<td>17.6</td>
</tr>
<tr>
<td>Portugal</td>
<td>8.1</td>
<td>8.5</td>
<td>20.4</td>
<td>28.5</td>
</tr>
<tr>
<td>Spain</td>
<td>3.8</td>
<td>3.3</td>
<td>21.0</td>
<td>23.3</td>
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<tr>
<td>Central European economies</td>
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<tr>
<td>Czech Republic (1994)</td>
<td>2.4</td>
<td>n.a.</td>
<td>21.1</td>
<td>20.0</td>
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<tr>
<td>Poland (1995)</td>
<td>5.0</td>
<td>5.0</td>
<td>18.0</td>
<td>19.0</td>
</tr>
<tr>
<td>Hungary (1994)</td>
<td>2.5</td>
<td>2.1</td>
<td>11.8</td>
<td>21.0</td>
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<td>Notes:</td>
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<td>Source: Authors.</td>
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<td>Notes:</td>
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</table>
Years Required to Close the Gap with the European Union

<table>
<thead>
<tr>
<th>Country</th>
<th>1993 GDP as percentage of the EU Average</th>
<th>Policy action</th>
<th>Years to raise GDP to 70 percent of the EU average</th>
<th>Years to raise GDP to 90 percent of the EU average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Czech Republic</td>
<td>53</td>
<td>Keep current policies</td>
<td>23</td>
<td>56</td>
</tr>
<tr>
<td>Hungary</td>
<td>48</td>
<td>Keep current policies</td>
<td>n.o.</td>
<td>n.o.</td>
</tr>
<tr>
<td>Poland</td>
<td>60</td>
<td>Keep current policies</td>
<td>194</td>
<td>141</td>
</tr>
</tbody>
</table>

n.o. Not obtainable with current policies.

Notes: see pp. 29-30, original manuscript.
Source: Authors.

From 65 to 21 years for Poland. Harmonization with the standards of the VFGEs will lead to large increases in expected growth rates: the Czech Republic can grow at 6.58 percent, Hungary at 4.61 percent, and Poland at 6.10 percent.

The less-advanced EU economies failed to emulate the VFGEs in fiscal policy: Greece, Portugal, and Spain (but not Ireland) saw steep increases in public spending and taxation as a percentage of GDP during the 1980s and first half of the 1990s, associated with a rising tax wedge (the difference between the cost of labor and the net wage), a high and rising unemployment rate, and a falling national saving rate. (Ireland bucked the trend after 1986, reducing total government spending from 53 percent of GDP in that year to about 43 percent of GDP in 1994.)

For several reasons the CEEs are subject to the same fiscal pressures as the less-advanced economies of the EU: a common ideological commitment to a universal social welfare state; an effort to harmonize social, fiscal, and tax policies as well as other areas of economic management, including a large government role in the economy; and the political and economic ratchet effects of entitlement spending (when generous social insurance systems are in place, they are extremely difficult to unwind). This outcome is not inevitable, however. The EU is going through deep soul-searching over the role of the state, as country after country reaches a point of fiscal stress. Perhaps the CEEs will be able to take a larger step toward a smaller and growth-promoting state.

There is no doubt that the CEEs have achieved a stupendous breakthrough in allocative efficiency since the start of market reforms. They became full-fledged market economies underpinned by administrative, political, and legal changes, in a relatively short period of time—about half a decade. Within another few years the CEEs should rival the Western European economies in other areas of legal and administrative reform, such as banking reform, securities market development, and competition policy.

But the size of the government spending and taxation as a proportion of GDP has not declined since the onset of reforms in 1989; total public spending remains about 50 percent of GDP, among the highest in the world, and certainly the highest for market economies at comparable levels of income. (A sharp cut in budget subsidies to enterprises and households has been offset by an equally steep increase in social spending as a share of GDP. The bulk of the increased spending went to retirement pensions.) The overall high levels of tax collection are also reflected in high marginal tax rates and a tax wedge on labor income that is vastly higher than that in the VFGEs, and even that in the less-advanced European economies.

While overall government spending is very high, budgetary investment spending is low by comparison with that of the VFGEs. CEEs have squeezed infrastructure spending excessively to make room for large current expenditures, particularly transfer payments. Extremely high public expenditure and taxation in the CEEs is likely to lead to substantial disincentives to labor supply, rising long-term unemployment rate, encouragement of black-market activities, lower foreign direct investment, large public deficits, and a reduction in national saving rates. Many of these effects are already at play: public sector saving is lower, deficits are higher, and overall national saving and investment rates are far lower in the CEEs than in the VFGEs.

The CEEs have several important growth-promoting tasks in addition to the completion of market reforms (especially privatization and financial market deepening) and fiscal reform (especially pension reform) to lower tax distortions and raise national saving rates:

1. A clear target date for membership in the EU is important in order to lock in the economic reforms and boost investor confidence. Most of the difficulties of accession can be overcome if a few basic principles are recognized:
   - The CEEs need market access, not financial aid from the EU. (In return for rapid accession, the CEEs should unilaterally renounce their desire for a significant share of EU structural funds.)
How Democracy Fosters Growth: 
A New Empirical Approach
by Jose Tavares and Romain Wacziarg

Most countries in Central and Eastern Europe and the former Soviet Union are recent democracies. There are still public debates on whether their political system is an asset or liability in the quest for economic advancement. The different priorities given to economic and political liberalization in Russia and China, for example, also bring into question whether there is an optimal sequence of liberalization.

It is often argued that political rights and freedoms are in themselves a desirable feature of society and that they cannot be traded-off against potential economic costs. Hence investigating the effects of democracy on economic growth is sometimes deemed irrelevant at best, and dangerous at worst. But whether the development of political rights is the result of material progress or is one of its determinants is a crucial policy question. Is the cause of democracy better served by allowing improvements in standards of living to take their effect or by actively promoting the prompt adoption of political rights and freedoms? Similarly, is the cause of economic development better served by prompt or delayed adoption of democracy?

Formal economic research has failed to address these issues convincingly. Most statistical analyses point to a weak effect of democratic institutions on the speed of material progress. Studies focusing explicitly on the role of democracy, such as that of Robert Barro (1995), have found that the effect of democracy on growth is not statistically different from zero when several growth-determining variables are held constant.

But these studies look at the direct effect of democracy on growth, an effect that is not well grounded in theory. If institutions matter for growth, they must matter indirectly through their effect on economic variables. Hence the mechanism through which democratic institutions affect growth deserves careful examination. Our work has attempted to examine how democratic institutions affect certain variables that are directly associated with growth in per capita GDP. We selected from the political science and the economics literature seven variables that determine economic growth and are likely to be affected by democracy. We then used econometric methods to evaluate the effect of democracy on each channel variable and the effect of each channel variable on growth. Our sample consisted of data on fifty countries, thirty-six of which were developing countries, from 1970 to 1989 (thus no transition economies could be included).

The Seven Channels

- The quality and stability of governance. By providing a clear system of alternating between political forces and by encouraging open debate over policy options, democracies allow peaceful and regular, rather than violent and unpredictable, transfers of power. Less uncertainty, resulting from less political instability, is likely to foster investment and growth.

Autocratic rulers have an incentive to set up highly distortionary policies that benefit a small set of insiders at the expense of the general population and to capture the resulting rents. Democracies make it easier to keep these abuses in check, and they control the quality of policymaking...
by guaranteeing freedom of the press and of association and by promoting the independence of the judicial authority. The results of our study suggest a strong and significant statistical relationship between the efficiency of government services and the extent of political freedom. A lower level of distortions allows for higher growth in per capita GDP.

The size and composition of public expenditures. Autocrats may face incentives to increase the size of government to maximize their powers and leverage on the economy. Such abuses may be better kept in check in democracies. If decisionmakers are also the owners of capital as in dictatorships, there is an incentive to select a growth-maximizing size for government. If the poor have a larger say in public affairs, as they do in democracies, they may tend to vote for distorting redistributive measures that may hinder growth. These arguments are not supported by our data, however. Going from autocracy to full democracy is associated with a 6.5 percent decrease in the ratio of government consumption spending to GDP. This decrease in the size of government fosters growth.

Democracies may spend more on productive expenditures because voters can voice preferences for types of spending that lead to tangible improvements in their welfare. On the other hand, democratic governments may face a shorter horizon because of the frequency of elections. This favors less-productive types of outlays, such as gifts to special interest groups or unproductive consumption spending. Democracies tend to spend less than autocracies on productive types of government spending, such as infrastructure and other public investments. This is a pathway through which democracy can be detrimental to growth.

Societal choices and the electoral process (human capital and income inequality). A substantial part of education and health spending is publicly financed and contains a redistributive element. Thus if democracies are more responsive than dictatorships to the basic health and education needs of the population, they will choose policies that promote human capital accumulation. We find strong evidence that democracy leads to higher levels of human capital, which in turn generates growth.

How Democracy Fosters Growth

Our empirical methodology has uncovered several ways in which democracy induces costs and benefits for growth. The following table displays the percentage points of growth that result from a switch from dictatorship to full democracy.

### Growth Generated When Switching from Dictatorship to Democracy

<table>
<thead>
<tr>
<th>Channel</th>
<th>Percentage of growth points</th>
</tr>
</thead>
<tbody>
<tr>
<td>Political stability</td>
<td>0.602</td>
</tr>
<tr>
<td>Governance</td>
<td>0.653</td>
</tr>
<tr>
<td>Government size</td>
<td>1.408</td>
</tr>
<tr>
<td>Trade policy openness</td>
<td>1.080</td>
</tr>
<tr>
<td>Human capital</td>
<td>0.035</td>
</tr>
<tr>
<td>Income inequality</td>
<td>-0.786</td>
</tr>
<tr>
<td>Public investment</td>
<td>-0.036</td>
</tr>
<tr>
<td>Total net effect</td>
<td>2.957</td>
</tr>
</tbody>
</table>

Source: Authors.

By promoting a smaller government, better governance, greater trade openness, higher levels of human capital, and less political instability, democracy generates large gains in growth. Because of these positive factors alone (that is, controlling for other determinants of growth), per capita GDP in a full democracy, such as those in Norway or New Zealand (the...
most democratic countries in our sample), will tend to grow 4 percentage points faster than that in a totalitarian country, such as Myanmar (the most autocratic country in our sample).

Democracy also has costs in terms of growth, having to do with income inequality and public investment, which jointly account for a 1 percentage point difference in growth rate between full democracies and complete dictatorships. Some of these costs may well be worth paying, however; for instance, less income inequality may be considered a desirable feature of society in its own right, even if it comes at some cost to growth.

We started out by asking whether the cause of democracy was better served by allowing the improvement in standards of living to take its effect, or by actively promoting the prompt adoption of political rights and freedoms. By explicitly investigating the channels of influence from democracy to growth, our approach has revealed the economic costs and benefits of democracy. The benefits were larger than the costs. Democracy fosters growth; development and political freedom are mutually reinforcing.

The authors are Ph.D. candidates at Harvard University. This article is based on their paper “How Democracy Fosters Growth” (1996). The paper can be obtained by contacting the authors at tavares@fas.harvard.edu or wacziarg@fas.harvard.edu.

References


The World Bank/PRDMG

The Less Equal the Asset Distribution, the Slower the Growth
by Michael Bruno and Lyn Squire

In 1955 economist Simon Kuznets argued that as a country industrializes, the gap between the rich and poor first widens and then gradually narrows. But Kuznets’s original work used historical data from the first half of the nineteenth century for just three countries, Great Britain, Germany, and the United States. Using a greatly improved information base, World Bank research showed that growth does not consistently affect equality either way.

Of the eighty-eight countries in which there was economic growth for a decade, equality improved slightly in about half the cases and worsened slightly in the other half. The changes over time were much smaller than the differences in equality across countries. While growth did not affect equality, it was strongly associated with reduced poverty. Incomes of the poorest fifth of the population improved in 85 percent of the cases in which there was economic growth for a decade. In general, the higher the rate of growth, the larger is the improvement in the poor’s incomes.

World Bank research shows that the less equal a country’s distribution of assets, the slower its economic growth. What is the impact of equality on growth? Using new data, the Bank study found that developing nations with a more equal distribution of assets, particularly land, grew more rapidly than countries with a less equal distribution. The Bank study did not find a similarly strong association between income equality and growth.

Why is a more equal distribution of land and other assets good for growth?

One likely explanation involves credit. Investment is crucial for economic expansion. Land is a prime form of collateral. In countries with a very unequal distribution of assets, many people find it difficult, or impossible, to invest even in their own health or education. The new research findings and the different experiences of countries suggest three lessons:

• Countries that wish to reduce poverty should aggressively pursue sustained economic growth.

• Countries with very unequal asset distribution should try to improve the access of the poor to productive assets. Land redistribution is often politically difficult and may hurt the poor if it reduces investment, which is crucial to growth. Other potential remedies include improving access to education, health care, and credit.

• Our research does not support the widely held view that governments must choose between equality and growth. The most effective policies will be those that simultaneously promote both.

Excerpted from the authors’ recently published article in the International Herald Tribune.

Michael Bruno is Chief Economist and Senior Vice President for Development Economics at the World Bank. Lyn Squire is Director of the Policy Research Department at the World Bank.

September-October 1996
Banking Turbulence in the Czech Republic and the "Bad Boys" from Motoinvest

Agrobanka, the largest private bank of the Czech Republic and the fifth largest bank in the country, was placed under forced central bank administration in mid-September. The intervention followed the collapse of the medium-size Plzen-based Kreditni Banka in August. The bank has run up losses of some 12 billion koruny ($450 million). The main reason for Kreditni’s failure is widely considered to be incompetent management, although allegations of fraud against several top bank officials are also under investigation. Ceska Pojistovna, Kreditni Banka’s major shareholder and the Czech Republic’s largest insurance company, was also hit by these events. The core of Kreditni’s problems was non-payment by a large number of the bank’s debtors, most of them local entrepreneurs with little creditworthiness by Western standards. Because of inexperienced management, Kreditni lent billions of koruny to high-risk borrowers who have been unable to repay their obligations. A special investigating committee, set up by the Czech parliament on October 1, will investigate the affair and present its findings by the end of February.

The upheaval in the Czech banking sector raises questions about bank supervision. In total, twelve banks have been stripped of their licenses, put into liquidation or placed under the administration of the Czech National Bank (CNB) in the past two years. In a recent analysis, the Prague newspaper Dnes said that Agrobanka’s difficulties are rooted in the government’s attempt to force Motoinvest, a private investment group specializing in financial ventures, out of the banking sector. Motoinvest has been involved in the Plzen Kreditni Banka as a major shareholder in the insurance giant, Ceska Pojistovna, which is directly controlled by the bank. Shareholders allied to Motoinvest also gained a 30-40 percent stake—practically corporate control—of Agrobanka. Motoinvest itself had a 14 percent stake in Agrobanka.

But who is behind the Prague investment group Motoinvest? The group has acquired a reputation of one of the Czech financial system’s leading “bad boys.” Nearly everyone in the group is under thirty. Jan Slosarik, one of the “boys,” explained the group’s credo: “You are on a field with given boundaries, but everything else is changing every day. Find your position, find your chance, and go for it.” Motoinvest’s chosen method of pursuit has been to go after the undervalued stock of Czech companies as the government pushed through its mass privatization plan. Motoinvest has also attempted to gain significant influence in the banking sector through hostile takeovers of some banks’ investment funds.

Since late last year, Agrobanka and the small Plzenska Banka, controlled by the Motoinvest group, have spent more than 1 billion koruny ($38.4 million) to convince investors that the group is their crusading friend, ready to do battle with the large banks and investment funds that dominate Czech finance and are responsible for the financial system’s opaqueness and inefficiency. Small investors should sell their investment fund shares to the group, the campaign argues. But a recent Business Central Europe portrait argues that Motoinvest’s empire has become increasingly like those of the large institutions it claims to be battling.

About three months ago, several state financial institutions, including the National Property Fund and the country’s largest health insurance company, Vseobecna Zdravotni Pojistovna, began withdrawing their deposits from Agrobanka. Agrobanka was also forced to pay off its obligations to other state-affiliated depositors. Its liquidity assets worsened, but other banks refused to lend to it, presumably because of its connections to Motoinvest. The four largest (state-controlled) banks—Ceska Sporitelna (the largest savings bank), Komercni Banka, Ceskoslovenska Obchodni Banka, and Investici a Postovni Banka—refused to trade with Agrobanka on the interbank market in an apparent joint effort to force Motoinvest out of the banking sector. (Motoinvest also owns a significant minority stake in Ceska Sporitelna, the country’s second-largest bank.) Motoinvest finally
expressed a willingness to leave Agrobanka (and the entire banking sector) but is asking for a large premium for its stake—around 130 percent of Agrobanka’s share price before forced administration.

Since it came under CNB administration, Agrobanka’s situation has stabilized somewhat. The four state banks quickly agreed to put together a rescue loan of 6 billion koruny ($231 million) for Agrobanka. The CNB has announced that it will honor Agrobanka’s financial obligations; all deposits, including interest, registered at Agrobanka as of September 17 are guaranteed. Agrobanka currently has deposits of up to 40 billion koruny ($1.53 billion). The European Bank for Reconstruction and Development (EBRD) has expressed an interest in buying up to 20 percent of the bank’s equity, provided that Motoinvest sell its shareholdings and that a strong strategic investor (either a foreign buyer or a creditable domestic buyer, such as Komercni Banka) buy a significant stake.

Given the importance of banks and bank-controlled investment funds in the governance of industry, the questions of bank governance and of the tangled and nontransparent webs of cross-ownership among banks, insurance companies, and investment funds revealed by the Kreditni and Agrobanka affairs take on wider significance. A new banking law that is being prepared proposes a further tightening of liberal conditions for investors. Important changes are likely to be made in the law (which will probably be passed next year), such as requiring CNB’s permission for purchasing a 10 percent or greater stake in a company (the threshold is now 15 percent). The apparent ability of Motoinvest to gain effective control of Agrobanka without this permission has been one of the most troubling aspects of the latest developments for CNB officials and sector observers.

Nobody knows what the future holds for Motoinvest. Director Jan Dienstl was arrested in mid-September, though he was later released. General director Pavel Tykac left the country saying that his life was in danger. He was followed into a self-imposed exile by Kreditni Banka board member Libor Sadilek. They and other high ranking officials from Motoinvest and Kreditni Banka are still under investigation, accused of misuse of funds and harming the bank’s creditors. For example, the Kreditni Banka’s economics director allegedly received a 3 million koruny golden handshake upon leaving his post in August, after the bank’s license had already been revoked by Czech authorities.

The banking sector shakeup has dimmed privatization prospects for the four largest state-owned banks. Privatization has been delayed already this year, but it was expected to move ahead after June’s parliamentary elections. Now Prime Minister Vaclav Klaus wants to postpone privatization to maintain the sector’s stability. Jan Kalvoda, leader of the Civic Democratic Alliance, a coalition partner in the government, argues that privatization is needed to create real market conditions in the sector. But experts doubt that privatization alone will reduce the market power of the “big four,” particularly the power of Ceska Sporitelna, the major provider of funds to the interbank market.

This article is based on recent reports of news agencies, the Open Media Research Institute, and Oxford Analytica, an Oxford, U.K.-based international research group.

“I was more involved in the policy side— they ran the day-to-day operations.”

From the World Press Review.
Quotation of the Month: “You want to make sure that people have health care and a full stomach and that they are not adversely affected by the transition.”
President James D. Wolfensohn on Strategic Issues of the World Bank Group

The Cancer of Corruption

We need to address transparency, accountability, and institutional capacity. And we need to deal with the cancer of corruption. In country after country, people are demanding action on this issue. They know that corruption diverts resources from the poor to the rich, increases the cost of running businesses, distorts public expenditures, and deters foreign investors. They also know that corruption erodes the constituency for aid programs and humanitarian relief. And we all know that corruption is a major barrier to sound and equitable development. Solutions can only be home-grown. National leaders need to take a stand. Civil society plays a key role as well.

Working with our partners, the World Bank Group will help any of our member countries to implement programs to discourage corrupt practices. And we will support international efforts to fight corruption and to establish voluntary standards of behavior for corporations and investors in the industrial world. The Bank Group cannot intervene in the political affairs of our member countries. But we can give advice, encouragement, and support to governments that wish to fight corruption—and it is these governments that, over time, will attract the larger volume of investment. The Bank Group will not tolerate corruption in programs that we support; and we are taking steps to ensure that our own activities continue to meet the highest standards of probity. If we find evidence of corruption in projects in which we are involved, we will cancel the projects. But we can encourage and work with the many countries that are interested in taking anti-corruption measures, through technical and monetary assistance.

Social Underpinnings

Social, cultural, and institutional factors are key to success and to sustainability. Without these social underpinnings, it is difficult for economic development to succeed and virtually impossible for it to be sustained. For economic advancement, you need social advancement—and without social development, economic development cannot take root. For the World Bank this means that we need to make sure that the programs and projects we support have adequate social foundations:
- By designing more participatory country strategies and programs, reflecting discussions not only with governments, but also with community groups, NGOs, and private businesses.
- By putting more emphasis in our project and analytical work on social, cultural, and institutional issues and their interplay with economic issues.
- By learning more about how the dynamics among public institutions, markets, and civil society affect social and economic development.

In virtually all transition economies, moving from a socialist to a private enterprise system requires strong social underpinnings. You want to make sure that people have health care and a full stomach and that they are not adversely affected by the transition. If you have political and economic advancement, you must have social advancement coming along with it. This is why we are discussing the possibilities of financing social programs in transition economies.
and probable projects in our International Bank for Reconstruction and Development (IBRD) guarantee pipeline—most awaiting government action or investor decisions for the next step. We are actively looking at how to expand this program even further. Under our charter the Bank may lend only to governments and may guarantee loans to the private sector only when there is a counter-guarantee by the government. There is tremendous pressure to allow some parts of the Bank Group to provide nongovernment guarantees.

The International Finance Corporation (IFC) has had a record year, leveraging more than $19 billion in support of projects worldwide. In the next year, the IFC will extend its reach to sixteen nations in which it has never worked before, where the investment climate is tougher. The Multilateral Investment Guarantee Agency (MIGA) also continues to exceed original expectations. Its guarantees have catalyzed foreign direct investments, now totaling an estimated $15 billion, and its on-line marketing and information service—the IPAnet—offers data and analysis on the business climate in more than ninety countries. Given the rapid growth in demand for its services, our Board will soon be discussing my recommendation for a capital increase for MIGA.

We have established a Private Sector Development Group to pool the strengths of these three institutions and to make them more easily accessible to our private sector partners. We need to attract more private flows to poor countries. In 1995, 75 percent of private flows, which totaled $170 billion, went to just twelve countries. About fifty countries, most of them very poor, received virtually no private inflows. Investment is linked to good policies and good governance, liberal trade regimes, and high savings rates, combined with sound legal and judicial systems. Simply put, capital goes to the countries that get the fundamentals right. We are working with our clients on those fundamentals. Strong financial systems are key. But there are pervasive problems with prudential regulations and their enforcement. About one in five developing countries face a banking crisis. Unproductive public expenditures and uncollected taxes are a further enormous drag on these economies. That is why the Bank Group, working with the International Monetary Fund (IMF), is helping our clients strengthen their financial sectors and reform their expenditure programs. If the new compact is to succeed, we must tackle the issues of economic and financial efficiency.

Sharing Development Experience

We have been in the business of researching and disseminating the lessons of development for a long time. But the revolution in information technology increases the potential value of these efforts by vastly extending their reach. To capture this potential, we need to invest in the necessary systems, in Washington and worldwide, that will enhance our ability to gather development information and experience and to share it with our clients. In effect, we need to become the Knowledge Bank:

* By networking, pooling our wealth of cross-country experience, capturing the best global thinking and expertise on a given issue, and making it easily accessible to our clients and partners.
* By expanding the role of our Economic Development Institute, which already reaches thousands through its learning programs, and is well on its way to reaching millions by harnessing teleconferencing, television, and the Internet.
* By pioneering new partnerships that connect our clients with global centers of knowledge and investment. Our World Wide Web site is accessed 1.5 million times a month. Through the Information and Development Fund, the Bank and its partners help the poorest countries to realize the potential of information technology.

Toward a Results Culture

I pledged last year to build a “results” culture at the World Bank—and this effort is showing tangible progress. We have stressed that we will measure our performance not by dollars lent or projects approved but by development impact: results on the ground. By putting quality ahead of quantity, we have fundamentally changed the incentives that guide our staff. Backed by tougher quality assurance for our work, we are:

* Increasing our country focus and client involvement in our assistance strategies by locating some of our country directors in our borrowing countries.
* Paying greater attention to our clients needs, with customized advisory services and important new products such as the single-currency loan, which allows our clients to borrow at an effective 50 basis points above the AAA rate. We are also speeding up our procedures.
* Improving our professional expertise through the creation of sectoral “networks” among our staff, with the first of these established in the human development area.
* Strengthening our management capacity, with a substantial executive education program and an exchange program with a broad range of private and public institutions.
* Investing more in our staff, including a doubling of skills-training this year.
* Looking at strengthening the field units.

There is an image of “World Bank bureaucrats.” I have no doubt that we have a number of them, maybe too many. But what you cannot ignore is that there is an enormous body of people in the Bank, an extraordinarily dedicated group of people, who have committed their lives to development.

This compilation is based on President Wolfensohn’s speeches and press conferences held during the Annual Meetings.

September-October 1996
The World Bank Invests in Social Capital: Interview with Head of the Social Task Group

Encourage public involvement in World Bank projects, set up a high-profile social learning group, and channel additional resources into a wide-ranging social development program—these are some of the major proposals of a World Bank task group that has just completed its report at the request of President Wolfensohn. The head of the task group on social development, Vice President Shahid Javed Burki (Latin America and the Caribbean Regional Office), explained major components of the program to Transition editor Richard Hirschler.

Q. What will the Bank do differently as a result of the task group’s recommendations?

A. The study is not yet completed though it will be shortly submitted to the Board of Directors for further discussions. But the major directions are already set: the bottom line is that the World Bank has to go beyond economic development, incorporating social concerns into its activities. Some major initiatives of the task group are the following:

• During the current and the next (1998) financial year all regional departments should present two or three country assistance strategies (CAS) to the management and the Board that cover social development. These social assessments should incorporate results of dialogue conducted with representatives of business, labor, workers organizations, and voluntary and other nongovernment groups. These groups should increasingly participate in programs that target the elimination of poverty, improvement of living standards, and expansion of spending on health and education. Public involvement in projects directly affecting their lives should be intensified. For example, the water supply rehabilitation project for Baku, the capital of Azerbaijan, including pricing policy, has been modified as a result of consultations with nongovernmental organizations (NGOs), the academic community, and consumers.
• Small, experimental social projects (pilots) should be kept alive indefinitely, if necessary, with modest means. In Russia, for example, the Bank’s pilot projects help municipal governments take over certain social facilities and services from enterprises.
• The Bank’s social investments should be small, simple to implement, and quick to bring results. Bank grants to NGOs—perhaps from the proposed Civil Society Fund—could be an efficient way to build capacity, try out new incentives, and reduce poverty among the poor who are not reached by government programs.

The research program should be expanded by fully integrating social dimensions of development. Topics should include:

• The social, institutional, cultural factors that go into policy formulation and implementation and the impact of these factors on development outcomes.
• The changing role of the state market and civil society and the implication of these changes for World Bank strategies.
• The social impact of Bank-supported interventions.
• New measures of progress, such as social indicators relating to the distribution of wealth or to levels of violence, crime, personal security, trust, and social capital.

A multidisciplinary social learning group should continue the task group’s work, overseeing the integration of social factors in the Bank’s activity, monitoring implementation, and collecting and disseminating information about successful projects.

Q. How will this new emphasis on social issues affect the financial stability of the Bank? Investment in health, education, and poverty reduction, while strengthening the social fabric of society, will not necessarily be profitable ventures. Maybe it is not even possible to talk about return rates. Can the Bank financially endure this activity in the long run?

A. I do not see any problem with that. We will continue to require the return rates that are considered necessary. To put it into a historical perspective, consider that in 1973 President Robert McNamara announced for the first time that the Bank’s projects would target rural development. However, the retained emphasis is on increasing production. As a next step, World Development Report 1980 on human resources development emphasized that human capital is as important as physical infrastructure and inputs. World Development Report 1990 on poverty recommended that governments target the poor in their development programs. Now we have gone one step further: supporting the social empowerment of the people—in other words,
formation of social capital. A new partnership is taking shape that will qualitatively change the relationship between the Bank and NGOs, foundations, client countries, and other lending organizations. Transition economies, forced to downsize their social welfare systems, can expect the Bank to focus on their specific problems and to increasingly involve NGOs in its efforts to mitigate the anguish of those losing out in the transition process.

How to Jump-Start Enterprise Adjustment: Lessons from a Moldova Project
by Vladimir Goran Kreacic

Enterprise restructuring is one of the most difficult areas for countries of the former Soviet Union. Our World Bank team had an interesting experience in Moldova in preparing and implementing, jointly with the government, a private sector development project.

A stabilization program and mass privatization in Moldova was not followed by enterprise restructuring. By 1995 output dropped to 40 percent of its 1989 level. Moldovan enterprises tried to avoid the hardening budget constraints through passive strategies: accumulating tax, wage, and interest arrears; delaying payment of electricity bills; and turning to barter. The population invested its privatization vouchers in Moldovan enterprises, only to become the legal owners of firms that were effectively owned by the creditors, which in the majority of cases was the state.

Why did the adjustment enterprises in Moldova fall so far behind that in Central European transition economies? While the budget constraints were equally hard, some basic differences played an important role:

- **Considerable geographic distance to competitive markets.** Moldova, a land-locked country between Romania and Ukraine, could not reap the full benefits of trade liberalization. In Central Europe, import liberalization forced local producers to respond in order to compete and survive. Central European managers are close to their Western counterparts and have easier access to start-up capital, know-how, and equipment suppliers—at small and medium-size enterprise levels it makes a difference.

- **Long exposure to the Soviet system.** The country inherited an irrational industrial structure with oversized enterprises.
- **Limited decisionmaking powers and absence of market-oriented managerial skills in enterprise directors who had been participants in a wider, highly centralized system.**

**The Groundwork**

The World Bank-supported private sector development project intended to jump-start enterprise adjustment by encouraging the indebted firms and their creditors to agree on out-of-court, informal debt settlement (debt moratorium), and a restructuring program. Together with the government, the Bank has offered both credit and technical (advisory) assistance for the restructuring, in order to:

- **Give enterprises some breathing room by restructuring current debt service payments.**
- **Give creditors hope of future payment, because downsizing the enterprises and sale of assets are designed to create liquidity to settle unpaid arrears.**
- **Give shareholders hope that through restructuring, a viable core business could be developed that will ensure profit and further expansion.**

Initially, many enterprises joined the program, mistakenly expecting some form of traditional subsidy from the state. By October 1995 almost fifty enterprises had signed a memorandum entitling them to a temporary freeze of past debts, while requiring them to meet their current obligations. In agreement with the creditors, the enterprises had to draft and start to implement a restructuring plan. At the time of the first review, in December 1995, six of the firms had met only about 80 percent of their current obligations. The creditors eliminated all six firms from the program. The remaining firms—ten of which also received technical assistance—became even more active in reducing costs, collecting receivables, selling unused assets and inventories, and searching for new markets.

Early results show improved production efficiency, significant cost reductions (through major downsizing of excess labor, energy conservation, and improved material management), creation of a number of smaller spin-off firms, and sustained ability to meet their current obligations (see box). In September 1995-March 1996 state and local authorities, the Social Fund, and other creditors received $103 million (equivalent), as enterprises started making their current payments. Many of the seventy-five local consultants, trained during project preparation, are providing basic restructuring services to enterprises. The demand for restructuring services continues to grow. Already sixty-two enterprises...
Transition

signed memoranda with their creditors, seventeen of which are receiving restructuring assistance.

In large part this success was due to the managers recognition that they have only two alternatives: create a positive cash flow from operations and asset sales or accept legal bankruptcy and liquidation. This recognition pulled the process out of its earlier paralysis.

Initially, managers and government officials insisted that enterprises needed only investment funds to buy advanced technology and make the enterprise competitive again. Opposition to any hard budget measures was enormous.

Methods for Promoting Change

Motivation. To counter such strong resistance, the World Bank team emphasized that further idleness could result in the loss of all jobs, whereas prompt action would result in the loss of only some jobs. To persuade enterprise managers and political and business leaders that business as usual was simply not possible, seven nonviable enterprises were closed and their assets sold at auctions. These pilot bankruptcies had a number of positive visible effects: they opened a channel for the sale of unused assets, generated cash for the fiscal budget and for the contracting enterprises, and facilitated the establishment of small and middle-size enterprises.

The project team members also organized seminars for top officials and parliamentarians, which focused on enterprise restructuring and liquidation, financial sector reform, and the effects of macroeconomic policy measures. Setting up meetings with officials from other European transition economies and initiating study tours to Central Europe proved instrumental in communicating the need for, and the inevitability of, change.

Partnership with locals. From the beginning, the World Bank team was eager to share ideas, concepts, and implementation strategies, including project design, with local partners to ensure a close relationship (the ownership of the project, in the Bank’s jargon). Together, the Bank team and local partners analyzed alternatives and subsequent project costs and benefits. Officials likely to be directly involved with the project attended study tours to the Czech Republic, Poland, Romania, and Slovenia. Local inputs were encouraged at every level. An enterprise assistance agency, ARIA, was designed to evolve as demand requires. Rather than staffing with foreign and local consultants, ARIA—with its skeleton staff—contracts out all restructuring work to emerging local private consultants, who in turn are trained by foreign experts.

Reaching critical mass and self-sustainability. During project preparation local partners were trained through the World Bank Economic Development Institute (EDI), the World Bank-IMF Joint Vienna Institute, the Central and Eastern European Privatization Network (CEEPN), the UN Industrial Development Organization (UNIDO), and other programs funded under bilateral arrangements. Gaining public support for reform was considered a priority; therefore the team focused on the dissemination of information, using local sources and media outlets, and initiated press briefings and training seminars (on entrepreneurship, for example) for local officials, enterprise managers, and students.

Messages for Future Projects

For future World Bank projects in the former Soviet Union, the Moldovan experience yields several clear messages:

During project preparation:

- Groundwork for the project should be devised early on (microactions should be based on macroeconomic conditions presented in the Country Assistance Strategy).

- Teams working on overlapping issues should coordinate activity to prevent misunderstandings and to maintain the project cycle timetable; innovative features should be discussed early on with those who have clearance authority in the respective regional department.

- Lawyers at the Bank should contribute to design in the early stages; departmental management should be promptly informed about any processing problems.

Career adjustment

"Very precise and fast, just as an ex-math professor should be.”

From the Hungarian daily Nepszabadsag.

Volume 7, Number 9-10
For efficient preparation in the field:

- Local partners with motivation, skill, and power should be identified and brought in to develop and prepare project components jointly.

- Nonfinancing aspects of the project should be delivered as early as possible—well before project approval by the Board of Directors, if grant financing is involved; early demonstration effects are extremely important.

- Pilot projects can improve partnership and extend local support. (In Moldova pilot liquidations demonstrated that assets released into the market facilitate the creation of new business.)

- Financing within the projects is secondary, and the government should not nurture unjustified expectations. World Bank teams should let the government know this early on, through clear and continuous communication with local officials.

- Brief, focused, and relevant technical notes amplify the teams' credibility and boost local interest, stimulate demand, and minimize misunderstandings.

- Local counterparts recognize hard work in the field and they are likely to reciprocate.

- Whenever possible, projects should use consultants who are familiar with the local decisionmaking culture and bureaucracy.

To secure sustainability:

- Ensure that local partners understand that complicated components or conditionalities in the technical assistance projects serve their effective implementation of those projects.

- If sufficient resources are not available, the project should be scaled down, rather than postponing the necessary preparation for the implementation phases.

- Project preparation should be designed so that the newly trained local consultants are offered a role in implementation. In Moldova, rather than creating a centralized institution and loading it with foreign and local consultants, trained local consultants are left in the private sector and subcontracted by foreigners or ARIA. ARIA and local enterprises have already proven that they can successfully diagnose and prepare basic restructuring programs for medium-size enterprises.

- If possible, components should not be delivered before there is a demand for them; components should be sequenced in such a way that the first action creates local demand for the next action. Thus in Moldova the hard budget constraint increased demand for restructuring assistance, and management contracts were introduced as an incentive to restructure and to enable managers to better evaluate the restructuring results, which in turn affect managers’ rewards. Managers are now pushing for accounting reform.

### Three Success Stories

**Spin-offs to employees.** By 1995 output of Mashfrigcomplex (MFG), an industrial refrigerator producer had dropped to 4 percent of its 1989 level, with monthly sales of $50,000, produced by 1,100 employees. The breakup of the former Soviet Union had completely eliminated its former markets. The government abandoned earlier efforts to privatize the company as a single unit. Instead, with foreign technical assistance, the government liquidated the company and helped to establish small enterprises by spinning off the remaining productive assets to former employees. Less than twelve months later, twenty-five registered private companies were operating on the former MFG premises, employing 213 workers—mostly former MFG employees—with an aggregate monthly sales volume of about $190,000 (equivalent).

Modern manufacturing design. The Stejaur furniture factory was one of the first management-employee buyouts in Moldova. In mid-1994, with technical assistance provided under the private sector development project, the company began to implement a Japanese-financial enterprise restructuring package for increasing productivity. The company today has a streamlined manufacturing process that occupies only a quarter of the space of the former plant. The rest of the premises has been leased or sold to four newly established small and medium-size enterprises, owned mainly by former Stejaur employees. Overall production costs have been cut by 30 percent, and the company has introduced new modern-designed furniture. Stejaur is now a profitable and expanding company.

Back from the brink. A visit to parts of the Farmaco pharmaceutical company that have not yet been restructured is a journey back to the nineteenth century. After signing its debt moratorium and restructuring memorandum with its creditors, Farmaco removed 150 truckloads of trash from the premises; cleaned, painted, and repaired the facilities; and rearranged the equipment. Farmaco has received offers from five foreign strategic investors to purchase shares in the company. The government is accelerating the privatization process to make the firm eligible for financing under the private sector development project's credit line.
The State in a Changing World: Ideas from the forthcoming *World Development Report*

*World Development Report 1997* will look at how an effective, capable state affects the provision of the goods and services, rules, and institutions that allow markets to flourish and people to lead healthier, happier lives. Keeping cross-country differences in mind, it asks why and how some states are more capable than others at playing a catalytic and facilitating role in sustainable development and poverty eradication, and how changes the world over—rapid globalization and technological change, the collapse of socialism, the reawakening of citizen action—are reshaping our thinking about the state.

The state is fundamentally a mechanism to facilitate the provision of public and collective actions, ranging from breathable air, safe water, sound currency, law and order, defense, and (in an increasingly information-based world) public information.

Capable state institutions are also needed to provide a system of checks and balances that present the arbitrary and capricious use of sovereign state power. Excessive checks and balances can lead to paralysis or gridlock; insufficient checks and balances can lead to abuse of state power for personal or misguided objectives. The challenge is to create a balanced state structure that mediates interests, protects the underprivileged and weak, delivers services, and focuses collective action on sustainable economic and social development and the eradication of poverty. The Report consists of five parts.

**Part One**

The first part will focus on how states are changing and how successful they have been achieving sustainable economic and social development. In some cases, there are efforts to retract and refocus an overstretched and ineffective state (as in the former Soviet Union). In other cases, changes involve removing a maze of checks and balances that has paralyzed the levers and agencies of the state. The changes can involve broad political reforms, as in Eastern Europe and Russia, where more democratic forms of government have emerged over the past decade. Or changes can result from political upheaval or ethnic and other social tensions that break down the basic functions of the state to law, order, and stability. In such dysfunctional states as Bosnia, building state authority will be a vital first step.

**Part Two**

The second part will analyze primary sources of pressure on states to change: markets, citizens, global forces. The Report will show how the balance between state and market has changed over time, from a relationship of control and antagonism to one of partnerships and complementarity. In solving the problems of market failure and helping markets to grow, some analysts argue that government intervention (if done the right way) can be market-enhancing. The Report will also examine concerns about the ability of markets to take appropriate consideration of inequality and of the welfare of future generations.

Citizens around the globe are becoming more active and vocal about state failures and inefficiencies. The Report will examine ways of checking potential abuses and violations of state power and subjecting state officials to public scrutiny.

Large global flows of private capital and lower transport and communication costs have made it tougher for individual states to act alone and independently. Governments that challenge financial markets do so at tremendous cost to their credibility. Rapid communication technologies have altered people's access to knowledge and are changing their expectations of government. This Report will ask whether global integration is leading to more disciplined government and to greater convergence in tax regimes, regulations, investment codes, and accounting and environmental standards.

**Part Three**

The third part will investigate how the state can become more efficient as an economic manager, rulemaker, protector, and service provider. How and why some countries appear to be more successful than others in setting good policies is still not fully understood. Why do countries continue to resort to short-term populist measures when their long-run costs are well-known? Greater efficiency and equity in tax policy and the allocation of public expenditures are essential elements of state reform. But many countries still spend too much on inequitable programs and on defense.

All too often, regulatory initiatives have been undermined by powerful vested interests and self-interested officials. Regulation sometimes raises transaction costs, undermines property rights, and thereby inhibits private sector development. The challenge is to identify a menu of regulatory tools from which countries can select those most likely to yield benefits in their specific country settings.

Designing effective programs to meet this end without falling into the trap of an expensive and ineffective welfare state remains a nettlesome challenge. What structural changes are needed in traditional transfer mechanisms, including pensions, unemployment compensation,
surerance pay, family benefits, and child benefits? How are compensatory schemes designed that cushion vulnerable groups from short-term adverse effects? This is particularly important for many countries of the former Soviet Union and Eastern Europe, where poverty doubled between 1987 and 1993. Changes in technology and better appreciation of the capacity of markets and nongovernmental organizations have created new opportunities for more competitive and efficient provision of public services and a new scope for competition and private financing (for example, telecommunications in Mexico, power generation in China, and road maintenance through contracting).

Part Four

The fourth part will show that introducing greater contestability (through decentralization, delegation, and participation) improves the operation of state institutions. To restrain arbitrary action, countries have at their disposal a wide variety of checks and balances (for example, a strong, independent judiciary) while maintaining the flexibility to pursue desirable public initiatives. Greater decentralization of decisionmaking to lower levels of government can make the state more responsive and accountable in service provision. The Report will examine country experiences in assigning expenditures and revenues to different levels of government and designing intergovernmental transfers and revenue-sharing arrangements. Reforms in core public sector institutions can improve performance along two interrelated dimensions: better decisionmaking and improved strategic priorities, as well as efficient and effective implementation of policies and programs.

Part Five

The fifth part will examine how reforms of the state can be sustained. Borders are becoming more porous. The false dichotomy between state and market is giving way to an understanding of their complementarity. Citizen action is increasing. Yet most states remain resistant to change. Beneficiaries of the status quo—including politicians, bureaucrats, and corporate or farming interests—will try to slow or derail changes that threaten their position, regardless of the broader social benefits.

Richer countries tend to rely more on democratic institutions. Therefore, it can be expected that economic progress will lead toward more democratic forms of government. Broad political contestability, however, appears to be neither necessary nor sufficient for sound economic and social policies, and many countries—the Republic of Korea (in the 1970s), Chile (in the 1980s), and China—have recorded remarkable economic and social progress within what appear to have been or to be noncontestable political systems. In several East Asian countries meritocratic bureaucracy, fiscal discipline, and state institutions to help information and coordination problems in the market have been identified as factors skillfully applied to ensure growth and improve public services, even without overall political contestability.

The Report will try to show that cross-border problems need cross-border solutions and so will require more international cooperation. To the extent that foreign aid has helped preserve large government, its decline can accelerate reforms. The necessary institutional strengthening of the state will require new forms of institutional and technical assistance.

Conclusion

On the basis of findings to date, the Report reaches the following conclusions:

- The state and its policies explain many differences in people’s lives around the globe. It is not the size of the state alone that matters—the capability matters more.
- The great (and false) debate between state and market seems to be over for now. There is growing realization that a more credible—not larger—state is needed to create the institutional infrastructure necessary for markets to flourish.
- All over the globe, citizens are demanding greater transparency and openness in the conduct of government; not only a cleaner government that delivers services but also one that effectively mediates competing interests.
- Globalization is making governments generally more responsive and less capricious in their economic actions. Handling twenty-first century problems will require a more agile, information-intensive state, working in concert with the international community, rather than a weak state subordinated to international interests.
- Reforms are under way, beginning with reducing the size of the state and moving toward strengthening vital state functions, in some cases requiring reconstruction of the state. Introducing greater economic contestability is a key to making state institutions work better.
- Changes in technology, better appreciation of the capacity of markets and nongovernmental organizations, greater decentralization to local government and communities, reforms in public sector management—all of these have created new opportunities for more competitive and efficient provision of public services.
- More effective international cooperation will be needed to help nations manage global challenges and take advantage of the emerging opportunities in the twenty-first century, as the demand for international collective action grows.

The World Development Report 1997 will be published next June. The Staff Director is Ajay Chhibber. World Bank, Room N7-063, tel. (202) 473-4869, fax (202) 522-0056, e-mail: achhibber@worldbank.org.

September-October 1996
Euromoney’s Country Ranking: The Winner Is...East and Central Europe!

In Euromoney’s semiannual ranking of country creditworthiness, the winners are the emerging economies of East and Central Europe. Southeast Asian economies are looking riskier, however, as debt ratios worsen and monetary instability spreads. The only rising economies in Asia are in Indochina. Vietnam rises three places to 63, partly as a result of its membership in the Association of Southeast Asian Nations (ASEAN); it is also expected to debut in the international bond market next year. Even Cambodia rises two places, although its ranking remains lowly at 109.

The place gainers are mostly in Eastern and Central Europe, as the reform programs put in place since the fall of communism begin to bear fruit. The biggest riser in the region is Slovenia, which is now rated as fractionally more creditworthy than the Czech Republic. Slovenia’s economy is expected to grow more than 4 percent a year, both this year and next. Poland, however, is forecast to produce the fastest growth in Central Europe this year and next, at more than 5 percent a year. As a result, Poland moves up three places. Russia, despite its continuing economic problems, is also rapidly improving its credit rating. As recently as last September, it ranked at 142. By March it had risen to 100; now it is 86. Boris Yeltsin’s reelection removed some of the political uncertainty, although his impending heart surgery—alected after our poll was conducted—will inevitably increase it again.

The Baltic States have also improved their rankings, particularly Lithuania, the highest ranked of the three, which rises 26 places to 59. All three countries are now in the international bond market. Their economies are looking healthy, and all are expected to show solid growth next year.

Methodology

The Euromoney country risk assessment uses analytical indicators, credit indicators and market indicators, in nine categories. The weighted scores are calculated as follows: the highest score in each category receives the full mark for the weighting; the lowest receives zero. In between, figures are calculated according to the formula: final score = weighting/(maximum score-minimum score) x (score-minimum score). The country risk ranking shows the final scores after weighting.

- **Economic data (25 percent weighting).** Taken from the Euromoney 1996-97 global economic projections. Each country scores the average of the evaluations for 1996 and 1997.

- **Political risk (25 percent).** Euromoney polled risk analysts, risk insurance brokers, and bank credit officers. They were asked to give each country a score between zero and 10 (10 indicates no risk of nonpayment; zero indicates that there is no chance of payments being made).

- **Debt indicators (10 percent).** Scores are calculated using the following ratios from the World Bank’s World Debt Tables 1995-96: (a) debt service to exports (b) current account balance to GNP and (c) external debt to GNP. Figures are the latest available, mostly for 1993.

- **Debt in default or rescheduled debt (10 percent).** A score between zero and 10, based on the amount of debt in default or debt that has been rescheduled over the past three years. Ten indicates no nonpayments; zero indicates all in default or rescheduled. Scores are based on the World Debt Tables 1995-96 and Euromoney estimates for countries that do not report under the debtor reporting system.

- **Credit ratings (10 percent).** The average of sovereign ratings from Moody’s, Standard & Poor’s, and IBCA.

- **Access to bank finance (5 percent).** Calculated from disbursements of private, long-term, unguaranteed loans as a percentage of GNP. OECD countries that do not report under the debtor reporting system receive a score of 5. Scores are based on the World Debt Tables 1995-96.

- **Access to short-term finance (5 percent).** Scores are calculated taking into account coverage available from the U.S. Exim Bank, the U.K. NCM and Export Credits Guarantee Department (ECGD), and membership in OECD consensus groups.

- **Access to international bond and syndicated loan markets (5 percent).** Reflects Euromoney’s analysis of how easily the country might tap the markets now, based largely on issues since January 1995. A score of 5 means no problem whatsoever; 4, no problem on 95 percent of occasions; 3, usually no problem; 2, possible problem (depending on conditions); 1, possible in some circumstances; zero, impossible.

- **Access to and discount on forfaiting (5 percent).** Reflects the average maximum tenor available and the forfaiting spread over riskless countries, such as the United States, based on the average maximum tenor minus the spread. Countries for which forfaiting is not available score zero. Data were supplied by Morgan Grenfell Trade Finance, West Merchant Bank, the London Forfaiting Company, Standard Bank, and ING Capital.

Volume 7, Number 9-10
# Transition Countries' Risk Rating: A Euromoney Ranking

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Source: Euromoney 1996.
Bank-Led Restructuring in Poland: Its Impact on Enterprises
by Cheryl W. Gray and Arnold Holle

Since 1993 Poland has been considered a model of commercial banking reform among transition economies. Poland’s Enterprise and Bank Restructuring Program (EBRP), adopted by parliament in early 1993, aimed to rehabilitate and lay the groundwork for privatizing seven of the nine commercial banks that had been created in 1989 out of the National Bank of Poland. Under the banks’ command, the EBRP planned to restructure and privatize a group of financially troubled state enterprises. The program required the banks to establish workout units and to take action by March 1994 to recover loans that had been classified as losses (or those in doubt of being repaid) as of end-1991 (the “base portfolio”) through one of several resolution paths stipulated in the law—repayment, bank conciliation, court conciliation, bankruptcy, state enterprise liquidation, or sale of debt.

How effective has the EBRP been in fostering the restructuring or closure of problem firms? To answer that question, the World Bank surveyed 139 of the 787 firms that had been through the program. Sixty-two of the firms had signed a bank conciliation agreement; 45 had gone into court conciliation, bankruptcy, or state enterprise liquidation, 22 had repaid or become current on their loans, and the debt of 10 had been sold.

The survey confirmed that the EBRP had a positive impact on balance, but that its benefits fell far behind the high expectations set for it. The reform program was clearly innovative and well designed. In general, banks and enterprises took the program seriously, and it appears to have been free of fraud or corruption. Compliance with its prescriptions was high but not perfect. For example, both the 1992 government stance and the 1993 law required that banks stop new lending (including rollovers of previous loans) to firms with debts already classified international accounting firms as losses or indoubt of being repaid. Yet, contrary to these directives, about one-eighth of the firms in the sample received new loans or rollovers. The EBRP also envisioned that enterprises entering bank conciliation would be commercialized (that is, transformed into joint stock companies). Seventy-five percent of firms were commercialized, but the rest were not.

Furthermore, the EBRP was very useful as a catalyst in forcing otherwise passive creditors to take action against bad debtors. Although the debts in question turned bad in 1991, creditors took no action at all in more than 80 percent of the survey’s sixty-two conciliation cases until the law was passed in early 1993. Even after the law was adopted, nothing happened in more than 60 percent of cases until bank conciliation was initiated, on average ten months later. By then, the debt had been in arrears more than two years. The signing dates of most agreements cluster closely around March 1994, the original EBRP’s deadline.

Finally, the division of firms among resolution paths appears to have followed economic logic (see figure). Better-off firms tended to enter conciliation, while weaker performers tended to go into bankruptcy or liquidation. Profitability was not all that mattered, however. Size also appears to have been important, with larger firms tending to enter conciliation regardless of profitability. This is not surprising; politically, these firms are more difficult to close.

Despite these strengths, the survey results suggest that the EBRP may have had limited power to promote necessary restructuring in firms. Furthermore, the program focus on the new and temporary bank conciliation process resulted in neglect of other more fundamental and longer-term workout and exit processes. The exit processes continue to be poorly designed for the needs of a market economy.

Bank Conciliation

Bank conciliation agreements appear to have been unsophisticated. They dealt primarily with financial conditions—mostly large debt write-offs and renegotiation of payment dates—and included very few tangible requirements for operational or management change. Weaker banks (that is, those with lower capital and higher bad debt ratios) were willing to undertake significant debt-equity swaps, but stronger banks undertook very few. Restructuring plans that were actually prepared for firms, appear to have greatly overestimated future profitability, particularly when weaker banks (the three banks to be consolidated with Pekao S.A.) were in the lead.

Given these features, it is not surprising that the agreements have resulted in little restructuring to date. The first
two years of the agreements’ imple-
mentation saw a slowdown in the rate of layoffs from previous years, an in-
crease in the average wage rate (after adjusting for inflation), and a decline in average operating profitability and cash flow. (Reported net profits soared, but this was because loan write-offs were booked as income.) The main effect of the conciliation process was to provide firms with breathing room. Weak operating performance in 1994 and 1995 suggests that many firms continued to have problems and that financial discipline was perhaps still somewhat soft. Indeed, booking write-offs as profit may have given a misleading impression of higher post-conciliation profitability, may lead to further pressure for wage increases or more debt forgiveness in the future.

Debt-equity swaps were not used as widely as originally hoped, and the conciliation process did not lead to extensive ownership change. Of the sixty-two state-owned enterprises in the sample, majority stakes in no more than one-fifth will eventually be in private hands if the banks themselves are privatized. The fact that most debt-equity swaps were concluded by the weaker banks (those last to be privatized)—and that the equity went proportionately to other, often passive, creditors (including the government)—heightens the concern that it may be a long time before these swaps translate into effective private ownership and governance.

**Court Conciliation and Bankruptcy**

Court conciliation cases in the survey were concluded on average in about six months—about the same time required for bank conciliation cases. Firms in court conciliation received smaller debt write-offs but greater extensions in debt maturity than firms in bank conciliation. On a net present value basis, the extent of debt relief under the two processes appears to have been similar. In contrast to bank conciliation, the extent of debt write-off in the court conciliation cases was positively correlated with two other economic variables: the firm’s operating profitability and its level of indebtedness. With regard to outcomes, the subsequent performance of firms in court conciliation did not improve, and in eight of ten cases, firms in our survey continue to have problems servicing their debt.

Poland’s bankruptcy and the related legislation have major weaknesses in design and implementation, most notably the low priority given to secured creditors, the institutional weakness of bankruptcy courts and related professions, and the difficulty that judges and trustees have in identifying and curbing fraudulent behavior. Bankruptcy is inevitably a slow process, and in the twenty-three survey cases the process was expected to take on average about three years. Creditors have little involvement in the bankruptcy process and in the sample, creditors were expected to recover little of their original claims (on average 17 percent of claims for banks and 7 percent for suppliers).

As currently designed, neither bankruptcy nor court conciliation gives creditors sufficient control over firms in financial distress. Both could work much better if redesigned, if supported...
by institutional development in the courts and related professions, and if better systems of collateral and debt collection were developed. Court conciliation could be redesigned in several ways to increase flexibility. Government claims should be included in the process. A smaller majority should be required for approval of a workout agreement—not varying with the extent of debt write-offs proposed. All creditors should be allowed to vote (whether present or not). And more financial and operational restructuring options could be available for inclusion in restructuring agreements. Creditors’ rights under bankruptcy should be strengthened by rearranging priorities to put secured creditors first, by reducing up-front fees, and by giving courts and trustees greater powers and resources to uncover and to punish fraudulent transactions. Any design improvements need to be complemented by strong economic policies that give banks and other creditors powerful incentives to use these debt-collection mechanisms.

**State Enterprise Liquidation**

State enterprise liquidation is the most problematic of the three formal processes. It is almost entirely controlled by debtors. In most cases debtor management chooses the trustee—and in some cases even serves as trustee! In the cases surveyed, state enterprise liquidation is proving to be significantly slower than bankruptcy. Firms continue to operate far longer than in the bankruptcy process, and more assets eventually end up under the control of managers and employees of the original firm. The process, though on paper designed for solvent firms, is often used as a way to get around bankruptcy and keep debtor management in control of assets for as long as possible. Creditors are the big losers. They have no power. In the cases surveyed creditors were expected to recover almost nothing (6 percent of claims for banks and 3 percent for suppliers). The loophole of state enterprise liquidation needs to be plugged if the other formal processes are to work as intended. It should be strictly limited to solvent firms. If this is not feasible, the process should be eliminated altogether because of the abuse it invites.

**Sale of Debt and Repayment**

The EBRP included a nonbureaucratic market-based alternative to these formal processes—sale of debt. This alternative appears to have played a very limited role, however. Few sales were attempted and even fewer concluded. Tax disadvantages and debtor antipathy appear to have undercut banks’ incentives to sell, and the difficulty of using debt to “pay” for purchases or swapping debt into equity appears to have undercut potential purchasers’ incentives to buy. A secondary market for debt can be an effective and nonbureaucratic means to increase financial discipline in problem firms, but it will take some time—and probably a change in tax and other rules—to build such a market in Poland.

The EBRP also allowed firms to repay or become current on debt and thereby avoid other resolution paths. A large number of firms (about 40 percent) did repay. Almost 40 percent of the cases surveyed used retained earnings to repay, while 28 percent have borrowed new money to pay back old debt—a result not necessarily in accord with the goals of the EBRP.

Therefore initial evidence suggests that the outcome of Poland’s first experiment with bank-led restructuring is decidedly mixed. The EBRP forced banks to confront their problems, helped them build institutional capacity in their workout units (though not necessarily in their credit units), and furthered the difficult task of weeding out and closing clearly unviable firms. Loans could be written down without creating an environment of general debt forgiveness. These are important achievements in transition, and the in many ways approach in Poland serves as a model for other transition economies.

The process, however, does not appear to have rapidly imposed strong restructuring mandates on problem debtors, and its success in privatizing them has been limited. The EBRP was a good start, but continued work is needed to build strong banks that can impose effective corporate governance on enterprises in times of financial distress. Now that bank conciliation has expired as an option, the Polish government should shift its energies to improving the traditional exit processes—formal and informal workouts and bankruptcy—fundamental to any well-functioning market economy.


Cheryl W. Gray, Principal Economist, Finance and Private Sector Development Division, Policy Research Department.

Arnold Holle, former consultant to the World Bank currently with Boston Consulting Group, London, U.K.
Letters to the Editor

With reference to the article "Quotation of the Month...Surprising Findings of the Economist Intelligence Unit’s Senior Economist," [See Transition, July-August 1996, page 9], may I express my skepticism concerning quantitative criteria of transition, such as the European Bank for Reconstruction and Development's (EBRD) "index of reform progress" or the Economist Intelligence Unit's (EIU) indexes. I well understand a researcher's overwhelming desire to quantify everything. But in the case of the economic transition from a centrally planned to a market economy, the process is of a nature that resists quantification, at least the kind based on proxies so far identified.

In brief, the conclusions emerging from the use of "reform progress indexes" are either self-evident or incorrect. For example, among the factors presumably crucial for reform, the article mentions "proximity to Western Europe," "size of countries," "wealth in minerals," and "external environment." What a great discovery! Much of this is what was called "geographical determinism," in the years of my youth. If proximity to Western Europe were so essential, a glimpse of the map could replace the wage-intensive exercise with indexes. This approach with indexes, however, leaves little room for the design and implementation of macroeconomic and structural measures, which I believe are the ultimate factors determining reform progress.

The methodology underlying the indexes is unclear. For example, it is hard to imagine what could be the basis, other than an arbitrary decision, for attributing a weight to each of the heterogeneous factors (in fact, we are comparing apples to oranges). What is worse, the calculations produce misleading results. According to the index rating, Uzbekistan has achieved more substantial progress on reform than have Armenia or Kazakstan, Belarus has a higher score than Georgia, and Hungary is ahead of Poland and Slovenia. Certainly, many aspects of analysis—such as progress in market institution-building—are highly subjective and therefore vulnerable to questions of validity. However, we might rely on the Fund's and the Bank's collective knowledge about the given countries, based on regular reviews of their economic and structural policies. I must say that my personal (and unofficial) impressions from the Fund's Board discussions of the economic policies of the aforementioned countries have often been contrary to the "measurements" you published. If strong empirical evidence contradicts a theoretical construction, something must be wrong with the theory, not the empirical evidence.

In sum, I believe that the use of the indexes, at least in their present form, contributes nothing to the analysis of economies in transition. The results are unreliable and misleading. I suggest that we avoid their use altogether, at least until the EBRD or any other organization comes up with a more credible methodology.

Andrei Vernikov
Adviser to the Executive Director of the IMF for the Russian Federation

Land Registration System Is a Must

Encouraged by your editorial in the July-August issue of Transition (See "World Bank Group Coordinates Private Sector Activities," page 1), I would like to share with your readers a few thoughts based on my experience as a consultant with UNIDO in Uzbekistan and as a World Bank project adviser in Poland.

In many transition economies privatization of housing is progressing slowly. Governments still own and manage a major part of the housing stock, and that stock deteriorates because of overall neglect and lack of funds for renovation. Also, foreign investors are unsure about their legal property rights when they invest in real estate and in some instances are exposed to deliberate harassment by administration officials. In several countries there are reports of fraudulent double sales of already privatized real estate (because of lack of an adequate land registration system). Mortgage financing could provide an important source of funds for the domestically funded expansion of these economies, using the private real estate stock as the basis for loans. But in many countries the land registration system does not provide for adequate security for lending on such a basis.

A few years ago, the UN Economic Committee of Europe began to work on harmonizing principals for a modern land registration system, giving special attention to the situation in the transition economies. The World Bank is financing a multitude of projects in transition economies, many relating to privatization, private (foreign) investment, expansion of national economies, land use, and land reform. It is a prerequisite for any of those programs to have a modern land administration system in place that can
adequately protect property rights. To establish some generally accepted principles, it would be desirable to conduct a multicountry study on the status of land registration systems—addressing legal, administrative, technical, and human resources issues. That study could be followed by the drafting of policies and guidelines for land registration systems and by country feasibility studies (according to priorities) to document current status and to present proposals for implementing such systems. These steps could then be followed by pilot projects and overall project implementation in the transition economies.

Reinhold Wessely  
President and CEO of Prime Consult GmbH  
Vienna, Austria

### Milestones of Transition

#### Bulgaria

Long-delayed mass privatization began on October 7. Some 3 million Bulgarians are expected to bid for shares in 968 companies out of a total of 1,063 state companies up for sale. Under the mass privatization scheme, the state will continue to exert control over “strategic companies,” such as oil refineries and tourist offices; only 25 percent of their shares will be offered to investors. Banks, arms factories, railroads, power plants, and service companies will not be privatized. About 65 percent of shares in medium-size companies and 90 percent in small companies will be privatized. Results of the bids will be announced by the end of November.

The Bulgarian government is seeking help from the European Union (EU) on the ongoing grain crisis, asking for grain shipments and commodity credits under preferential terms to be repaid in three years. Bulgaria is also negotiating with Ukraine and Kazakhstan. This year’s harvest—about 1.9 million tons—is the lowest in ten years. Since the beginning of 1996, bread prices have increased fivefold.

Bulgaria will barely be able to service half its foreign and domestic debt in 1997, said Deputy Prime Minister and Economic Development Minister Rumen Gechev. According to Reuters, the risk has increased that Bulgaria will become the first country to default on a Brady debt restructuring deal, as economic recovery remains remote and is strongly linked to external funding. Bulgaria issued some $5 billion of Brady bonds in 1994 as part of a $8.16 billion foreign commercial debt restructuring deal, but its economy failed to meet projections mapped out by the London Club.

#### CEFTA

Another relaxation of mutual trade restrictions was decided during the mid-September summit meeting of the five Central European Free Trade Association (CEFTA) countries (the Czech Republic, Hungary, Poland, the Slovak Republic and Slovenia) in Jasna, Slovak Republic. Government heads agreed on further liberalization of trade in industrial products, standards for rules of origin of goods, and a step-by-step reduction in Slovenian tariffs on agricultural goods. The five countries also agreed to admit Romania next year and said that Bulgaria was near to fulfilling membership criteria. Lithuania and Ukraine have also indicated their desire to join CEFTA, which would make the association a market with 150 million consumers.

#### China

China expects its foreign exchange reserves to swell to $100 billion by year’s end, ranking it second behind Japan and ahead of Germany and Taiwan (China) among countries with healthy foreign exchange balances. Dai Xianglong, the governor of China’s central bank, People’s Bank, made the forecast while announcing that the country’s foreign exchange reserves reached $90.8 billion at the end of July. Dai predicted that inflation could be held to between 7-8 percent this year, against the official 10 percent target. He also said that GDP growth could exceed 9 percent, against the original target of 10 percent. The central bank, however, will keep a firm grip on monetary policy.

#### Czech Republic

The January-August foreign trade deficit reached 100 billion koruny ($3.7 billion) at the end of August, equal to the trade deficit for the full year in 1995. The deficit is being fueled by rising wages and a slowdown in the growth of domestic production. Experts estimate that the annual trade deficit for 1996 may reach as much as 140 billion koruny. Prime Minister Vaclav Klaus has asked five of his ministers to prepare analyses of the situation and suggest solutions. Some economists and exporters have urged the government to devalue the koruna.

In mid-September the Czech government approved a balanced state budget for 1997, estimating revenues and expenditures at 549.1 billion koruny ($20.3 billion). Expenditures to promote exports are expected to increase 60 percent, while those for transportation will rise 57 percent and those for housing, 42 percent.

At their September 16 meeting Czech economic ministers recommended that energy prices be gradually freed over the next two years. They offered lower-income families compensation for higher energy prices.
Jindrich Vodicka said that higher energy prices will also be reflected in pension increases. Energy prices have been subsidized by the state, and the cost of producing energy is currently higher than its sale price.

**European Union**

The EU’s European Investment Bank plans to increase by 50 percent next year its lending in Eastern Europe, which now totals almost 2 billion deutsche mark ($1.3 billion) annually. To date, the Bank has made loans worth 1.6 billion deutsche marks in Hungary. Wolfgang Roth, vice president of the European Investment Bank, said the bank believes that the development of the railway network should be among the top priorities for Hungarian infrastructure projects. Other areas in which the bank stands ready to lend to Hungary include environmental protection, water management, energy projects, and extension of the Budapest metro system.

As a necessary prelude to admitting new members from Central and Eastern Europe, the EU’s fifteen heads of state, pledged in a Dublin summit to rewrite the EU’s founding treaties. They promised to finish on schedule in June 1997. Talks with aspiring member states—from Estonia to Malta to Poland—are set to begin six months after the close of the constitutional conference, and most of Europe’s leaders hope the first new members will join around 2000. The goal of the constitutional review is to streamline the EU’s bureaucracies, strengthen its foreign policy machinery, and beef up its crime-fighting abilities.

**Hungary**

According to a Central Statistics Office report, real wages were down 7.2 percent in the first half of 1996, unable to keep pace with average annual inflation of 25.8 percent. The average net monthly wage was 28,200 Hungarian forints in companies and state institutions with more than ten employees, a year-on-year increase of 16.8 percent. The lowest wage, 21,000 forints, was registered in the textile industry, while the 49,000 forint average in the banking sector was the highest. The average monthly gross wage was 42,950 forints, with white-collar workers receiving on average 56,690 forints and manual laborers 32,650 forints. Employees in public education got only 9 percent more than a year earlier and employees in state medical services only 11 percent. Wages in government offices grew 13 percent on average to 38,810 forint gross.

Budapest is still among the twenty-five most expensive cities in the world, but an abundant supply of first-class office space keeps rents from rising quickly. According to a recent list in The Economist, office rents are higher in Moscow and Prague than in Budapest. The peak prices, deutsche mark (about $36) per square meter per month, were paid in 1991-92. Increased supply has lowered the figure to about 40 deutsche mark ($26). Currently, 80-85 percent of first-class offices are rented by foreign firms.

The privatization process maintained its momentum in the first six months of 1996, followed by a temporary interimission. According to a Finance Ministry report on the economy, the power plant Tiszai Erőmű has been sold, and tenders for the Bakonyi and Vertesi plants have been invited. Preparations to privatize large state-owned companies, such as the bus manufacturer Ikarus, the rubber company Taurus, and the transport company Volan, have begun. In October the process was temporarily suspended, following an unprecedented scandal known as the “Tocsik case.”

Lawyer Maria Tocsik, received a consulting fee of 804 million forints ($5.1 million) (a “success fee”) for negotiating with municipalities on behalf of the state privatization agency. The supervisory board of the state privatization agency questioned whether Tocsik did any substantial work and charged a number of top privatization officials with irregularities (for example, forcing local governments to renegotiate compensation deals, that had already been settled by the law. As a consequence, Minister for Trade and Industry, Tamas Suchman, who is responsible for privatization, resigned and almost all top officials of the state privatization agency, including General Manager Imre Szokai, were fired. Several criminal and administrative investigations are under way.

Hungary’s new pension system is scheduled to be introduced in early 1998. Csaba Laszlo, deputy state secretary at the Ministry of Finance said that the current plan envisages that two-thirds of a young employee’s pension contribution goes into the state pension system and the other third into an individual savings account, managed by private pension funds. Other active wage-earners would have the option to join the private pension fund scheme. The plan also involves a continued rapid expansion of voluntary private pension schemes. Personal savings totaled 2,400 billion forints at the end of July, while the assets of investment funds totaled only 90 billion forints.

Hungary’s trade deficit totaled $1.7 billion in the first seven months of this year. The seven-month trade deficit in 1995 was $2.1 billion. Exports were up 5.2 percent from the same 1995 period at $7.3 billion, while imports practically stagnated at $9.0 billion.

**Poland**

Poland’s new privatization plan envisages the selling of about 120 large and medium-size companies in 1997, together with about 300 smaller firms, with most
state-owned assets being privatized by 2000. The plan was approved by the cabinet on September 30. Prime Minister Wlodzimierz Cimoszewicz stressed that the appointment of Miroslaw Pietrewicz of the Peasants’ Party—which has been less enthusiastic about privatization—to head the new Treasury Ministry (to oversee privatization) does not mean any slowdown in the process.

As a result of the recent restructuring of Poland’s public administration, the Treasury Ministry began to take control of 204 of the largest strategic state enterprises (power plants, coal mines, and vodka distilleries), while ownership of 1,168 firms is being transferred to local governments. The privatization ministry has been abolished. The Treasury Ministry will own all state equity still held in partly privatized firms, including banks, insurance companies, and LOT Polish Airways. The Committee on European Integration will replace the Ministry of Foreign Economic Affairs, which, along with the Ministry of Industry and Trade and the Antimonopoly Office, was abolished. The Economics Ministry and the Office of Competition and Consumer Protection are assuming the functions of the abolished offices.

First-half GDP grew just over 4 percent year-on-year. Although growth is not as vigorous as in 1995, it remains strong. As nominal earnings growth gathers momentum, it may prove difficult to achieve dramatic success in bringing inflation down further in the 1997 election year.

Russia

Russia’s GDP fell 6 percent in this year’s first nine months from the same 1995 period. Industrial production fell 5 percent in the nine months, and was down 6.8 percent in September from a year earlier. Output steeply declined in metals, consumer goods, including cars, vodka, meat, fuel, and energy. Production of gas and some foodstuffs increased (sugar, 65 percent, vegetable oil, 46 percent). The number of unemployed was up 20,000 at the end of September from the previous month at 6.7 million and 425,000 higher than a year earlier, although the unemployment rate remained steady at 9.2 percent. Consumer prices were up 31.7 percent in September, compared to the same period in 1995.

According to Economics Minister Yevgeny Yasin, Russia is preparing radical reform measures that are aimed at jump-starting struggling companies to return the country to economic growth. The first steps are expected to be approved in the next few weeks, but the reforms will take 2-3 years to implement. These measures include:

- **Tax reform.** Lightening the tax burden, simplifying the tax code, and broadening deductions for legitimate business expenses. The government also will begin a long-promised shift from levies on corporate profits to consumption and personal income taxes. (The new tax code is not expected to be ready for presentation to parliament before the spring, says an October 23 article in the Nezavisimaya Gazeta.)

- **Incentives to improve accounting and management.** Giving companies tax incentives to adopt Western accounting standards, implementing clear protections for shareholders’ rights, and providing realistic assessments of the value of assets.

- **Shifting social programs from companies to local governments.** Turn the burden of social sector subsidies still borne by companies—a holdover from the Soviet era when companies provided housing, health care, and education for workers—to local governments. Remaining subsidies for utility rates also will be removed, with welfare and pension benefits shifted from the current broad eligibility to a need-based system.

According to the State Statistical Committee, Russia’s federal budget deficit reached 51.3 trillion rubles ($9.5 billion), or 4.3 percent of GDP, this year’s first seven months. This is more than the 3.85 percent limit initially agreed to with the IMF (both figures use Russian methodology). Some 55 percent of the deficit was covered by the issuance of state securities and 45 percent by external financing. Tax arrears totaled 48.1 trillion rubles.

Ministers are split into two camps and Russia is on the brink of a fierce bureaucratic battle, following a fairly long political breathing space, the Nezavisimaya Gazeta argued on October 1. The finance group, led by First Deputy Prime Minister Vladimir Potanin and including Finance Minister Aleksandr Livshits and Economics Minister Yevgenii Yasin, wants to concentrate on reducing the interest rate (in part to allow more foreign borrowing), fighting tax arrears, and breaking up monopolies like Gazprom. The sectoral group, led by First Deputy Prime Minister Aleksei Bolshakov, wants to halt the slide in industrial production.

Lukoil signed a $5 billion, eighteen-year joint venture agreement with Atlantic Richfield CO (Arco) of the United States for project development in the former Soviet Union. This is the first such venture between a Western and a Russian oil company. Arco is expected to provide nearly 100 percent of financing in return for a 46 percent ownership interest in whatever projects the joint venture builds.

The project closest to fruition is a proposed $1.5 billion, 900-mile pipeline that would connect the Tengiz oil field in Kazakhstan to a port on the Black Sea. Arco already holds an 8 percent stake in Lukoil, which controls about one-fourth of the conservatively estimated 50 billion barrels of Siberian reserves. Lukoil needs capital to pursue new projects. Siberia
could someday supply Arco’s West Coast-based refining and marketing network now fed mainly by North Slope oil fields in Alaska, which are declining at the rate of 6 percent a year. Alaska accounts for 63 percent of Arco’s worldwide production this year.

An October 9 article in Pravda noted that average life expectancy in Russia had fallen to 64 years by the end of 1995, 58 years for men and 70 years for women. Mortality rates for men age 40 to 44 climbed from 7.6 per 1,000 in 1990 to 15.2 in 1995. For men age 55 to 59, mortality rates climbed from 23.4 and 36.2. Environmental pollution, and the increase in unemployment, poverty, crime, and drug addiction contributed to the deteriorating indicators.

Russia’s health care sector received only 38 percent of the funds earmarked in the 1996 budget in the first ten months of the year, revealed Health Minister Tatyana Dmitrieva. Hospitals and research laboratories received only 52 percent of expected funds, and medical educational institutions, 71 percent. This money is barely enough to pay salaries, which are often delayed, and only covers some 30 percent of necessary medicines or equipment.

Russia is planning several major privatization projects for the next few months, announced Alfred Kokh, the new head of Russia’s State Property Committee, which oversees privatization. The sales of large stakes in the telecommunications concern AO Svyazinvest and the electricity utility RAO Unified Energy System are aimed primarily at foreign investors. Government officials from the Russian parliament and leading banks have reached broad agreement not to challenge last year’s controversial loans-for-shares privatizations. They agreed to make the mechanism more transparent in the future. At last year’s auctions, leading banks won control over state-owned stakes in top companies as collateral for loans to the budget.

Critics attacked the deals as rigged, giving well-connected banks access to blue-chip companies at below-market prices. Under the terms of the deals, the banks have the right to sell the shares after September 1, using the proceeds to pay the loans and keeping 30 percent of any additional profits. But with the stock market in the doldrums, lenders have shown no desire to sell the shares.

**Slovak Republic**

The seven-month trade deficit reached 31.9 billion koruny ($1 billion), up from 26.97 billion koruny in January-June. January-July imports grew 26.2 percent year-on-year, compared to only 4 percent growth for exports. The trade balance further deteriorated in the first ten months. According to experts, devaluation remains a possibility in the medium term.

**Ukraine**

Ukraine’s 1997 budget forecasts the first post-Soviet growth in the economy and a halving of inflation. Deputy Prime Minister Viktor Pynzenyk told reporters that the budget foresees a 1.7 percent rise in GDP from the projected 1996 figure, and a fall in inflation to 24.9 percent from 48 percent expected this year. The budget deficit is expected to fall to 4 percent of GDP, or 2.4 percent by western calculations, from 6.2 percent this year. Pynszenyk said the government will not revive the inflationary printing of money to meet targets.

Ukraine’s central bank stopped defending a rate of 1.76 hryvna to the dollar, announced Viktor Yuschenko. The authorities will let the hryvna float freely on local foreign exchange markets, after spending $200 million on boosting confidence in the new currency since its September introduction. (The new currency is being issued in banknotes with a face value of 1, 2, 5, 10, 20, 50, and 100. Citizens could exchange unlimited sums of their karbovantsy at a rate of 100,000 for 1 hryvna. Hryvnya equivalents of up to 100,000,000 karbovantsy are being paid in cash to citizens, while sums above that are being credited to citizens’ bank accounts.

The Wall Street Journal reported from Kiev that Ukraine’s murky tax laws are driving many potential investors away. Profits on government securities are tax exempt if the securities are held to maturity, but profits could be subject to a 30 percent capital gains levy if sold in the secondary market before redemption. It is unclear whether this tax applies to state debt. A 15 percent withholding tax and the lack of double-tax treaties may surprise some investors when they repatriate profits. A central bank official said that tax policy needs to be codified and made uniform.

Declining life expectancy, growing infant mortality, and a high number of abortions all contributed to a negative population growth in Ukraine of -5.8 percent in 1995, down from -4.7 percent in 1994. Ukrainska Hazeta reported on September 26. The average life expectancy dropped from 69.4 years in 1992 to 68 (among men, to 62.8 years) in 1994. Of every 1,000 infants born, 14.5 died within their first year. The number of abortions declined slightly, from 154.3 for every 100 deliveries in 1994, to 153.1 in 1995.

**Vietnam**

The Vietnamese dong will be allowed to depreciate gradually. The head of Vietnam’s central bank announced that interest rates in the coming months will be cut to bolster economic growth and reduce a growing trade deficit. Nguyen Van Tru, head of the Ho Chi Minh branch of the state bank, said in an earlier article
that the policy of keeping the dong stable against the dollar at around 11,000 over the last two years—while inflation rose more than 25 percent—has encouraged imports. The profit from dollar-priced rice exports has effectively been shrinking because of inflation. Import quotas should be lifted on many items, while import taxes raised.

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

World Bank/IMF Agenda

Annual Meetings: Hong Kong in 1997 and Prague in 2000

The World Bank and International Monetary Fund (IMF) will hold their annual meetings in Hong Kong in September 1997, some three months after the former British colony rejoins China. The IMF and the World Bank have accepted the Czech Republic’s invitation to hold the annual meetings in Prague in 2000.

World Bank Urges Reforms in Bulgaria

Bulgaria’s Deputy Prime Minister Rumen Gechev noted on October 7 that the IMF Executive Board would consider releasing a second $116 million installment on a $582 million, twenty-month agreement in November. The first $116 million installment was made in July and helped Bulgaria make debt payments that were due that month. Disbursement of the new installment is particularly important because it is linked to $200 million in other loans pending from multilateral agencies and up to ECU 60 million ($76.4 million) from the European Union. Bulgaria has sufficient reserves to repay $230 million in debt due through the end of the year, but it faces a $1.4 billion debt bill in 1997. Inflation is expected to climb to more than 100 percent, up from 32 percent in 1995. Release of the money had been delayed from September because the IMF was waiting for completion of Bulgaria’s first large cash privatization deal, the first voucher auction under mass privatization, and court proceedings on sixty-four pending bankruptcies of state-owned companies. (The closures could lead to the loss of an estimated 30,000 jobs.) The fate of nine banks put under supervision since September 23 has to be resolved as well. On September 3, the World Bank approved a $24.3 million loan for a social insurance administration project to provide financing for expert advisory services, foreign and local training, computer hardware and software, fellowships, study tours, public education materials, minor office upgrading, and incremental operating costs.

Reconstruction in Bosnia

According to a recent report from the World Bank and the European Commission, some $880 million of the $1.89 billion pledged to the reconstruction of Bosnia at donor conferences in December 1995 and April 1996 is under implementation (that is, contracts have been tendered, signed and are under way). An estimated $558 million of the $880 million was disbursed for critical reconstruction between January and August 1996. Another $500 million or so could be tendered or contracted by year end, bringing the total under implementation to nearly $1.4 billion, or about 75 percent of 1996 pledges. The report lists four actions required from donors to maintain the accelerated pace:

- The $647 million in firm commitments still awaiting tendering should be pushed forward.
- With three-fourths of 1996 pledges expected to be under implementation or disbursed by year end, new pledges will be needed in early 1997 to prevent implementation delays.

- Donors need to coordinate programs more actively with each other and to ensure a major role for the government through sectoral task forces.
- Investments should be made sustainable over the medium term by establishing viable budgets at all levels of government, ensuring that recurrent costs are funded, and establishing appropriate sectoral policies for cost recovery and resource mobilization.

World Bank Sponsors “High Tech” Animals in Bosnia . . .

The World Bank is making available 3,500 cows and 2,600 goats to Bosnian farmers, as part of a $50.4 million emergency aid project designed to kick start Bosnia’s war-torn agriculture sector. “These high-tech German animals,” said Michael Koch of the Bank’s Sarajevo office, “are intended to replace some of the estimated 600,000 cows lost during Bosnia’s conflict.” The project, a collaboration between the UN’s International Fund for Agricultural Development and the World Bank, is providing farmers with livestock, machines, and veterinary support helping to reestablish a structure for loans and repayments that could serve as a model for the shattered banking system. In late September the World Bank approved a $90 million International Development Association (IDA) credit for Bosnia to help the country rebuild government institutions and relaunch banking and other reforms. Thirteen World Bank projects are operational in Bosnia, and 629 contracts, with a value of $140 million, have been signed with the Bank’s financing.
... and an Electricity Loan to Ukraine

On October 10 the World Bank approved a $317 million loan to Ukraine to help finance an electricity market development project. The project will provide working capital for the country's thermal power plants. The project includes components for: increasing fuel stocks and spare parts stocks at fourteen thermal power plants to sufficient levels, carrying out deferred maintenance at fourteen thermal power plants, installing metering and communications equipment to improve recording and billing of electricity flows at key wholesale market delivery points, and introducing technical services and training for project implementation, financial management, and development of a privatization program. The project will be implemented over three years, and completion is expected by June 30, 1999. Total cost of the project is $377.6 million.

Ukraine Expects $900 Million in 1997...

Ukraine expects to receive $900 million in World Bank loans next year for energy and agriculture development projects, said Deputy Prime Minister Viktor Pynzenyk. "The possible funding from the World Bank would be greater than ever before," Pynzenyk said after talks at the Bank and the IMF. The World Bank would like to approve up to $1.5 billion in loans to Ukraine in fiscal year 1997, and hopes to be able to disburse between $600-$650 million in calendar year 1996. In 1994-95, the Bank provided $527 million. A $300 million loan for enterprise development and a $300 million loan for agricultural reform have recently been approved. A $300 million loan for the Coal Sector and other projects are currently in the pipeline. A recent Bank report says that about 300,000-400,000 miners in the Donbass coal basin may leave the industry. The Government is putting in place a social mitigation and employment creation program.

...and Hopes for a New Facility from the IMF

The IMF should decide by December whether to grant Ukraine a $2.5-$3 billion, three-year extended finance facility to succeed an $867 million stand-by running into early 1997, said Ukraine's central bank Governor Viktor Yushchenko. Ukraine will then negotiate with the IMF on a stabilization loan, to a maximum $1.45 billion, to stabilize the hryvnia.

Russia Seeks Bank Restructuring Loan

Russia's financial authorities seek a $1 billion World Bank loan to help restructure the country's fragile banking system, hard-hit by a rapid decline in inflation that has exposed Russian banks' bad loan portfolios. Russia's central bank and finance ministry are working on raising the loan. "Banking system restructuring," said First Deputy Chairman Alewxander Khandruyev, "is the central bank's and the government's priority."

The IFC Outreach Initiative

The International Finance Corporation (IFC) will help to attract private investment to countries that Western businesses have largely shunned. The IFC has selected sixteen countries and regions (developing and transition economies) and will send in investment officers to generate business opportunities for local and foreign entrepreneurs. The countries include Albania, Azerbaijan, Bosnia-Herzegovina, Macedonia FYR, and the Slovak Republic.

Higher Education Loan to Romania

In mid-September the World Bank approved a $50 million loan to help reform the higher education system in Romania and to train academic staff and professionals in the new fields required in a market economy. The project has three components: support for improvement in the management of semiautonomous councils that have oversight of intermediary education system councils, support for new program development for undergraduate and continuing education, and support for the development of instruction and research of advanced courses and research grants at the master's and doctoral levels.

$200 Million Credit for the Kyrgyz Republic?

The World Bank was ready to provide a $200 million credit for the development of the Kyrgyz Republic's agriculture, energy, and social security sectors, said World Bank Vice President Johannes Linn (Europe and Central Asia Regional Office) during a recent visit to the country's capital, Bishkek. Kyrgyz was one of the first transition economies to achieve real growth. So far this year, GDP has grown 3 percent, and the Bank expects 7-8 percent GDP growth in 1997.

http://www.imf.org

The IMF now has a Web site on the Internet. The public has access to on-line IMF press releases, information on IMF lending, the IMF's 1996 Annual Report, and a variety of other material. The IMF's Dissemination Standards Bulletin Board for global economic transparency standards may also be accessed through the IMF's home page. The site also contains a directory of IMF publications that may also be accessed through the site's own e-mail address for requesting free publications, and an order form may be downloaded for priced publications.

Record Lending Strains IMF Liquidity

According to the Financial Times, record lending to Mexico and Russia has pushed the IMF's liquidity to its weakest point in

September-October 1996
five years. The IMF’s 1996 Annual Report noted commitments of about $26 billion through stand-by and extended arrangements in the latest financial year, compared with $22 billion the year before and $20 billion at the height of the debt crisis in 1982-83. This level of commitments cuts the liquidity ratio of uncommitted usable resources to liquidity liabilities to less than 90 percent in April 1996, from 126.1 percent in 1995. IMF liquid resources and the liquidity ratio are expected to continue falling to about 70 percent (the “red line”) next year, said IMF Managing Director Michel Camdessus in a recent news conference in connection with the annual IMF/World Bank meetings. Camdessus urged a doubling of quotas, while noting that a minimum increase of two-thirds is necessary to preserve the IMF’s size relative to the world economy.

Road Development in China

On October 10 the World Bank approved a $300 million loan to China for the second Xinjiang highway project, supporting growth and modernization of the transport system and alleviating infrastructure bottlenecks in Xinjiang, the largest of China’s provinces and autonomous regions. The project is the latest in a series of Bank loans totaling $2.6 billion that are aimed at improving China’s highway system. From 1980 to 1994 gross output of agriculture and industry grew at an annual rate of 19.7 percent in Xinjiang, increasing trade and traffic volumes on its roads. Isolated from China’s economic and political centers, Xinjiang is serviced by only one main railroad and two highways; future economic growth is impeded by this sparse transport network.

$1.5 Billion IDA Credits for Vietnam?

The World Bank will press on with $1.5 billion in IDA credits to Vietnam during the next three fiscal years, said Javad Khalilzadeh-Shirazi, World Bank Director at the East Asia and Pacific Regional Office (Country Department 1). Khalilzadeh-Shirazi discussed plans for the forthcoming international donor conference on Vietnam during his recent visit to Hanoi. The conference, the fourth of its kind, will take place in Hanoi this year rather than in Paris so Vietnam can explain a new five-year economic plan.

IDA Rehabilitates Gas Delivery in Azerbaijan . . .

In mid-September the World Bank approved a $20 million IDA credit to rehabilitate and improve Azerbaijan’s gas delivery system. The credit will be given to the Azerbaijan government, which will lend it to the national gas company Azerigas to install or upgrade gas meters at industrial and commercial enterprises, upgrade the gas system’s equipment, and streamline the company’s management. The Bank identified Azerbaijan as the country most dependent on natural gas. The current distribution system loses or is unable to account for an estimated 20 percent of its inputs.

. . . and Supports Tajik Reforms

On September 12 IDA provided a credit of SDR 34.8 million for an agricultural recovery and social protection program. The credit will support macroeconomic reforms and the government’s efforts to design and implement agricultural and farm reforms by providing noninflationary budget resources to ease liquidity constraints. The credit will focus on benefits for children and low-income and nonworking pensioners and will allow regular payments of wages and salaries.

In One Sentence

* On September 12 a $5 million World Bank loan was approved for Uzbekistan for a pilot water supply engineering project that will eventually supply 25,000 people.

* A $45 million World Bank structural adjustment loan to Macedonia FYR will provide balance-of-payments support to further liberalize its foreign trade regime and privatize agricultural estates.

* An $80 million structural adjustment loan to Lithuania, approved in early October, will help to restructure the country’s troubled banking, energy, agricultural, and social protection sectors, including a new regulatory framework in the banking sector; introduce commercialization, institutional reform, and privatization in the energy sector; open the agricultural sector to private sector opportunities and international trade; and improve the legal framework and administration of social insurance while increasing private sector involvement.
Conference Diary

Die weitere Entwicklung der EU und die Wirtschafts- und Währungsumon (Future Development of the EU and the Economic and Monetary Union) November 4-5, 1996, Bad Saarow, Germany

Organized by Konrad-Adenauer-Stiftung, Bildungswerk Berlin. Topics include: development of the EU after Maastricht; chances and problems of the monetary union; political union and the common foreign and security policy; and the eastern enlargement of the EU. Information: Konrad Adenauer Stiftung, Bildungswerk Berlin, Molkenmarkt 1-3, 10174 Berlin, Germany, tel. 49-30-238-5546, fax 49-30-238-4494, Internet: http://www.kas.de/.

Forging Alliances in Global Markets
November 6-8, 1996, New Orleans, United States

Organized by the International Management Development Association (IMDA). Topics include: managing change in global markets from the perspective of regional development. Information: Zafar U. Ahmed, Institute for International Business, College of Business, Minot State University, Minot, North Dakota 58707, United States, tel. 800-777-0750 ext. 3826, fax 701-858-3127, e-mail: ahmed@warp6.cs.missouri.edu.

Transnationale Vernetzung der Infrastrukturen—Katalysator für die Einheit Europas (Transnational Networking of Infrastructure—Catalyst for the Unity of Europe) November 6-7, 1996, Berlin, Germany


Twenty-Eighth National Convention of AAASS
November 14-17, 1996, Boston, United States

Organized by the American Association for the Advancement of Slavic Studies. Information: Wendy Walker, American Association for the Advancement of Slavic Studies, 8 Story Street, Cambridge, MA 02138, United States, tel. 617-495-0677, fax 617-495-0680, e-mail: aaass@hcs.harvard.edu.

Von Albanien bis Aserbaidjan—Wirtschaftskooperation im Suedostlichen Europa (From Albania to Azerbaijan: Economic Cooperation in South East Europe) November 18-20, 1996, Tutzing, Germany

Organized by Evangelische Akademie Tutzing. Information: Evangelische Akademie Tutzing, Schloss Strasse 2+4, 82327 Tutzing, Germany, tel. 49-8158-2510, fax 49-8158-251133.

Arbeitslosigkeit in Polen und Arbeitslosigkeit in Deutschland—Ein Vergleich (Unemployment in Poland and Unemployment in Germany—A Comparison) November 26-30, 1996, Opole, Poland

Organized by Evangelische Akademie Muelheim and Wissenschaftliches Schlesisches Institut in Opole. Information: Evangelische Akademie Muelheim, Uhlenhorstweg 29, 45479 Muelheim an der Ruhr, Germany, tel. 49-208-599060, fax 49-208-599-6600.

The Further Development of CEFTA: Institutionalization, Deepening, Widening?
November 28-30, 1996, Warsaw, Poland

Organized by Friedrich-Ebert Foundation and the Cooperation Bureau for Economic Research on Eastern Europe. Topics include: CEFTA integration and the role of common institutions; CEFTA on the road to a common market; CEFTA’s enlargement; the role of CEFTA in the Balkans, Lithuania, and Ukraine; CEFTA as the catalyst for Eastern enlargement of the EU. Information: Heinrich Machowski, Cooperation Bureau for Economic Research on Eastern Europe, German Institute for Economic Research, Koenigin-Luise-Str. 5, D-14195 Berlin, Germany, tel. 49-30-897-7836, fax 49-30-897-7899, e-mail: 0308977080-0001@t-online.de, tribakova@diw-berlin.de.

The Post-Soviet World: A Period of Transition
November 29, 1996, Reading, United Kingdom

Organized by the Centre for Post-Soviet Studies, University of Reading. Information: Joan Batchelor, The Centre for Post-Soviet Studies, GSEIS, University of Reading, Whiteknights, P.O. Box 218, Reading RG6 6AA, United Kingdom, tel. 44-0118-9318378, fax 44-0118-9755442, e-mail: J.M.Batchelor@reading.ac.uk.

September-October 1996
Twenty-Third International Conference: “Macromodels '96”
December 4-6, 1996, Lodz, Poland

Organized by the Institute of Econometrics and Statistics, University of Lodz. Topics include: national economy models; evaluation of forecasts and analysis of uncertainty in modeling; and modeling economies in transition. Information: Piotr Wdowinski, Scientific Secretary, Macromodels '96, Institute of Econometrics and Statistics, ul. Rewolucji 1905 r. 41, 90-214 Lodz, Poland, tel./fax 48-42-323007, e-mail: intek@krysia.uni.lodz.pl.

Significance of Politics and Institutions for the Design and Formation of Agricultural Policy
December 9-11, 1996, Halle/Saale, Germany

Organized by the Institute for Agricultural Development in Central and Eastern Europe (IAMO). Information: Peter Weingarten, Institute for Agricultural Development in Central and Eastern Europe (IAMO), Magdeburgerstr 1, 06112 Halle/Saale, Germany, tel. 49-345-5008129, 49-345-5008110; fax 49-345-5126599, e-mail: weingarten@iamo.uni-halle.de.

Satellite Business Forum for Russia and the CIS
December 10-11, 1996, Hotel Radisson Slavyanskaya, Moscow, Russia

Organized by the Adam Smith Institute. Topics include: international cooperation and strategic partnerships; the shape of the Russian federal space program; the impact of international agreements and regulations; the commercialization of Russia's satellite and launch industry; and financial considerations and business applications of satellites. Information: Dorothea Jilli, Adam Smith Institute, Conference Division, 11-13 Charterhouse Buildings, London EC1M 7AN, United Kingdom, tel. 44-171-505-6043, fax 44-171-251-6909, e-mail: 101574.674compuserve.com.

Albanian Economy Toward Free Market
December 14-16, 1996, Tirana, Albania

Organized by PHARE-ACE 1995 and the University of Athens. Topics include: public sector; foreign trade; exchange rate and monetary policy; small-medium enterprises; foreign investment; sectoral issues; agricultural policy; banking; regional development, and privatization. Information: A. Panethimitakis, University of Athens, 1, Sofokeus Str., 10559 Athens, Greece, tel. 30-1-321-1454, fax 30-1-322-1965, e-mail: alexpan@ath.forthnet.gr.

Ninth Annual Bank Conference on Development Economics (ABCDE), 1997, Washington, D.C., United States

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

Second International Conference on Enterprises in Transition
May 22-24, 1997, Split, Croatia

Organized by the University of Split, Faculty of Economics. Information: Second International Conference on Enterprises in Transition Organizing Committee, University of Split, Faculty of Economics, Radovanova 13, HR-21000 Split, Croatia, tel. 385-21-341866, 385-21-362465, fax 385-21-366026, e-mail: eitconf@oliver.efst.hr.

First Exhibition and Conference for the Russian Security Industry
June 16-20, 1997, Moscow, Russia


Globalization, Technological Change, and the Welfare State
June 1997, Washington, D.C., United States

Organized by the Johns Hopkins University, American Institute for Contemporary German Studies. Topics include: the impact of global competition and technological change on the demand for skilled and unskilled labor; the flexibility of the labor market in adapting to changes in the demand and supply for labor; the impact of regulation in the labor market, the service sector, and the environment on changes in the demand for labor; the impact of social costs on the demand for labor and real wages; and the role of trade policy in relation to labor and environmental standards. Information: Mathias Moersch, Economic Studies Program, American Institute for Contemporary German Studies, 1400 16th Street NW, Suite 420, Washington, D.C. 20036-2217, United States, fax 202-265-9531, e-mail: mmoersch@jhunix.hcf.jhu.edu.
New Books and Working Papers

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

World Bank Publications


Technical Papers


Discussion Papers


Other World Bank Publications


This seventh annual collection of profiles, text, and summary statistical tables describes the recent economic performance of 117 developing economies through December 1995. The country profiles summarize national development strategies and describe each country's economic features, current socioeconomic issues, recent political developments, and medium-term prospects.

Policy Research Working Papers


Social spending by Russian enterprises represents as much as 20 percent of gross wage costs. What to do about social services that Russia's state enterprises have traditionally provided is a major issue in enterprise restructuring and public policy reform. If taxes and the provision of social services are rationalized at the time those social assets are divested, pioneering steps could be taken in restructuring the social sector. As enterprises are restructured, the public sector must become involved in:

- Protecting critical services, such as kindergarten, that might otherwise disappear as enterprise funding is reduced.
- Facilitating housing and health services reform.
- Guaranteeing citizens' access to public services.
- Reducing costs by rationalizing the management and provision of services. Municipal governments are divesting enterprises of housing in a nontransparent way. Vested interests have many ways to postpone or block divestiture—even though most enterprise managers welcome it because it will reduce their costs and administrative burden. To order: Larisa Markes,


The authors find a strong relationship between export performance and growth in vertical intra-industry trade with the EU. The Czech and Slovak Republics, Hungary, Poland, and Slovenia all rely heavily on the EU for inputs—more so than Austria, Portugal, and Spain, for example. As their per capita exports to the EU have also grown the fastest, this appears to be a characteristic of successful transition. Simple redirection of traditional exports from markets in the Council for Mutual Economic Assistance (CMEA) did not play an important role in the growth of exports to Western Europe. Instead, sale increase to EU countries consists of products not previously exported to the CMEA, or of traditional export items that have been substantially upgraded or differentiated.

Inflows of foreign direct investment correlate highly with levels of intra-industry trade. But if large investments in the automobile sector are excluded, these investments seem unlikely to have been a major force driving the growth of intra-industry trade. To order: Faten Mabab, Room H8-087, tel. 202-973-5853, fax 202-477-8772, e-mail: fhatab@worldbank.org.

IMF Publications


IFC Publications


Air pollution has earned Kunda the dubious distinction of the “Gray Town of Estonia.” Social benefits exceed private costs by a margin wide enough to justify the environmental investment in terms of increased social welfare; beneficiaries range from the company and nearby residents and entrepreneurs to residents of neighboring countries. The findings can have a significant bearing on investment decisions, management operations, and government policy.

* * * * *

IMF Working Papers


The weakening financial and administrative capacity of transition economies affects the government's social protection programs. The formal sector is shrinking, and unemployment and underemployment are rising rapidly. The revenue base of social protection programs is shrinking, together with the ability of these countries to target social benefits. Therefore, social benefits have to be restructured, relying more on self-targeting mechanisms to deliver benefits, and immediate steps have to be taken to improve payroll tax compliance.


Other IMF Publications


The world economy's growth rate will accelerate gradually through the rest of the 1990s, reflecting a sharp rebound in activity in the transition economies of Eastern Europe and the former Soviet Union. But this upturn is vulnerable to setbacks in the reform process. The world economy is expected to grow 4.1 percent next year, with growth in the developing world falling slightly to 6.2 percent. Transition economies should be able to sustain growth rates of 4 to 5 percent a year in the long term, but major efforts are also needed to put their banking system on a sound footing; this is essential for the mobilization and effective allocation of domestic saving.

OECD Publications


The relationship between financial development and overall economic growth is reciprocal. By aligning these two factors, the authors identify four "convergence clubs," groups of economies that are heading for different growth regimes. Identifying into which category a country falls can help policymakers to devise the most beneficial policies.


Time series (going back to the mid-1980s) detail debt service and debt stock data for both major country groups and 135 individual countries and territories. Data on net resource flows to major country groups and separate debt tables for the successor states of the former Soviet Union, former Czechoslovakia, and the pre-1991 Yugoslavia are also included.


OECD's periodic review of the Slovak economy. Quick economic growth of the Slovak Republic has astonished many analysts. It recorded one of the best macroeconomic performances among Central and East European countries. The country's gross domestic product grew 7.4 percent in 1995. The inflation rate, which stood at 25.1 percent at the end of 1993, was reduced to 6.1 percent by May 1996. State budget and current account balances recorded surpluses in 1995. The unemployment rate peaked at the beginning of 1995, at 15 percent, but fell to 11.9 percent by May 1996. The report focuses on the need to restructure the banking sector and privatized companies. It also deals extensively with the Slovak Republic's potential for expanding its tourist industry.


Centre for the Study of Public Policy

To order: CSPP Publications, University of Strathclyde, Livingstone Tower, 26 Richmond Street, Glasgow


Tacis Publications


Georgian Economic Trends: Monthly Statistical Updates and Quarterly Reviews. To order: Oliver Weeks or Simon Stone, 16 Zandukeli Str., Tbilisi, Georgia, tel. 995-3293-9161, fax 995-3293-9160, e-mail: oliver@gyet.kheta.ge.

Review of Economies in Transition Publications

To order: Pave Palace, Bank of Finland Unit for Eastern European Economies, P.O. Box 160, FIN-00101 Helsinki, Finland, tel. 35-89-183-2268, fax 35-89-183-2294, e-mail: pave.palace@bonnet.f; Internet: http://www.bof.f/env/eng/it/iten.stm.


Tatiana Popova and Merja Tekoniemi, Social Consequences of Economic Reform in Russia, September 1996, 26 p.

Interstate Statistical Committee of the CIS Publications

To order: Interstate Statistical Committee of the CIS, 39, Myasnitskaya Str., 103450 Moscow, Russia, tel. 7-095-207-46-51; 7-095-207-42-37, fax 7-095-207-45-92, e-mail: statpro@sovam.com.


The CIS Countries in Figures, 1996, 275 p.

Collegium Budapest Institute for Advanced Studies Publications

To order: Collegium Budapest Institute for Advanced Study, H-1014 Budapest Szentháromság utca 2, Budapest, Hungary, tel. 361-156-1244, fax 361-175-9539, e-mail: collegium.budapest@colbud.hu.


University of Leicester Publications


Frankfurt Institute for Transformation Studies Publications

To order: FIT, Europa-Universitat Viadrina, Postfach 776, D-15207 Frankfurt, Germany.


Jan Winiecki, Foreign Investment in Eastern Europe: Expectations,

Other Publications


A significant part of the transformation process, arms conversion is a multidimensional problem. It includes all aspects of the military industrial complex—range, quality and cost of production, organizational structure, finance, personnel policy, and sectoral and intersectoral relationships. The book discusses macrostructures and microconditions of arms conversion and presents research results from Central and Eastern European countries and various industrial branches. To order: LIT Verlag, Dieckstr. 73, 48145 Munster, Germany, tel. 49-251-235-091, fax 49-251-231-972.


Popularly elected legislatures of the region provide a crucial link between the administrative organs of the state and the population. Their role—establishing the legal and regulatory frameworks for economic activity, deciding budget allocations, and providing effective mechanisms for administrative oversight—is therefore critical. Through legislation and oversight, parliaments influence and even determine the conditions for economic development. Their actions also have a critical impact on the investment environment—promoting legal standards, sound budgets, tax codes, and privatization programs. More broadly, the parliament serves as a representative institution.

From the World Press Review.
The support for parliaments in transition provided by U.S. Congress and implemented by the Congressional Research Service included:

- Establishing a modern technical information system, also making available and effectively using the global Internet system.
- Developing a parliamentary library to strengthen the information and research capabilities of a modern parliament.
- Generating independent, objective research capabilities to inform the parliament’s deliberations and legislation.
- Providing adequate training for members, staff, and interns in the use of a modern parliamentary support system.


Experience suggests that privatization is neither a panacea for all government’s ills nor sufficient to ensure economic progress. The advantages of privatization can be maximized when government ensures a competitive environment, has adequate procedures for promoting cost reduction and service quality, strongly supports small and medium-scale enterprise development and state enterprise restructuring, and performs an effective regulatory role to minimize corruption and inequity. Ultimately, privatization is most likely to succeed in a vibrant and vigorous market economy, which governments have an important role in creating, supporting, and sustaining. To order: Publications Unit, International Training Centre of the ILO, Corso Unità d’Italia 125, I-10127 Turin, Italy, fax 39-11-663-4266.


Since 1991 dynamic new organizations were created in the former Soviet Union by public-spirited citizens ready to make their institutions more humane, their economies more productive, their environments cleaner, and their legal systems more just. The enormous variety of these grassroots initiatives spread from the Research Center for Human Rights in Moscow to the Red Crescent Society in Azerbaijan and the Wildlife Foundation in Khabarovsk.

The Handbook provides contact information for hundreds of independent associations and describes their principal programs and activities. A special section introduces Internet resources related to the newly independent states, from electronic mailing lists to World Wide Web and Gopher sites, as well as utilities for moving from Latin characters to Cyrillic and vice versa. Contact information for more than twenty clearinghouse organizations, as well as descriptions of more than 150 projects in the newly independent states, created by U.S.-based entities, ranging from cultural exchanges to financial sector reforms and housing development, are also part of the volume. To order: Institute of Economic Affairs, 2 Lord North Street, Westminster, London SW1P 3LJ, United Kingdom, tel. 44-171-799-3745, fax 44-171-799-2137.


The economy is too important to leave to central bankers. With exchange...
rates permanently fixed and monetary policy under the European central bank’s control, national governments will have few policy instruments at their disposal. If they follow diverging fiscal policies, the monetary union could be endangered by individual governments’ pursuit of irresponsible courses. That is why Maastricht set limits on government debt. But if those limits are fixed in advance and forever, governments have no room for maneuvering. Economies need to be managed, and economies tied together by a common currency also need a common fiscal policy. The Maastricht Treaty sidestepped that issue by fixing only the entry requirements. If the governments involved cannot take concerted steps now to combat unemployment, however, it is doubtful they will be able to do so later. In that case, it may be better not to have a common currency at all.

The countries of Central and Eastern Europe desperately need to get closer to the European Union. Although communism is dead, the institutions and attitudes of an open society are not yet firmly established. Negotiations on the admission of new members will probably start in earnest in 1999. Further enlargement will render the intergovernmental process completely unworkable. The bureaucratic method of building an integrated Europe has exhausted its potential.

The Intergovernmental Conference should convene a Constitutional Assembly, but it would not be empowered to appropriate further slices of national sovereignty without first obtaining the approval of each of the member countries. Only a bold measure, clarifying the nature and identity of the European Union can stop the gradual disintegration of Europe and prevent a return to the conditions prevailing between the world wars.


To order: International Business Press, 10 Alice Street, Binghamton, New York 13904-1580, United States, tel. 800-342-9678, fax 800-895-0582, e-mail: getinfo@haworth.com.


The balance of payments of most Central and Eastern European countries experienced a notable improvement in 1994; exports grew strongly and current account deficits shrank in a majority of countries. In 1995 the deficit increased again, although the aggregate current account deficit of the region remains, in terms of GDP, significantly below its 1993 peak. Projections for 1996-97 point toward a renewed decline in the deficit to about its 1994 level.

Three countries (the Czech Republic, the Slovak Republic, and Poland) have obtained investment grade marks from the major international rating agencies. The region’s foreign debt-GDP ratio has fallen by one-third between end-1990 and mid-1995, but the ratio remains relatively high for the region as a whole. To order: European Commission, rue de la Loi, Wetsstraat 200, B-1049 Brussels, Belgium, tel. 322-296-1858, fax 322-295-7619, 322-299-3302.

Useful Web Sites

Collection of Hungarian Economic Laws (in English)

Meta database, derived from several Hungarian data bases
http://www.iqsoft.hu/~molnark/meta/meta_e.html

http://www.oecd.org/puma/sigma/2pmf2/22pmfioc.htm

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