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Theme of the Issue: China—Russia Comparison

Modernizing China's Growth Paradigm
Eswar Prasad and Raghuram Rajan  3

Understanding Migration in Russia
Yuri Andrienko and Sergei Guriev  5

Insert: Invasion or Necessary Stimulant?
Zhanna Zaionchkovskaya  6

Labor Migration and Wage Inequality
Xiaohan Zhong  7

Has Trade Liberalization Brought Gender Equality?
Yin He  8

China–Russia Trade Dynamics
Natalya Volchkova  9

The Russian Stock Market: Lessons from the First Decade
Alexei Goriaiev and Alexey Zabotkin  11

Entrepreneurship in China and Russia Compared
Simeon Djankov, Yingyi Qian, Gerard Roland, and Ekaterina Zhuravskaya  13

Why Shock Therapy May Lead To Worse Performance Than Gradual Transition
Vladimir Popov  14

Industrial Agglomeration and Regional Specialization in China
Jiangyong Lu and Zhigang Tao  16

Russia's Regions: In What Social Space Do We Live?
Natalya Zubarevich  17

Unleashing the Potential: Growth and Investments in Russian Regions
Olga Mosina  19

New Findings

Mongolia’s Competitiveness and Economic Growth 21
Janusz Szyrmer

Insert: Mongolia’s Economic Development Dynamics  22

FDI in Eastern Europe and NIS
Irina Tytell and Ksenia Yudaeva  23

Tajikistan — A Long Way to Recovery
Aybek Gorey  24

Insert: Tajikistan is Still the Poorest CIS Country  24

World Bank \ IMF Agenda  25

New Books and Working Papers  27

Conference Diary  30

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Dear Reader,

In this issue we consider the transition experiences of the two largest transition countries — Russia and China. Most of this issue's papers were presented at the 2005 Global Institute Russia-China Conference in Beijing by Chinese and Russian economists, who had received their Ph.D.s at western universities, and then returned to their home countries. Thus, the issue also symbolizes the transition of the economics profession in these countries during the reform years.

At the beginning of transition, Russia and China chose different reform strategies. The political system in China has been kept intact, and the government has kept a tight control over the economy. State enterprises were left in government hands, while the private sector developed mainly through new investments. Nowadays, China has a complex and fairly developed economy which is largely private. In this situation the incremental reform approach, which the Chinese government has used so far, becomes more and more difficult to implement. In order to sustain growth momentum China needs to reform its financial sector and exchange rate policy. Such comprehensive reforms carry a lot of risk, but then the risks of not moving at a sufficient pace can be even greater, as Prasad and Rajan argue in their article.

Russia started its reforms 13 years later than China, and adopted sweeping reforms with much deeper scope. Its political system underwent significant changes, which are now being partially reversed however. Most Russian enterprises were privatized more than 10 years ago. Some researchers believe that Russia reformed too fast, and a more gradual approach could have resulted in smaller losses and a faster return to the growth track (Popov). In the last six years Russia has been growing at an impressive rate. Its growth, fueled by high oil prices, was mainly based on restructuring and incremental investments into existing enterprises. To keep growing Russia needs to move to investment-based growth, and in order to do that it needs to undertake comprehensive measures aimed at business climate improvements both at the federal and regional level (Mosina).

In both countries reforms were accompanied by increased migration flows. In China most migration has been internal, from rural to urban areas, and had a positive effect on wages of both migrants and local workers (Zhong). Russia needs more migration, both internal, which will remedy the misallocation of labor created under communism, and external (immigration), which will help prevent current population shrinkage. Government policy has so far been ineffective on both scores: it has restricted the much-needed migration flows and created illegal immigrants (Andrienko, Guriev).

Trade liberalization was a part of both countries’ reform strategies. In China it led to the gender gap narrowing for women who have higher education, yet widening the gap for women without this level of schooling (He). Russia has not yet fully exploited the potential opportunities of trade with China, particularly as a development tool for its Far East regions (Volchkova).

As the comparison of entrepreneurs in the two countries shows (Djankov, Qian, Roland, and Zhuravskaya), despite cultural differences, it is attitude to risk and social background that separates entrepreneurs from non-entrepreneurs in both countries. Thus, as this issue demonstrates, despite the difference in reform strategies, Russia and China often face similar challenges and can learn a lot from each other’s experience.

Ksenia Yudaeva, Managing Editor
Modernizing China's Growth Paradigm

China's current stage of development may make the present incremental and piecemeal approach to reform untenable

Eswar Prasad and Raghuram Rajan

China's remarkable growth performance over the last three decades is widely attributed to its unique development model. A principal element of this model has been an incremental and experimental approach to reforms, with the reform process being guided by some general principles rather than a detailed blueprint. This has been complemented by a dual-track approach, which involves maintaining a planned track while encouraging the development of a market track in different areas of the economy, thereby allowing for efficiency gains at the margin without creating losers in absolute terms. This development paradigm—with its virtues of flexibility, adaptability, and pragmatism in the face of various constraints to reform—has served China well, generating high and relatively stable growth over an extended period.

Our main contention in this article is that this paradigm, for all its virtues and success so far, may be in need of an overhaul. China's dramatic structural shifts towards a complex market-oriented economy and its increasing integration into the world economy are likely to expose shortcomings in this approach. Notwithstanding the constraints that still exist due to deficiencies in policy and institutional frameworks, and the effects of various problematic legacies, there may now be few alternative, broader and more concerted reforms in order to maintain high growth and economic stability. This is not to say that a different approach is not without risk, but we view the traditional approach as increasingly untenable and likely to generate greater risks of its own. Furthermore, the policy distortions required to maintain the old approach could have adverse welfare consequences.

Of the multiple transitions that China's economy has been undergoing—from rural to urban, from low income to middle income etc., two are particularly relevant for our discussion. Firstly, China is rapidly moving from a command economy to one led by the private sector, with this sector's share in GDP now estimated to be one-half to two-thirds. Secondly, from being a relatively closed economy before the 1980s, China has become very open to trade and more integrated into global financial markets. Although these transitions have been actively encouraged by Chinese policymakers, each has brought with it some challenges, including rising unemployment and disparities in income, especially between the rural and urban areas, growing dependency on external demand and vulnerability to external shocks.

Nevertheless, China's economy has continued to grow at an impressive rate over the last two decades, and unlike many other emerging market economies, it has not experienced any crises or other sharp disruptions to growth during this period. Let us take a closer look at what is behind this growth performance and how the different economic pressures have been managed so far.

**Key Macroeconomic Policies**

China's exchange rate policy has of course received the most attention recently. The renminbi's value against the U.S. dollar had been maintained at a fixed level since 1995, indicating the importance of policymakers attach to this nominal anchor. In principle, its value is now set with reference to a basket of currencies. In practice, however, the renminbi still appears to be pegged to the dollar, with limited de facto flexibility.

The management of capital flows has been another key component of macroeconomic policy. Capital controls, along with tax benefits and other incentives, have been used to promote inward FDI while other inflows have been discouraged. Capital controls have also played an important role in protecting the banking system from external competition by restricting the entry of foreign banks and by making it harder to take capital out of the country.

The uncertainties related to the transition process, the limited availability of instruments to borrow against future income to finance purchases, and the lack of international portfolio diversification opportunities have all contributed to high household savings. Financial repression has meant that there are few alternatives to funneling these savings into deposits in state-owned banks. Households willingly hold bank deposits despite the weaknesses of the banking system because of implicit deposit insurance provided by the government. This provides abundant liquidity for banks to expand credit, which largely finances investment by state enterprises. Thus, the investment boom in recent years has been fueled by cheap credit and overoptimistic expectations of future demand growth in sectors that are doing well at present.

Certain policy choices intended to maintain macroeconomic control have thus made investment rather than private consumption the main source of demand growth. While factor accumulation is a time-honored path to higher growth for many developing countries, whether such a high level of saving mediated through an inefficient banking system can produce long-lasting welfare gains is dubious. The costs of these inefficiencies are ultimately borne by depositors, in terms of low real returns on their savings, or through the financing of fiscal transfers to firms and financial institutions.

Financial sector reform and development are clearly crucial priorities for growth and stability. But they can not be taken in isolation from other macroeconomic policies, including exchange rate flexibility. It is essential that China introduces greater flexibility in its exchange rate, which would give it a more independent monetary policy and also allow the exchange rate to play a role in correcting external imbalances. It would also remove one of the hindrances to banking sector reform because a fixed exchange rate.
rate reduces the central bank’s ability to use market instruments such as interest rates to guide credit growth and instead perpetuates a reliance on administrative measures, vitiating efforts to make the banking system more commercially oriented. In addition, by making capital account liberalization (a stated medium-term objective of the government) less risky and by creating incentives to develop financial products to hedge foreign exchange risk, a flexible exchange rate could help stimulate broader financial market development as well.

Such policy shifts would allow for growth to be rebalanced towards self-sustaining domestic demand and tilt domestic demand itself towards private consumption and away from investment.

**Incremental Approach to Reforms Increasingly Difficult**

In discussing policy choices, it is important to recognize that Chinese policymakers are operating in a difficult environment with numerous institutional deficiencies, including a weak legal framework, poor governance, and economic data of dubious quality. Furthermore, local governments have a significant degree of autonomy in economic matters. Given the leadership's objective of maintaining political and social stability, these factors make the process of undertaking policy reforms a tight balancing act.

China has therefore typically taken the approach of instituting reforms in an incremental manner. This has meant either taking small steps or confining reform experiments to specific provinces. For example, tax reforms are generally first instituted in one or two provinces; the experience is then carefully studied before rolling out a nationwide version of the reform. The learning-by-doing approach to reform has a number of advantages: it reduces the costs of policy errors and uncertain outcomes in the reform process, and also gives policymakers a clearer sense of the political and social pressures that could arise in opposition to such reforms.

There are potential limitations to the incremental approach, however, as China’s economy becomes more developed and complex. Firstly, some critical reforms, especially those related to broad macroeconomic issues such as exchange rate flexibility, cannot be isolated to specific geographical areas or sectors of the economy. Secondly, as the economy becomes more sophisticated, some players become more mobile and more able to take advantage of distortions. For instance, additional small moves towards exchange rate flexibility could increase speculative inflows in anticipation of further revaluations, thereby further complicating the conduct of domestic monetary policy.

Thirdly, and perhaps most important, China has reached a stage of development at which many key reforms are unavoidable interconnected, and it may become increasingly difficult to undertake individual reforms in isolation. The restructuring of the banking sector would proceed much better if state enterprises were reformed and implicit pressures for state banks to continue providing cheap capital to state enterprises were eliminated.

**Financial Sector Reform a Core Priority**

Financial sector reform will necessitate turning the state banks into more efficient financial intermediaries driven by commercial considerations. But it also requires developing broader financial markets that can give firms alternative sources of funding and provide households with alternative investment opportunities.

This is also one of the key sectors in which a difficult balance will need to be struck between picking up the pace of reforms and not getting too far ahead of institutional constraints. Continued interest rate liberalization, for instance, is important for the banking system to function efficiently. But an all-out sprint towards full liberalization without adequate regulatory and supervisory mechanisms in place could create subversive incentives that might decrease financial system stability.

Fiscal policy has a role to play in the reform agenda as well, especially in terms of strengthening the social safety net to reduce the political and social costs of market-oriented reforms. Reorienting some government spending towards essential social expenditures, including healthcare and education, and reducing uncertainty on these fronts may help to give households the confidence to increase consumption levels.

Aspects of political economy also pose some difficulties. Constituencies that favor the current system can be effective at blocking reforms. The current period of high growth and low inflation provides an opportunity to counter these forces by making resources available that could help broaden the dual-track approach to reform, allowing more of the economy to be opened up to market forces while weaning the rest of the economy off state support. This could be paralleled by further opening of the economy to external influences, thereby creating possible pro-reform coalitions.

Chinese policymakers certainly face a difficult balancing act — to push along each set of reforms at a reasonably rapid pace while, at the same time, overcoming broader institutional constraints. They have managed such balancing acts well in the past. But, going forward, it may be harder for them to feel their way through controlled policy experiments. Broad and significant policy movement will be more of a leap into the unknown, and will carry attendant risks, but the risks of not moving at a sufficient pace and along a broad front are even greater.

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Russia's current migration policy is counterproductive as it both restricts much-needed migration and creates illegal immigrants

Yuri Andrienko and Sergei Guriev

Russia is in the middle of a severe demographic crisis. If the current trend continues, its population will shrink by 20% to 112 — 119 million people by 2050. Despite some minor improvements recently, ageing and depopulation are likely to continue for decades. According to the 2004 World Population Data Sheet, Russia’s population has been declining at a rate of - 0.6%, which is the world’s second fastest rate after Ukraine.

In the nearest future, Russia will also face a shortage of people of working age. To compensate for this, Russia will need to triple its current inflow of immigrants to the level of 1 million per year. Fortunately, there is a huge potential pool from which to draw from: tens of millions of skilled Russian-speaking residents from former Soviet Union countries, many of whom are willing to migrate to Russia.

Current External Migration Policy Restrictive

Starting from 1989, 11 million people immigrated to Russia according to the 2002 Census. These were mostly ethnic Russians who were repatriated from other CIS countries.

As for labor migration to Russia, only a small proportion (less than 5%) of immigrants goes through official channels. The stock of illegal immigrants, mainly from the CIS, is estimated at 4 — 5 million. Workers come from more than 100 countries, mainly Ukraine (32%), China (14%), Turkey (7%), and Vietnam (7%). They are primarily employed in agriculture and forestry (25%), trade (20%), construction (17%), and transportation (15%).

External migration is heavily regulated around the world for mainly political rather than economic reasons. Russian migration regulation has been converging towards the restrictive migration policies of the OECD countries. However, while Russia suffers from similar demographic problems to developed countries, unlike them, it is a middle-income country with a corrupt and inefficient bureaucracy. So designing and implementing EU-style migration regulation is unlikely to work (nor does it work well in Europe). Administrative barriers to migration turn into a source of rents and bribes for officials and create a large pool of illegal immigrants. Given the general problems with crime and law enforcement and the lower costs of legal migration due to the fact that most migrants come from CIS countries and have the same cultural background, Russia should be much more in favor of lenient immigration policies than EU countries.

To compensate for depopulation and shortage of working age people, Russia will need to triple its current inflow of immigrants to the level of 1 million per year.

The costs being incurred from the large stock of illegal immigrants are large and growing. Hence, an immigration amnesty is both unavoidable and welcome, and Russia will probably have to make this decision in the coming few years. The amnesty should be coupled with a transition to a point-based system of admission for new legal migrants, which will help to rationalize the skill composition and geographical destinations of immigrants.

Millions to be Moved

Internal migration is also important for Russia's social and economic development. It may help mitigate huge inter-regional imbalances in income and unemployment and put scarce labor resources to more efficient use. Russia has inherited an industrial structure that dates back to the Soviet industrialization period when location decisions were not microeconomic data on immigrants already in the country. This will finally provide Russian policymakers with reliable information to design migration policy in the future.
necessarily made for economic reasons. Capital markets remain underdeveloped and problems with property rights protection and contract enforcement persist. Capital would not flow to some regions even in the absence of any barriers simply because of cold temperatures and prohibitive transportation costs.

Even though some labor reallocation occurred during transition, there are still millions to be moved. Despite economic growth in the past six years, quickly rising wages, and little unemployment in many prosperous regions, there are still many regions with low wages and high unemployment. In the past there has been very limited interregional convergence in income and no convergence in unemployment rates. Even though the interregional differentials are higher than in the US, unemployment rates. Even though the interregional differentials are higher than in the US, interstate migration is much lower.

If one assumes a 5.5% natural unemployment rate, there are 2.3 million unemployed who could find jobs in labor-scarce regions. There are also many workers in depressed regions who could make a substantial contribution to Russia’s growth by moving away from these low-productivity and low-wage regions to productive, high-wage ones.

Removing Barriers to Internal Migration

The number of Russians changing their place of residence fell from 3.2% of the population in 1994 to 1.4% a decade later. This is partly due to internal administrative controls, including a registration system. However, far from all migrants register in their new place of residence, so the flow of migrants may be significantly larger. The 2002 Census counted more people in European Russia than had been expected based on the birth and migration data.

Some policies that can help remove barriers to internal migration include:

1. Abolish internal administrative controls. Their existence simply redistributes rents in favor of bureaucrats. Once the administrative controls are gone, this rent would transform into higher real estate prices that would transfer the rents in favor of the residents and raise tax revenues.

Beyond Transition • January—March 2006

Invasion or Necessary Stimulant?

The transition to a market economy has dramatically increased the economic distance between the European part of Russia and its eastern regions, almost pushing the Far East out of the domestic market and closer to the Asia Pacific countries. The Far East, especially the Primorsky and Khabarovsk regions, has a favorable geographical position in the Asia-Pacific and its further development is logically to be associated with integration into that region.

In the period between 1989 and 2002, the population of the Far Eastern Federal District dropped by 1.3 million people, i.e. by 16%, of which 1 million emigrated. Neighboring China, with its huge demographic potential, is perhaps the main source of labor for the border areas of Siberia and the Far East. Today bringing in Chinese labor is seen as being the key and indispensable condition of the region’s development and of stemming the process of its depopulation.

At present, contrary to the aggressive tone of the media and the whipping up of fear in the face of the supposed “Yellow Peril” assessments of the Chinese presence are more moderate. The 2002 census registered 35,000 Chinese in Russia. The total number of Chinese who had visited Russia during that year was 800,000. Local assessments of Chinese presence are much lower. For the most part Chinese immigrants are low-skilled workers employed in such sectors as construction, agriculture and retailing, where skills are acquired on the job.

For China, emigration of its own population is a necessity. The Chinese authorities are encouraging the outflow of people from the country and are exploring every avenue towards this end. In connection with Russia’s bid to join the WTO China is demanding that Russia open up its labor market to Chinese workers. This can be seen not only as the wish to consolidate China’s position in Russia, but also to be ahead of potential competitors for jobs in its northern neighbor. Although one should treat such demands with due caution, the easing of the border and customs regime in some points on the Chinese-Russian border and the creation of free-trade zones could benefit Russia as well by contributing to the development of its eastern regions. In the first place this means replenishing its labor force.

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Labor Migration and Wage Inequality

Labor immigration in China seems to have positive effects on wage growth for both labor migrants and local workers.

Xiaohan Zhong

Since the beginning of China’s reforms and especially after the late 1980s, the system of permanent residence registration (Hukou) and related government policies, which had been preventing people from migrating for several decades and had thus resulted in the segmentation of the labor market, gradually but persistently became less strict. Labor from less-developed rural areas in mid and west China flocked into developed urban areas along the eastern coast.

The impact of this so-called “tide of rural labor” has seen rural migrants taking jobs unoccupied by urban workers and thus coming to dominate in all kinds of unskilled occupations, such as construction workers, repairers, waiters, cleaners or nannies. Related to (but probably not resulting from) such an occupational segmentation, rural migrants have been earning much lower salaries than their urban counterparts. Additionally, labor flows have not led to wage convergence across regions. On the contrary, in the past two decades the trend has been divergence between urban and rural labor, and east and west regions.

The theoretical model proposed in our research paper is based on Kremer and Maskin (1996). The model gives a specific production function, where a typical production process can be accomplished only through the cooperation of workers playing different roles, e.g. "white-collar" and "blue-collar" workers. There are two assumptions: first, there are imperfect substitutions of skills in these two roles, and second, the relative importance of these skills differs. Under some conditions, our theoretical model shows that:

- After entering urban labor markets, the less-skilled rural migrants will do blue-collar work only, and urban workers will do white-collar work only, thus, these groups exist alongside each other with no crossover or mixing.
- Real wages of rural migrants in urban labor markets will remain unchanged, and those of urban workers will rise.

Labor Migration Benefits All Workers

The implications of the model are quite striking: labor migration, through cross-match, benefits both rural and urban workers. However, the wage gap between rural migrants and urban workers increases. Finally, occupational segregation and wage differentials are both outcomes of skill differentials, no causality exists between them. East-west regional divergence can also be explained by using a variation on this model.

How does labor immigration affect local wage growth? In our analysis, which uses provincial cross-sectional data in various periods after the reform and averaged across years, we find that throughout the reform era, labor immigration was increasing local workers’ wage growth rate. In a typical year, 1% labor immigration (as a share of the local population) raises local wage growth rate by roughly 1% (see Graph).

From the above theoretical and empirical analyses several important implications follow: first, skill differences seem to be root causes of both wage inequality and occupational segregation. Thus, education might be the single most important approach to eliminating the ‘dual labor market’ and related inequalities. Second, labor migration has really been a reform without losers. The theory explains why there are hardly any tensions between rural migrants and urban workers, at least from the urban side. Third, wage inequality may be a natural result of resource re-allocation by markets, and not by policy discriminations. Regional divergence may not be a bad thing at all — wage differentials and occupational segregation are at least better than market segmentations, for everyone involved.

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Has Trade Liberalization Brought Gender Equality?

Trade liberalization in China has narrowed the gender wage gap for women with higher levels of education but increased discrimination in the labor market against uneducated women in urban areas.

Yin He

It is a widespread phenomenon all over the world that female workers have lower wages than their male colleagues. The 2004 labor market survey of graduating college students in Beijing, Shanghai, and Guangzhou, the three biggest cities in China, shows that the number of employers who believe that male college graduating students are more efficient as "professional workers" is 46% higher than the number of employers who believe in the efficiency of female graduates. For sales jobs, the proportion is nine to one, and for management jobs four to one. None of the employers think that female graduates can do better than their male colleagues in manufacturing. Therefore, the number of employers who are willing to hire a male student for a given wage is 14 times higher than those willing to hire a female student.

It is believed that part of the gender wage gap can be explained by wage determinants, such as education and experience. Due to cultural traditions and the fact that females usually spend more time and effort on family, females generally get a lower level of education and less work experience. Moreover, females may not be suitable for some jobs, e.g., laborers or engineers, so female workers, on average, get a lower wage than males. However, it is true that these characteristics can not completely explain the gender wage gap, and labor markets all around the world do discriminate against women.

More importantly, the gender wage gap is closely correlated with trade liberalization. Trade liberalization could narrow the gender wage gap via two channels. Firstly, it increases the overall income and development level of a country, so that access to education is easier and less costly for females. Secondly, trade brings more competition into the domestic market, which reduces the profit margin and leaves domestic employers with fewer resources to discriminate. However, trade liberalization could also widen the gender wage gap. As openness increases competition, minority groups in the labor market such as female workers have lower bargaining power and get a lower wage rate.

We examine two household income surveys conducted in China in 1988 and 1995. Between those years China's imports increased from US$55 billion to US$132 billion, exports expanded from US$47 billion to US$149 billion, and annual real income per capita almost tripled, according to China Statistics Bureau and UN Commodity Trade Statistics.

Fairer Pay for College Graduates in Import-Competing Sector

In studying the effect of trade liberalization on the change in the gender wage gap, especially the change in the gap for groups with different education levels, we find that the wage level for both female and male increased dramatically between 1988 and 1995 in line with the large increase in trade liberalization. However, Chinese female workers continuously experienced a lower income level than male workers with the same education level, political identity, and contract type, in the same industry sector and a firm with the same type of ownership. Moreover, trade liberalization was significantly associated with the wage increase for females with technical school or college degrees, while for females with only high school education or lower degrees there was no such increase.

The number of employers willing to hire a male student for a given wage is 14 times higher than those willing to hire a female student.

Beyond Transition • January—March 2006
markets, their profit margin decreased, which forced them to be more efficient in production and management. The biggest gender wage gap reduction was in the group with completed technical education, followed by high school graduates, college graduates, and finally by workers with junior high school and elementary school education. The reason for such a sequence lies in relatively low skill-intensive exports from China in the late 1980s and early 1990s. Employers in the exporting sectors preferred workers who had professional training from technical school rather than with a higher level of general education. So, in this case, female employees with technical school and high school qualifications were treated more equally due to the increase in exports.

Finally, in urban areas the income of females without any qualifications not only increased by a smaller margin generally, but also became even lower compared to their male colleagues. The change in openness was positively correlated with an increase in the gender wage gap for workers without qualifications from 1988 to 1995. A one percentage point increase in the ratio of imports to GDP from 1988 to 1995 implies that the gender wage gap for workers without qualifications increased by RMB 43.95 Yuan. The adoption of the "household contract responsibility system" increased the productivity of the agricultural sector on a large scale and released millions of people as surplus labor — largely comprised of unskilled female workers — from the rural areas. As a result, unskilled female workers in urban areas suffered from a huge inflow of unskilled labor, and with relatively lower wage levels the wage gap further increased.

To summarize, female workers continuously experienced discrimination in the labor market in the late 1980s and early 1990s. Trade liberalization brought more severe competition into the domestic market and more equality for most workers. More specifically, it narrowed the gender wage gap for women with a relatively higher level of education, especially those who graduated from college and technical schools. However, females without any qualifications in urban areas suffered the most discrimination in the labor market, mostly due to the shift in relative labor demand in favor of people with relatively higher education levels and the large-scale migration of uneducated female labor from the rural areas.

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tronic equipment and optics, as it does of light industry products.

Thus, while Russia's exports are highly dominated by minerals, its exports to China are better-balanced. Chinese exports to the rest of the world, on the contrary, are much better diversified than its exports to Russia.

The Balassa index approach provides a deeper analysis of export composition. The indexes are constructed on commodity or industry aggregation levels and show how biased the trade in a good of a particular country is relative to the worldwide trade in this good. Balassa indexes above 100% for both exports and imports mean an extensive trade both ways, i.e. a country exports and imports the particular good on a larger scale than the world as a whole. This kind of intra-industry trade is more characteristic of developed countries, where trade flows can make up to 70% of a country's trade. The goods (industries) with the export index above 100% and the import index below 100% are the goods (industries) in which a country specializes as an exporter according to comparative advantage principles.

Examined this way, Russia and China demonstrate obvious differences in their trade composition. China trades many more goods intra-industrially than Russia. These include transport equipment, watches, chemicals, textile, fur, wool, and others. The only such good in Russia is textiles. China has a comparative advantage in export of explosives, processed food, and leather goods, while Russia specializes mostly in resources: metals, fuel, and fertilizers. This implies that China's trade composition has some features usually attributed to developed countries, while Russia's structure of trade flows is typical for a developing country.

China's trade composition has some features attributed to developed countries, while Russia's structure of trade flows is typical for a developing country. Between themselves, China and Russia also mostly trade in goods in which they have a comparative advantage, and have little intra-industry trade.

**Russia's Exports to China at "Normal" Level**

In order to understand the extent of Russia-China trade in the context of world bilateral trade flows we perform a gravity model analysis and compare predicted and actual trade flows. Controlling for GDP per capita, size, distance between capitals, existence of a common border, regional trade agreements, etc. we find that the level of Russia's exports to China can be considered as "normal" given the economic and geographical size of both countries, their development levels, and their cultural and historical differences. At the same time there is a little bit of "under-trading" from China's side. Therefore, given language differences, the absence of a shared (colonial) history and a currency union, there are limited possibilities for large-scale growth in the bilateral trade volume.

**A Special Place for the Russian Far East?**

China has recently been trying to increase its presence in traditional and new markets in Russia. The Chinese are interested in getting access to Russia's natural resources and technological potential. At the same time Russia could benefit from better economic cooperation between its Far East regions and a rapidly developing southern neighbor. Due to their remote geographical position and high transportation costs these regions have not been getting any significant positive effects from economic development in European Russia. The proximity of these regions to a huge and fast-developing market could play an important role in stimulating business activity in the Far East and the geographical diversification of production in Russia. The only way to exploit this opportunity is through greater trade integration between the Far East regions and China.

However, a simple analysis of the regional trade flow distribution from Russia to China shows that the regions currently most actively involved in trade are those further away from China. Perm, Irkutsk, Karelia, Voronezh, Belgorod, Vologda, Chelyabinsk, Tula, Murmansk, and Nogorod regions have above average trade with China, while the Far East clearly under-exploits the potential advantages of trade linkages with China.

Hence we believe that regional initiatives, rather than a country-wide trade policy would give higher returns in terms of increasing trade linkages between China and Russia.

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The Russian Stock Market: Lessons from the First Decade

Since 2005, the Russian stock market has become more sensitive to macroeconomic factors, as opposed to corporate governance scandals and political risks as was the case before

Alexei Goriaev and Alexey Zabotkin

The Russian stock market has become one of the largest emerging markets in the world. Starting from scratch in late 1994, it has now reached the total market capitalization of over US$400 billion, or 60% of GDP. More than 250 Russian stocks are listed locally or abroad, the monthly trading volume is over US$14 billion, and IPOs are booming. Yet, the path leading to this outcome has not been smooth, reflecting the ups and downs of Russia’s transition and investors’ perceptions of the country’s risks.

During the last 11 years the RTSI, the most prominent index of the Russian stock market, has grown by more than 11 times, which corresponds to the average annual return of around 50%. However, high returns were accompanied by high risks, both in time and cross-sectional dimensions. In almost every year, the RTSI’s annual high exceeded the same year’s low by more than 50%. The worst year was 1998 when the RTSI lost 85% of its value after the Russian government defaulted on its debts and devalued the rouble. The cross-sectional variance of returns was also considerable, with the difference between the lowest and highest deciles of annual returns always above 150%. What were the fundamental determinants of the investment risk driving the RTSI and explaining differences in individual stock returns?

Mirroring History

Throughout its brief history, the Russian stock market has mirrored the country’s defining moments from the 1996 re-election of President Yeltsin, which headed off the threat of a Soviet revanche, to the serious setbacks of the financial debacle of 1998 and, more recently, the destruction of Yukos (see Figure 1). Yet, the extreme volatility associated with these shocks should not obscure the market’s sensitivity to many less dramatic, but still important developments, including those in corporate governance and Russia’s relations with the outside world.

In the first years of the market’s history, up to the resignation of President Yeltsin at the end of 1999, the market was moved by a binary perception that Russia would either fall back into Soviet times if the communists came to power, or else would develop into a market-based system. The RTSI’s first months were marked by a steady decline reflecting fears of the seemingly inevitable victory of the communist party in the coming elections. In the second quarter of 1996, the RTSI tripled as the initially hopeless prospects of Yeltsin’s re-election dramatically reversed. However, after the re-election, the political leadership lacked the political capital to implement tough but essential reforms, above all fiscal reforms. This became a root cause of the 1998 financial crisis, even though the collapse had been precipitated by the Asian crisis.

Meanwhile, the administration’s weakness was compounded by the growing power of the so-called “oligarchs” who had acquired control of natural resources assets in the notorious “shares-for-loans” privatization schemes in late 1995. With many senior officials and legislators effectively on the payroll of different business groups, the already weak administration became even less capable of carrying out reforms, including the enforcement of better corporate governance standards. The risk of expropriation by Yeltsin’s successor increased the incentive for the oligarchs to extract as much cash from their companies as they could, which meant abusing minority shareholder rights in a series of scandalous dilutions, transfer pricing and poor disclosure.

Figure 1. The RTSI dynamics in 1995–2005
The years after President Putin's election in March 2000 can be divided into two periods. Initially, it took two years for investors to recover confidence in Russian equities. In July 2000, President Putin and business leaders reached a compromise including a de facto amnesty of the 1990s privatization schemes in exchange for the oligarchs' consent to stay out of politics. This agreement, along with the adoption of the new law on joint stock companies in 2002, transformed the incentives for improving corporate governance, as the controlling owners of major corporations became interested in increasing their companies' market valuation.

**Yukos First to Improve Corporate Governance**

The company that took the lead in the move from vice to virtue on the corporate governance front was Mikhail Khodorkovsky's Yukos. Once a nightmare for minority shareholders, starting from 2000, Yukos began setting new standards in reporting, auditing, and dividends payments. In June 2002, the shareholdings of Khodorkovsky and his partners in the Menatep group were disclosed. As a result, the company's share price increased by more than twelve times in the course of two years, which made Yukos Russia's second-largest company (see Figure 2). Corporate governance improvements in other Russian companies have also increased their market capitalization.

Putin's popularity assured political stability, and a recovering oil price and prudent fiscal policy were keys to macroeconomic stability. In addition, the new administration demonstrated the readiness and ability to pursue serious structural reforms, including the introduction of a flat 13% income tax in 2000. Yet it was only in the fourth quarter of 2001 that the rally in the stock market started. It was triggered by the external shock of the 9/11 events, when Russia emerged as a US ally in the new "war on terror".

Since then, there has been one major interruption in the market's progress — "the Yukos affair". In the second half of 2003, Yukos' top managers and major owners, Mikhail Khodorkovsky and Platon Lebedev, were arrested on charges of tax evasion and embezzlement. The company was put under scrutiny and received numerous backdated tax claims that eventually amounted to US$27.5 billion. Apparently investors interpreted the Yukos events as a sign of a toughening of government policy towards the business community. Analysis of stock price sensitivity to Yukos events shows that firm-specific political risks appeared especially high for non-transparent private firms, oil companies, and companies privatized via loans-for-shares auctions.

The Yukos affair triggered four corrections in the market, the most serious of which, in April — July 2004, dragged the RTSI down by 33%.

In the end, investors believed that the destruction of shareholders' equity in Yukos along with several other instances of backdated tax claims against private companies would not lead to a widespread expropriation of companies by the state. Since 2005, the Russian stock market has become more sensitive to macroeconomic factors, such as oil prices, money liquidity and global equity market performance, rather than corporate governance scandals and political risks, as was the case before. A favourable macroeconomic environment spurred the most recent rally in the market, which started in August 2005 and nearly doubled the RTSI by February 2006. The continuing surge in oil prices helped the government to boost its revenues, repay a large fraction of debt and set up a stabilization fund. Companies in the oil and related industries have also benefited. Excessive money liquidity, driven by the high domestic banking system's liquidity and foreign inflows, has pushed up demand for stocks. In addition, the Russian market has become more integrated into global equity markets, which themselves have shown decent performance during the period.

The relative success of the Russian stock market at this point in time reflects substantial progress in the development of new institutions and economic reforms. Yet, many problems remain: high concentration, low liquidity, sensitivity to non-economic risks, and, as a result, potentially high market volatility. These issues must be gradually solved to ensure further development of the market.

Alexei Goriaev is Professor at the New Economic School and a Lead Economist at CEFIR, Moscow. Alexey Zabotkin is Director of Equity strategy at Deutsche UFG, Moscow. The article summarizes the authors' research on Russian financial markets, and Alexey Goriaev's presentation at the China-Russia Conference in Beijing in December 2005.
Entrepreneurship in China and Russia

Chinese and Russian entrepreneurs have many common characteristics: they take risks, choose work over leisure, and want more money compared to other people.

Simeon Djkov, Yingyi Qian, Gerard Roland, and Ekaterina Zhuravskaya

This comparison of Chinese and Russian entrepreneurs is based on a pilot survey conducted in Russia in 2003 — 2004 and in China in 2004 — 2005, which is a part of a large-scale research project in Russia, Brazil, China, India, and Nigeria. In both Russia and China, individuals in seven large cities in four different regions were surveyed. The samples include both entrepreneurs and non-entrepreneurs in order to understand how these groups differ in terms of individual characteristics, sociological variables, and their perceptions of the institutional, social and economic environment.

Entrepreneurs on average are more mobile across jobs and geographically. In Russia, they have lived in more localities and have had a significantly higher number of professional activities than non-entrepreneurs. Chinese entrepreneurs have worked in a larger number of industries compared to non-entrepreneurs.

In line with the common perception that entrepreneurship is associated with risk-taking, entrepreneurs report significantly lower risk aversion than non-entrepreneurs. When asked whether respondents were willing to accept one of two risk-neutral gambles, 77% of entrepreneurs in Russia and 90% of entrepreneurs in China responded yes (compared to 67% and 57% of non-entrepreneurs, respectively).

Entrepreneurs report higher levels of satisfaction with life compared to non-entrepreneurs. In Russia, 92% of entrepreneurs said they were happy compared to 73% of non-entrepreneurs. In both countries a very strong reason for not retiring was the desire to earn more money. In Russia, job satisfaction and a feeling of being useful for society also played an important role; the opposite was true for China however.

Compared to non-entrepreneurs, a larger share of parents of Russian entrepreneurs (73% vs. 48%) had higher or special education. There are no differences in parents’ education in China. Nevertheless, fathers of entrepreneurs in both countries were more likely to have been bosses or directors (19% vs. 12% in Russia, and 30% vs. 13% in China).

82% of Chinese entrepreneurs think that local government favors them whereas only 49% of Russian ones share the opinion.

Of the Chinese entrepreneurs 82% think that local government favors them and 70% of non-entrepreneurs share this view. In Russia, only 49% of entrepreneurs are of the same opinion (53% of non-entrepreneurs). Compared to the rest of the population, Russian entrepreneurs have a more negative perception of the government’s attitude towards entrepreneurship (at all levels of government). Entrepreneurs in China feel more secure with respect to property rights protection and trust courts more compared to non-

Another important difference between entrepreneurs and non-entrepreneurs relates to leisure-work choices. Entrepreneurs were much less likely to agree to retire if they had received a windfall income of 100 to 500 times the annual GDP per capita of the country. In both countries, a very strong reason for not retiring was the desire to earn more money. In Russia, job satisfaction and a feeling of being useful for society also played an important role; the opposite was true for China however.

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Why Shock Therapy May Lead to Worse Performance Than Gradual Transition

The speed of reforms involving a reallocation of resources should be such that the scale of restructuring does not exceed the investment potential of the economy

Vladimir Popov

Among many explanations for the transformational recession that occurred in the 1990s in most transition economies, there is one that hardly anyone can deny: the adverse supply shock caused by the change in relative prices. The evidence from all transition economies shows that a reduction of output in a country is well explained by distortions in industrial structure and trade patterns (it remains statistically significant no matter what control variables are added). The magnitude of these distortions, in turn, determines the change in relative prices, when they are deregulated.

In Russia, industries with the greatest adverse supply shock (deteriorating terms of trade — relative price ratios for outputs and inputs), such as light industry, experienced the largest reduction of output (see Graph 1). Such an explanation is simple and straightforward, yet somehow it is not discussed much in the literature.

Consider a country where deregulation of prices (or elimination of trade tariffs/subsidies) leads to a change in relative price ratios and thus produces an adverse supply shock for at least some industries. Capital should be reallocated from industries facing declining relative prices and profitability to industries with rising relative prices. Assume that 50% of total output is concentrated in non-competitive industries: this whole sector should disappear either gradually or at once depending on how fast relative prices change; capital is not homogeneous and cannot be moved to the competitive sector, whereas labor can be reallocated to the competitive sector without costs.

If prices are liberalized instantly, then a non-competitive sector becomes unprofitable and output falls immediately by 50%; later savings for investment are generated only by the competitive sector, so it takes a number of years to reach the pre-recession level of output. If reforms are carried out slowly (gradual price deregulation or elimination of tariffs/subsidies), so that every year output in the non-competitive sector falls by, say, 10%, this fall could be largely compensated by the increase in output in the competitive sector. The best trajectory, of course, is one with a speed of deregulation that leads to the reduction of output in the non-competitive sector at a natural rate, i.e. as its fixed capital stock retires in the absence of new investment.

The example illustrates that there is a limit to the speed of reallocating capital from non-competitive to competitive industries, which is determined basically by net investment/GDP ratio (gross investment minus retirement of capital stock in the competitive industries, since in non-competitive industries the retiring capital stock should not be replaced anyway). It is not reasonable to wipe away output in non-competitive industries faster than capital is being transferred to more efficient industries.

Market type reforms in many post-communist economies created exactly this kind of a bottleneck. Countries that followed the shock therapy path found themselves in a supply-side recession that is likely to become a textbook example: an excessively quick change in relative prices required a degree of restructuring that was simply not achievable with the limited pool of investment. Up to half of these economies was made non-competitive overnight due to the change in relative prices after deregulation. Output in these non-competitive industries was falling for several years and fell in some cases to virtually zero, whereas the growth of output in competitive indus-

Graph 1. The RTSI dynamics in the period 1995–2005

R = 0.4062
tries was constrained, among other factors, by limited investment potential and was not strong enough to compensate for the output loss in the inefficient sectors.

Hence, at least one general conclusion from the study of the experience of transition economies appears to be relevant for the reform process in all countries: provided that reforms create a need for restructuring (reallocation of resources), the speed of reforms should be such that the scale of required restructuring does not exceed the investment potential of the economy. In short, the speed of adjustment and restructuring in every economy is limited, if only due to the limited investment potential needed to reallocate capital stock. This is the main rationale for gradual, rather than instant, phasing out of tariff and non-tariff barriers, of subsidies, and other forms of government support of particular sectors (it took nearly 10 years for the European Economic Community and for NAFTA to abolish tariffs).

Empirical evidence for such an explanation seems to be very persuasive. The collapse of output during transition can be best explained as adverse supply shock caused mostly by a change in relative prices after their deregulation due to distortions in industrial structure and trade patterns accumulated during the period of central planning (additional adverse supply shock came from the collapse of state institutions), while the speed of liberalization, to the extent that it was endogenous, that is, determined by factors of political economy, had an adverse effect on performance. In contrast, at the recovery stage ongoing liberalization starts to affect growth positively, as the impact of pre-transition distortions disappears. Institutional capacity and reasonable macroeconomic policy, however, continue to be important prerequisites for successful performance.

Not surprisingly, in 2004 — 2005 the list of countries that exceeded the 1989 pre-recession level of output included a lot of procrastinators in terms of economic liberalization: in addition to 5 central European countries and Estonia, there were also Turkmenistan, Uzbekistan, Belarus and Kazakhstan, not to mention China and Vietnam.

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**Graph 2. GDP in 2004 as a percentage of 1989**

- Moldova
- Georgia
- Ukraine
- Tajikistan
- Azerbaijan
- Kyrgyzstan
- Russia
- Lithuania
- Bulgaria
- Latvia
- Croatia
- Armenia
- Romania
- Kazakhstan
- Belarus
- Estonia
- Turkmenistan
- Czech Republic
- Uzbekistan
- Hungary
- Slovakia
- Slovenia
- Poland

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### China GDP and Industrial Output (1994–2005)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP</th>
<th>Industrial Output</th>
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<tr>
<td></td>
<td>RMB, bn</td>
<td>% yoy</td>
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<tr>
<td>1994</td>
<td>4819.8</td>
<td>13.1</td>
</tr>
<tr>
<td>1995</td>
<td>6079.4</td>
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</tr>
<tr>
<td>1996</td>
<td>7177.7</td>
<td>10</td>
</tr>
<tr>
<td>1997</td>
<td>7897.3</td>
<td>9.3</td>
</tr>
<tr>
<td>1998</td>
<td>8440.2</td>
<td>7.8</td>
</tr>
<tr>
<td>1999</td>
<td>8967.7</td>
<td>7.6</td>
</tr>
<tr>
<td>2000</td>
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<td>8.4</td>
</tr>
<tr>
<td>2001</td>
<td>10965.5</td>
<td>8.3</td>
</tr>
<tr>
<td>2002</td>
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</tr>
<tr>
<td>2003</td>
<td>13582.3</td>
<td>10</td>
</tr>
<tr>
<td>2004</td>
<td>15987.8</td>
<td>10.1</td>
</tr>
<tr>
<td>2005</td>
<td>18232.1</td>
<td>9.9</td>
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Source: China Economic Indicators at www.worldbank.org/china

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The World Bank & CEFIR
Industrial Agglomeration and Regional Specialization in China

An increase in the geographic concentration of economic activities in recent years indicates the increasingly important role of economic, rather than political, forces behind location decisions.

Jiangyong Lu and Zhigang Tao

There are two ways of characterizing geographic concentration of economic activities: one is to examine if production in selected industries is concentrated in a few regions, called industrial agglomeration, and the other is to look at the specialization of economic activities in selected regions, called regional specialization. These two measures are closely related. Industries become more agglomerated as regions become more specialized. Conversely, industries become more dispersed as regions become despecialized.

From the founding of the People’s Republic of China in 1949 up until 1979, the Chinese government dispersed its important industries across the country, especially in mountain areas, for political and strategic reasons. Obviously, the geographic distribution of economic activities was economically suboptimal. With the economic reform started in 1979, it is expected that the geographic distribution of economic activities will have dramatic adjustments toward economic optimality. Previous research has shown that geographic concentration in China declined after partial economic reforms and started to increase later on. However, there is some controversy over the time span of these trends partly because of a lack of large samples of firm-level data.

We used firm-level data of more than 160,000 industrial firms year-on-year from 1998 to 2003, covering all state-owned firms and non-state owned firms with annual sales of more than 5 million RMB. These firms stand for the majority of China's industrial output, and so the data is highly representative. Each firm's detailed address and product information was double checked to make sure every firm had a correct regional and industrial classification. We also applied G. Ellison and E. Glaeser’s recently developed measurements for industrial agglomeration, which had not been previously implemented for Chinese data.

Foreign Firms Concentrated in Coastal Regions

Using Geographic Information System (GIS), we drew several maps of the geographic distribution for firms with various ownership structures and found that:

- Of all types of enterprises, state-owned firms are distributed most evenly across the country.
- Collective-owned firms were more concentrated than state-owned enterprises, but more dispersed than other types of firms including Chinese private enterprises and firms with foreign investments.
- The fastest growing type of firms between 1998 and 2003 was private firms, which had grown from 9,000 to 60,000 in the sample.
- The share of foreign firms has not changed much during the period, and has remained concentrated in coastal regions.

Industrial Agglomeration Increased Across Sectors

Calculation and comparison of various indexes with other studies of China and other countries produced the following findings:

- Industrial agglomeration measured by the Hoover Index (measures the evenness of distribution across territorial units — ed.) increased between 1998 and 2003 for all industry and region combinations.
- In relation to the United States (US), the most comparable country in terms of aggregation level in the data, the percentage of "not very agglomerated industries" in China (80%) is much higher than in the US (10%).
- Concerning the degree of co-agglomeration, which measure how sub-industries within broader industrial groups agglomerate together, the levels for China were also lower than those of the US for most industries.

We first analyzed regional specialization in China by dividing the country into three regions: coastal, inland, and western; then analyzed the situation in smaller regions, including provinces, cities, and counties. Our findings can be summarized as follows:

- The coastal region was specialized in significantly different industries as compared to the inland and western regions, while differences between the inland and western regions were not obvious.
- Regional specialization indices showed that the degree of regional specialization for most provinces increased between 1998 and 2003. Meanwhile, coastal provinces were the most specialized, followed by inland provinces, then western provinces.
- Intra-regional similarity, which measures how sub-regions within broader areas specialize in similar industries, increased for most regions.

Our study has uncovered strong evidence for increasing geographic concentration — both regional specialization and industrial agglomeration — in China in recent years. It suggests that, with the economic reforms started in 1979, economic forces have been playing a dominant role in the geographic concentration of economic activities despite local protectionism. This will strengthen the competitiveness of China's industries in the long run.

Jiangyong Lu is a Research Fellow of the Center for China in the World Economy at Tsinghua University, Beijing. Zhigang Tao is a Professor of the Faculty of Business and Economics at the University of Hong Kong. This summary of research findings is based on the authors' presentation at the China-Russia Conference in Beijing in December 2005.
Russia's Regions: In What Social Space Do We Live?

Natalya Zubarevich met BT to discuss Russia’s regional inequalities, regional policies and trends in the social and economic development of the regions

BT: Given the heterogeneity of Russia's regions, can one single out some common features in their social and economic development? Have any trends emerged recently?

The overall trend has been economic growth since 1999; the differences are only in the rate of growth and its sustainability. Import-substituting regions were the first to start growing, but their economic growth has gone up and down depending on the rise in household incomes as well as the demand in the extraction industries for engineering products. Growth in the export-oriented regions got off to a late start, but then accelerated thanks to the rise in world prices for their export commodities. Some regions have witnessed a slowdown of growth or even a decline, but the latter was often related to institutional factors. For example, industrial decline in the Tomsk region in 2005 was due to problems connected to the Yukos affair, and in the Samara region institutional factors were added to the problems of the leading enterprise, carmaker AvtoVAZ, which led to stagnation.

A second sustained trend has been the universal reduction of poverty, which has, however, lagged behind income growth. Average per capita incomes in the majority of regions were back to the pre-default level by late 2002, but it was not until the end of 2004 that the poverty level dropped to the 1997 level. This implies that the distribution of the benefits of economic growth was uneven among social groups, with the poor left on the sidelines.

Furthermore, with the exception of the least developed regions which had growing demographic pressures, Russia’s economic growth was accompanied by a significant reduction in unemployment in the regions only as it rebounded after the default. But between 2002 and 2005 the unemployment level hardly changed at all because export-driven growth creates almost no new jobs. As a result, such growth cannot be regarded as sustainable.

Yet another factor is investment, which should back up economic growth. The geography of investments, however, reveals obvious regional disparities. In Russia investments flow to two destinations: oil and gas-producing regions and metropolitan agglomerations (Moscow and St. Petersburg and their surrounding areas). More than half of Russia’s regions receive minimal per capita investments in fixed capital.

Finally, Russia is probably unique in that no other country has experienced five years of sustained economic growth and at the same time a decline in life expectancy. All these factors indicate that the current economic growth is unsustainable and of an inferior quality.

BT: How acute is the problem of inequality for Russia’s regions?

First of all, it is not a novel problem. We have been facing it for more than a decade. Second, economic backwardness is often camouflaged by redistribution. Per capita budgetary expenditures in some of the poorer regions are higher than in most averagely-developed and even in some comparatively well-developed regions, if adjusted for inflation. Even more revealing is a comparison of neighbors with similar living conditions: in the very poor Buryat Autonomous Okrug per capita budgetary expenditures are 1.2 times higher than in the more developed Irkutsk (1.8 times higher in 2003).

The problem is that the need for "camouflage", that is, financial injections into the weakest economies, is growing, and so are the risks of continuing such a policy. Pumping huge amounts of cash from the center to the regions will not solve the problem until a coherent policy emerges for stimulating internal sources of growth and the natural competitive advantages, however small, that a region may have. If instead resources continue to be funneled into inefficient institutions, as is the case today, nothing but corruption and a "free-rider" mentality can result.

There is a growing awareness of the dead-end nature of the policy being pur-
sued, and there are signs of a shift towards a policy of supporting the stronger regions. The draft regional strategy of the Ministry of Regional Development proposes identifying 10 — 12 advanced regions that will become "sources of growth". This is all very well, but the Ministry is sure that it can determine who will be lucky enough to be designated as the "locomotives", based on the criteria that it has come up with itself.

In my opinion, such dirigisme is patently ineffective. It is necessary to loosen the financial "knot" and to allow more independence to the regions, which are already demonstrating better governance. This will help create various regional development models, foster normal competition among the regions for investments, and broaden the choice of best practices for the remaining regions. At present, such choice is depressingly straightforward and essentially consists of trying to get closer to the redistribution of oil money. As soon as the oil boom subsides, all the unresolved problems will resurface.

BT: What are the most effective measures, at all levels, that could diminish the gap between regions?

There are no simple recipes. One has to balance aid and development to, on the one hand, prevent the degradation of underdeveloped regions and, on the other, grant the stronger regions a degree of independence that would enable them to tap all their resources. It is impossible to find an effective solution in the framework of Russia's rigid vertical power structure, when decisions that are deemed to be effective are handed down from above. This leads to total distortion of the original idea; as the measures move down the hierarchy they are fleshed out with details that turn them into a caricature of those originally planned.

Inequality is inevitable, it stimulates development. The important question is of the degree of inequality and the mechanisms used to stimulate development. Natural positive trends are already emerging: city agglomerations and the areas around them develop the fastest. Advancements are already being diffused in Russia from big cities to regional capitals, to smaller cities with export-oriented industries. This diffusion comes in the form of faster income growth and the expansion of local service markets and modern consumer behavior followed by a change of incentives. Another area of growth is sea port regions located on the main trade routes (especially in the south) whose development has accelerated in recent years.

Despite these positives, delicate and creative work lies ahead which cannot be easily combined with the extension of the vertical power structure down to the municipal level. Thus, the logic should be simple: to follow the trend and speed up the geographical diffusion of advancements rather than having this diffusion proceed orthogonally to the development trend.

BT: What regions, in your opinion, have the biggest potential to become more competitive?

There is institutional potential in at least three Russian regions that have a strong innovative component in governance and business management: Tomsk, Samara, and Perm. The Krasnodar and the Rostov regions (in the future, also Kaliningrad) are certainly up and coming, although until recently their coastal locations — an important factor in the world economy — have played a minor role.

Three agglomerate areas of growth are emerging in Russia: Moscow and the Moscov region, including the Yaroslavl region and adjacent parts of neighboring regions; St. Petersburg and the Leningrad region; Rostov and Krasnodar and their port zones. There are comparatively large "nuclei" in the Volga and Urals areas: Perm, Samara-Togliatti agglomeration, and Yekaterinburg, although each is not without problems. The situation in Tatarstan depends heavily on political factors. East of the Urals Tomsk has the most advanced institutions, and possibly Krasnoyarsk, while Novosibirsk has so far been short of resources. Growth in the Far East (other than the oil-rich Sakhalin) is the most problematical, because it is being arrested by the corruption-ridden institutions in the Primorsky region and excessive dirigisme in Khabarovsk, as well as puny federal investments.

So, for now the growth zones do not reach further than Lake Baikal. This configuration is based on natural growth factors — agglomeration, infrastructure and institutions — and so may be a long-term one.

Natalya V. Zubarevich is Professor at Moscow State University. She is Director of the Program "A Social Atlas of Russia's Regions" which the Independent Institute for Social Policy in Moscow has been creating since 2003. Julia Babich conducted the interview.

BT
Unleashing the Potential: Growth and Investment in Russia's Regions

Performance of the Russian regions has depended on their relationship with the federal authorities and local businesses, their ability to implement reforms, and support to new sources of growth.

Olga Mosina

Progress in investment and growth in Russia's regions has been limited and highly uneven, despite the many potential opportunities. In order to sustain the high economic growth levels of recent years, Russia needs to diversify its economy. Active promotion of small business growth and foreign investments in the regions are crucial factors in this regard. Both large foreign investors and small domestic firms tend to have relatively little leverage to work around ill-functioning institutions and corrupt bureaucracies, so market-friendly and well-functioning institutions, regulations and policies are very important for these two groups.

High Potential, Poor Performance

The investment climate in Russia as a whole remains relatively poor, which is not surprising given the low level of institutional development (measured by governance indicators in Kaufmann et al.). According to UNCTAD, Russia ranked 97th out of 140 economies in 2003 in terms of inward FDI performance and 27th in terms of inward FDI potential. The accumulated investment stock in 2004 was US$98 billion (or 17% of GDP), which can be compared to US$245 bln in China (15% of GDP) and US$61 bln in Poland (25% of GDP).

Just as the Russian economy as a whole is dominated by Moscow and the energy rich regions, so are the foreign investments. To date, the city of Moscow alone has attracted about one-third of the FDI stock, and the top five regions some 70% of the FDI stock.

The low level of FDI is revealed by data on foreign owned firms' share in total industrial output (see Map). The average share of foreign firms in industrial output (constructed using firm-level balance-sheet data and excluding offshore firms) is 10.3%, and their share in employment is 5.4%. As a comparison, in the early 2000s the average share of employment by foreign firms in Poland was 20%, Czech Republic 32%, and Estonia 41%. The highest share of production by foreign-owned companies is found in the food and timber industries, in which many firms are relatively small and young. The share of foreign-owned firms in the fuel industry remains the lowest among all industries, due to political reasons.

Why have some regions succeeded to improve their attractiveness, while others have failed? Apart from the obvious factors, such as geographical location, urban-rural differences and the availability of natural resources, regions have differed in:

- their relationship with the federal authorities and local businesses,
- their ability and willingness to implement reforms,
- their support for entrepreneurship and innovations.

Reforms Working in Opposite Directions?

Two reforms that have affected the federal-regional relationship were introduced in Russia in the last few years. The political reform of 2004 gave the president the power to appoint governors. The rationale for the reform was to improve the accountability of regional governors and their measures to improve the welfare of local residents, and to increase the political control of the center over the regions. The fiscal reform aimed at improving the regions' fiscal incentives, dividing financial responsibilities between the federal and regional governments, and reforming the system of social benefits. While this political reform lowered the governors' bargaining power tremendously, the fiscal decentralization gave the regions greater autonomy. The reforms may, thus, work in opposite directions. Although the center now has more power to fire governors, the latter might no longer have strong incentives to care about the welfare of citizens, and instead care more about making a positive impression on the president.

Another phenomenon that has had an effect on regional growth is so-called state capture, whereby politically powerful firms receive preferential treatments, such as tax breaks, investment credits, subsidies, free grants of state property, etc., and influence the rules of the game and create obstacles to the emergence and development of competitive businesses. A CEFIR study of state capture across regions shows that it may in fact generate short-term growth, because captors usually represent a large share of the regional economy, and as they benefit from the system, the regional economy also benefits. However, this is not sus-
tainable growth, and the long-term costs from the lack of diversification are potentially large for the regional economy. Besides, the rest of the economy suffers: with an increase in capture, firms without political influence stagnate, their productivity, sales, and investments decline. Regional budgets are negatively affected as tax collection decrease and budget arrears increase. The degree of capture, it is found, depends on industrial concentration, level of education, and voter awareness.

One can note that the regions that are on the top-20 list for least state capture are the very same regions that occupy the top-20 list for growth and a high share of small business activity. In terms of these factors, St Petersburg comes out as a particularly strong performer.

**SMEs Growth Responded Positively to Reforms**

According to the Russian SME Resource Center, small and medium-sized enterprises (up to 250 employees) were non-uniformly distributed over Russia in 2003: the number of enterprises per 1000 economically active people varied from 44 in the Republic of Buryatia to 450 in the Republic of Altai.

The fastest growth of SMEs took place in 2002, when most reforms aimed at easing administrative burden for firms and limiting the abilities of local governments to intervene in the functioning of small business were implemented. However, during this period growth was unevenly distributed across regions (Table 1). Regional variation in reform implementation may help to explain this difference.

Five rounds of monitoring surveys conducted by CEFIR in 2002—2005 indeed concluded that the regulatory burden for small businesses — in the form of inspections by government agencies, licensing, certification, tax administration, and registration procedures — remained high and that the problems stemmed from regional and local enforcement, rather than federal legislation. The five surveys also showed that reforms seem to initially have had a significant positive effect, but the speed of progress declined over time.

Despite large variations in regional performances, regions could not be ranked as “good” or “bad,” as there are significant differences in how severe each problem is within one region. For example, in the fifth round, Sakhalin was the worst performer in terms of costs for licensing, but the best region in terms of inspections.

Overall, three main determinants for reform progress are: local fiscal incentives and a high level of pre-reform small business presence in a region. As with state capture, less concentration of output has a positive role for the regional economy, and is associated with more dynamic reform progress.

Regional and local authorities also have a potentially significant role in improving the regional business climate, as the survey of the business climate perceptions by small business owners suggests (see Table 2). While macroeconomic stability is obviously beyond the reach of regional administrations, they could do a lot to improve tax administration, battle corruption and ensure a level playing field for all firms. A positive finding of the survey is that competition — the only problem on the list that firms in a free market economy should worry about — increased in significance throughout the years, indicating that local markets, in which most SMEs operate, have become more competitive.

**New Sources of Growth**

Regional authorities could also help industrial firms which are going through a process of massive technological and organizational restructuring to innovate more. A joint study by CEFIR and the Institute for the Economy in Transition in Moscow estimates that the number of firms engaged in both innovations and imitations was as high as 60% in 2005. A lack of funding, both from internal and external sources has been cited as the main obstacle to innovations. However, regional governments have a vital role in fostering innovation by improving the infrastructure and supporting education and continued training, as 24% of firms named shortage of qualified personnel and management as a significant barrier, and for 16% of firms this barrier was infrastructure. Such support would allow a more efficient use of the existing human capital, capable of innovating, and not only imitating. This task will become more and more urgent as the Russian technological position improves.

The discrepancy between the investment and growth potential and the highly uneven progress in Russia’s regions is to a great extent based on the institutional, political, fiscal and social structures of Russia. Postponement of vital reforms and the poor implementation of reforms in combination with directly contradictory reforms are the main challenges to bridging the gap.

The piece is based on the joint report “Unleashing the Potential: Growth and Investments in Russia’s regions”, prepared by researchers at the Centre for Economic and Financial Research (CEFIR) in Moscow and the Stockholm Institute of Transition Economics. The papers referred to in the article are listed in Bibliography at the back of the volume.

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**Table 1: Regions with a relatively large share of small business employment**

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Moscow Region</td>
<td>35.6%</td>
</tr>
<tr>
<td>St Petersburg City</td>
<td>31.8%</td>
</tr>
<tr>
<td>Kaliningrad</td>
<td>22.5%</td>
</tr>
<tr>
<td>Leningrad</td>
<td>22%</td>
</tr>
<tr>
<td>Samara</td>
<td>19.6%</td>
</tr>
<tr>
<td>Voronezh</td>
<td>18%</td>
</tr>
<tr>
<td>Tomsk</td>
<td>17.5%</td>
</tr>
</tbody>
</table>

**Table 2: General perception of business climate, selected indicators**

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macroeconomic instability</td>
<td>3.28</td>
<td>2.78</td>
<td>2.60</td>
<td>2.89</td>
</tr>
<tr>
<td>Competition</td>
<td>2.62</td>
<td>2.69</td>
<td>2.78</td>
<td>2.86</td>
</tr>
<tr>
<td>Tax administration</td>
<td>3.10</td>
<td>2.67</td>
<td>2.59</td>
<td>2.59</td>
</tr>
<tr>
<td>Unequal competitive environment</td>
<td>2.26</td>
<td>2.09</td>
<td>2.19</td>
<td>2.3</td>
</tr>
<tr>
<td>Corruption</td>
<td>2.10</td>
<td>1.87</td>
<td>1.93</td>
<td>2.03</td>
</tr>
</tbody>
</table>

Note: 5=threatens firm’s existence, 4=a very serious problem, 3=a serious problem, 2=a slight problem, 1=not a problem.
Mongolia's Competitiveness and Economic Growth

The main obstacles to Mongolia’s economic growth are government bureaucracy, corruption, infrastructure, and taxes, while the country’s strengths include a good education system, flexible labor markets, and an ability to innovate

Janusz Szyrmer

On the World Economic Forum’s (WEF) competitiveness index Mongolia ranked a low 96th. In 2005, Mongolia was included in the WEF ranking system for the first time and became one of 117 countries covered by the 2005 WEF Global Competitiveness Report.

The WEF defines competitiveness as the "collection of factors, policies and institutions, which determine the level of productivity of a country" and thus the level of prosperity that can be attained by an economy. Productivity is viewed as the key driver of the rates of return on investment which in turn determine growth rates. A more competitive economy is one that is more likely to grow faster over the medium and long term.

WEF competitiveness indexes are based on both standard statistics and opinion surveys of business executives. By their very nature, grades given to different competitiveness factors are arbitrary to some extent, and in some cases can be quite controversial. The WEF rankings are closely and positively correlated with the countries' current levels of overall economic development (GDP per capita), with the richest countries classified as the most competitive. Yet this can lead one to question whether the methodology is consistent with the WEF's definition of competitiveness. Are such countries as Sweden or Belgium, which have a high competitiveness index, more likely to grow faster than emerging market economies with lower competitiveness grades, e.g. Vietnam, China, India, Armenia, and Croatia?

Mongolia is 96th in the 2005 growth competitiveness ranking and lies in 102nd place in the GDP per capita ranking (in purchasing power parity dollars), with GDP per capita equal to US$1,918 in 2004. One can thus conclude that Mongolia is doing reasonably well, since its competitiveness is ranked higher than its level of development.

Yet, upon examination of other aggregate indicators, such as national disposable income (including foreign aid), Mongolia is likely to be positioned higher on the development level scale, in which case its performance would not look as good as it does in the WEF report.

On the other hand, one would expect that a classification based on other development prospects indicators that reflected the current and expected rates of growth over the medium and long term, would provide a much higher growth competitiveness score to Mongolia than the one granted to it by the WEF. By arranging the countries in order of 2004 annual growth rates, the relationship between competitiveness and development looks very different from the WEF correlation above. No relationship between WEF growth competitiveness rankings and GDP growth rates can be spotted. Mongolia belongs to the group of countries with the fastest growing economies and low WEF competitiveness rankings. Thus, shifting score evaluations from the level to the rate of change would probably result in quite different rankings for competitiveness, in which many developing countries, including Mongolia, would be given much higher ranks than those produced by the WEF.

A succinct evaluation of Mongolia, based on the results of a survey of business executives (see Figure 1), shows that government bureaucracy, corruption, infrastructure, and taxes are the main stumbling blocks for Mongolia's economic growth.

Table 1 presents Mongolia's main strengths viewed through the prism of WEF variables. The best performing variables are those that get much higher ranks than the country's overall growth competitiveness ranking (i.e. above 96 out of 117). The variables for which scores are below the average are those

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**Figure 1. The most problematic factors for doing business in Mongolia**

- Inefficient government bureaucracy
- Inadequate supply of infrastructure
- Tax rates
- Corruption
- Access to financing
- Tax regulation
- Poor work ethic in national labor force
- Inadequately educated workforce
- Crime and theft
- Inflation
- Policy instability
- Government instability/coups
- Restrictive labor regulations
- Foreign currency regulations

Percent of responses
that place Mongolia in the group of worst performers.

The areas in which Mongolia is doing relatively well are as follows:

1. The flexibility of Mongolia’s labor market, which helps competitiveness, as considered by business executives. Wages are set by the market rather than by the government.

2. Mongolia’s education system has relatively high enrollment rates in tertiary-level education and generally high levels of teaching in math and sciences.

3. The country’s capacity to absorb new technologies and innovate, which is supported by the good education level.

4. The conditions for doing business in the country, including the safety of doing business (low threat of terrorism) and improvements in the access to bank credits.

The areas in which Mongolia is performing worse than all but a few countries are:

1. Most of the supplies to domestic businesses come from abroad. Exporting companies are primarily involved in resource extraction and are poor at product design, marketing, sales, logistics, and after-sales services. Besides, the number of foreign markets that exporting companies sell to is very limited.

2. Corporate governance and business standards/culture are indicated as problem areas. Firms offering poor protection to minority shareholders interests are not highly responsive to customers and make insufficient efforts to retain them.

3. In the opinion of Mongolian business executives, the legal framework for private businesses to settle disputes and challenge the legitimacy of government actions and/or regulations is inefficient and subject to manipulation. Public spending is wasteful, and the government fails to provide many public goods and services. Nor is the government transparent and neutral in its dealings. When deciding upon policies and contracts, government officials often favor well-connected firms and individuals. Many firms make undocumented irregular payments or bribes in relation to exports and imports.

4. Environmental protection and management are singled out as major failures of Mongolian policy. The companies in natural resource, extraction or processing industries rarely concern themselves with the degradation of ecosystems. Government authorized disclosures of environmental performance and pollutant releases are virtually nonexistent. The environmental regulation is lax compared to most countries.

The very presence of Mongolia in a reputable ranking system, such as the WEF’s, awards it a status that many countries with larger and more developed economies still do not have. The areas of strong performance boost the image of Mongolia in the international community and promote Mongolia’s involvement in the global economy. Of course, Mongolian leaders should opt for policies that help improve the country’s competitiveness scores. Yet, bad scores have their uses too. They can fuel public dialogue and bring the attention of policymakers and leaders to important issues in the country’s overall development.

Janusz Szyrmer is a Senior Policy Advisor to the Government of Mongolia. He has previously served as an advisor to governments of several former Soviet bloc countries. He was also a faculty member at the University of Pennsylvania and other universities in the US and other countries. The graphs in the article have been produced by J. Doljinsuren.

### Table 1. Mongolia’s Strengths (WEF rankings)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor market</td>
<td></td>
</tr>
<tr>
<td>Flexibility of wage determination</td>
<td>14</td>
</tr>
<tr>
<td>Pay and productivity</td>
<td>27</td>
</tr>
<tr>
<td>Education</td>
<td></td>
</tr>
<tr>
<td>Gross tertiary enrollment</td>
<td>47</td>
</tr>
<tr>
<td>Quality of math and science education</td>
<td>62</td>
</tr>
<tr>
<td>Technology</td>
<td></td>
</tr>
<tr>
<td>Government prioritization of ICT</td>
<td>22</td>
</tr>
<tr>
<td>Capacity for innovation</td>
<td>66</td>
</tr>
<tr>
<td>Business conditions</td>
<td></td>
</tr>
<tr>
<td>Business costs of terrorism</td>
<td>15</td>
</tr>
<tr>
<td>Access to credit</td>
<td>35</td>
</tr>
</tbody>
</table>

### Key indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2000</th>
<th>2004</th>
<th>2006 (projected)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP (US$ million)</td>
<td>946.6</td>
<td>1516.0</td>
<td>1790</td>
</tr>
<tr>
<td>GDP (% change, previous year)</td>
<td>1.1</td>
<td>10.6</td>
<td>6.0</td>
</tr>
<tr>
<td>Unemployment rate</td>
<td>4.6</td>
<td>3.6</td>
<td>—</td>
</tr>
<tr>
<td>Consumer price index</td>
<td>11.6</td>
<td>7.9</td>
<td>4.3</td>
</tr>
<tr>
<td>Exports of goods (US$ million)</td>
<td>535.8</td>
<td>872.0</td>
<td>883.0</td>
</tr>
<tr>
<td>Imports of goods (US$ million)</td>
<td>-676.0</td>
<td>-1021.0</td>
<td>-1150.0</td>
</tr>
<tr>
<td>Foreign direct investment (US$ million)</td>
<td>40.0</td>
<td>93.0</td>
<td>115.0</td>
</tr>
<tr>
<td>Total external dept (US$ million)</td>
<td>837.0</td>
<td>1360.0</td>
<td>1511</td>
</tr>
</tbody>
</table>

FDI in Eastern Europe and NIS

Spillovers from foreign investments in Russia, Ukraine, Poland, and Romania are positive only for FDI that are export-oriented or hold a dominant position in an industry

Irina Tytell and Ksenia Yudaeva

It is believed that FDI can improve host countries' technological capacities and managerial style. This is due to both the direct effect on the companies that receive FDI and because of the spillover effect on domestic companies in the same industry and in upstream industries through backward linkages. This enthusiasm is, however, not based on rigorous economic theory and evidence. We study the potential effect of FDI entry on domestic companies' production functions in Russia, Ukraine, Poland, and Romania, the largest and most populous countries in the region.

These countries represent a wide spectrum of macroeconomic performance and institutional development. In terms of general effectiveness and rule of law, Poland ranks by far the highest and Ukraine the lowest. The corruption level is lowest in Poland and highest in Ukraine, with Romania and Russia somewhere in the middle. Russia and Ukraine are much less open to trade and foreign investment than Poland and Romania.

The sources of data include the national statistical authorities in Russia and Ukraine (with the data covering large and medium-sized industrial enterprises) and Amedeus database of Bureau van Dijk for Poland and Romania (with the data also including some smaller manufacturing firms).

Foreign Firms are More Efficient

In comparing the productivity and factor intensities of domestic and foreign firms, we find that firms with FDI are significantly more productive, less labor intensive, and more capital intensive than domestic companies in all four countries. In Russia, firms with foreign capital are 70% more efficient than domestic firms, while in Poland the difference in efficiency is just 9%. Such variation in efficiency is due in a large part to differences in the productivity of domestic firms.

However, we find no presence of productivity spillovers, with the only exception of export-oriented FDI, which have positive spillover effects on the productivity of domestic firms in Russia. This result does not necessarily mean that knowledge spillovers do not exist, but possibly that they are offset by the negative effect of the increase in competitive pressure from the foreign companies.

In a country with a better investment climate, such as Poland, domestic companies in the sectors with high FDI presence are more capital intensive and less labor intensive than domestic companies in other sectors. This suggests that foreign entry may indeed force domestic firms to introduce technological changes, and to upgrade their capital. In a poor investment climate, such as in Russia, the effect of foreign entry is the opposite, possibly because foreign investors only outsource the production of simple labor intensive components to local producers.

How does foreign presence affect the change in, rather than the level of, productivity of domestic firms? According to our results, foreign and partly foreign companies in Poland and Romania squeeze the market available to the larger of the competing domestic firms. There is no evidence for positive productivity spillovers to domestic firms, except in sectors where foreign and partly foreign firms dominate. In Russia and Ukraine, foreign presence does not appear to have a significant effect on the productivity of domestic firms.

The Role of Education and Institutions

Formally, the education level in all the countries that we consider is quite high. According to the latest population census, in Russia about 77% of the population has at least secondary education; in Ukraine this proportion is 84% and in Poland and Romania it is comparatively high. However, the education level of the local population differs substantially from region to region within a country, which may potentially influence both the decision of foreign firms to locate in a certain region and their choice of technologies.

According to our analysis, the effects of education on the characteristics of foreign investors do not follow any single pattern. Only in Ukraine productivity spillovers from FDI depend positively on education. Results for Russia and Poland suggest that education may play a role in facilitating the effect of foreign presence on the production function of domestic firms.

The institutional environment, measured by the corruption level, has a more complicated effect on foreign and domestic firms. In Russia, foreign firms, located in relatively uncorrupt regions, are much more productive than domestic firms. As a result, productivity spillovers on domestic firms are negative and domestic firms have to change their production functions in order to better compete or work as suppliers for foreign firms. The productivity of foreign firms, located in more corrupt environments, is not significantly different from the productivity of domestic firms, possibly because foreign firms are subject to interference from local authorities. The lack of competitive pressure reduces the incentives to adopt new technologies that would allow domestic firms to become more efficient.

Ksenia Yudaeva is Academic Director at Center of Strategic Research, Moscow. Irina Tytell is an economist at the IMF. Full text of the paper can be viewed at http://www.cefir.ru (WP No 60). The views expressed in this article are those of the authors and should not be attributed to the IMF, its Board of Directors, or its management.

The World Bank & CEFIR
Although Tajikistan was one of the first ex-Soviet countries to initiate economic reforms, the following years turned any dreams sour due to various internal factors. Already the poorest and the least urbanized country among the former Soviet Republics, the country went through a catalogue of catastrophes, including a severe three-year drought and a civil war; its economic ties with the CIS countries, mainly Russia and Ukraine, broke down.

With inflows of capital, resources and know-how from Russia halted, Tajikistan's industrial and commercial base collapsed; in the beginning of 2005 production was still a mere 50% of the 1989 output. The priority of the government's economic policies is on returning to the standard of living prior to the collapse of the Soviet Union.

The legislative reform that took place in the mid 1990s was quite successful and paved the way for stabilization and enhancing future economic growth. Indeed, according to CIS Statistical Committee data, Tajikistan's economy has been growing at an average rate of 10% each year starting from 2000. In October 2000, the former currency was abandoned and the country adopted the new currency Tajik Somoni, successfully completing the conversion by April 2001.

Recent research undertaken by the Turkish Foreign Economic Relations Board has outlined the obstacles to foreign investments in and trade to Tajikistan. These include:
- A very small banking sector and, consequently, a very low level of financial intermediation. The number of banks is quite large but many of them are small, so the sector is subject to consolidation, with 17 banks closed down in the last five years. On a brighter note, the banking sector is now predominantly in private hands (86% of all banks). Foreign banks are free to operate legally but conditions are still not desirable for most.
- An underdeveloped transport infrastructure. Tajikistan is a landlocked (and mountain-locked) country, so it depends on neighboring countries for the transportation of export and import commodities. The only commercially viable railroad and the few highways that exist are in a bad state of repair, the car and truck fleet is worn out, and maintenance and technical service facilities are lacking, so transporting export goods to international markets is very costly.
- Lack of any significant deposits of fossil fuels. Tajikistan has therefore to rely on hydroelectric power. The country has vast water resources and the greatest potential for hydroelectric power production in the region, but this is still under-utilized. The country needs massive investments in building and modernizing dams. Unless this is done, foreign investment, especially in manufacturing, will be hindered by the current energy usage level.
- Immensely underdeveloped communication technologies, with only 3.6 telephone lines for every 100 people. Internet communications and e-trade possibilities hardly exist.
- Human capital hugely deteriorated during the civil war, which broke out after gaining independence, when many skilled Russians fled the country.

Policymakers should focus on assisting small and medium-sized enterprises, fostering entrepreneurship and investing in human capital. The country's current overdependence on primary products should be reduced, thereby promoting a more diversified and healthier economy. In this, foreign investors and trade partners can play a big role.

Aybek Gorey is a graduate student at Monash University, Australia. The article is based on the ongoing research project carried out by the Turkish Foreign Economic Relations Board, in which the author participates. The project results are available at http://www.deik.org.tr.

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**Tajikistan is Still the Poorest CIS Country**

**Growth.** Since 1999 Tajikistan GDP per capita in current prices grew by an average annual rate of 10%. Much of the growth was generated by expansion of the cotton market and rise in world cotton prices. Tajikistan's economy continues to be heavily influenced by cotton and aluminum production and by massive inflows of labor migrant remittances. Commodity exports make up 70% of the export structure. The IMF estimates that remittances may have generated up to 20% of the GDP in 2004.

**Income Poverty.** Although the number of poor fell to 64% in 2003 compared with 81% in 1999, about 70% of the population lives on less than US$2 per day. While people's average earnings increased, the revenue and expenditure gap continued pushing different income groups farther apart. Gini coefficient by expenditures rose from 0.33 in 1999 to 0.35 in 2004 and by revenues from 0.47 in 1999 to 0.51 in 2004. Although inequality was higher in rural than in urban areas, their absolute poverty rates of 65% and 59% respectively suggest a relatively uniform distribution of poverty.

**Business Climate.** Recent surveys suggest that the number of entrepreneurs in Tajikistan is growing. Most businesses operate in wholesale, retail, and catering industries. According to a 2003 IFC survey, most SMEs continued to regard the business climate in Tajikistan as difficult. Half of the respondents considered that administrative requirements, such as licensing, certification, import-export documentation and taxes, are difficult to fulfill due to their complexity and the poor condition of the public agencies administering them. Only 14% of entrepreneurs had a good understanding of business laws.

Based on World Bank PRSP Second Progress Report, June 2005
Latest Quarterly Russian Economic Report Released

The Quarterly Russian Economic report estimates that Russia's GDP grew by 6.4% 2005, compared with 7.2% in 2004. Preliminary data for the first two months of 2006 suggest a continued industrial slowdown. Non-tradable sectors are driving GDP growth, and investment remains concentrated in oil and gas. The April 2006 issue analyzes current economic policy and also takes a look at how Russia can make its budget less dependent on oil. A new multimedia webpage for the Report provides a slideshow with useful data, as well as a chapter-by-chapter breakdown of the findings. To view the report, visit: http://www.worldbank.org/ru.

Three More Countries in ECA Receive Funding to Combat Avian Flu

On the heels of the World Bank agreement in January to allow countries to draw from a US$500 million avian flu fund, the Bank's Board of Directors has approved avian flu projects in three countries in the Europe and Central Asia (ECA) region: the Kyrgyz Republic, Azerbaijan, and Turkey. The Kyrgyz Republic was selected because it is located on a major migratory flyway path and the current capacity in the country to monitor migratory birds and potential transmission of disease to and among local poultry is very weak. The World Bank grant will help minimize the threat avian flu poses to humans and to prepare for, control, and respond to future outbreaks. In Azerbaijan, funds were made available by restructuring an existing Second Institution Building Technical Assistance Project, and additional funds will be drawn from two agriculture and health care projects currently under preparation. The new operation for Turkey has similar goals as the Kyrgyz grant. For more information, visit the World Bank's Avian Flu website at: http://www.worldbank.org/avianflu.

Fast Track Initiative Aims to Achieve Education MDG

Major donors for education gathered in Moscow on March 14 to assess progress toward the Millennium Development Goal of universal primary education by 2015. In 2006, Russia assumed the G8 presidency and the co-chair of the global compact on education, known as the Education for All — Fast Track Initiative (FTI). Three years ago, world leaders recognized that with more than 100 million children out of school, it would be impossible to achieve this goal without drastic efforts. In response, the FTI was created in 2002 as the first ever global compact on education to help low-income countries achieve a free, universal basic education by 2015. At the meeting, Russia's Minister of Education and Science Andrei Fursenko pledged US$7.2 million to the Initiative. The FTI has put into place two funds, including the Catalytic Fund, which provides short term financial help to close the education financing gaps for poor countries with too few donors, and the Education Program Development Fund, which provides technical support so countries can develop sound education strategies. For more information about FTI, visit: www.fasttrackinitiative.org.

World Bank Touts Knowledge Economy as Key to Economic Growth

To maintain current high growth rates, countries in the ECA region must invest in reforms that improve their so-called "knowledge economy." A new World Bank publication, Public Financial Support for Commercial Innovation, analyzes the necessary reforms for converting the strong research base in most ECA countries into commercially viable applications. The multimedia webpage for the report contains a slideshow of key data, a video clip of the author, and a chapter-by-chapter breakdown. This study was released at the fifth annual ECA Knowledge Economy Forum, held in Prague from March 28—30. This year's Forum focused on "Innovation and Technology Absorption for Growth." To download the World Bank report, visit: http://www.worldbank.org/eca/kestudy.

New Strategy Released for Kosovo

With the final status of Kosovo currently looming, the World Bank approved an Interim Strategy Note aimed at helping generate new sources of economic growth, addressing environmental legacy issues, and ensuring macroeconomic stability. In post-conflict countries, the World Bank prepares Interim Strategy Notes in partnership with other donors to plan for resource mobilization. Against the backdrop of weak economic growth, widespread poverty, and poor governance, the Strategy addresses two central themes: sparking growth and ensuring associated environmental and social improvements. The Strategy spans fiscal years 2006 and 2007 and envisages around US$19 million in grant funding for Kosovo. Since fiscal year 2000, the Bank has approved 22 grants totaling US$95 million to Kosovo. The Strategy for Kosovo was developed in cooperation with the European Commission and other donors. For more information on the World Bank's work in Kosovo, visit: http://www.worldbank.org/kosovo.

Northern Aral Sea Fills Up Ahead of Schedule

The Northern Aral Sea in Kazakhstan, whose surface had shrunk to half its original size, has filled up just months after the Kok-Aral Dam was erected between it and the Southern Aral Sea in August 2005. The World Bank is involved in the restoration of the Aral Sea as part of the Syr Darya and Northern Aral Sea project. Its experts originally predicted it would take five to 10 years to fill up the northern portion of the sea. With the water level already high, a sluice can begin operating to allow excess water to flow into the parched Southern Aral Sea in Uzbekistan. The sea began to shrink in the 1960s, when massive water diversion for cotton cultivation under the Soviet Union drained the two rivers that feed the sea, the Syr Darya and Amu Darya. The resulting three-fourths
The Czech Republic officially observed its graduation from World Bank borrowing on February 28 in Prague, and World Bank President Paul Wolfowitz was there for the occasion meeting with top officials, students, young Roma leaders, and financial sector experts. The World Bank — Czech Republic relationship has focused more on partnership than on borrowing, particularly since 1998. The Bank supported the country’s European Union accession process, capital and financial market reform, enterprise restructuring, and fiscal management improvement. Banking regulation and accounting standards is a pioneering area for the country, which overcame a banking crisis in the late 1990s in the wake of transition. For this reason, the government and the Bank also hosted an Institutional Foundations for Sound Finance forum to coincide with the graduation celebration and the visit of Wolfowitz. To read more about the World Bank’s cooperation with the Czech Republic, visit its country page at: http://www.worldbank.org/cz.

EU8 Quarterly Report Reflects Favorable Growth

The World Bank’s EU8 Quarterly Economic Report covers the economic development of the eight Central and Eastern European countries that joined the European Union in May, 2004 (excluding Malta and Cyprus). The most recent report, published February 9, states that economic performance in these countries was largely favorable in 2005 despite a mixed external environment and weak reform momentum related to recent or prospective elections in the Visegrad countries. Each issue focuses on a special topic, and this time the report analyzes aggregate growth patterns in the EU8 economies, examining the main factors affecting growth as well as some of the policies that may help to sustain or enhance growth prospects. The analysis is supplemented by a more detailed, sector-based examination of the largest country in the region — Poland. For the most recent report, visit: http://www.worldbank.org/eu8-report.

Czech Republic Graduates from World Bank Borrowing

Speaking in Prague on the occasion of the Czech Republic’s formal graduation from borrower to donor status at the Bank on February 28th, 2006, President Wolfowitz made a strong case for the Bank’s continued engagement in middle-income countries. Wolfowitz outlined the reasons why the Bank remains crucially relevant even in places like China, Brazil, Russia or Poland. A third of the world’s poor live in middle-income countries. Middle-income countries are “indispensable to the mission of the World Bank Group to fight poverty worldwide,” said Wolfowitz. Because of their experience, middle-income countries act as a crucial link in the transmission of development knowledge to poorer countries. Their strength and continuing development contributes to: ensuring stability, developing regional integration, responding to global challenges, and eliminating enduring pockets of poverty. If middle-income countries are key contributors to the World Bank’s effort to alleviate world poverty, the Bank must make sure these countries continue to grow on solid foundations. This is where the Bank’s vast know-how in poverty reduction and development programs comes into play. “More than ever, we are focused on supporting middle-income countries, helping them to meet their development challenges — by helping them to build strong institutions,” said Wolfowitz. For more information, visit: http://www.worldbank.org/eca.

A Breath of Fresh Air

A protracted effort to liberalize Tajikistan’s air transport sector finally bears fruit. Starting from February 3, weekly Turkish Airline flights to Dushanbe are opening the country to further trade, aid and investments. Tajikistan’s reputation as a travel and business destination had long suffered from the country’s lack of modern hotels, Tajik Air’s near-monopoly on flights and the physical isolation of the landlocked country. Improving the transport sector was identified as a key development issue by the World Bank back in 2001. Until now, 80% of Tajikistan’s international air traffic has been with Russia.

Turning the Tide: HIV/AIDS in Eastern Europe and Central Asia

In the last year alone, there were 270,000 new HIV/AIDS cases in Eastern Europe and Central Asia, according to UNAIDS estimates. In the region, 1.6 million people live with the disease — a number which has increased almost twenty-fold in the last decade. This fast-growing epidemic is affecting mostly younger people and an increasing number of them are women. There are signs that HIV/AIDS is spreading from traditionally vulnerable groups, such as intravenous drug users and sex workers, to the general population. A three-day conference called “Facing the Challenge,” has been organized by the Russian Government with the support of UNAIDS, the World Bank and other international partners on May 15 against this back-drop. Its goal is to strengthen the collective capacity of Eastern European and Central Asian governments, civil society groups, experts, people living with AIDS and donors to respond to the epidemic, nearly 25 years after HIV/AIDS was first identified. For more information, visit: http://www.worldbank.org/eca
After the Soviet Union’s collapse, Armenia faced a whole lot of problems common to all former Soviet republics. Armenia’s electricity system and its entire energy supply system had been designed to operate as part of a much larger, integrated Trans-Caucasus system. The problems with this system began to show in 1992. The start of the war over Nagorno-Karabakh, and the resulting imposition by Azerbaijan and Turkey of an economic blockade, cut off Armenia’s only source of gas and oil for its thermal plants. Four years prior to that, a massive earthquake had forced a shut down of the Medzamor nuclear power plant, a source of roughly one-third of Armenia’s generating capacity. Supply from a new gas pipeline, built in 1993 through neighboring Georgia, was regularly interrupted by acts of sabotage. It’s obviously now that Armenia’s power sector has made impressive progress since the beginning of the reforms. The report offers 12 lessons from Armenia’s experience that may have relevance to other countries under-taking similar reforms.

European Bank of Reconstruction and Development (EBRD)
http://www.ebrd.org/pubs/econo/series/wp.htm

Clemens Grafe, Martin Raiser, and Toshiaki Sakatsume
Beyond Borders: Reconsidering Regional Trade in Central Asia
March 2006

This paper investigates the barriers to trade in Central Asia, using relative prices to shed some light on this issue. It finds that the impact of borders on price variations across different locations in Central Asia is much smaller than conventionally thought. While prices vary significantly across the region, variations within one country are just as large as variations across countries. This may be due to obstacles to trade, and in particular rent-seeking by enforcement agencies at the numerous internal check points. The paper also confirms that in relative terms, the borders with Uzbekistan are considerably more difficult to cross than those with Kazakhstan or the Kyrgyz Republic.
transition countries. The report also takes a close look at the performance of enterprises in the region. It assesses what types of firms — private or state-owned, foreign or domestic — have been the most successful in increasing their sales and improving efficiency and highlights the main factors that influence a firm’s performance.

CERGE-EI
http://www.cerge.cuni.cz/publications

Jan Bena and Jan Hanousek
Rent Extraction by Large Shareholders: Evidence Using Dividend Policy in the Czech Republic
WP 291, February 2006

This paper is an empirical study of dividends from a transition country in Central and Eastern Europe (CEE). Since many CEE countries underwent a similarly quick transition from a state-controlled to a market economy, thus the findings based on data from the Czech Republic may to a large extent be valid for other countries from this region as well. Theoretical papers suggest that large shareholders have a dual impact on firms. On the one hand, large owners have a strong incentive to monitor management to ensure that a firm’s value is maximized, while on the other hand, their behavior is motivated by the possibility to extract rents and enjoy the private benefits of control. The paper studies whether this rent extraction takes place, how significant it is, and whether minority shareholders are able to monitor large shareholders in order to preclude rent extraction.

Peter Toth and Petr Zemcik
What Makes Firms in Emerging Markets Attractive to Foreign Investors? Micro-Evidence from the Czech Republic
WP 294, March 2006

The paper conducts a firm-level study, which investigates factors influencing FDI in a given firm. The authors concentrate on a host country as opposed to concentrating on a country of origin. The paper does not study aggregate FDI flows but instead their distribution among domestic firms. The authors address the question of which firms are chosen by foreigners, based on the decision to purchase a share of a firm in the Czech Republic. The authors find that foreigners target firms with a high concentration of ownership, preferably in industries characterized by greater profit volatility, in countries where labor costs and corporate income taxes are lower as compared to the country of origin.

Centre for the Study of Economic and Social Change in Europe (SSEES)
http://www.ssees.ac.uk/economic.htm

Igor Filatotchev, Natalia Isachenkova and Tomasz Mickiewicz
Corporate Governance, Manager Independence, Exporting, and the Performance of Firms in Transition Economies
WP 62, February 2006

Using data on 157 large companies in Poland and Hungary this paper examines interrelationships between corporate governance, the independence of managers from owners in terms of strategic decision-making, exporting, and performance. It is found that manager independence is positively associated with a firm’s financial performance and exporting. In turn, the extent of manager independence is contingent on the firm’s corporate governance parameters: it is negatively associated with ownership concentration, but positively associated with the percentage of foreign directors on the firm’s board. The authors interpret these results as an indication that (i) risk averse, concentrated owners tend to constrain managerial autonomy at the cost of the firm’s internationalization and performance, (ii) on the other hand, board participation of foreign stakeholders, enhances the firm’s export orientation and performance by encouraging executive autonomy in decision-making.

Ruta Aidis
Entrepreneurship in Transition Countries: A Review
WP 61, January 2006

The aim of this paper is to provide an overview of the key issues surrounding entrepreneurship development in transition countries focusing on six main themes. Though it can be argued that the transition countries started from more or less the same point when they embarked on their transitional path, in this paper we indicate a number of differences in initial conditions which further influenced SME development. By surveying the existing literature on SME development, this paper illustrates that as the transition process progresses entrepreneurship development in transition countries is a story of increasing divergence. The transitional context provides unique opportunities for entrepreneurial activities to develop. However, at the same time this environment presents unique challenges for entrepreneurial development. This is especially true for knowledge-based entrepreneurship as the free-market system matures within a context of low levels of SMEs and inherited negative attitudes towards entrepreneurship.

Piotr Jaworski and Tomasz Mickiewicz (eds)
Polish EU Accession in Comparative Perspective: Macroeconomics, Finance, and the Government
ISBN: 0-903425-76-9, SSEES Occasional Papers # 65

The book offers a collection of papers on the macroeconomic and financial aspects of Poland’s EU accession, seen in comparative perspective. There are two main themes that are covered. One relates to empirical estimations, evaluating the effects of integration on fiscal balance, prices, and FDI flows. The second theme relates to institutional reform and policy recommendations. Benecki and co-authors, and also Antczak, in their papers discuss how transparency and fiscal rules, including those implied by EU accession, may help to reduce the deficit bias in fiscal policy. Supported by empirical evidence, Ilieva and her co-author, Kluza and co-authors, and Janecki and his co-author, argue Central Bank independence is critical for maintaining low inflation. In relation to finance Jaworski, Wierbicki, and Bednarczyk discuss institutional change in the insurance sector, running parallel to EU accession and implications for the offer of insurance to SMEs. Giblin, Barry, and Weresa focus on FDI and argue that to have a beneficial effect.
The paper studies the effect of media coverage on corporate governance outcomes by focusing on Russia in the period 1999 — 2002. Russia provides a setting with multiple examples of corporate governance abuses, where traditional corporate governance mechanisms are ineffective, and where an exogenous source of news coverage can be identified by the presence of an investment fund, the Hermitage fund, that tried to shame companies by exposing their abuses in the international media. The authors show that the news coverage in the Anglo-American press positively affects the probability of reversal of an instance of corporate governance abuse. Media had an effect through two main mechanisms: media pressure that led to an intervention by a regulator or a politician, or the choice by the company itself to relent, after realizing that continuing the battle would incur too high a cost to reputation.

Sergey Guriev and Guido Friebel
Attaching Workers Through In-kind Payments: Theory and Evidence from Russia
WP 57, December 2005

When economies are hit by massive shocks dramatically affecting the productivity of capital in different sectors, resources, in particular labor, ought to reallocate across regions. In a perfect world, this reallocation should be swift, but there may be important obstacles slowing it down, e.g. underdeveloped housing markets and social norms. The authors argue that strong endogenous forces may also be at work. Firms may devise "attachment" strategies to keep workers from moving out of a local labor market, e.g. non-monetary forms of compensation. When capital markets are imperfect, workers must have cash to finance the costs of migration. But when they are compensated through in-kind payments or fringe benefits, they are forced to consume and cannot save the cash needed for migration. The authors set up a simple model that can generate predictions on how competition between employers affects geographical mobility and worker welfare. Using data from Russian Longitudinal Monitoring Survey (RLMS), they find evidence for the model: a one-standard-deviation increase in market concentration increases the probability of in-kind payments by at least three percentage points.

Bernard S. Black, Inessa Love, and Andrey Rachinsky
Corporate Governance and Firms’ Market Values: Time Series Evidence from Russia
WP 53, November 2005

The paper studies the connection between the firm-level governance of Russian companies and their market values over 1999 — 2004. The research exploits the out-of-equilibrium nature of Russian corporate governance, due to Russia's continuing transition to a market economy and its recovery from the 1998 financial crisis. The importance of corporate governance to investors in Russian firms has spawned no less than six different indices. The availability of different indices, covering similar firms over a similar time period, lets the authors assess the predictive power of different approaches to measuring governance. It also matters how one measures governance.

Other Publications

Peter H. Solomon (ed.)
Recrafting Federalism in Russia and Canada: Power, Budgets, and Indigenous Governance
Centre for Russian and East European Studies, University of Toronto

The volume is based upon a workshop held in December 2004 — the third one in a series of workshops relating to federalism and regional development in Russia and Canada. The first two articles, by Vladimir Leksin and Irina Podporina, explain the strength and weakness of the federalism reforms undertaken under Vladimir Putin. Leonid Polishuk in his chapter explores the costs and benefits of political, as opposed to technical, decentralization within federations and analyzes the steps taken by President Putin in centralizing power within the Russian Federation by eliminating the direct election of governors and republican presidents. The last three essays, by Mikhail Todyshev, Gary Wilson, and Natalia Loukacheva, deal with the situation of indigenous people within the Russian and Canadian federal systems. All the articles demonstrate common elements faced by Russia and Canada relating to governance in federations, including such general problems as imbalances in the economic strength of provinces or regions and the role of municipal government, and problems specific to indigenous people.

Devesh Kapur and John McHale
The Global Migration of Talent: What does it Mean for Developing Countries?
October 2005
http://www.cgdev.org/content/publications/detail/4473

The paper shows that human capital flows from poor countries to rich countries are large and growing. A leading cause is the increasing skill-focus of immigration policy in a number of leading industrialized countries — a trend that is likely to intensify as rich countries age and competitive pressures build in knowledge-intensive sectors. While fears of the "brain drain" were exaggerated in earlier decades, the recent celebration of "brain gain" is also overdone, especially as highly selective migration policies deprive poor countries of scarce innovators and institution builders. The authors explore available policy responses to improve the net effect on development without making the international migration system even more illiberal than it is today.
12th World Congress of Social Economics
June 8 — 10, 2007, Amsterdam, the Netherlands

The Association for Social Economics will hold its Twelfth World Congress at the University of Amsterdam. The general theme is "Social Values and Economic Life." It is not necessary to be a member of the Association to participate. Five broad areas for exploring the theme of social values and economic life include: (1) family and community relationships; (2) the workplace and its social organization; (3) the social nature of market relationships; (4) macroeconomic social policy issues; and (5) economic methodology and the history of economic thought.

Information: http://www.socialeconomics.org/callMay30.htm

World Urban Forum III
June 19 — 23, 2006, Vancouver, Canada

UN-HABITAT and the Canadian government are organizing the third World Urban Forum, a meeting that will bring together public and private institutions, experts and decision-makers from around the world to discuss the key urban challenges facing the world today. The Forum's main theme is: "Our Future: Sustainable Cities — Turning Ideas into Action".


Warsaw East European Conference, Third Annual Session
July 5 — 8, 2006, Warsaw, Poland

Organizer: The Center for East European Studies at Warsaw University. The main theme is 25 years of change in the post-communist world: from the Cold War and communist totalitarianism through to Solidarnost and perestroika to post-communist democracies, new dictatorships and color revolutions. A list of specific topics, application and paper proposal forms are all available at the conference Internet site.

E-mail the application form and proposals to Jan Malicki with the subject "Form" to: conf.studium@uw.edu.pl. Information: http://www.uw.edu.pl/en.php/gen_inf/conf_06/list_en.html

Barriers to Entry and Expansion in the Developing World: The Role of Institutional Constraints
August 28, 2006, Amsterdam, the Netherlands

This workshop will seek common ground between the themes of poverty and the role of access to finance in development. Both empirical and theoretical works will be presented that examine the set of barriers to establishment and growth in developing countries. Possible areas include: government regulation, access to finance, human capital access, corruption, the economics of the informal sector. Empirical works that make effective use of micro-level datasets that convincingly address these questions are of particular interest.


Risk, Regulation and Competition: Banking in Transition Economies
September 1 — 2, 2006, Ghent University, Belgium

The conference is organized by the Department of Financial Economics, Ghent University, and the Interuniversity Attraction Poles Program financed by Belgian Science Policy. Both theoretical and empirical research related to the following topics will be considered:
- Banking risk and systemic stability in transition economies
- Financial regulation and supervision
- Bank market structure.

Information: http://www.feb.ugent.be/financo/rcbte2006/

Ninth Bi-annual Conference of the European Association for Comparative Economic Studies
September 7 — 9, 2006, University of Brighton, UK

The ninth EACES Conference is organized in association with the Brighton Business School at the University of Brighton (UK). The general topic of the conference is "Development Strategies — a Comparative View." Suggested themes include:
- Comparative economics
- Economic development
- The enlarged EU: the EU and its neighborhood
- Privatization and governance
- Finance and monetary issues
- Marketing and Performance Measurements in Emerging Markets.

Information: http://eaces.geLso.unityn.it/Eaces/Conference.htm, contact: Marcello Signorelli: signorel@unipg.it and Jens Holscher: J.Holscher@Brighton.ac.uk.

Institutions: Economic, Political and Social Behavior
10th Annual Conference of the International Society for New Institutional Economics
September 21 — 24, 2006, Boulder, Colorado USA

The conference program will include organized sessions, selected papers, and keynote addresses by 1993 economics Nobel Laureate Douglass C. North, Spencer T. Olin Professor of Arts & Sciences, Washington University, and by Jane Menken, Director of the Institute and Behavioral Science and Distinguished University Professor of Sociology at University of Colorado. The issues under discussion will also include social behavior and law, new institutional economics in political economy, anthropology, and the social sciences.

Information and application form: http://www.isnie.org

EALE Conference 2006
September 21 — 23, 2006, Prague, Czech Republic

The 2006 meeting of the EALE will be organized by CERGE-EI, the Center for Economic Research, in collaboration with the Institute of Economic Studies at Charles University, the Czech Economic Society, the Czech National
Bank and the EALE Secretariat in M aastricht. Papers are invited in any area of labor economics.

Additional information, list of themes, terms of participation, registration forms can be found at: http://www.eale.nl/conference/eale2006/call2006.htm

**Business and Marketing Strategies for Central and Eastern Europe**

November 3 — December 2, 2006, Arcotel Hotel Wimberger Vienna, Austria

14th Annual Conference of the Department of Marketing, College of Commerce, DePaul University Chicago and the Institute of International Business, Vienna University of Economics and Business Administration, Austria.

Empirical research, case studies or discussion sessions are sought which address such topics as comparative analysis of market entry conditions in CEE countries, market entry through exports versus market entry via capital investment, acquisitions as opposed to joint ventures in CEE, marketing strategies to reach CEE consumers, marketing-mix-decisions for markets in CEE, financial strategies for opening CEE markets, case studies of CEE experiences by western firms.

Abstracts of papers, in English, should be received by September 15, 2006. The final papers must be ready by November 1, 2006.

For more information or to send abstracts contact either of the conference sponsors: Prof. Dr. Reiner Springer, Vienna University of Economics and Business Administration, Althanstr. 51, 1090 Wien, Austria, Phone +43-1-313 36/4377, fax: + 43-1-313 36/751, e-mail: reiner.springer@wu-wien.ac.at or Prof. Dr. Petr Chadraba, Department of Marketing, College of Commerce, DePaul University, 1 East Jackson Boulevard, Chicago, Illinois 60604, USA, Phone: (312) 362-6889, fax: (312) 362-5647, e-mail: pchadrab@depaul.edu

**International Conference on Social Policy and Regional Development**

November 30, 2006, Zagreb, Croatia

Organizers: Institute of Economics, Zagreb and Friedrich Ebert Stiftung, Croatia. The conference aims to explore aspects of territorial cohesion, social inclusion and social justice. It will focus on the regional (sub-national) dimensions of social policy, and the social dimensions of regional development policy. A range of questions to be addressed at the conference include:

- The impact of regional inequalities on overall socio-economic development
- The likely social, economic and territorial implications of the new EU cohesion policy
- The relationship between regional competitiveness and social cohesion
- The role of social networks in regional economic development
- The problems and possibilities resulting from the decentralization of social policy.

Contact: Dr. Marijana Sumpor, Conference coordinator, tel. +385 (01) 2335 700; fax: +385 (01) 2335 165, e-mail: conference@eizg.hr, web sites: www.eizg.hr, and www.fes.hr.

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