TRANSITION

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Transition and Macro-Adjustment Division • Country Economics Department • The World Bank

Persistent Economic Decline in Central and Eastern Europe

What Are the Lessons?

What are the main causes of the precipitous fall of output in the Central and Eastern European (CEE) countries? What is the role of macroeconomic policies relative to that of structural and external shocks? What are the main obstacles to a sustained recovery in economic activity? In June a two-day conference in Washington cosponsored by the International Monetary Fund and the World Bank addressed these issues. Participants included scholars, officials from the CEE countries, and IMF and World Bank staff.

More than two years have gone by since the series of political changes in Central and Eastern Europe, and the hopes for a rapid transition to prosperous market economies have all but faded. Startling changes were observed in most of these countries. But the initial euphoria has been replaced by a more sober assessment of the magnitude of and the complications entailed in the task ahead—which in turn is dwarfed by the challenge facing the ex-Soviet states.

In the process of transition remarkable progress has been made in establishing private product markets, reorienting international trade, and instituting legal reforms. The growth of the small-scale private sector has been strong. In other areas the process has moved relatively slowly, including privatization of large-scale enterprises, adoption of market-oriented managerial practices in the state-owned sector, conversion and restructuring of productive activities, and consolidation of institutional reform to support the implementation of macroeconomic policies.

Common Features of Transformation

A common feature of the transformation has been the sharp decrease in

What's inside...

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measured output as comprehensive reforms were put into place. According to official statistics, output has fallen across Central and Eastern Europe in the past two years. The most dramatic output losses—measured output has fallen by more than half—have been in Albania, the former German Democratic Republic (GDR), and the successor states of the former Yugoslavia. These extreme cases are attributable to special circumstances—in Albania, the disruptive disintegration of an unusually closed regime; in the GDR, the absence of a macroeconomic constraint, with its implied protection of domestic production through the exchange rate; and in Yugoslavia the civil war.

Nonetheless, by most conventional measures the other five countries in Central and Eastern Europe seem to be in the grip of a severe and extended recession. After falling by 8 percent in 1990, the gross domestic product (GDP) of these countries (Bulgaria, Czechoslovakia, Hungary, Poland, and Romania) on average declined another 8 percent or so in 1991. Industrial production has dropped even faster, by an average of 17 percent in 1990 and about 11 percent in 1991. As of March 1992, only the former GDR showed clear signs of having turned the corner. Production in the other economies appears still to be falling, although not as rapidly as before. In most of the countries output is declining while inflation remains high and unemployment increases.

The nature, the speed, and the scope of the contraction in production have had different twists in the CEE countries. But it is possible to note some common features:

• All CEE countries have experienced large losses in measured output, regardless of their initial specific conditions.

• The extent of output contractions was not well anticipated, even when the radical nature of the reform programs was apparent. Projections made by many western experts as well as by international organizations have consistently underestimated the rates of output decline in 1990-91.

• The fall in output does not seem to have been accompanied by the radical economic restructuring that many expected as part of the reform process. Labor markets have shown signs of adjustment. In Czechoslovakia, Hungary, and Poland industrial output fell to about 65 percent of its 1989 levels by the end of 1991, and industrial labor forces decreased by one-quarter in 1989-91. The weakness of both ownership and creditor institutions cushioned the transmission of shocks and macroeconomic policies to

Policy suggestions from Richard Portes

• In external policy, I stand by the view that *the move to convertibility* should come as soon as it is at all feasible (of course a sufficient devaluation of the nominal exchange rate will eliminate excess demand for foreign exchange, but that may give a real exchange rate so low as to be unsustainable and indeed undesirable). But a move to convertibility must be accompanied by a sensible exchange rate policy: do not devalue excessively, peg initially, then go to a crawling peg. Some of the output loss has been due, directly or indirectly, to violation of one or more of those principles.

• Excessively abrupt opening of the economy has unwisely and unnecessarily exaggerated the initial shock. There is a prima facie case for *initial tariff protection*—for senile even more than for infant industries. Indeed, it is also the case that some of the apparently senile industries and firms could in fact adjust, but do not get a chance. This may be third-best to the second-best of a wage subsidy, which may be infeasible.

• The authorities should immediately take steps to *reverse the "state desertion"* that has left state-owned enterprises floundering: commercialize the enterprises, pay attention to their management and the environment in which it operates, improve corporate governance, and rehabilitate industrial policy. In the conditions of Central and Eastern Europe, we cannot trust the market to select and eliminate negative value-added activities and to develop activities that do have good long-run prospects. The market cannot and will not restructure the large state-owned enterprises—and they are too big to fail—until they are broken up and there is some expansion elsewhere in the economy. But we cannot trust the old nomenklatura to guide the restructuring any more than we can trust the market. This is therefore a major challenge for foreign advisors.

• A financial cleanout is long past due. The market cannot and will not work if credit markets do not function. The bottom line is that it is urgently necessary and quite feasible to *recapitalize the banks, cancel the debts of firms to be privatized,* and, meanwhile, institute cash-limited subsidies to the state-owned enterprises. Not to have done this immediately was the single most important error in sequencing, with the greatest cost to restructuring and output.

• Finally, some of the lost trade could and should be recreated. A substantial part of the problem is that the switch to the market has been incomplete within the former Soviet Union and between it and its former CMEA partners. After the initial shock of liberalization, there is a serious coordination failure—markets are not yet functioning. The enforced move to barter has created great inefficiency and has brought a dramatic fall in the volume of transactions and, consequently, of output. The most urgent measure is to create the simplest institutional framework for monetary exchange—*a payment or settlements mechanism* with a mutually acceptable means of exchange and facilities for organizing transactions. Grand schemes for payments unions are a distraction; they are not feasible (and perhaps not desirable). But if we believe in the market, the least we can do is to create the institutional framework for it to function. This is the quickest way to raise output in the short run, or at least to stop it from falling yet farther.

Richard Portes is Director of the Centre for Economic Policy Research, London. This comment is based on his conference presentation.

the enterprises. The enforcement of tight financial discipline on enterprises is still lax and erratic. The incidence of bankruptcy and liquidations (outside the former GDR) has been relatively low. Firms have had access to various buffers, including inventories and involuntary interfirm credits. The underdevelopment of financial markets—and their passivity in initiating bankruptcy proceedings to accelerate restructuring—was a major bottleneck in speeding restructuring and recovery. A second bottleneck was the unresolved ownership and control of state enterprises.

• The prospects for a rapid resurgence in production do not seem favorable across the region. In some countries, such as Czechoslovakia and Hungary, it has been estimated that real output per capita might return to prereform levels by 1996; in Bulgaria and Romania it may take until the next decade.

The ubiquity of the collapse in output prompted several questions: Is the sharply falling output an unavoidable phase of the reform process? If so, is loss of output a desirable, although costly development—given the need for radical structural transformation? Should it therefore be regarded as a problem, or is it part of the solution? Can the market mechanisms effectively take root without action being taken to curtail the scope of the public sector's economic activity?

Major Causes of Declines in Output

The conference considered four major causes of the declines in output:

Statistical Overstatement. Estimates presented for Poland in 1990 put the actual declines at between 5 percent (measured from the demand side) and 9 percent (measured from the supply side) compared with official estimates of 12 percent. Official statistics might not adequately capture the growing private sector and can face daunting index number problems. In addition, measurements do not allow for efficiency gains resulting from the elimination of shortages and lines. It was noted that food demand in Poland fell only 2 percent whereas the consumption of many consumer durables actually increased.

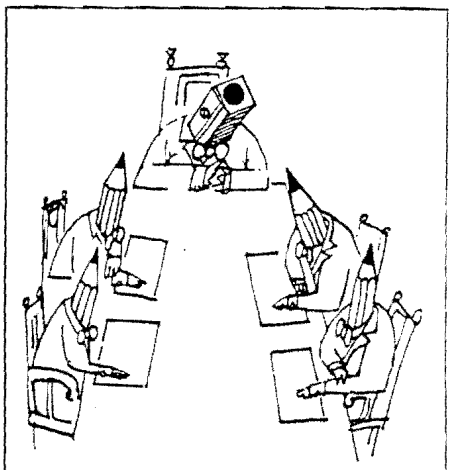
The Trade Shock. CMEA trade has fallen since 1989, mainly because of the disappearance of 85 to 90 percent of trade with the former USSR. In addition, the shift to world prices, especially for Eastern Europe's manufactures, has imposed substantial terms of trade losses, averaging 4 percent of GDP for Czechoslovakia, Hungary, and Poland. How much has this trade shock reduced output in Eastern Europe? Estimates presented at the conference suggested a reduction of about 8 percent of GDP for Czechoslovakia and Hungary and 4 percent for Poland. A reasonable conclusion might be that the trade shock was responsible for at least one-third of the fall in regional output. This is supported by the experience of Finland, where GDP since 1989 has fallen by some 6 percent, due in part to a loss of Soviet trade of 2 percent of GDP.

Macroeconomic Policies. Macroeconomic policies certainly contributed to the decline in output. The open question is whether the "big bang" policies were overly restrictive—whether hyperinflation could have been avoided at a lower cost to output. Some presentations suggested that this might have been the case for Poland, and that the initial degree of macroeconomic imbalance in Czechoslovakia had perhaps been exaggerated in planning the stabilization program. The subsequent recovery in real credit volumes (except in Hungary, which followed a more gradual strategy) did not signal recovery, however. Instead, increased credit reflected the growth of arrears, which resulted in a continued credit squeeze on the more promising firms—the outcome of underdeveloped financial markets and ownership arrangements. Without improvements here, pumping credit into the economies would not be an adequate solution. There is also reason to question the initial jump toward extremely liberalized trade policies—instead, moderate tariffs could have provided revenues and a breathing space for firms.

Enterprise Behavior. Finally, to what extent did the fall in output result from perverse behavior at the microeconomic enterprise level in response to macroeconomic policies? Some aspects of adjustment were encouraging, such as the considerable adjustment of employment in response to falling industrial output and the realignment of trade away from the CMEA toward the West—a shift that did not simply reflect the switching of existing exports. On the other hand, within the industrial sectors signs of structural reallocation were modest, although a shift from industry into (largely private) services was taking place. This is an important area for more research.

In retrospect, are we still so surprised by the collapse in output? Greater external finance could have cushioned the reforms, and in hindsight these could have been fine-tuned to improve performance. Underlying the general structure of the reforms, however, was a strong political imperative—to break rapidly with the old system and join the West. This should not be forgotten when evaluating initial outcomes. Sustaining reforms now involves increasing efficiency, which requires further systemic changes and financing. There are evident lessons here for the ex-Soviet States—which are facing an even sharper cut in import capacity than Eastern Europe—and for countries offering assistance.

Mario I. Blejer and Alan Gelb
The World Bank



From the Bulgarian magazine, Sturshel.

The Russia File: Phasing In the Assistance

Interview with IMF Department Director, John Odling-Smee

There is no off-season at the IMF or, for that matter, at the World Bank. Experts in both institutions have been working on the first assistance packages for the states emerging on the territory of the former Soviet Union. If only for its sheer size and economic potential, Russia is the most important of these recipients. But time seems to be running out in Russia, where production indicators are down, poverty is on the rise, and adversaries of the "western-style" reforms are on the offensive. Can the IMF help turn the tide? We asked John Odling-Smee, Director of the IMF's European II Department, who is dealing with the fifteen states of the former Soviet Union.

Q. How much has been achieved so far?

A. Shortly after the new Russian government's inauguration last November, the Fund started discussions with Russia on a comprehensive economic program the IMF could support with a stand-by arrangement. In February these discussions resulted in a memorandum that summarized a good, although rather general, macroeconomic program. Had it been elaborated in a little more detail, the program could have been recommended to the IMF Board for financial support. However, things began to change in Russia in March and April; at the session of the Congress of Peoples' Deputies the government met strong opposition and, while surviving the challenge, it had to make a number of economic concessions. By late spring the political shift had become more obvious as managers of industrial enterprises and state farms emerged as an important political force. Their interests had to be taken care of, which translated into more directed credits and budgetary concessions and the appointment of some of their representatives to the cabinet. Macroeconomic policies became more expansionary than was envisaged in the earlier memorandum.

After Russia became a member of the IMF on June 1, our discussions continued in the hope that this time they would result in agreement on a program that the Fund could support financially. However, little progress had occurred on another crucial issue, namely, agreement on how to coordinate monetary policies with other members of the ruble zone. IMF staff tried to accelerate the process and in May, at the Tashkent meeting of the central bankers of the fifteen states of the former Soviet Union (FSU), the Fund came forward with its own guidelines, based on a voluntary agreement between those states that were ready to keep the ruble as their national currency. Even though most participants were ready to accept that as a starting point, the Russians remained concerned. They believed that a voluntary agreement would not bring under control the credit expansion by the non-Russian members of the ruble zone. They wanted the Central Bank of Russia to have a more powerful position than the Fund had envisaged in its guidelines.

To sum up, both the Russian government's expansionary monetary and fiscal measures and the slow progress in coordinating monetary policy in the ruble zone delayed agreement on a program that we could support with an upper credit tranche stand-by arrangement.

Q. According to some press reports the stalemate was overcome as a result of the mid-June Washington meeting between IMF Managing Director Michel Camdessus and Yegor Gaidar, who had just been appointed acting Prime Minister. As a result, $4 billion of IMF support had been agreed on, and another $6 billion would be made available as a stabilization fund for the ruble, conditional on progress in the Russian economic reforms. Are these reports accurate?

A. Not quite. At the Washington meeting the Managing Director and the Russian Prime Minister indeed decided that the ruble area difficulties should not hold up an accord between the Fund and the Russian government. To handle this peculiar situation they agreed on a three-phase approach. In the *first phase*, a first credit tranche arrangement had been signed. [Editor's note: The first tranche equals 25 percent of a member's quota in the IMF. For Russia, whose quota is approximately $4 billion, this is about $1 billion.] According to the Russian economic program, which we subsequently agreed with the government, by the end of the year the monthly inflation rate should be brought down to single digits, and the budget deficit (net of that part to be financed by foreign assistance) should be cut to 5 percent of the Russian GDP. This would be a great achievement, as before the present measures we expected a budget deficit corresponding to 17 percent of the GDP in the second half of 1992. The Executive Board of the IMF agreed to the first credit tranche arrangements on August 5, 1992. (See box on page 5.)

As to the *second phase*, the objective would be to reach an agreement on a program that could be supported by an upper credit tranche arrangement

later in the autumn. We assume that the Russian government would further tighten monetary and fiscal policies, cutting the annual inflation rate to low single digits by next year. It is also assumed that Russia would by then have come to some agreement with the countries of the ruble zone about the coordination of monetary policy. In the meantime a reasonably controlled monetary expansion and a tight budget policy in Russia would offset any tendency for other countries using the ruble to apply insufficient monetary and fiscal discipline. We should not forget that Russia represents more than 60 percent of the economic potential of the ruble area.

Q. This second phase is said to involve a stand-by credit of at least $3 billion —the figure is based on the remaining 75 percent of the $4 billion Russian quota in the Fund. Is this assumption correct?

A. One cannot at this stage specify the exact amount of the upper credit tranche arrangement. It depends on the strength of the program that might result from the impending negotiations, and of course the proposal would have to be approved by the IMF's Board. In the *third phase* Russia would be able to use a $6 billion fund to help stabilize the ruble. The stabilization fund would be set up by the IMF with the help of financing under the General Arrangements to Borrow, which is provided by the G-10 plus Switzerland and Saudi Arabia. Setting up a stabilization fund, however, is only appropriate when the ruble's exchange rate is fixed. And it can only be fixed in a reasonably stable macroeconomic environment, in which the exchange rate itself—after a period of floating—has stabilized at a sustainable level.

Q. Recent economic surveys indicate that a large part of Russian industry is heading toward bankruptcy. The Russian Minister for Economy predicts an 18 percent decline of GDP this year. There are already signs that monetary and fiscal restrictions are causing pervasive poverty. In the first six months of this year the cost of living increased ten times, while the average monthly income in June reached only 4,100 rubles (less than $30 at end-July exchange rate). Don't you think that overly drastic actions could throw the country's economy into a deep recession?

A. The monetary and fiscal measures we are talking about are to ensure the macroeconomic stabilization of Russia, which is a key to further progress in the economy. Only if enterprises feel the heat from being overmanned or in a redundant line of business will they be willing to make adjustments. We in the Fund think that the government should not excessively subsidize enterprises or provide them with cheap or easy credit. The sooner enterprises realize that they should adjust instead of relying on subsidies, the quicker the transition will take place, and the faster the economy will move to a sustainable industrial structure. This adjustment from the old inadequate manufacturing enterprises to the new industrial structures is not without costs, however, not even in Western economies. Unemployment must come at some stage; it will be the result of the need to close or scale back the old plants before new employment opportunities have had a chance to develop, rather than the result of macroeconomic stabilization per se.

The most important thing is to ensure that the government has an adequate

The IMF says ...

"The International Monetary Fund has approved a request by the Russian Federation for a stand-by arrangement in the first credit tranche, authorizing a drawing of up to the equivalent of about $1.04 billion. This is the first use of IMF credit by the Russian Federation, which became a member of the IMF on June 1, 1992, with a quota of about US$4.15 billion.

The stand-by arrangement approved today, which has a duration of five months, and the policy program that it supports, constitute the first stage of a phased process of collaboration with the IMF. Successful implementation of this policy program, together with further measures aimed at stabilization and acceleration of the reform process, as well as agreement on monetary coordination with other states of the former U.S.S.R. that decide to remain in the ruble area, could lay the basis for a second stage of financial support from the IMF, including a possible upper tranche stand-by arrangement. When conditions are appropriate, a third stage, involving the pegging of the exchange rate and activations of a stabilization fund, could follow....

Macroeconomic policies are designed to reduce the budget deficit in the second half of 1992 by approximately 1.5 percentage points of gross domestic product (GDP) from the deficit that would have prevailed if no new measures had been taken. At the same time, the growth of central bank credit to the banking system will be limited, and a flexible interest rate policy, responsive to developments in prices, the exchange rate, and the level of official reserves, will be followed.

During the second half of this year, the government intends to accelerate structural change in the areas of enterprise reform, privatization, anti-monopoly and pro-competition policy, financial sector reform, and in the agricultural sector. Work in all these areas has been proceeding in close cooperation with the World Bank, and in addition, the government in June approved a medium-term program for transformation of the economy that sets out reform strategies in these areas.

The Russia authorities are committed to protecting the most vulnerable groups of the population during the economic transformation process, while ensuring that social safety net expenditures are consistent with macroeconomic stabilization."

IMF press release from August 5, 1992. *See page 16 for more information on the World Bank loan to Russia.*

social safety net in place. We have to remember that the old Soviet system always had a fairly generous system of transfer payments to pensioners, working mothers, sick leavers, and the like. The unemployment compensation scheme that the Russian government introduced last year was also generous. [Editor's note: If a worker becomes unemployed, he is entitled to three months' severance pay from his enterprise, after which he becomes eligible for unemployment benefits from the state.] Both the government and the Fund are concerned that if unemployment were to rise to a high level, the budget might not be able to bear the costs. A few months ago the government presented to the parliament a new scheme that would be less generous, but still adequate. Unfortunately, the parliament was not able to pass that [proposal], and the existing scheme will not be modified until parliament returns after the summer recess.

Q. Did the IMF reckon with the possible political and social repercussions of preparing the policy guidelines for the Russian reform program?

A. So far the opposition to the government's economic policy has come mainly from the enterprise managers, and not the general population. Of course that could change eventually. It was predictable, especially in view of Eastern European experience, that managers would resist the economic changes that are involved in moving to a market economy. I do not think, however, that there is a magic solution to avoiding the pain of transition. Of course, the costs of adjustment should be minimized as much as possible. A key way to minimize them is to move quickly in reforming enterprises and enforcing the hard budget constraint.

Q. Still, the question remains: Isn't there a risk that such drastic changes in the economic system will trigger reactions that the economists are not really prepared for? Are there any studies or other research that assess the human factor in the transition process, the costs of liquidating traditional institutions, and the adjustment of deeply ingrained behavior patterns? Is the IMF dealing with this issue?

A. Such studies could, of course, point to the enormous social and personal tensions that will occur during the transition to a market economy. The Russian government will be taking these into account in navigating its route, and the Fund will be supporting it with our expertise. We are as concerned as the Russian government to find the route that will minimize the tensions. This does not mean that we, or anyone else, will be able to devise perfect solutions. There are bound to be difficult periods along the way, and adjustments to our course will be required from time to time. The important thing will be to keep moving forward on all the main economic elements of the transition that everyone agrees must take place, especially macroeconomic stabilization, privatization, development of the legal framework, and reform of enterprises.

Social Systems in the New Central Asian States: Replace with Care!

Three new states of the former Soviet Union—Tajikistan, Turkmenistan, and Uzbekistan—are operating broad and complex systems of social security as a legacy of the past. These systems generally have the following characteristics:

- The state is responsible for providing jobs for citizens, and once a job is obtained there is little possibility of losing it.

- State enterprises provide a wide range of fringe benefits. Firms have their own kindergartens (one or more), subsidized restaurants, prophylactic sanatoriums (or even hospitals), summer and winter vacation homes, and children's camps. Firms also provide low-cost apartments. Employees are entitled to use these benefits free of charge or at a very low cost. The capital and operating costs of these facilities are paid out of the firms' profits.

- A large variety of subsidies keep consumer prices down. For example, in Turkmenistan in 1991 the government spent 839.3 million rubles—13.9 percent of Turkmenistan's 1991 budget expenditures—on subsidies for food, housing, transportation, clothing, and the like. Meat, milk, dairy products, bread, and flour account for almost 92 percent of the subsidies.

- Large social transfers—both in kind and in cash—cover the entire population. Transfers in kind include access to health care services, education (at all levels and all types; this includes school transportation and dorms for students), social welfare institutions (homes for the old and for the handicapped, orphanages, holiday resorts) free of charge or at very low prices. Transfers in cash include pensions, sick leave, maternity leave, allowances to newborns, children, and students, and social relief to poor families and to families with five or more children.

Patterns of Financing

Health care, education, and social welfare institutions are financed through the government. Wage earners pay 37 percent of their salaries to social security. The money collected through this contribution is divided between the pension fund (about 83 percent) and the trade unions (about 17 percent). The pension fund pays the pensions, as well as child allowances for children up to six years of age. The trade union's fund covers sick leave, maternity leave, newborn allowances, funeral allowances, and the current and capital costs of health and holiday resorts. In all three republics both pension funds and trade union funds recorded deficits last year, but losses were reimbursed from the republics' budgets.

In Uzbekistan about 17 billion rubles were transferred to the population last year (both in kind and in cash): 7 billion rubles for pension, sick leave, maternity leave, and child allowances, and 10.2 billion rubles for health, education, and social relief. The latter alone represented about 30 percent of the country's total budget outlay in 1991.

In Tajikistan 1.62 billion rubles (40 percent of total budget expenditure) were spent on health, education, and social relief including transfers to the pension fund to cover its deficit, and 1.24 billion rubles went to cover pensions, child allowances, and transfers through the trade unions. These expenditures totaled about 3 billion rubles, or 75 percent of Tajikistan's total budget in 1991.

Turkmenistan spent 3.3 billion rubles on health, education, and social relief in 1991. This included money transferred to pension funds and trade union funds (to cover their deficits), which equaled approximately 56 percent of total budget expenditure. About 70 percent of Turkmenistan's budget was transferred to the public, including 800 million rubles in subsidies on food, housing, transportation, clothing and footwear. Pension fund revenues reached 1.5 billion rubles (1.2 billion rubles for pensions and child allowances and about 300 million rubles for benefits paid through trade unions). Total social transfers to the public amounted to about 5.6 billion rubles.

Social benefits in the three countries are generous in terms of both their variety and the number of beneficiaries. For example, in 1989 the share of Turkmens of pensionable age (for women, from age 55; for men, from age 60) in the total population was about 7.6 percent, but the share of pensioners was 10.8 percent because of early retirements. This means that the average age of Turkmen pensioners is relatively low. In Uzbekistan 8.5 percent of the population are of pensionable age and 11.6 percent are pensioners.

The eligibility requirements for social benefits are low. Each citizen is entitled to receive at least a few of the benefits. There are almost no means-tested benefits, and as a consequence the system does not include any targeting.

The benefits are spread over the population. In other words, they are basically considered a "social right" for each member of the society. There are no elements of the "insurance principle."

Warnings and Proposals

For decades Uzbekistan, Tajikistan, and Turkmenistan—as part of the USSR—took almost complete care of their citizens. The state provided child allowances, free education, free health services, jobs, free vacations, and subsidized food and housing. Citizens developed the habit of relying on the state. Social transfers (both in kind and in cash) were an important source of family income. Data from the Statistical Yearbooks for Uzbekistan and Turkmenistan for 1990 show that social transfers in kind and in cash made up between 40 percent and 45 percent of the average per capita family income (not including food and other subsidies). Therefore, a reform of the social system is extremely sensitive politically. Denying certain population groups some social benefits while reforming the social safety net might be considered by these groups an abuse of their human rights.

The three states, like all countries in the former Soviet Union, face serious economic difficulties. Continuing the social transfer systems in their current form exceeds the economic power of these countries.

Measures should be taken to make the social transfer systems more affordable, more efficient, and more effective. These measures should include targeting to direct social transfers toward the most vulnerable groups to prevent absolute poverty; significantly reducing the number of benefits; using more rigorous eligibility criteria, such as higher retirement ages; reducing allocations for social expenditures; introducing user charges; and privatizing some services.

Because wages are low, income range is flat, and individuals are dependent on transfers in kind, it is clear that radical reform is conditioned on an increase in the real value of wages. Only with a wage increase will individuals and their families be able to afford health care, education, and housing, services for which cost recovery and user charges would be appropriate.

In the new Central Asian states, letting inflation take its toll and allowing a real decline in benefits through price increases cannot substitute for real social policy reform. Such a hands-off approach could cause a further decline in the already poor quality of services in education, health, and social welfare institutions.

Aleksandra Posarac
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Research Update
The Labor Market in Transitional Socialist Economies

Policymakers in the transitional socialist economies need a better understanding of the nature and dynamics of two new phenomena: the rapid growth of unemployment and the fall in real wages. A new research project of the World Bank, *"The Labor Market in Transitional Socialist Economies,"* will monitor the results of key policy changes in the labor market in Bulgaria, the Czech and Slovak Federal Republic, Hungary, and Poland. The four countries provide a range of stages and rates of labor market transition and of economic reform in general. This will facilitate a comparative analysis that distinguishes between common and country-specific features of the transition. The project will also allow a more precise understanding of the growing unemployment, the relationship between wage and employment behavior, the extent of wage flexibility, the implications of wage behavior in both private and public sectors for overall employment, and the consequences of incomes regulation under different country experiences.

The transition inevitably implies rising unemployment and significant changes in wage- and employment-setting procedures. To understand these changes better, the research project raises the following issues:

- Consequences of recent stabilization programs for employment.
- Characteristics of unemployment; policies to be adopted to reduce the level and persistence of unemployment.
- Main features characterizing wage and employment setting in both socialized and emerging private sectors.
- Consequences of differing wage and employment behavior in the socialized sector and the emerging private sector for aggregate wages and employment.
- Effect of incomes policies—with regard to wage setting—on restraining inflation; the magnitude of the associated efficiency costs.

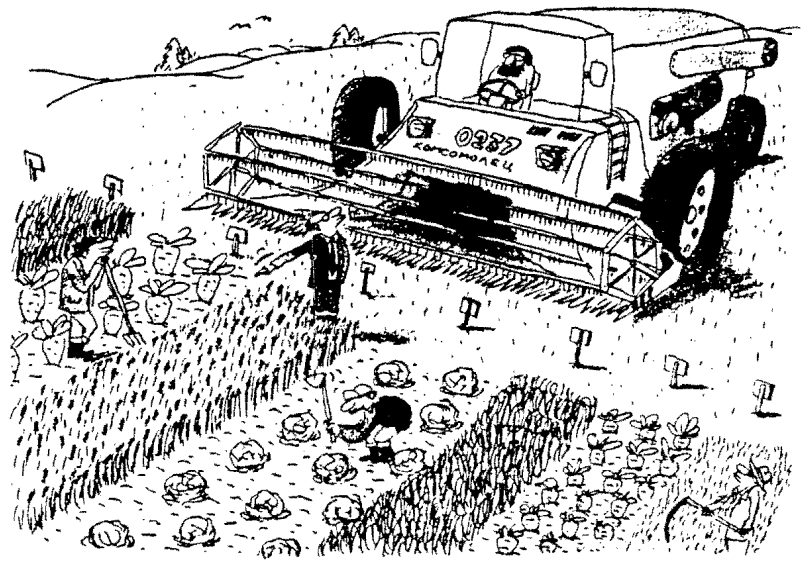
The research will have two associated components. The first, a largely empirical component, will involve detailed country studies. These will provide an explicit macroeconomic framework in which labor market variables will be central. Monthly and quarterly time series covering prices, wages, employment, and unemployment will be generated. In addition to aggregate macroeconomic data, the country studies will rely, where feasible, on establishment and survey data, particularly with respect to changes in employment and factors determining employment transitions.

The second component will comprise comparative and analytical work. The comparative work will extract broad trends and policy lessons from the country studies. Although the project will not pool data in econometric work, it will draw on country-level estimations, particularly for price-wage dynamics, in developing its comparative analysis. The analytical work will be centered on wage bargaining, employment setting, unemployment dynamics, and the design of incomes policies.

The project began in April 1992 and will run until April 1994. Intermediate output from the project includes papers on unemployment and incomes policies. At the end of the first year four country studies will be available, to be followed at the conclusion of the project by comparative and analytical papers. The output will be made available first in working papers and at the conclusion of the project in book form. Researchers plan to hold a mid-project conference to report on country study findings and a final conference for policymakers and officials, to outline the major results from the overall research program.

The research project is managed by Simon Commander and Fabrizio Coricelli at the World Bank. The two project managers collaborate with Olivier Blanchard (MIT), Richard Jackman (LSE), and Jan Svejnar (University of Pittsburgh and CERGE, Prague). For additional information contact Simon Commander (202) 473-6293 or Fabrizio Coricelli (202) 473-9159.

Post-socialist agriculture '92



From the Slovak magazine, Rohac

Hungarian Minister Tamas Szabo Explains Reorganization of State Property

"Self-privatization proved very successful"

Hungary, although avoiding spectacular mass-privatization techniques, is going ahead with privatization of the still dominant state property, relying mainly on the initiatives of enterprise management. To accelerate the process new laws have been approved by the parliament, creating a new superstructure, the State Assets Holding Ltd., which will operate enterprises remaining permanently in state ownership. During a recent visit to Budapest Richard Hirschler, editor of *Transition*, asked Tamas Szabo, minister without portfolio responsible for privatization, to explain the reasons for the latest measures.

Q. How could you summarize the Hungarian privatization process?

A. Ownership reform and ownership creation took three different courses in Hungary. First, we have created ownership by law. The parliament approved legislation that authorizes local governments to own property, transfers cooperative ownership to individuals, and compensates former owners for expropriated property.

Second, the initially small private sector is expanding vigorously and already accounts for 25 percent of the gross domestic product. In recent years the number of entrepreneurs starting their own businesses exploded. Foreign investments are also increasing by leaps and bounds, creating advanced industrial cultures (for example, in the automotive industry).

Third, privatization of state enterprises is surging ahead. Early this year about half of the 1,900 state enterprises selected for privatization (representing about 35-40 percent of total state assets) were already involved somehow in the privatization process—at least they were transformed to joint-stock companies. Private owners have taken over about 10 percent of the state assets slated for privatization.

Q. What is the significance of the latest package of privatization laws that came into force in late August?

A. We realized that we have to work out different approaches to organizing and operating public assets, depending on whether we want to hold on to them permanently or to sell them either partly or completely. In the latter case an acceleration of the privatization process seemed appropriate. Accordingly we had to work out a legal framework both for efficient management of the remaining state assets and for speeding up the privatization. In my interpretation these second-generation privatization laws have several messages. One message is that the operational structure of the public enterprises should correspond to the market's requirements. The owner—that is, the government—and the management must be separated, meaning that the enterprise should turn into a joint-stock company.

The public speaks of "forced transformation" of these enterprises, but there is no coercion involved. Rather there is an acceleration of a process that started in 1988. Of course during transformation restructuring is also desirable—downsizing companies, and decentralizing huge conglomerates by separating self-supporting production or service units. In general, we want to increase the number of actors and possible competitors in the market.

Q. What companies does the government want to keep in the public sector, and what would be the productive share of the private sector in gross domestic product by the end of the transition process?

A. That is exactly the other message of these privatization laws: the government is ready to determine which enterprises it wants to keep in the public domain and which are slated for privatization. During the preparatory work it became evident that the assets to be retained as state property is not an outrageous figure at all. I was afraid of intense pressure from the ministries to retain properties under their supervision, but was pleasantly disappointed.

The state wants to retain 100 percent of only a few strategically important enterprises. I can count them on one hand, such as the railways and the postal service. In other cases the state wants to sell out part of the stocks, and keep a majority or, for that matter, only a minority stake in the company (for example, keep a majority stake in the Hungarian Airlines, the Electric Power works, and some state farms, and a minority stake in the oil industry, a few large petrochemical

companies, and some pharmaceutical enterprises). Also, the banks and the telecommunications services will remain, in part, state property. For banks the state's share will decrease to 25 percent by the end of the 1990s.

Compared with the estimated value of all assets in Hungary, the value of the state property will not reach even 33 percent, and considering subsequent privatization of other state assets in the long term, the share of state property in Hungary will drop to less than 20 percent. This ratio, I presume, corresponds to the average share of state sectors in the market economies. To cut the state sector so drastically in such a short time is an extremely ambitious goal; however, we believe that the present 70-75 percent share of the state sector can be reduced to less than 50 percent by the end of 1993 or early 1994. Our privatization program is supported by the European Community and the World Bank.

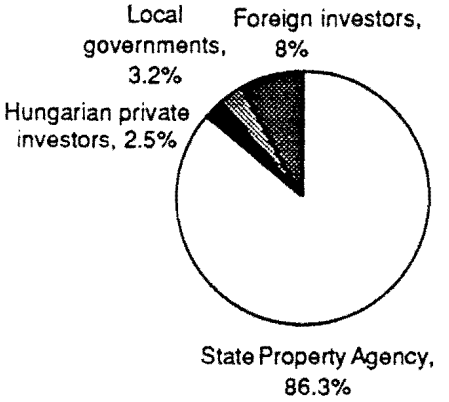
Q. What new privatization techniques are being used to accelerate the process?

A. It turned out that the centrally managed privatization programs bring only modest results. The "preprivatization" plan aimed to rapidly lease out small shops and restaurants, but initially could not attract enough applicants. Nor were original expectations met in the so-called first and second privatization programs—the planned sale of selected large enterprises with the help of competing domestic and foreign consulting companies.

On the other hand, self-privatization (previously called spontaneous privatization), in which state companies initiate their own transformation and look for new owners, proved very successful. Although moral objections have been raised at this method based on the concern that such uncontrolled processes invite fraud and encourage individuals [former managers] to salvage their power [for the new political and economic order], the risk must be taken because there isn't a more rational way. The government recognizes this and has decided to extend the decentralized privatization program launched last fall, which entrusts enterprise management and domestic and foreign consulting companies with initiating and carrying out privatization. We have already started the second program of this kind, with the participation of about 300 small or medium-size enterprises.

Nothing induces or forces the state enterprise to compete

Owners of state assets transformed to joint-stock companies
(between 1990 and March 31, 1992)
Total assets = 424.47 billion forints



Source: State Property Agency.

Q. Coming back to the new privatization laws, what are the major new elements?

A. The law for managing the temporarily state-owned property actually is the law regulating the State Privatization Agency and the privatization process. For assets to be retained temporarily by the state, enterprises must start their own transformation to joint-stock companies by the end of 1992 or the State Property Agency will intervene and complete the process by June 30, 1993. At the same time, bearing in mind that domestic investors lack enough accumulated savings to buy state property on a cash basis, the law indicates a number of privatization methods that can help future entrepreneurs acquire property without cash. By transferring ownership, investors might use optional lease. Employees might be able to buy out their enterprise under a long-term credit scheme called the Employee Share Ownership Program (approved by the parliament). We still have to work out the proper regulation of management buyouts.

Q. And what should happen to those assets labeled permanent state property?

A. We have been looking for a market solution, relying on the suggestions of the World Bank and the European Community. Under the law on management of permanently state-owned property, we are setting up the State Assets Holding Ltd, to oversee and manage the remaining assets. It will be structured as a joint-stock company and will administer the transformation of state enterprises into joint-stock companies. It is even possible that competition will develop between the State Privatization Agency (SPA) and the State Assets Holding Ltd, as there will be no strict line dividing the SPA with its charge of privatizing some state property and the Holding with the charge of operating other enterprises over the long term. The SPA will supervise the state property in its charge until it is sold out, while the Holding, after reviewing enterprises under its control, might decide to restructure or even sell some of them.

Q. Will it be possible to create a competitive environment in the state sector?

A. When the share of the public sector is as high as 75 percent, which is the case now in Hungary, nothing induces or forces the state enterprise to compete. Even the competition from foreign goods and services under the new liberalized import regime is inadequate to do that. Whether we want it

or not, the state must play a major role in restructuring the economy and creating a favorable environment for market competition, otherwise inertia combined with the survival instinct of the state enterprises could stymie reform.

Q. Do you suggest then that restructuring of the state enterprises should precede privatization?

A. Not long ago privatization went along the easy way; we tried to sell enterprises as they were, without upgrading them. We have changed our approach. As I mentioned earlier, even during the transformation process, when enterprises are becoming joint-stock companies, production units can be separated from overdiversified enterprises and can become privately owned new businesses. The tough bankruptcy law will also generate a dynamic restructuring because loss-making enterprises, as they are liquidated, will be forced to give up part of their assets to new owners, perhaps through the commercial banks. Also, the pre-privatization restructuring could be supported by a credit-consolidation fund, which could take care of the bad loans of the banks and restructure the loss-making enterprises under market pressure. Both this kind of restructuring and the privatization process could be accelerated by several new institutions proposed by the government, such as a new credit-guarantee system, a specialized bank that provides loans for land purchases, and a bank that provides mortgage loans. These new institutions could be financed at least partially from privatization earnings.

Q. How much earnings do you expect this year from selling state enterprises to foreign and Hungarian investors?

A. We expect about 57 billion forints (about $750 million) this year, of which some 25 billion forints will help finance budget expenditures. After taking care of other responsibilities, 16 billion will remain to develop the financial institutions. Two billion forints will be used to launch the State Assets Holding Ltd.

The Czech-Slovak privatization program: What comes after the first wave?

Czechoslovak Deputy Finance Minister Vladimir Rudlavcak said on August 19 that 75 percent of the vouchers purchased earlier this year by 8.5 million Czechs and Slovaks interested in participating in the process of privatization have been traded for company shares. Rudlovcak said that after the first two rounds of this initial privatization wave, of 1,500 companies, 1,369 still have some shares to sell in the third round (which began on August 26 and ends on October 8). All together, 56 percent of all shares offered have now been allocated.

Between May 18 and June 8, Czechoslovak voucher holders sent in their bids for shares in 1,500 state-owned firms whose 299 billion crowns in assets were put up for sale. (See *Transition*, May 1992, page 3.) Of the 8.6 million vouchers purchased earlier in the year, 72 percent had been lodged with the privatization investment funds, leaving 2.9 million individual voucher holders bidding in the first round. Two million bid for Czech firms and 890,000 for Slovak firms.

On June 30, the overall results of the first round of bidding were announced. At that time 29.9 percent of the shares on offer were actually allocated, for a value of 90 billion crowns in nominal shares. The 420 privatization investment funds participating in the round were allocated shares worth 70 billion crowns, and individuals acquired shares worth 20 billion crowns.

Some 1,022 firms were undersubscribed, that is, bids came to less than 75 percent of the nominal value of the assets. Bidders were given shares in these firms equal to the nominal value of their bids, but the remaining shares were withdrawn and offered in a second round, at a lower price.

In only forty-eight firms did the level of bids fall within the range defined by the government as acceptable for complete sale, namely, 25 percent above or below the asset value. These were mostly small firms.

Some 469 firms were oversubscribed, usually receiving three to five times as many bids as there were shares available. Most voucher holders (and presumably the privatization investment funds too) appeared to place their shares in companies listed among the one hundred top companies based on profits per employee in 1991. Apart from current profits, voucher holders were also attracted by firms with foreign participation. The most popular firms were almost exclusively banks, hotels, breweries, ceramics works, and foreign trading companies.

About 800 firms that were supposed to be included in the first round, but were not processed in time, were added to the second round, which began on July 8 and ended on August 18.

The third round of auctioning (still in the first wave) started on August 26. It will proceed without a change in the rules, said Lubomir Dolgos, the Slovak privatization minister. Dolgos met with his Czech counterpart, Jiri Skalicky, and they decided that the two republics should proceed separately with the second wave of voucher privatization. Thus far Czech funds have invested 95 percent of their shares in Czech companies, while Slovak funds have invested a full 47 percent in Czech companies, and individual Slovak shareholders 19 percent in Czech companies. In absolute figures, Czechs, who outnumber Slovaks by two to one, now hold 2.6 million shares in Slovak companies, while Slovaks have invested 7.5 million shares in Czech industries.

"National constitutions which are to be passed by the Czech and Slovak parliament must clearly define citizenship to decide who can acquire property in which republic," Skalicky said, but added: "The settlement must not infringe on property rights of the individual shareholders.

Based on reports from Oxford Analytica and news agencies.

Quotation of the Month:

"Levels of disbursements are disappointingly low"

A New York Think Tank Wants to Upgrade International Assistance

Edited excerpts from the "1992 Report of the IEWS Task Force on Western Assistance to Transition in the CSFR, Hungary, and Poland: Moving Beyond Assistance," commissioned by the Institute for East-West Studies, European Studies Center, New York / Prague / Stirin / Warsaw.

In the framework of the G-24 assistance program involving the twelve European Community (EC) member states, the six European Free Trade Association (EFTA) countries, the United States, Canada, Japan, Australia, New Zealand, and Turkey, some $23.4 billion has been pledged to the CSFR, Hungary, and Poland, from end-1989 to end-1991. Including commitments to these three countries by the IMF and the World bank Group, assistance totals $33.8 billion over the same period. Global commitments to the post-communist countries of Europe (Albania, Bulgaria, the CSFR, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, and Yugoslavia) to end-1991 amounted to some $52.5 billion including food and medical aid, economic restructuring and technical assistance, export credit and investment guarantees, debt relief, and balance of payments support. To this amount, the G-24 contributed $38.2 billion, and the international finance institutions another $14.3 billion (at an exchange rate of Ecu 1=$1.26, May 1992).

The media and the public tend to focus on commitment figures, yet it is levels of disbursement that are disappointingly low and give cause for concern. Disbursements of total assistance to Poland by end-1990, for instance, were approximately 27 percent, to Hungary 16 percent, and to the CSFR less than 2 percent. In part the low level of disbursement is attributable to the reluctance of recipient governments to take up assistance resources—which often place financial burdens upon them—before they are sure they can use the resources efficiently and to good purpose. According to calculations made by the G-24, as of April 1992—excluding the debt reorganization for Poland—the grant component of assistance commitments to the CSFR, Hungary, and Poland stood at $2.11 billion, an average of 8.5 percent.

During the first phase of transition, [characterized by financial assistance for supporting stabilization], the Coordination Unit of the G-24 countries played an important part in coordinating assistance efforts. The second phase of transition—structural transformation—will take longer than the stabilization phase and is likely to last from ten to fifteen years or until the three countries achieve full membership in the EC. This phase requires a new assistance strategy [based on] full partnership, coordination, and an operational vehicle to ensure effective implementation.

Donor Partner Governments Should:

- Decide, in keeping with a mandate established by the G-7, to transform the existing Western assistance coordination system by means of a new operational vehicle, the Assistance Coordination Council (ACC), to be chaired by the Commission of the EC. It should have five committees, each bearing responsibility for a major sector of assistance: macroeconomic assistance (under the leadership of the IMF); structural transformation and adjustment (World Bank); microeconomic policies and privatization (European Commission); technical assistance (European Bank for Reconstruction and Development [EBRD]); and noneconomic assistance (Council of Europe). The five committees would draft statements of intent and policy recommendations for consideration and possible adoption by the ACC itself, and negotiate—among themselves—an overall strategy for Western assistance to the Central European states. The ACC would be staffed and supported by a slightly enlarged G-24 Coordination Unit, inside the EC Commission. Representatives of the three Central European governments would be included as full partners.

- Begin to provide full and up-to-date data on assistance figures. At present, neither the Organization for Economic Co-operation and Development (OECD) nor the G-24 Coordination Unit is given such information. Data must be broken down into categories and must be compatible. Commitment figures must be distinguished from disbursement figures. Governments should refrain from making commitments that cannot be met and from publishing impressive but misleading assistance figures. These practices have caused disillusionment and damaged relationships with recipient governments and their publics.

- Conclude agreements to ban the use of tied assistance to Central Europe, particularly in the form of export credits (along the lines of the recent OECD agreement on Third World countries).

- Provide a higher proportion of assistance in grants as opposed to loans; establish funds on the model of the EC Regional Development Funds, with the aim of co-financing private investment in selected regions.

- Open their markets progressively to Central Europe. EC members and institutions should not use the antidumping provisions of the treaties to unduly restrict access of sensitive exports from Central Europe. Liberalized market access will increase the attractiveness of Central Europe to private investors.

• Provide incentives for private investment in Central Europe, particularly tax incentives and increased governmental investment guarantees for viable Western investment.

Recipient Partner Governments Should:

• Coordinate national policies to match the forms and amounts of Western assistance provided.

• Create a mechanism to establish domestic priorities for assistance and to attend to national, regional, sectoral, and local needs on an equitable basis.

• Create a favorable environment and management mechanism for effective absorption and use of Western assistance.

• Delegate some of their control over the distribution of assistance to regional and local authorities. Decentralization, despite its short-term costs, is necessary to develop capacity from the ground up.

• Share experience, expertise, information, and training among themselves in order to concert their policies toward donors and encourage subregional and cross-border cooperation.

International Organizations Should:

• Ensure that complementary forms of Western assistance—for instance, currency convertibility support, market access, debt relief—are used to match the needs of the three recipients.

• Acknowledge that assistance for transition differs from development aid; be more flexible in conditionality in view of proven commitments to reform and growing budgetary deficits during a world recession.

• Encourage and support regional policy cooperation initiatives. The European Community is urged to extend appropriate regional policy programs to the three countries now, in anticipation of their full membership in the Community. In particular, environment and infrastructure problems demand a subregional coordinated approach.

• Co-finance investment in infrastructure in Central Europe. This will reduce major impediments to the absorption of assistance; provide better overall infrastructure on a pan-European basis, benefiting donors as well as recipients; create jobs, thus reducing unemployment in the region; and attract additional capital from public and private sources—the World Bank estimates that for every $1 it lends, a further $2-$3 are raised, either through co-financing or from the recipient government.

• Help mobilize internal savings and attract foreign investment through schemes on the model of the Enhanced Co-financing Operation (ECO), which encourages the involvement of commercial banks in assistance projects. The World Bank's use of ECO provides a good example.

• And finally, the European Community should start to consider how increasing market access to the Community for products from Central Europe might complement EC policies aimed at transforming declining industries into competitive ones inside the EC. The readaptation methods used by the High Authority of the European Coal and Steel Community in dealing with the coal crisis of the 1950s, and the more recent experience of the Community programs helping restructure the steel industry in the 1980s and 1990s, are models that could be built on and expanded in the future.

Information: IEWS, New York, Ms. Michelle Boyd, Distribution Dept., tel: (212) 557-2570.

Milestones of Transition

Romania doubled the price of staple foods such as bread, sugar, and cooking oil on September 1 by slashing subsidies. Electricity was also hit—its price will rise by 62 percent. The cuts will add to year-on-year inflation that reached 228 percent in June, when the last price data were released. Cash handouts and wage rises were agreed between the government and major unions to sweeten the economic medicine. According to the Romanian Statistical Board, industrial production in July dropped by 13.7 percent as against June, and was 32.9 percent lower than in July 1991. Labor productivity was 11.1 percent lower in July as against June. The number of unemployed as of August 17 was 750,000 (6.7 percent of the labor force). Although in July the trade balance registered a surplus of US$22.2 million, the overall deficit for the first seven months of the year amounts to US$641 million.

Hungary's recession is proving far deeper and more prolonged than expected, according to a new official forecast. The National Bank of Hungary is braced for a drop of 5 percent in gross domestic product this year, a drastic revision of its original forecast of zero growth. Unemployment, currently just less than 11 percent, is set to rise to up to 20 percent next year, a government report to parliament warns.

China can sustain double-digit economic growth even though faster reform is bound to bring some chaos, Wang Shiyuan, secretary general of the State Commission for Restructuring the Economy, said. The official People's Daily reported that GNP in the first six months of 1992 increased by 10 percent over the same period

last year, with industrial production, consumer spending, overseas trade, and domestic investment all on the rise. China's foreign trade overall surged 20.2 percent, powered by the country's five special economic zones, which accounted for 15 percent of the total. But the trade surplus shrank by more than $1 billion in the first half of the year, as imports rose 23.4 percent to $33.06 billion, while exports increased by 17.3 percent to $35.61 billion. The resulting $2.55 billion surplus was 29.7 percent less than last year's $3.63 billion.

Ukraine National Bank Chairman Vadim Hetman said his country plans to leave the ruble zone by October 1 and is seeking a $1.52 billion stabilization fund to support the grivna. Hetman said Ukraine had not yet decided whether to peg the grivna to a specific currency, although the Ecu and a basket of Western currencies were being considered.

The highest paid people in **Russia** today are said to be presidents of stock or commodity exchanges (earning up to 80,000 rubles a month), followed by private businessmen (up to 55,000 rubles) and street traders (up to 15,000 rubles), according to the Moscow daily, Pravda, which published data on wage levels on June 30. By contrast, an army general earns a maximum of 10,000 rubles and the director of a state enterprise, 6,500 rubles. A construction worker can earn up to 3,500 rubles. The lowest pay goes to kindergarten teachers (maximum 1,500 rubles) and manual workers (1,300 rubles).

The population of **Russia** will reach 148.5 million at the beginning of 1993, up only 0.1 million from 1992, according to a forecast by the Russian State Committee for Statistics. The population growth will result from immigration exceeding emigration. The birth rate continues to fall; preliminary calculations show 1.7 million births in 1992, compared with 1.8 million in 1991 and 2.2 million in 1989. For the first time since the 1950s, the number of births will equal the number of deaths, resulting in zero real population growth. The number of deaths in 1992 is expected to increase by 15 percent to reach 1.7 million.

Russian Economics Minister Andrei Nechaev has given a projection of Russian economic performance in 1992. The gross domestic product is expected to decline by 18 percent and the national income by 19 percent. Nechaev noted that the cost of living rose by a factor of ten in the first half of 1992 and that the average family monthly income was 4,100 rubles in June. The minister forecast that the general wholesale price index will rise by three times over its first quarter level, while consumer prices will double.

Mongolia's industrial output fell by 23.7 percent during the first six months of this year against the same period in 1991, largely because of disruptions in electricity production and shortages of raw materials, according to official figures. Inflation, spurred by shortages of locally produced consumer goods, continued to spiral upward, with the consumer price index indicating that prices leapt by 122 percent from January to June.

Prices in the first six months of 1992 rose by 40.7 percent in **Bulgaria**, and inflation reached 5.76 percent in June, announced the National Statistical Institute. The NSI expected about 5 percent inflation in July.

Angola's effort to rebuild its economy after fifteen years of Marxist rule will take at least ten years and will require increased foreign investment, according to Helder Azevedo, head of the foreign investment department of Angola's Planning Ministry. The country needs to build or rebuild roads, telecommunications networks, and power plants. Azevedo said that the country is negotiating with the World Bank to receive aid for some of its development projects.

The research institute of **Japan**'s Ministry of International Trade and Industry's (MITI) is promoting the Japanese economic model for Russia and other former socialist economies. The institute, which has written two reports on the implications of Japan's experience for the former USSR, is urging these countries not to adopt extreme laissez-faire policies, but rather to supplement macroeconomic stability with some kind of industrial policy." The MITI group feels Japan is a good model because, like Russia, it had to democratize and demilitarize quickly. The group recommends some form of wage and price controls to preserve economic stability and encourages developing strategic industries. Japan's Finance Ministry is also pushing for a closer study of policies that nurture new industries.

Czechoslovakia sets date for split. Slovak Prime Minister Vladimir Meciar told reporters "we assume the Czechoslovak federation will cease to exist on January 1, 1993, and that the Czech and Slovak republics will come into being as two state bodies." A federal law on the dissolution of the Czechoslovak federation should be adopted by the end of September by the parliament, together with a law on the division of property and successor rights. Meciar said the deadline for the adoption of the laws on property succession rights could be extended into October. By the end of November both regional parliaments should negotiate and adopt laws on future coexistence covering fields such as civic, property, and financial relationships. December would be reserved for negotiating any outstanding issues. Meciar's Czech counterpart, Vaclav Klaus, said both sides had agreed to set up a customs union beginning next year and had reached consensus on setting up two separate currencies that would be firmly tied with a fixed rate of exchange."

Tanzania's Prime Minister John Malecela said that his government had decided to delay privatizing the marketing of cash crops until next year.

Conference Diary

Why Is It Worth Investing in Hungary?
November 9-10, Budapest, Hungary

Conference organized by the Hungarian Economic Association, the Joint Venture Association, the Institute for World Economics, and the Dunaholding Ltd. Hungary would like to attract even more capital from outside sources and keep up with the dynamics of capital imports. The conference intends to provide information on the government's long-term policy plans and to discuss problems encountered by foreign businesses in Hungary. Topics include: Current Stage of Privatization in Hungary, Situation in the Banking Sector, Investment Possibilities for Foreign Enterprises, and View of International Institutions. Leading domestic and foreign scholars and business persons are expected to participate and interact with Hungarian government policymakers.
Information: Mr. Tamas Halm, Director, Hungarian Economic Association, Budapest V, Jozsef Attila, u.8, fax: (361) 266-2862.

Business Outlook and Economic Transition of Eastern Europe and the Former Soviet Republics
November 17-19, Rome, Italy

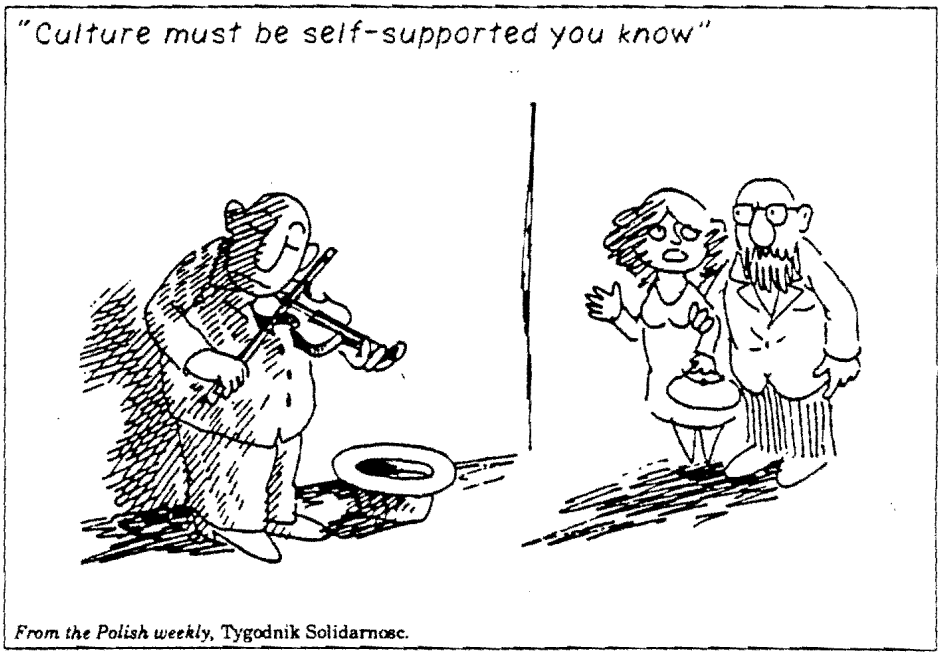
Organized by PlanEcon, Inc., a Washington-based business and consulting firm. Topics include economic and political overviews of the regions, sectoral reviews of the food, automotive, consumer goods, and engineering industries, and a symposium on energy.
Information: Mary Hogan, PlanEcon, Inc., 1111 14 Street, NW, Suite 801, Washington, D.C. 20005. Tel: (202) 898-0471, fax (202) 898-0445.

AAASS National Convention
November 19-22, Phoenix, Arizona

24th Convention of the American Association for the Advancement of Slavic Studies. This year's agenda includes roundtables on Causes and Consequences of Change in the ex-Soviet Union, and Industrial Organization and the Transition from Socialism to Capitalism; panel discussions on Economic Restructuring and Privatization, Continuity in Russian Industrial Administration 1860-1990, Political and Economic Transition in the Baltics, and "Farmer Threat"; and progress reports on Land Reform in Russia and Central Asia, and Transitions in Mass-Elite Culture in Central and Eastern Europe.
Information: Sandy Costa, Coordinator, AAASS, Jordan Quad, Acacia Bldg., 125 Panama St., Stanford, CA 94305-4133. Tel: (415) 723-3220, fax: (415) 725-7737.

Privatization and Socioeconomic Policy in Central and Eastern Europe
June 7-10, 1993, Krakow, Poland

An international conference organized by the Boston College and hosted by the Jagello University, The Krakow Academy of Economics, and Krakow International Center. The conference will address a number of questions: Who benefits from and who bears the burden of economic and social change? What determines the willingness of firms to locate and invest in transitional economies? How can society balance economic efficiency and social justice? The kick-off plenary session will focus on national reports from Bulgaria, Czechoslovakia, Germany, Hungary, Poland, and Russia and will include three invited papers on privatization from economic, social, and business perspectives. Topics of the workshops include: Approaches to Privatization; Economic Rights and Industrial Relations; The Role of the State and the Political Process; Women's Issues; The Role of the West and International Organizations; The Privatization of Social Programs and Social Services.
Information on paper proposals (deadline: November 14, 1992) and attendance: Prof. Demetrius Iatridis, Boston College Graduate school of Social Work, Chestnut Hill, MA 02167. Tel: (617) 552-4041 or (617) 552-4034, fax: (617) 552-3199.



From the Polish weekly, Tygodnik Solidarnosc.

World Bank/IMF Agenda

World Bank Lending in Fiscal 1992

New lending commitments to member countries from the IBRD and the IDA totaled $21.7 billion in fiscal 1992, which ended June 30. The comparable figure for fiscal 1991 was $22.7 billion. World Bank loans to China reached $2.55 billion in fiscal 1992, compared with $1.6 billion in fiscal 1991. The lending was provided to finance nineteen projects, including projects in electric power, railways, roads, public health, primary education, and the environment. Mongolia received $35 million worth of IDA credits and Laos $40 million worth. IBRD and IDA commitments by to the countries of Central and Eastern Europe and Central Asia in fiscal 1992 totaled $1.78 billion, down from $2.94 billion in fiscal 1991. This decline is attributable in part to elections and continued policy debate in Poland and suspension of new commitments to Yugoslavia.

MIGA Guarantees

The Multilateral Investment Guarantee Agency (MIGA) issued twenty-one investment insurance contracts, including five contracts for investments in Poland in fiscal 1992 (which ended June 30). The contracts had a combined maximum coverage of $313 million. The total direct investment of the fiscal 1992 contracts was about $1 billion. As of June 30, MIGA had eighty-five member countries. Thirty more countries, including most of the former Soviet republics, have submitted applications for membership in the agency.

Membership Tally

The former Soviet republics of Georgia, Latvia, and Moldova have joined the IBRD. Georgia joined on August 7, Latvia on August 11, and Moldova on August 12. Georgia also joined the International Center for the Settlement of Investment Disputes, and Latvia has joined the IDA. Georgia made a payment of $9.3 million to join the IBRD. Latvia paid $5.7 million, and Moldova $7.6 million. The other former Soviet republics that have joined the IBRD are Russia on June 16, Estonia on June 23, Lithuania on July 6(paid $6.3 million), Belarus on July 10 ($17 million), and Kazakhstan on July 23. There are now 166 members of the IBRD and 144 members of IDA. Membership of the IMF totaled 168 countries by August 12, when Moldova joined the Fund. Members' quotas in the IMF total SDR 96,465.05 million (about $139.83 billion).

Product Development Loan to Hungary

Hungary will make it easier for manufacturers and traders to market, transport, and sell consumer products through a project being supported by a $100 million World Bank loan, approved in the current financial year. Most of the funds from the IBRD loan will be channeled to participating banks through the National Bank of Hungary. The banks will provide loans to private-sector firms involved in wholesaling, retailing, warehousing,

World Bank's first loan to Russia and plans for the future

On August 6 the World Bank approved a $600 million loan to the Russian Federation to provide foreign exchange to purchase imports critically needed to address the country's recent decline in production. This "rehabilitation" loan will support the first phase of the government's reform program, including privatization and restructuring of state-owned enterprises, promotion of foreign direct investment, pro-competition and anti-monopoly policies, reform of financial institutions and the commercial banking sector, and establishment of a social safety net to protect those who may be affected by the reforms. Subsequent World Bank operations will support the government's efforts to expand programs for privatization and social protection and extend reforms to the agriculture and energy sectors.

The rehabilitation loan has two main parts: $250 million for imports by the growing commercial private sector and $350 million for priority imports by the health, agriculture, transport, and energy sectors. The latter portion of the loan breaks down as follows:

- Up to $100 million has been allocated for pharmaceutical and medical equipment to stop the rapid decline in health services that has resulted from shortages of foreign exchange.
- The agriculture sector will receive $150 million to improve efficiency and reduce losses because of inadequate storage and food-handling problems. Critical inputs needed to maintain agricultural production, such as high-yielding seeds and veterinary drugs, may also be financed.
- The transport sector will receive $50 million for spare parts and equipment needed to put buses back in service and improve cargo handling at the major ports, including St. Petersburg.
- The energy sector will receive up to $50 million for spare parts critically needed to maintain production.

The "rehab" loan has a term of fifteen years, including five years of grace, at the Bank's current 7.6 percent rate of interest.

"During the current fiscal year [which began on July 1], the World Bank could approve loans totaling as much as $1.7 billion for as many as five projects. In the coming years, the World Bank is considering a lending program of about $2 billion annually," said Yukon Huang, division head in the Bank's Europe and Central Asia region. In an interview with World Bank News he added that "Russia's external financing requirements—in terms of new lending—might be about $15 billion annually during the next few years. Most of this money will have to come with guarantees from official sources or from institutions such as the World Bank. Substantial flows of private capital won't become available until economic reforms take root."

packaging, trucking, and other services, to streamline their operations. The project includes training and expert advice for the staff of both public and private-sector agencies.

IDA Loan to China

IDA has approved a credit of $147 million for a project that will help increase agricultural production, rural incomes, and employment in Sichuan Province. The project will expand irrigation to more than 135,000 hectares, provide training and research, and expand soil conservation measures.

Albania: IBRD, IMF Assistance

The World Bank has opened an office in Tirana, Albania. Mr. Kutlay Ebiri, a Turkish national, has been appointed resident representative of the new office. He took up his assignment on August 1. In another development, the IMF approved its first-ever credit for Albania—a $29 million stand-by credit to be drawn over the next twelve months—in support of the government's economic and financial program. The government program shoots for stabilization of output by 1993, with an early revival of agriculture and a reduction in monthly inflation to 2-3 percent by mid-1993 (from 6 percent in June 1992).

Michel Camdessus in the Baltics

Speaking at the end of a three-day visit to Lithuania in mid-August, IMF Managing Director Michel Camdessus expressed satisfaction with the government's moves toward privatization and its efforts to balance the budget. He added that "the Fund probably will be ready to help Lithuania introduce its own currency in October," when the country plans to replace the ruble. Prime Minister A. Abisala said the country needs $120 million to $150 million from the IMF to stabilize the currency. M. Camdessus also visited Latvia and suggested that the IMF Executive Board might extend the maximum credit allowed to the country (currently about $70 million). In Tallinn he vowed to back Estonia's application for $40 million in IMF funds.

New Books and Working Papers *

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

P. Marer, J. Arvay, J. O'Connor, M. Schrenk, and D. Swanson
Historically Planned Economies—A Guide to the Data
The World Bank, Washington D.C., 1992, 264 p.

Efforts to assess the economic performance and financial flows of the CEE countries and the former Soviet Union have been frustrated by the practical problem of finding reliable data and converting them to comparable terms in market economies. The Guide addresses these problems, but will need periodic revision. The first part acquaints the reader with statistical issues that are important for viewing economic and social conditions in the historically planned economies (HPEs) in a global context. The next part presents HPE data in tables for comparative analysis. The third part provides country-specific details on how data are molded during transition and cites country examples of basic data problems. The last part explains data sources and methods.

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

W. Easterly, R. King, R. Levine, and S. Rebelo
How Do National Policies Affect Long-Run Growth? A Research Agenda
The World Bank, WB Discussion Paper No. 164, Washington, D.C., 1992.

The recent decline in output in the formerly planned economies of Europe has refocused attention on economic growth. These countries' experience mirrors a less drastic economic decline in developing countries whose median per capita growth rate in the 1980s was -0.3 percent (excluding the oil countries).

The paper examines five types of national economic policies: fiscal policy (growth effects of taxes and public spending), monetary policy (do countries with high and unstable inflation grow more slowly?), trade intervention (do tariffs, quotas, and high black market premia on foreign exchange have growth effects or one-time-only level effects?), financial policies (do penalties on domestic financial intermediation lower growth?), and finally, openness to foreign capital (how do restrictions on direct foreign investment affect growth?). The paper emphasizes the specific relationships between policy and growth that can be used to quantify the effects of various policies and their interactions. It also examines the relationship between growth and broader measures of welfare such as social indicators and environmental quality.

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David Begg and Richard Portes
Enterprise Debt and Economic Transformation: Financial Restructuring of the State Sector in Central and Eastern Europe
Centre for Economic Policy Research (CEPR) Discussion Paper Series 695, London, 1992, 43 p.

The authors argue that possibly the most important obstacle to economic restructuring in Central and Eastern Europe is the widespread failure of enterprise debtors to pay creditors, who in turn have strong incentives not to declare bankruptcy. In these circumstances a disproportionate share of bank credit effectively goes to refinance incumbents, which impedes entry into the credit market.

Banks have scant incentive to enforce debt contracts. "Creditor passivity" may arise when the expected value of a debtor's assets are less than the cost of enforcing bankruptcy or when there is an option value in waiting to see whether the debtor's fortunes improve. If banks are severely undercapitalized, have extensive nonperforming loans, and face political pressures to finance struggling state-owned enterprises (SOEs), they may

conclude that their debtors are too big to fail.

This institutional passivity redistributes liquidity from sound to potentially unsound enterprises. The paper proposes a structural reform of credit markets, with recapitalization of banks and enterprises. The government would take over all nonperforming loans from the banks and replace them at par with treasury bills. If the government wishes to keep loss-making SOEs going, it should do so by explicit, cash-limited fiscal subsidies. In a second stage, the SOE debt held by the government is marked to market, just like the physical assets of the enterprises, as part of the preparation for privatization.

Other recent CEPR Discussion Papers:

J. Bradford De Long and Barry Eichengreen
The Marshall Plan: History's Most Successful Structural Adjustment Program. No. 634, 48 p.

Ken Mayhew and Paul Seabright
Incentives and the Management of Enterprises in Economic Transition: Capital Markets Are Not Enough. No. 640, 58 p.

Konstantine Gatsios
Privatization in Hungary: Past, Present, and Future. No. 642, 46 p.

Michael Burda and Michael Funke
Trade Unions, Wages, and Structural Adjustment in the New German State. No. 652, 31 p.

Gordon Hughes and Paul Hare
Industrial Policy and Restructuring in Eastern Europe. No. 653, 46 p.

Peter Bofinger and Daniel Gros
A Multilateral Payment Union for the CIS: Why and How? No. 654, 35 p.

Gerard Roland and Khalid Sekkat
Market Socialism and the Managerial Labour Market. No. 655, 16 p.

M. Guzek, J. Biskup, and E. Kawecka-Wyrzykowska
Creation of a Free Trade Area in Czechoslovakia-Hungary-Poland: Consequences for the Polish Economy. No. 659, 17 p.

Peter Bofinger and Ivan Cernohorsky
Some Lessons from Economic Transformation in East Germany. No. 686, 27 p.

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

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Laszlo Csaba
Transition to the Market: Theory and Evidence
KOPINT-DATORG, Discussion Paper No. 5, Budapest, Hungary, 1992, 26 p.

Author sums up some lessons of postsocialist systemic transformation:

• There is little incentive for the public to buy loss-making or debt-ridden public firms unless the government creates the necessary conditions and even gives preference to investment over consumption.

• Rather than hoping for a quick and sizable adjustment on the supply side, the time horizon for meeting expectations must be lengthened and the extent of improvement that is hoped for must be lowered.

• Government shouldn't be complacent in fighting inflation, as grave fiscal imbalances could threaten price stability. Still, a degree of realism is recommended, as the period of protracted contraction might not be a good time to apply textbook-prescribed stringent monetary and fiscal policies.

• Empirical evidence in Hungary indicates that too much attention was devoted to privatization techniques and the correct valuation of assets, and too little to strategic issues. Sellers were often surprised, for instance, when buyers purchased a plant only to use it for dumping waste or to get rid of a competitor. Conclusion: ele ments other than property structur affect the competitive nature an quality of the market.

• A change in the proprietary stru ture will not necessarily result in more meritocratic selection of mar agers. Social security directorates an self-governments might be endowe with sizable properties, but their se vices could deteriorate unless they ar forced to compete with the privat sector.

• Speed is not a good indicator success for the transformation pr cess. Sustainability becomes an ind pendent variable and an importar measure of success. The shortest di tance between two points may be straight line. However, if one of th points is at the top of a 6,000 met high mountain, climbing straight might not be the safest or fastest wa of getting there.

Other titles in this series:

Gabor Oblath
Accumulation of Foreign Deb and Macroeconomic Problems Debt Management: Hungary Case. No. 1.

Laszlo Csaba
Economic Consequences of Sovi Disintegration for Hungary. No. 2, 26 p.

Bart W. Edes
Import Liberalization and Indu try Protection: International Pr cedents and Possible Options fc Hungary. No. 3, 30 p.

Laszlo Csaba
Russia's Road to Chaos. No. 4, 41

Kamilla Lanyi
Hungarian Agriculture and th Collapse of Comecon Markets. No. 6.

To order: KOPINT-DATORG, Inst tute for Economics, Market Researc and Informatics, H-1051 Dorottya 6, Budapest, Hungary. Tel: (361) 118-055, fax: (361) 118-6483.

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Jamie De Melo, and others
Tax Evasion and Tax Reform in a Low-Income Economy: General Equilibrium Estimates for Madagascar
World Bank Policy Research WPS 918, 1992, 34 p.
Available from Dawn Ballantyne, the World Bank, Rm. N-10023, tel: (202) 473-7947.

Jerzy Gajdka and Alexander Hamilton
Privatization in Poland
CIBER, University of Maryland, College Park, Maryland, Occasional Paper No. 19, 1992, 22 p.
Information: CIBER (Center for International Business Education and Research), College of Business and Management, University of Maryland at College park, College Park, MD 20742. Tel: (301) 405-2136, fax: (301) 405-7635.

Michal Mejstrik
The Czechoslovak Large Privatization
CERGE, Charles University, Faculty of Social Sciences, Prague, WPS 11, 1992, 30 p.
Address: Taboritska 23, 130 87 Prague 3, Czechoslovakia.

Gang Fan and Wing Thye Woo
Decentralized Socialism and Macroeconomic Stability: Lessons from China
University of California, Davis, Dept. of Economics, Working Paper, 1992, 29 p.
Available from Donna Raymond, Dept. of Economics, University of California, Davis, CA 95616. Tel: (916) 752-9240.

New Books

Marko Simoneti and Andreja Bohm, eds.
Privatization in Central and Eastern Europe in 1991
(Papers of the CEEPN II. Annual conference in Vienna, Austria, November 1991. covering country privatization reports and specific implementation issues.)
CEEPN, Ljubjana, Slovenia, 1992, 183 p.

Reprivatization in Central and Eastern Europe
(Papers of the CEEPN roundtable on Reprivatization of Commercial and Industrial Enterprises, Ljubjana, Slovenia, May 31-June 1, 1991.)
CEEPN, Workshop Series No. 1, Ljubjana, Slovenia, 1992, 88 p.

Preparing Enterprises for Privatization: Business Valuation
(Papers of the CEEPN and UNDP workshop on Enterprise Privatization, Bratislava, Czechoslovakia, October 1991.)
CEEPN, Workshop Series No. 2, Ljubjana, Slovenia, 1992, 156 p.

Information: CEEPN Secretariat, Dunajska 104, P.O. Box 92, 61109 Ljubjana, Slovenia. Tel: (3861) 182 331, fax: (3861) 346 389. (CEEPN—Central and East European Privatization Network—is a regional association of privatization agencies, ministries, and other institutions and was established in June 1991.)

Jack A. Barbanel and Lynda A. Maillet
Business in the [former] Soviet Union: A Primer and Overview [Updated Supplement]
Transnational Juris Publications, Ardsley-on-Hudson/NY, 1991, 287 p.
Information: TJP Inc., P.O. Box 7282, Ardsley-on-Hudson, NY 10503. Tel: (914) 693-0089, fax: (914) 591-2688.

Gyula Horvath, ed.
Regional Policy and Local Governments
Centre for Regional Studies, Hungarian Academy of Sciences, Pecs, Hungary, 1991, 215 p.
To order: Library, Centre for Regional Studies, P.O. Box 199, Pecs, H-7601, Hungary. Tel: (3672) 12-755, fax: (3672) 10-390.

Gur Ofer and Aaron Vinokur
The Soviet Household under the Old Regime: Economic Conditions and Behavior in the 1970s
Cambridge University Press, Cambridge/New york, 1992, 396 p.

Janos Matyas Kovacs and Marton Tardos
Reform and Transformation in Eastern Europe: Soviet-type Economics on the Threshold of Change
Rutledge Press, London/New York, 1992.

Vladimir Tismaneanu and Patrick Clawson, eds.
Uprooting Leninism, Cultivating Liberty
University Press of America, Lanham/New York/London, 1992, 87 p.
Information: University Press of America, 4720 Boston Way, Lanham, MD 20706.

Kazimierz Z. Poznanski, ed.
Constructing Capitalism: The Reemergence of Civil Society and Liberal Economy in the Post-Communist World
Westview Press, Boulder/San Francisco/Oxford, 1992, 230 p.
Information: Westview Press, 5500 Central Avenue, Boulder, CO 80301-2847.

Change in the Masthead: A Note to Our Readers

Our readers certainly have noted that in our newsletters' masthead the division for "Transition and Macro-Adjustment" has replaced the "Socialist Economies Reform Unit." The switch signals organizational changes in the Country Economics Department of the World Bank; the Socialist Economies Reform Unit has merged with the former Macroeconomic Adjustment and Growth Division and a new division was born. These changes became necessary as demand increased for analytical work on the growing number of member countries in transition and for research that links macroeconomic issues to microeconomic policy and structural changes. While *Transition's* profile remains unchanged, we hope that the reorganization will inspire new authors to share their research findings with our readership.

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