Independence and economic efficiency: a program for Ukraine

Concerns are frequently expressed that Ukrainian independence will result in costly economic disruption both for Ukraine and the rest of the former USSR. The following outline of a three-year economic reform program aims to dispel these perceptions and reconcile Ukraine's political aspirations with the objectives of economic efficiency.

The most successful economies of the world rely largely on market mechanisms, have relatively open economic borders — or at least strongly outward-oriented non-autarkic economic policies — and pursue prudent government budget and monetary policies. On the basis of key historical lessons, a rapid but step-by-step process of reform in the Ukrainian economy is proposed. The reform would promote a smooth transition to a normal market economy within the country, ensure rational market-based relations with members of the Commonwealth of Independent States (CIS), as well as with the global economy, and minimize the inevitable economic costs associated with the dissolution of the former USSR economic system.

Suggested measures

- Stabilization of macroeconomic imbalances, particularly government budget deficits and excessive monetary emission.
- Legal consolidation of individual property rights (including those pertaining to agriculture) and a two-year privatization program, starting with immediate fast-track procedures for registration of new businesses, auction of retail outlets, and rehabilitation of transport vehicles.
- Gradual liberalization of foreign trade and immediate free-trade relations with the CIS and the Baltic states.
- Introduction of the Ukrainian currency (hryvnia), with immediate current account convertibility, enabled by pegging the hryvnia to the Ecu at an appropriate rate (see below), setting up a special stabilization fund based on an IMF stand-by agreement, and participating in a payments union within the CIS.

(continued)

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Some elements of this program (allowing and promoting small-scale private sector development) could be introduced immediately. Various other elements could be implemented after a preparation period of perhaps three to four months, although some of them would likely have to continue up to at least three years.

**Stabilization program**

A stable macroeconomic foundation characterized by low and sustainable government budget deficits and a prudent monetary and credit creation policy — particularly pertaining to the introduction of the new currency — should be the keystone of a successful economic reform program. Without basic macro stability, inflation could thwart the introduction of a credible currency as well as the successful implementation of other reform elements. Key steps toward stabilization are the following:

- significant cuts in government expenditures, including subsidies to enterprises, military expenditures, and administrative expenditures related to the central planning bureaucracy;
- introduction over two years of a revamped system of taxation including an income tax (on wages, salaries, profits, and interest) and a value-added tax;
- reduction of the deficit on public expenditures from the present level of about 15 percent of net material product (NMP) to a of 10 percent in the first year, 5 percent in the second, and 2 percent in the third year; and
- avoidance of wage indexation and taxation of excess wage increases.

**Privatization**

To provide the stimulus for efficient restructuring and future economic development, it would be preferable to secure the legal basis for property rights and embark quickly on a program of privatization. Full privatization cannot and need not be accomplished rapidly, but it can and should be started immediately. This recognizes that private sector development should reinforce not only decentralization of existing assets but also rapid development of new small and medium-size enterprises, which become a fertile breeding ground for entrepreneurial activity and for competition with the state sector. The following actions are suggested:

- immediate removal of the administrative and regulatory barriers that constrain registration of new private enterprises, and establishment of a one-step fast-track registration procedure. This should include the freedom to establish private trucking and transportation services, in particular to help alleviate the problem of food waste that occurs because of inefficient links between farms and retail outlets;
- privatization of small retail and service establishments through a combination of auctions and sales (to current employees) after no more than three months of preparation;
- immediate legislation authorizing privatization of land, followed by a detailed and widespread action plan;
- privatization of large enterprises after a half-year of preparation and over a two-year period, by establishing the joint-stock ownership status of state enterprises, followed by auctions to local and foreign bidders; distribution to the population of ownership vouchers in mutual funds that hold shares of enterprises (the Polish privatization model); and retention of a small portion of the mutual funds by the government treasury.

During the initial period, communal services, health and education services, urban transport, and air and rail transport (but not inter-urban bus transport) should remain state-owned. Their possible privatization should be considered later.

**Markets and prices**

The general principles underlying freedom of economic activity have already been established through several laws passed in Ukraine in the last year, including the Law on Property Rights, the Law on Banking Operations, and the Law on Foreign Economic Relations. It is important to note the enshrined principle that all is allowed that is not explicitly forbidden by law. The reform program, however, needs to include further:

- preparation of more detailed operational laws in the areas of bankruptcy, commercial law, taxation law, financial and accounting regulations and standards, labor laws, and safety and health regulations;
- price liberalization with certain food items could be placed on partial ration on the basis of minimal subsistence needs for particular segments of the society (in early January most consumer prices were freed excluding some key consumer staples, public transport and communal services);
- introduction of a social safety net, comprising pensions with full indexation (already largely in place, but they might need review), unemployment compensation, and food coupon and/or income supplements for the neediest groups. The emphasis of such support programs should be on targeting the neediest, and programs should rely as little as possible on subsidized prices for essential items.

At the end of two years, this program should be fully operational and allow complete liberalization of prices for basic consumer goods.

**Liberalizing foreign trade**

Policies for external economic relations will have the objective of creating an open trading environment, providing opportunity and stimulus for exporters, and allowing for the competitive impact of imports. An early, albeit moderate, liberalization of imports could also contribute to offsetting monopoly effects. The following specific steps are recommended:

- initiation of free trade arrangements with countries of the former USSR and discussions on expanding the CIS to include future arrangements for a common economic market or economic community;
- removal of all export restrictions and taxes, except on sensitive items such as munitions and armaments, radioactive materials, and narcotics, and for those goods eligible for import quotas in foreign markets, including textiles, steel, and food products;
- removal of import quotas and restrictions, replacing them as needed with tariffs, at the outset by an average of 25 percent (comprising tariff-groups of 0 percent, 15 percent, 25 percent, and 40 percent respectively), and reducing them to an average of 10 percent by the end of the third year; and
- for foreign investment, implementation of regulatory laws that would detail the basic principles outlined in the Law on Foreign Economic Rela-
tions, approved in April 1991, to ensure equal treatment of foreign and domestic firms.

The purpose of introducing a new convertible Ukrainian currency to replace the ruble is not to sever economic links with the economies of the former USSR — now the other countries of the CIS and the Baltic states — but to put those links on a more rational market basis. This will also have the effect of increasing opportunities for economic links with other countries, in particular the rest of Europe. The immediate agreement for a free-trade zone within the CIS is a first step in ensuring that the links are not unnecessarily severed. Further discussions with these countries on moving beyond a free-trade zone to a common market should begin without delay.

The introduction of the hryvnia should be accompanied by setting up a foreign reserve stabilization fund, with international support, in an amount tentatively estimated at $1.5 billion to $3 billion, based on the earlier levels of trade outside the USSR, and the presumption of a free-trade and a clearing arrangement with countries of the former USSR. The hryvnia should be pegged to the Ecu and be internally convertible at a rate (to be determined but certainly not to be announced in advance) that will allow an equilibration of the earnings from foreign exchange and the demands of importers. All foreign exchange earnings should be, as in most such programs, yielded at the new rate to the Central Bank, which would sell foreign exchange to importers at the same rate. Capital flows will be regulated for the full three years of the program.

Oleh Havrylyshyn is Professor of Economics and International Relations at The George Washington University, Washington, D.C. He will be working in Kiev during 1992 as Head of Economic Programs, Council of Advisers to Presidium of the Ukrainian Parliament.

"A CIS payment union could play a useful interim role"

Q: What is the main difference between your proposal and some similar programs recommended for other economies in transition from Marx to market?

A: Major elements of our proposals are, of course, similar to those suggested for other economies in transition. Our overall program is unique, however, in the sense that: Ukraine is trying to deal simultaneously with the collapse of the command economy structure and the reestablishment of independence. Ukraine needs, therefore, to introduce its own currency and develop an independent, functioning banking system without delay.

Q: Your program urges a free trade zone and eventually a common market for the ex-republics, as well as the introduction of import tariffs for non-CIS countries. Isn't there a risk that the program will preserve the distorted trade relations of the former member states of the USSR? What is your stand in the debate about whether to create a CIS payment union?

A: I do not see any contradiction between preserving market-based intra-CIS trade and developing economic relations with other countries simultaneously, provided prices are free and trade is conducted through a convertible currency, pegged to a reasonable lever, such as the Ecu.

Presuming that not all CIS member states are ready to carry out monetary reforms, an intra-CIS payment mechanism could make sense, at least temporarily, to avoid a drastic drop-off in existing intra-CIS trade, with all the multiplier effects that would involve. If CIS members make rapid parallel moves toward internal convertibility of their respective currencies, trade could develop sufficiently without the creation of a payments union. This is unlikely in the near term; hence, a payment union plays a useful interim role.

Q: The program suggests the introduction of a value-added tax (VAT) and an income tax as part of fiscal reform. On the other hand, the IMF team that recently was in Ukraine has proposed — according to the Financial Times — a drastic reduction of payroll taxation and the introduction of a tax at the manufacturing stage in lieu of VAT, which it believes is "too complex" to administer. What is your comment on this particular issue? And in a larger context, how can the multinational financial institutions coordinate their activity with the Government of Ukraine and with each other in the most effective fashion, and in what areas?

A: I agree the VAT cannot be made effective immediately, but the administrative efforts to develop such a tax need to begin immediately. On the broader issue of multinational institutions, several constraints need to be reconciled. For example, the need for financial and technical assistance is immediate, but our implementation capacity is extremely limited. With only 400 people in the Ministry of Finance, Ukraine's administrative resources will be stretched very thin in dealing with the IMF and the World Bank. An early decision to divide responsibilities between the two would help; for example, the IMF could assist with stabilization, and the Bank with specific sectoral needs.
Aiding the Commonwealth of Independent States — a bridge (loan) too far

Of the $46.8 billion of international assistance pledged so far to the CIS — over half of it in the form of export credits or guarantees — the U.S. has offered about $5 billion. The Bush administration’s commitment to easing the republics’ economic plight totals as follows: $1.25 billion in loan guarantees and a $165 million grant for emergency supplies and technical aid this winter. The guarantees will be disbursed in four tranches: an immediate $500 million, followed by three tranches of $250 million each during 1992. The administration pledged an additional $400 million for humanitarian aid at the International Aid Conference in Washington on 22-23 January.

The EC and its member states have committed $32.5 billion, of which the largest share is from Germany — $22.5 billion, including export credit packages of $6.5 billion. Other German aid includes nearly $2 billion in balance of payments support and $6.5 billion for the reparation of Soviet soldiers stationed in the former East Germany.

Western assistance is required in the following areas:

- technical assistance;
- emergency food and medical aid, especially in the big cities;
- export credits, loans and grants to finance vital imports;
- a stabilization fund for the new republican currencies;
- aid for disbanding and retraining the military; and
- long-term assistance with the establishment of a market economy.

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- long-term assistance with the establishment of a market economy.

Russia needs humanitarian aid, balance of payments support, and a stabilization fund to peg the ruble at a reasonable rate, according to Yegor Gaidar, Deputy Prime Minister and Minister of Economics and Finance of the Russian Federation. "Stabilization plans must be announced as soon as possible. Unless the people can see that inflation is going to be capped, wages will increase again, and we shall then be into a disastrous wage-price spiral." The Russian government wants the IMF to approve a reform program with conditional aid, similar to IMF plans for Eastern European countries, before Russia officially joins the IMF. The IMF is currently examining Russia's proposed reform program. If an agreement is reached, the World Bank will be able to provide structural adjustment funds alongside the IMF program.

Western aid will be linked to several conditions, such as willingness to undertake economic reform; inter-republican agreement to maintain central control of all nuclear weapons; and an undertaking by all the ex-Soviet republics to honor existing debt. That debt — according to French officials — reached about $65 billion at the end of 1991, although Russian officials estimate a total of $81-84 billion. According to commercial bank estimates, the CIS faced a total external debt service commitment of $12-16 billion in 1991 and $11-15 billion in 1992. In October 1991, all 12 republics (excluding the Baltic states) reached agreement on servicing foreign debt, without dividing up assets and liabilities. In November, eight republics agreed to honor the Soviet Union's foreign debt; two weeks later nine of the republics signed a more precise agreement — Russia, Georgia, Kazakhstan, Armenia, Tajikistan, and Kirgistan signed without reservation, and Ukraine, Belarus, and Azerbaijan with reservation. The Russian Federation agreed to take responsibility for 61.34 percent of the debt burden, Ukraine 16.3 percent, Belarus 4.3 percent, and Kazakhstan 3.9 percent. The Baltic states have stated their willingness to contribute to the repayment of this debt. The agreement also envisaged that the CIS Vneshekonombank (Foreign Trade Bank) will act as sole agent for external debt-service payments. So far the following settlements with Western creditors have been made public:

(i) Official foreign debt: The Paris Club of 17 government creditors, which is owed some $32 billion by the Soviet Union and its successors, agreed on January 4 to defer repayment by the former Soviet republics of $3.2 billion in principal on long- and medium-term debt contracted before January 1, 1991. The creditors will review at the end of March whether the republics are implementing economic reforms drawn up with the help of the IMF. Russia wants to negotiate a three-year moratorium on official debt, to supersede the present one-year moratorium. No agreement has been reached on the coordination and timing of debt repayment. Some republics have delayed payments to Vneshekonombank.

(ii) Commercial debt: A settlement between 12 German banks and the CIS Vneshekonombank and the Russian Central Bank was reached on December 16. The ex-Soviet Union was given a three-month reprieve on repayment of principal on bank debts assumed prior to January 1, 1991, and due for repayment by March 30, 1992. This deal excludes public issues, bond placements, short-term debts and facilities, on which the CIS will continue to pay principal as well as interest. The sum deferred could be some $3.4 billion.

Russia has to deal in 1992 with the problems of how to provide coverage of its share of former Soviet debt and how to secure financing for vital imports

### Forecast for Russian exports in 1992 compared to all republics in previous years:

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<th>All republics</th>
<th>Russia</th>
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<tbody>
<tr>
<td>Exports</td>
<td>1990</td>
<td>1991</td>
</tr>
<tr>
<td>Total value (U.S. $ billion)</td>
<td>101.5</td>
<td>50.58</td>
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<tr>
<td>Including:</td>
<td></td>
<td></td>
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<tr>
<td>Crude oil (million tons)</td>
<td>109.0</td>
<td>40-45</td>
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<tr>
<td>Hard coal (mt)</td>
<td>35.4</td>
<td>20-25</td>
</tr>
<tr>
<td>Petroleum products (mt)</td>
<td>50.0</td>
<td>28-28</td>
</tr>
<tr>
<td>Natural gas (billion cu. m.)</td>
<td>109.0</td>
<td>100-105</td>
</tr>
<tr>
<td>Rolled steel (million m.)</td>
<td>8.4</td>
<td>3-3.5</td>
</tr>
<tr>
<td>Sawn timber (million cu. m.)</td>
<td>7.0</td>
<td>4.5-5.0</td>
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The estimated value of necessary imports to Russia amounts to as much as $30 billion. This primarily consists of agricultural goods and ready-for-consumption foodstuffs such as grain, sugar, meat, vegetable oil and butter, of some $13 billion; production machinery and equipment, spare parts and semi-finished products for light industry and food, to a value of about $5.8 billion; and medicines of $5 million dollars. A significant part of the imports have to be financed from foreign assistance.

From Oxford Analytica and news agencies' reports.
After Mengistu: New economic agenda in Ethiopia

In May 1991, troops of the Ethiopian Peoples Revolutionary Democratic Front marched into Addis Ababa, putting an end to 17 years of dictatorial rule by President Mengistu. During his tenure, Mengistu drastically changed the economic landscape of the country. Productive incentives vanished in the face of enforced collectivization and state domination of nearly every sphere of economic life. To confront civil resistance over the years, Mengistu placed the economy on a war footing, diverting the nation's resources and productive capacity and further impoverishing the country with massive borrowing for military hardware.

Devastated economy

In March 1991, President Mengistu finally acknowledged the economic impasse and announced a program to move Ethiopia toward a market-based economy, hoping to attract sorely needed support from international donors. His program to liberalize the economy (Transition, Vol. 1 No. 4/5, August 1990) was a turning point, with the government openly recognizing the failure of the centrally planned economy to provide sustained growth and the need to develop the private sector. The initial response by the private sector, especially the small-scale agricultural producers, quickly subsided as the government failed to meet its promises. The fiscal deficit reached unsustainable proportions and became highly monetized. The birr (the Ethiopian currency) remained overvalued, making exports uncompetitive, and the state sector used up the bulk of scarce foreign exchange.

The resulting inflationary deficits that destabilized the economy and undermined early hopes for the government's change of course. Last year, budgetary war expenditures reached an estimated 15 percent of GDP, domestic bank financing of the war effort reached 11 percent of GDP, inflation rose to 45 percent, reserves fell to zero, and GDP declined 5 percent. (GDP per capita is below $125, making Ethiopia one of the poorest countries in the world.)

In late May 1991, Mengistu was forced to leave the country, and a transitional government took power. The new leaders had to grapple with an economy characterized by a dominant, overmanned public industrial sector and extensive state planning and regulation, as well as an under-nourished private sector struggling to survive largely within the parallel economy. Foreign exchange and essential inputs have been in short supply, while the overvalued currency has driven most economic transactions into the parallel market.

In such a dire economic situation, even non-enforcement of regulations has led to important changes, including the spontaneous break-up of many state farms, liberalization of freight transport tariffs, and greater labor mobility. The end of the war also meant a sharp cut in military expenditures, thus relieving the economy of a substantial burden. This will improve Ethiopia's budgetary position and free resources for productive activity. (However, in 1991 the budget deficit was still substantial - estimated at 16 percent of the GNP — as government revenues dropped to the lowest level in 10 years. This was a result of substantial growth in informal transactions, including significant smuggling of exports.)

Transitional program

The main challenge for the Government of Ethiopia is how to strengthen the private sector and integrate it with a drastically weakened formal system. This means combining strategies for growth with continued responsibility for safeguarding and rehabilitating millions of unemployed, displaced, and vulnerable people.

The government's recently announced transitional economic program acknowledges the failure of the centrally planned economy and is committed to the growth of a market economy, with some important caveats. According to the program, the state's future role will be to:
- provide development policies and a framework,
- develop and maintain infrastructure and human capital,
- create a favorable environment for private capital and investment,
- manage fiscal policy, with special attention to inflation,
- attract international assistance, and
- participate in certain economic activities, including state farms that can be run profitably.

According to the program, farmers will be guaranteed unhindered use of land as well as freedom to sell their products at their own prices. Families will have the right to inherit land, however they cannot sell the land, “to avoid a concentration of land in the hands of large landowners.” The government intends to reduce rural taxes as well. (Agriculture provides 70 percent of Ethiopia's export revenue and engages 75 percent of the working population.)

Furthermore, most industrial activities will be managed by the private sector, and only a few key enterprises — including large-scale engineering and metal industries, fertilizer plants, gold, copper, and potash mining, and other strategic raw materials industries — will remain state-owned or will operate in partnership with domestic or foreign investors.

In domestic trade, the private sector is expected to become dominant, although in addition to its regulatory functions, the state will reserve the right to make bulk purchases of essential goods to hold down prices. In foreign trade (a traditional government monopoly), private sector activity is also to be
encouraged, although the future role of the state is "still to be studied and decided upon."

Banks, insurance companies, and sizable financial institutions will continue to be controlled by the state, although the private sector will be encouraged to participate in joint ventures. Air and rail services, and post and telecommunications will remain under government control.

The general tone of the program is anti-monopolistic, emphasizing the need to make the remaining state sector profitable, streamline it, and expose it to open competition. At the macroeconomic level, the program's priorities include:

- cutting budget expenditures, primarily through limiting administrative and defense spending,
- reforming the taxation system, and
- improving export performance to reduce trade deficit.

The program also recognizes the distortions produced by the overvalued currency but is cautious about taking action before adequate signs of economic growth.

Pluses and minuses

As to the uncertainties surrounding the program's outcome, the government's consensus-building style is likely to encourage the growth of the informal economy and reduce the government's own power to exercise economic influence, at least in the short term. The undetermined status of the state of Eritrea, and the lack of logistical and policy coordination between Eritrea and Ethiopia could further complicate matters. Eritrea engaged in unilateral economic actions recently; for example, it devalued the birr. Congestion at the port of Assab, now under Eritrean control, could further limit economic growth in Ethiopia.

Despite the many obstacles, the Ethiopian government's emphasis on democratic process and the prospects for improved security could stimulate production and investment, provided the policy framework offers the necessary incentives. And despite inevitable political opposition, the government already has been able to open up regions and resources that were previously inaccessible to the economy.

The credibility of the new regime has attracted substantial donor goodwill, as exemplified in a proposed multidonor World Bank's led emergency reconstruction and recovery project likely to be over $600 million, a substantial part of which would come from World Bank's IDA. These funds will help restore damaged infrastructure and social assets, provide essential transport facilities, and help jump-start agricultural and industrial production. However, future donor support will depend on the progress of the government in converting principles into action.

From an economic point of view, a rapid and substantial reform program

Quotation of the Month: "The key is a functioning monetary system."

George Soros urges action in the ex-USSR

We are now in the climactic stage of the revolution. In some ways it resembles the climax in Eastern Europe in 1989. But there is one major difference: in the case of Eastern Europe the climax marked the beginning of a new era. When the communist system was swept away, the foundations of an alternative system were already present. There were nations with long histories; there was a more or less well-organized opposition and a general desire to become part of the modern world.

Not so in the Soviet Union. The foundations for an alternative system of organization are missing. We are at a loss even to describe the territory we are talking about. It will take a long time and a great deal of effort to transform the republics into independent states with well-functioning administrations. The same applies to the state-owned enterprises that make up the bulk of the economy. In these circumstances, the collapse of the Soviet system is unlikely to give birth to a new system. It is more likely that one revolutionary climax will be followed by another until the very foundations of civilization will be destroyed. How far the process of destruction can go is anybody's guess. But the Russian Revolution of 1917

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From an economic point of view, a rapid and substantial reform program will bring many advantages. The economic downturn can be halted and reversed, and the hardships associated with reform could be mitigated by external support. Such a program carries a greater political risk than a slow and gradualist approach, considering the other difficulties the government faces, such as ethnic conflicts. A piece-meal approach, however, could backfire in the long run. If the government acts too cautiously, like a caretaker administration anxious to maintain its consensus support, it could risk the very prospects of peaceful political transition — and jeopardize the economic recovery itself.

Quotation of the Month: "The key is a functioning monetary system."

George Soros urges action in the ex-USSR

What can the international community do in the face of this seemingly inexorable descent into chaos? In my opinion, it is the only force that could possibly slow down and eventually reverse the process of disintegration. The key is to help bring a functioning monetary system into existence. There can be no market economy without money; money is primarily a question of credibility, and in today's conditions it is impossible to establish a monetary system that would enjoy the confidence of the people, without Western involvement.

All this is rather abstract. I shall try to be more specific. In Russia, the "good guys" are in charge of economic policy. They have embarked on a radical program. They have liberalized prices without changing the monopolistic struc-
ture of the economy. They are relying on monetary policy, but they do not control the central bank.... The result is an inflationary explosion, which was inevitable and was meant to create the preconditions for monetary stabilization. The situation is similar to Poland's at the beginning of 1989 but, in many respects, worse.

In Ukraine a coupon system was introduced on January 10. Consumer goods can only be bought with coupons, and people receive part of their wages in coupons. But the government failed to distinguish between coupons and rubles in the enterprise sector, so enterprises supplying consumer goods are paid in rubles, not in coupons. Moreover, the coupons are recirculated and additional coupons issued every month. The whole scheme doesn't make sense. It is an engine for generating hyperinflation. The coupons started out being worth 10 rubles, fell to 4 rubles within days and are likely to end up as worthless as the ruble. Prices are skyrocketing, and food is scarce.

Ukraine was forced to introduce some kind of coupon scheme because the Russian central bank refused to supply rubles; but the form the coupon scheme took accelerated the inflation of the ruble, and this was taken by Russia as a declaration of economic warfare.

The situation is not as hopeless as it seems. It is also possible that... the way will be open for a coordinated monetary stabilization program in both Russia and Ukraine, with the help of the international monetary institutions. That is where the shortage of time comes into play. For this scenario to be realized, it has to happen in the next few months. It is unlikely that without some positive results the reform orientation of the Russian government can last much longer. Unfortunately, the international monetary institutions will not be ready in time. The IMF is unable to admit the successor states of the Soviet Union to membership before summer [see World Bank/IMF Agenda. Ed]. In my opinion, that is too late. The only way the time gap can be closed is by organizing international assistance for monetary reform no later than April. Emergency food aid can play an important role in extending the tolerance of the population for a few months; technical aid is, of course, indispensable, but the future hinges on monetary reform.

In the midst of decay and disintegration, there are some forces at work on integration. They need to be reinforced. I realize that the private sector cannot do much about monetary reform, but the government can.

Institutional network of the Soros foundations

The Soros network of foundations is helping the countries of the former Soviet empire to make the transition to open societies.

Note: Year refers to the start-up year, dollar amount to the commitment in 1991; activities of each fund are summarized.

**Non-profit foundations**

- **Soros Foundation—Hungary, Budapest, New York, 1994, $6 million.** Supports health, education, independent publishers, self-help organizations.
- **Soros Foundation—Soviet Union. New York, 1987, $0.5 million.** Administers grants to affiliated Soros foundations in the CIS and the Baltic states.
- **Soros Foundation—Romania. Bucharest, Cluj, Iasi, Timisoara, and New York, $1 million.** Supports independent press and backs English-language training.
- **Open Society Fund—Lithuania. Vilnius, 1990, $1 million.** Supports education and promotes ethnic cultures and publications.
- **Open Society Fund—Latvia. Riga, 1991, $0.1 million.** Focuses on issues of citizenship, nationalities, minorities.
- **Soros—Yugoslavia Foundation. Belgrade, 1991, $0.5 million.** Supports health education, independent media.

**Non-profit institutions**

- **Central European University. Prague, Budapest, 1990, $25 million.** Offers courses in economics, environmental sciences, sociology, and political sciences, history, and law.

From The Giving—The Chronicle of Philanthropy, a U.S. publication.

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**Excerpts from George Soros’ address to the Citizens Democracy Corps Conference on Private Sector Assistance to the Commonwealth of Independent States, January 22, 1992. Soros, a Hungarian-born Wall Street investor, is chairman of the Soros Management Fund.**

"I don't want to panic, but isn't this how inflation starts?"

From the Czechoslovak weekly Mlady Svet.
Milestones of Transition

On January 19, Bulgaria's parliament passed a law on foreign investment to bring foreign capital into the country. The law allows foreigners unlimited transfers of profits in convertible currency. Restrictions on foreign participation in joint-stock companies have been eliminated, although such participation must not exceed 49 percent in companies that purchase land. Foreigners have most of the rights as Bulgarians in setting up businesses and acquiring property. They can buy land for building but not for farming, however.

Russia has outlined its privatization plans for 1992 as part of a far-reaching program to ensure transition to a market economy. Science Minister Boris Saltykov said the Russian government has defined three categories of enterprises: those that could be privatized in 1992; those that couldn't, such as mineral resources, banks, railways, civil aviation and weapons plants; and those that could be privatized with special permission, such as companies producing medicines, alcohol and tobacco products and baby food. He said the government hoped to receive 92 billion rubles from privatization in 1992 and 300 billion rubles in 1993.

All subsidies to state and collective farms are to be ended, announced Russian President Boris Yeltsin in early January. Yeltsin offered help to private farmers, signing a decree that simplifies setting up businesses and acquiring property. He also said that most former state-owned companies were bought at more than their book value, then stabilized, gained new markets, and boosted their technological level. Collective and state farms would have to turn over to any worker submitting an application his or her share of the farm's land within a month. Farmers would be able to swap or mortgage their land and, on retirement, sell it or pass it on to their heirs. There will be four main types of agricultural enterprise, according to Agriculture Minister Viktor Khlyustov: private farms, associations of farmers, share-holding societies and collective enterprises. He also said that Russia needed to import 20 million tons of grain this year but that its own producers could begin to meet domestic needs in 1994.

Russia's parliament on January 26 approved a 420.5 billion ruble first-quarter budget, aimed at curtailing a deficit of 10.3 billion rubles (1 percent of GNP). Spending cuts are focused on defense, where outlays would fall to 4.5 percent of GNP, or 50 billion rubles, less than one-fifth the 1991 level. Industrial and farm production subsidies would drop to 2.7 percent of GNP, from 9 percent. GNP will likely decline 19 percent in the first quarter after falling 11 percent for all of 1991. The budget estimates inflation at 400 percent in the first quarter. Revenue forecasts are for 160 billion rubles from value-added tax, 146 billion from other taxes, and 228 billion from exports. The minister of economics, Yegor Gaidar, has said that curbing money supply growth and imposing a tough financial and monetary policy represented the government's only chance to achieve stabilization. Deputy Labor Minister Fyodor Propokov said unemployment may reach 7 to 8 million in the second half of the year. Other news: Central Bank Chairman Georgy Matyukhin said foreigners would be allowed to buy into Russian firms only at a special exchange rate of, possibly, 8-10 rubles to the dollar. Customs tariffs were suspended as of January 15, and a new customs regime is being drawn up. Boris Yeltsin has signed a decree allowing Russian citizens and organizations to trade "at any place, in any goods," with some restrictions applying.

The Polish parliament has approved the 1992 budget, projecting a deficit of 17.6 trillion zlotys, almost a quarter of the revenue for the period. Uncoupling of public sector wages from the inflation rate and a cut in payments to the unemployed, to 36 percent of the average income, were also approved. Finance Minister Karol Lutkowski and Economic Minister Jerzy Eysymontt expressed hopes of renegotiating some terms of an IMF agreement. Eysymontt emphasized that the country's deepening recession has to be stopped, at the expense of letting inflation hover around 60 percent. He expects industrial stagnation in 1992, followed by moderate growth and visibly lower inflation in 1993. (In 1991 industrial output in Poland fell 14.2 percent below the 1990 level. Engineering sector output dropped 22.4 percent.)

Hungary's revenues from the privatization of 10 percent of its state assets last year topped $530 million. Lajos Csepel, head of the State Property Agency, said that most former state-owned companies were bought at more than their book value, then stabilized, gained new markets, and boosted their technological level. In another development, a tough new budget has come into force as of January 1. It allows for a public sector deficit of 1.9 percent of GDP, after a 3.5 percent deficit in 1990. State spending would fall to 62 percent of national output, from 66 percent in the previous year's budget. The budget appears to meet IMF approval for continuing a three-year program of financial assistance. It thus clears the way for Hungary to draw $435 million in IMF credits this year in addition to the $970 million disbursed in 1991.

During 1991 the gross foreign debt of Czechoslovakia reached $19.3 billion, up from $8.1 billion in 1988, reports Oxford Analytica, the London-based economic research group. Annual repayments were $1.5 billion in 1990, or 19 percent of convertible currency earnings. Czechoslovakia, in turn, is owed $4.7 billion by the ex-Soviet states and $1 billion by Syria. Cash reserves increased from $1.2 billion in January 1991 to $2.85 billion at the end of November, but total capital inflows were a mere $395 million.

Romania's budget deficit in 1991 was 65.5 billion lei, double the targeted shortfall. Romanian Central Bank Governor Mugur Isarescu said he expected the economy to pick up in the first quarter of 1992 because of a surge in foreign trade.

State Council spokesman Yuan Mu reported recently that China's inflation is under control, with the 1991 domestic price index having risen only 4 percent. The 1991 GNP growth would be 7 percent, compared with a target of 4.5 percent set at the beginning of the year, and industrial production would grow by 13.2 percent, more than double an early estimate of 6 percent. Agricultural production is set to grow by about 3 percent this year. Mu added that the budget deficit is likely to be several billion yuan more than the projected 12.3 billion yuan.

Civil war in Yugoslavia has forced a quarter of the population below the poverty line, thrown many thousands out of work, and caused galloping inflation. More than 6 million of the late federation's 24 million inhabitants are now classified as impoverished, with 2 million people jobless and 60 percent of firms operating at a loss, while prices continue to soar. Hardest hit are farmers, 40 percent of whom are living below the official poverty line, according to Agence France Presse.
The collapse of the Soviet Union and the recession in the West will exacerbate Eastern Europe’s already poor prospects for political harmony and economic recovery in 1992, claims Oxford Analytica, the London-based economic research group. Its main observations are the following:

- All the Central and East European countries face growing political turmoil in 1992, with the possible exception of Hungary.
- The divide between Central and Eastern Europe (Poland, Czechoslovakia, and Hungary) and the Balkans (Romania, Bulgaria, Yugoslavia, and Albania) will deepen; only the CEE countries will be regarded by the EC as latter-day Greeces, Spains and Portugals, struggling to come to terms with political pluralism in a European context.
- The CEE economies will continue to suffer from a severe recession through 1992. The sharp deflationary effects of the macroeconomic stabilization programs that are required to counter the threat of hyperinflation will be aggravated by the accelerated collapse of the former Soviet economic space. If the CEE economies do not receive substantial assistance from the developed industrial economies in the form of access to markets and inward investment, as well as balance of payments support, the economic prospects for 1992 will be bleak.
- A continued and even accelerated reduction in CEE trade with Russia in 1992 is a strong possibility. Trade with the Soviet economic space, which accounted for nearly two-thirds of the value of CEE trade before 1989, virtually halved in value in 1991, partly as a result of the replacement of barter by trade in hard currencies. The drop in Russian oil production accelerated in 1991, falling from a peak of 624 million tons in 1988 to an estimated 510 million tons in 1991; in November it was running at an annual level of under 450 million tons. Russia will not be able to meet its own demand for crude oil, let alone demand from Ukraine, Belarus, and the CEE. (All CEE imports of oil and gas from Russia transit Ukraine and/or Belarus by pipeline; these states also depend on Russia for oil and gas supplies.) Although it could be argued that this reduction of trade will accelerate the move to market structures and the closure of obsolete plants in the CEE region, it will also deepen the recession and cause unemployment to exceed expected levels.

**CEE prospects**

These problems could complicate reform measures and re-awaken pressures for more interventionist and less deflationary policies.
- Long-term economic prospects appear to be brightest in Hungary, Czechoslovakia, and Poland; however, the effects of the collapse of the Soviet economy and the continuing Western recession could still result in a 5-10 percent drop in the three countries’ combined output for 1992.
- In Poland, predictions for a small growth in output in 1992 will barely materialize if the CIS/Russian economy collapses, as this would stimulate further recession and possibly further loss of output. GDP fell by 8-10 percent in 1991. Exports to the EC grew 20 percent while imports from the EC grew 90 percent, eliminating the trade surplus.
- Czechoslovakia pursued the most deflationary policies in 1991; as a result, its monthly rate of inflation by mid-year was negligible, but retail trade has virtually halved since then. Industrial production fell sharply in the first quarter of 1992.

**PlanEcon’s more optimistic forecast — slow economic growth starting in 1993**

(percentage change over previous year)

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*Source: PlanEcon Inc., Washington, DC.*
springs and since then has been running at only 70 percent of the level of a year earlier. GNP for 1991 is expected to have fallen by 15-20 percent, and a further fall of 10 percent is probable in 1992.

- Hungary, the least dependent of the CEE economies on the Soviet market, experienced a 60 percent fall in its trade with the former Soviet Union in 1991. It has also been successful in attracting Western investment and still has the greatest potential for integrating its economy with the world market. GDP (which fell by 8 percent in 1991) could fall by 2-5 percent in 1992, with decline in industrial output roughly double these levels, while inflation will continue to run at about 30 percent.

### Coupon Privatization in Czechoslovakia

Registration in Czechoslovakia for its voucher-based large-scale privatization scheme was due to close on January 31, but officials have extended the deadline. For the past two months, citizens have been buying voucher booklets at 35 crowns each, paying a registration fee of 1,000 crowns ($35), a little more than the weekly average wage. Later the coupons can be exchanged for shares in state companies, representing about 40 percent of the economy.

So far, 271 investment funds have been registered. These funds will be able to bid for firms where direct voucher bids amount to less than the book value. The funds may also solicit vouchers from citizens and invest them on their behalf.

Several funds are aggressively advertising to attract investors. For example, the Harvard Capital and Consulting Fund is running advertisements guaranteeing investors a ten-fold return on their 1,000 crown voucher.

The Czech Ministry for Privatization is evaluating 4,500 privatization projects that were prepared partly by the enterprises' current management and partly by those opposed to the management projects. The first round of voucher privatization—involving property worth 150-200 billion crowns, of which most will be in the Czech republic—is due to start on March 16. In principle, all the projects, including those not relying on vouchers, should be determined by May 31.

The mass privatization in Slovakia will include 139 companies with total assets of 61.1 billion crowns, out of which about 89 companies will be privatized through vouchers, with assets amounting to 24.1 billion crowns. The plan is that large-scale privatization, including voucher privatization, should run simultaneously in both the Czech and Slovak Republics.

Some successful firms seem content to accept the voucher method:

- The East Slovak Ironworks, which made 4 billion crowns profit last year on sales of 35 billion crowns (80 percent from exports), is proposing to offer 97 percent of its 15 billion crowns capital for sale through vouchers. The remaining 3 percent will go toward the national restitution fund, which is required of all projects.

- The famous Plzen brewery, whose seven plants have a book value of 2 billion crowns, rejected its many foreign suitors, including a last-minute bid from the Dutch De Groen family company. Plzen will offer 40 percent of its shares through vouchers, 20 percent to investment funds, 40 percent through banks to domestic buyers, and 5 percent to employees.

Proposals that avoid the voucher method and opt instead for direct sales or management buyouts are thought to number roughly 400, or one in 10 of the submitted proposals. There are no guidelines on how the ministry intends to deal with these proposals; they will be handled on a case-by-case basis.

### The Balkans

The Balkan economies' prospects are far dimmer.

- Romania faces shortages of energy and food in urban areas unless it receives Western assistance. A balance of payments deficit of nearly $2 billion in 1991 has exhausted hard currency reserves and will necessitate a cutback in imports in 1992. Industrial production fell by 15 percent in 1991, and a further decline of 5-10 percent may be expected in 1992.

- Bulgaria was highly dependent on the Soviet market for energy; it is now heavily reliant on the much-criticized Kozlodui nuclear power plant for domestic energy. GNP fell by 25 percent in 1991, with inflation running at 400 percent. A positive trade balance largely reflects the collapse in imports from the EC.

- Republics in the former Yugoslavia will be preoccupied by warfare, with consequent debilitating controls and demands on the economy, despite hopes for the mini-economy of Slovenia.
Letter to the Editor

It is interesting to note the vehemence and strength of conviction of those who have responded to I.J. Singh's excellent article on the "schizophrenia" of socialist reform theory (Transition, July/August, 1991). Perhaps it is time for a response from someone working on China instead of those working on Central and Eastern Europe.

The heart of the argument is that it is a comparison of "apples and oranges," and of course this has some truth. However, there are only two arguments that seem to me to be of real importance among those mentioned in the various letters. Mr. Csikos-Nagy (Transition, October 1991) raised the fundamental issue that the two reforms are aimed at different ends; thus, in one sense China's gradualism may be as irrelevant to Central and Eastern Europe as is that region's privatization for China. Similarly, Mr. Thomas (Transition, November 1991) quite rightly mentions the external shocks that give such a strong impetus to the need for structural adjustment and stabilization. Interestingly, no one has mentioned the political underpinning of Mr. Csikos-Nagy's point: that the socialist system of Central and Eastern Europe was "imposed," and thus is readily shed, while China's socialist system grew out of a genuine peasant revolution. For these reasons, of course, the solutions to the economic problems of Central and Eastern Europe will be very different from the Chinese solutions, and our advice must be tailored accordingly.

But for the rest of the debate, it just will not do to say the economies are different and so there is no relevance. At the heart of our job is to select relevant experience from wherever we can find it and adapt it to the situation of the countries we are working on. We point the Chinese toward banking issues in Germany and Yugoslavia, trade reform in Mexico and Korea, and industrial policy in Japan and France. Yet these countries are far more unlike China than are the formerly socialist CEE countries.

Mr. Singh's point is surely this: China has had considerable success in certain areas, such as agriculture, non-state industry and export development. China has also managed, thus far, to contain social disruption within reasonable bounds as it gradually transforms its economy. (It has also had some notable failures in terms of the performance of state-owned industry and the viability of the state banking system.) Let us look at this experience with care and see what we can take and adapt in framing our advice to other countries. That doesn't necessarily mean copying the pace at which China has introduced reforms — for the absence of deep macroeconomic crisis and the different end-points are of critical importance here — but perhaps there are universal reform lessons about sequencing and about the efficacy of certain policies. Let me suggest four of these:

(i) that in the less industrialized countries, aggressive agricultural reform can be selected as a leading reform sector, focusing on land ownership reform and relaxation of crop planning;
(ii) that active promotion of non-state industry and of new industries may be more important than attempts to restructure and rescue existing industries;
(iii) that promotion of trade through appropriate export support mechanisms may be as important in the first place as import liberalization and, if successful, may lead rapidly to a greater role for the external sector in the economy; and
(iv) that it is possible to provide safety nets to the people most likely to be affected adversely by reforms.

It would be wrong to conclude that Mr. Singh is saying everyone should go slow in reform. But the economics of reform should be concerned equally with market failure as with planning failure. The job of advising the reforming countries of Eastern and Central Europe must be difficult enough without ignoring one whole body of experience in China, both in ways to introduce market systems successfully, as well as in areas where the market may continue to need some help from government until the transition is complete. Those of us who work on Chinese economic issues will also need to watch the experience of CEE countries, particularly with respect to the restructuring of state-owned enterprises.

Thus, let us at least take Mr Singh's last sentence to heart: the time has indeed come for a more systematic dialogue.

Peter Harrold,
EA2CO, World Bank

From the Croatian cartoonist Felix.
Conference Diary

For the Record

Privatization in Central and Eastern Europe

Second Annual Conference on Privatization in Central and Eastern Europe. Organized by the Central and Eastern European Privatization Network (CEEPN) and the Economic Development Institute of the World Bank, and hosted by the Austrian Ministry of Finance. Participants included heads of the region's privatization agencies and representatives of the World Bank, EBRD, EEC, UNDP, and UNIDO. Topics were organized under four headings: country presentations, mass privatization, spontaneous privatization, and approval of privatization transactions. Country presentations covered macroeconomic environment, sociopolitical conditions, the institutional and legal framework, and gave a status report. Participants agreed that CEE countries suffer acute shortages of qualified staff to implement the privatization process, and they suggested establishing a network of privatization agencies. Workshops on the following have been scheduled: Investment Funds (February 1992); Small-Scale Privatization (March 1992); Preparing Contracts (April 1992); and Direct Sales (April/May 1992).


Forthcoming

Social Legacy of Socialism
February 21-22, Washington, DC.

Sponsored by the George Washington University and the Woodrow Wilson Center. Topics to include social aspects of the transition process, policies to combat unemployment and reform health, education, and social security systems in the post-socialist economies.


Industrial Restructuring in Eastern Europe
February 26-28, Cambridge, MA

International conference, sponsored by the National Bureau of Economic Research, Inc., and organized by Olivier Blanchard, Rudiger Dornbusch, Kenneth A. Froot, and Jeffrey Sachs. Agenda includes country studies on the former USSR, Poland, East Germany, Slovenia, Hungary, and Czechoslovakia; and sessions on labor markets, public finance, the economics of bankruptcy reform, private business in Eastern Europe, and foreign trade during Eastern Europe's transition.

Money in Transition: From Plan to Market
March 5-6, Washington, DC

The 10th annual Monetary Conference of the Cato Institute. Speakers will include the Czechoslovak Finance Minister Vaclav Klaus on "Creating a stable monetary order in the transition from a planned to a market economy;" Nikolai Petrakov, Director of the Moscow Institute for Market Economy, on "Monetary stability and monetary credibility: What must be done?"; Oleg Bogomolov on "Preconditions for monetary stability;" and Steve Hanke on "Commodity standards and currency boards: are they compatible?"

Information: Meredith Copeland, Cato Institute, 224 Second Street, SE, Washington, DC 20003, tel: (202) 546-0200, fax: (202) 546-0728.

SASE Annual Conference
March 27-29, Irvine, CA

Fourth annual international conference of the Society for the Advancement of Socio-Economics, held jointly with the Society for Economic Anthropology. Topics include "The third way: socio-economic models between capitalism and socialism;" and "Socio-Economic requirements for transforming planned into market-type economies."

Information: Steven Helland, 714 H German Library, 2130 H Street, N.W. George Washington University, Washington, DC 20052, tel: (202) 994-8167, fax: (202) 994-1639.

Dismal gruel

"The wretched of both the former Soviet Union and the still more wretched Third World are getting no utopianism but the recipes of the IMF and the World Bank — which are, at least in their initial stages, foul-tasting. Is there not a case for a revival of some of the fire and passion of Marxism, in order to give the poor the dignity of struggle and the rich of the earth the smell of a bit of fear? No. The last thing anyone at the bottom of the heap needs is utopia and utopians, especially Marxist ones. Out of power, they confuse; in power, they repress.

The dismal gruel of the IMF, dispensed as homilies of the 'there is no rapid road to success;' the IMF helps those who help themselves;' expenditure slashed and budget balanced: result-happiness—kind, is much better than the pretensions of 'scientific socialism.'

From The Financial Times, London.
World Bank/IMF Agenda

IBRD loan to Poland

The World Bank will lend Poland $100 million for reorganizing its agriculture. The new line of credit, announced after a recent meeting in Warsaw between Wilfried Thalwitz, Vice President of the Europe and Central Asia Region and Polish Agriculture Minister Gabriel Janowski, is aimed at modernizing the purchase of farm products. "The greatest danger that exists is that of rekindling inflation," Thalwitz told reporters. In talks with President Lech Walesa and various ministers, he backed attempts by Poland's new government to rein in its budget.

Ex-republics apply for membership

On December 19, Ukraine was the first member-state of the CIS to submit an application to join the IMF and the World Bank. Russia applied January 3, followed by Azerbaijan, Armenia, Byelarus, Moldova and Kazakhstan which submitted their applications in late January.

Admission in April?

The G7 ministers recently requested the IMF to finalize the arrangements for membership for the Baltic and CIS member states that can meet IMF conditions. Bonn officials believe a letter of intent concerning an IMF program for Russia could be agreed to by the end of February and submitted to the Board in March, with membership for Russia following as early as April. An IMF official told a recent Moscow briefing that Russia's economic reform program was going in the right direction, "opening up the economy, removing controls, liberalizing prices and giving a chance to private ownership." More action was needed on Russia's budget deficit (last year it was 20 percent of the GNP) and on the balance of payments before organizations could step in with a ruble stabilization fund. Monetary sources said the U.S. wants the former Soviet republics to have their own seat on the IMF board but is reluctant to increase the number of Board members. According to Reuters news agency, to speed up membership the IMF intends to calculate an overall quota for the former USSR (4.5 percent of the total) and divide among the CIS.

The Bank and the CEE region

"It is illusory to believe that a market economy can be created overnight out of former command economies," said Kemal Dervis, Director of the Central European Department of the World Bank, at a recent meeting of the French Banking Association in Paris. He added that macroeconomic stabilization requires a strong upturn in the enterprise sector, vigorous growth of new small-scale enterprises, and a successful diversification and restructuring in the medium- and large-scale sectors. It is vital to accelerate privatization in the CEE region, Dervis emphasized. The World Bank supports mass privatization, although the need for supervision and the administrative difficulties of implementing it should not be underestimated. According to Dervis, most former Soviet republics are likely to become World Bank members by September.

IDA support to Angola

Angola is set to expand water and sewer services and improve health conditions in two rapidly growing coastal cities, Lobito and Benguela. IDA is supporting the effort with a credit of $45.9 million. The project marks the third time that IDA has approved lending to Angola.

...and to Mongolia

IDA has made its first loan to Mongolia since the country became a member of the World Bank in February 1991. The first project, supported by a credit of $30 million, will bolster Mongolia's agriculture, energy, and transport sectors by financing imports, such as equipment, materials, and spare parts. Another project, supported by a credit of $5 million, will help the government reform the public sector and develop the private sector. The credit will finance advisory assistance, training, and other support for the staff of government agencies in charge of carrying out economic reforms.

Bank energy loan to China

The World Bank is supporting a project to boost the power supply in Henan Province in the central part of China with a $180 million loan. The government will increase the production capacity of the Yanshi Thermal Power plant through the installation of two 300-megawatt generating units, the construction of power lines, and the provision of technical assistance to local engineers who will oversee the project.

Debt relief to Tanzania

The Paris Club of official creditors has granted Tanzania debt relief of 50 percent of its $5 billion external debt. Creditor nations have been given three options: to write off half the country's debt service obligations, with the rest consolidated at market rates, payable over 23 years after a six-year grace period; consolidate at concessional rates to halve the net present value of payments due on non-concessional loans, with repayment over 23 years; or consolidate at market rates, with repayment over 25 years, including a 14-year grace period. The terms are similar to those granted to Nicaragua and Benin by the Paris Club in December. In another development, IDA announced a credit of $10 million to support Tanzania's plan for developing a hydropower plant.

Procurement guidelines

On January 22, international representatives of the construction industry discussed amendments to the Bank's procurement guidelines with senior advisers from the World Bank. The meeting was chaired by Raghavan Srinivasan, head of the Bank Procurement Policy and Coordination Unit. The Bank is currently evaluating a revised edition of the guidelines, to improve the competitive environment for Bank-financed procurement and to make procurement more attractive to a wider range of bidders.
Contrary to predictions prior to the "big bang" program, employment in Poland has declined nearly uniformly across all sectors, mainly because of a general drop in output. There is no evidence of substantial restructuring within the state sectors, no evidence of bankruptcies or sector disinvestment, nor of a significant shift in employment. Restructuring may not occur in the absence of large-scale privatization, and even if it does, in the short term, any supply response may be limited. That would boost the already high level of unemployment, raising questions about the political sustainability of the program. (Unemployment in Poland reached 2.1 million, or 11.4 percent of the active population at the end of 1991.) Wages substantially declined in real terms in early 1991 as enterprises faced a severe supply shock and tight bank credit. Beginning last March, however, wages increased faster than prices, probably contributing to the persistence of inflation. In addition, the current wage policy scheme—based on monthly indexation and links between wages and profitability—has been ineffective. Improvements could be achieved by lengthening the interval of wage indexation, simplifying the wage rules, and dropping firm-level performance criteria. An agreement among various parties (government, trade unions, workers councils, managers, farmers) could anchor wage increases to the expected inflation rate and nation-wide productivity gains, subject to revision at three- or six-month intervals.

Gerhard Pohl  
Economic Consequences of German Reunification: 12 Months After the Big Bang  

The author concludes that the "big bang" approach worked in Germany because it was politically unthinkable to restrict migration from the east to western Germany. The 1:1 conversion of GDR marks into Deutschmarks was essential to keep wage differentials within limits and migration within bounds. The present relatively high wages in eastern Germany (50 percent of West Germany's) are the result of last year's collective bargaining agreements and are sustainable only with massive financial assistance.

The advantages of the east's importing the Federal Republic's entire economic and legal system outweigh the inevitable transition costs. Some transition measures concerning labor market adjustment or incentives to attract foreign capital were insufficient, however. The author questions the feasibility of the suggested general employment subsidies, as they would have been applied indiscriminately and would have perpetuated inefficient industries. Targeted employment programs and investment subsidies are better alternatives. The latter, as early experience suggests, do not distort investment decisions.

Contact CECSE, the World Bank, N 6·037, tel: (202) 473·7188.

Other recent World Bank Policy Research Working Papers:

Jan Svejnar and Katherine Terrell  
Reducing Labor Redundancy in State-Owned Enterprises  

Contact Barbara Gregory, the World Bank, S 10·053, tel: (202) 473·3744.

Evidence of reform experience in China, Hungary, and Poland suggests that price reform must be part of a larger reform strategy that moves at a fairly brisk pace to minimize transitional costs. Repeated flare-ups of inflation could fundamentally alter the expectations of agents, making reform harder to accomplish. Uncertainty hampers development of entrepreneurial skill and foreign investment. To maximize allocative gains of price liberalization in China, complementary actions are suggested, such as maintaining a macroeconomic balance and positive real interest rates; imposing harder budget constraints on state enterprises; facilitating the exit of inefficient enterprises (bankruptcy laws, reforms to the system of enterprise-tied benefits, social safety net); using a tax-based income policy to moderate wage demands; initiating housing and rental reforms; and adjusting the indirect tax system.

Domestic price liberalization, with exchange rate adjustment and trade liberalization, allows for a closer link between domestic and international relative prices. However, in China, additional time-bound tariffs are advisable to protect industries that have good medium-term prospects but could not survive behind a low uniform tariff.
Other World Bank Discussion Papers:

Shahid Javed Burki and Shahid Yusuf
*Developing Mongolia*

Homi J. Kharas
*Restructuring Socialist Industry: Poland's Experience in 1990*

Shahid Javed Burki and Shahid Yusuf (eds.)
*The Sectoral Foundations of China's Development* (Selections from the World Bank's recent economic and sector work on China)

Contact World Bank Publications, tel: (908) 225-2165 or: P.O.Box 7247-8619, Philadelphia, PA 19170-8619.

* * *

Simon Johnson and Bakhtior Islamov
*Property Rights and Economic Reforms in Uzbekistan*

The paper, published before the dissolution of the USSR, examines why small-scale privatization is proceeding more rapidly in Uzbekistan than in Russia or Ukraine. (According to 1988 statistics, 11 percent of labor was employed privately in Uzbekistan, and only 2 percent in Russia.) In 1988, out of a total Uzbek labor force of 10 million, more than 1 million people worked on farm plots. In 1990, about 2,500 small and medium-sized shops, can­teens, and taxi and service firms were "private," that is, leased to the employees. Early in 1991, the Uzbek parliament adopted a series of laws on private ownership, enterprises, taxation, banks, and entrepreneurship that recognize private property, guarantee equal treatment for different types of ownership, and give the right to hire and fire employees.

The paper argues that individuals in Uzbekistan have gone perhaps furthest in using the former Soviet government's cautious endorsement of new property rights. Uzbekistan has a relatively high labor-land ratio that makes small-scale agricultural production more feasible. The republic's long established traditions and the extensive network of private traders help to reduce barriers to entry in small-scale urban activities. The Uzbek government has merely legalized processes that were based on previous underground activities. Bureaucrats in Soviet Central Asia have always been more inclined to take an equity position in non-state enterprises, and such relationships reduce the costs of establishing property rights. "Winners" in the republic are small-scale urban and rural producers and their technocratic sponsors.

Other recent WIDER Working Papers

Simon Johnson
*Spontaneous Privatization in the Soviet Union: How, Why and for Whom?*

Ardo H. Hanson
*The Importance of Being Earnest: Early Stages of the West German Wirtschaftswunder*

Contact WIDER Publications, Annankatu 42 C, 00100 Helsinki, Finland, tel: (358-0) 693-841; fax: (358-0) 693-8548.

New Books and Working Papers *

* The CECSE unit of the World Bank regrets that it is unable to supply the publications listed.

Grzegorz W. Kolodko, and others
*Hyperinflation and Stabilization in Post-socialist Economy*


Paul Marer and Salvatore Zecchini (eds.)

Vito Tanzi (ed.)
*Fiscal Policies in Economics in Transition*
(Based on IMF staff reports on technical assistance to build up fiscal institutions and formulate fiscal policies in the CEE countries; edited by the IMF Director of the Fiscal Affairs Department)

Anders Aslund (ed.)
*Market Socialism or the Restoration of Capitalism?*

Stephen Howes and Peter Lanjouv

Stephen Pudney and Wang Limin
*Rationing and Consumer Demand in China: Stimulating the Effects of a Reform of the Urban Food Pricing System*


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