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Unemployment in Eastern Europe: Social Disease or Economic Necessity?

Transition in Eastern Europe started in earnest two to four years ago, when unemployment was minimal and employment was massively dominated by state firms. Since then, output has declined by large magnitudes with, as yet, only limited signs of recovery. At the same time, the state sector's share of output and employment has declined significantly in the East European economies, albeit at differing speeds. A private sector has emerged and is expanding rapidly, accounting for between 10 and 45 percent of total employment. Out of this process, widespread unemployment has emerged (see table on next page).

At the start of these various transitions, it was widely held that:

- The decline of the state sector would be large and rapid.
- Privatization would be primarily from above and would be swiftly implemented.
- Unemployment would emerge and would introduce a more conventional mechanism of equilibration in the labor market.
- Flows from the state sector would be primarily to unemployment, with the private sector hiring mainly from among the unemployed.

Emerging Patterns

Experience to date has been somewhat different. But some clear patterns emerge, even with considerable qualification across country and time.

The state sector's decline has been more gradual than initially predicted, although there is clear evidence that state firms have widely initiated restructuring prior to, or even in the absence of, title change. One corollary of this has been the surprisingly high level of worker flows into and out of state firms. With the exception of the Czech Republic and Russia, large-scale privatization from above has been absent, testimony in part to the power of insiders to block changes that ignore their perceived interests. Conse-

What's inside. . .

Public Disclosure Authorized

Unemployment in transition economies, 1991-93

	Unemployment level (thousands)						*Unemployment rate (percent)*					
	Dec. 1991	*Dec. 1992*	*June 1993*	*July 1993*	*Aug. 1993*	*Sept. 1993*	*Dec. 1991*	*Dec. 1992*	*June 1993*	*July 1993*	*Aug. 1993*	*Sept. 1993*
Bulgaria	419.1	576.9	586.5	610.3	603.0	..	11.5	15.6	15.5	16.2	16.0	..
Czech Republic	232.0	134.8	138.6	148.6	158.6	167.0	4.4	2.6	2.6	2.8	3.0	3.2
Slovak Republic	319.4	260.3	318.1	339.4	344.8	..	12.7	10.4	12.5	13.3	13.5	..
Hungary	406.1	663.0	657.3	677.1	675.0	670.0	7.4	12.3	12.6	13.0	13.0	12.9
Poland	2155.6	2509.3	2701.8	2811.8	2829.6	2830.0	11.8	13.6	14.8	15.4	15.4	15.4
Romania	386.0	929.0	1036.1	1040.8	1029.8	1055.0	3.1	8.2	9.3	9.0	9.0	9.3
Croatia	276.0	261.0	246.0	246.2	246.2	247.0	14.1	17.8	17.2	17.2	17.2	17.3
Macedonia	168.8	173.3	174.2	172.1	..	..	24.5	26.8	28.7	28.6	..	..
Slovenia	91.2	118.2	127.9	132.9	..	..	10.1	13.3	14.4	..	..	..
Yugoslavia[a]	707.1	749.0	744.0	752.0	753.0	..	21.4	24.6	24.8	25.0	..	..
Armenia	..	56.3	87.6	89.7	93.2	..	..	3.5	5.0	5.3	5.5	..
Azerbaijan	3.8	6.4	6.7	17.7	..	..	0.1	0.2	0.3	0.6	..	..
Belarus	2.0	24.0	54.9	58.2	62.0	..	-	0.5	1.1	1.2	1.3	..
Kazakhstan	4.5	33.7	37.6	37.3	36.8	..	0.1	0.5	0.5	0.5	0.5	..
Kyrgyzstan	0.2	1.8	2.7	2.7	2.8	..	-	0.1	0.1	0.1	0.1	..
Moldova	0.1	15.0	9.8	9.8	10.2	..	-	0.7	0.5	0.5	0.5	..
Russia	69.0	577.1	717.1	716.8	713.9	..	0.1	0.8	1.0	1.0	1.0	..
Tajikistan	..	6.8	11.7	12.5	13.7	..	..	0.3	0.6	0.6	0.7	..
Ukraine	6.8	70.5	73.3	75.8	78.1	..	-	0.3	0.3	0.3	0.3	..
Uzbekistan	..	8.8	15.1	15.4	15.0	..	..	0.1	0.2	0.2	0.2	..
Georgia	..	18.9	27.1	28.5	..	..	..	1.0	1.5	1.6	..	..
Estonia	0.9	14.9	19.6	18.7	16.2	15.3	0.1	1.9	2.7	2.6	2.3	2.4
Latvia	1.8	31.3	64.6	69.7	73.1	73.6	0.1	2.1	4.4	4.8	5.0	5.3
Lithuania	4.7	20.7	32.2	32.9	32.4	32.1	0.3	1.0	1.7	1.8	1.6	1.7
Ex-GDR Lander	1037.7	1100.7	1100.0	1166.5	1174.7	..	11.8	13.9	15.1	16.0	16.2	..

[a] Serbia and Montenegro.

Source: Economic Commission for Europe and National Statistics.

.. Not available.

quently, the growth of the private sector has occurred mainly through new initiatives, for the most part concentrated in services and hence filling the gaps inherited from the previous system.

The decline in state employment is largely a true decline rather than a result of changes in title. But the scale of decline has depended not only on the size and type of negative shocks suffered by state firms but also on combinations of factors within the firms, such as relative bargaining power between workers and managers, and factors external to the firms, such as the degree to which a hard budget constraint has been enforced.

Although the internal constraints have differed in the Czech Republic, Hungary, Poland, and Slovenia, there appears to have been a common response. Initially, firms proceeded slowly, relying on attrition to reduce their labor forces. Over time, as soft government finance has lessened, declines in employment significantly greater than attrition levels have resulted. And labor productivity, after initially falling, has subsequently revived. In contrast, in Romania and countries of the FSU, soft budget constraints have led to far more gradual declines in state employment.

One fear at the start of the reforms was that state firms would not only protect employment but would, given uncertainty over future survival and access to rents, behave in a manner consistent with short-run objectives, maximizing current labor income and effectively decapitalizing firms. This fear has, for the most part, proven unwarranted, in part because of the restraints placed on wage claims by the incomes policies applied in all countries, but also because incumbents' horizons have lengthened as the prospects of widespread privatization from above have receded and their concern with preserving employment has grown. Thus, real wages, deflated by consumer prices, have remained in all cases significantly below their pretransition levels. But wages, deflated by producer prices—as has also been true of unit labor costs—have recovered and in some cases now exceed the prereform levels. This suggests that the presence of wage rigidities should not be discounted, despite the initial flexibility of real consumption wages.

The private sector's expansion has partly been a function of the rate of decline of the state sector. Where ambiguity in policy or explicit mechanisms for maintaining the state sector have been kept in place—as in Romania—growth in private firms has clearly been held back. That has been the outcome in Bulgaria, but for rather different reasons. In Bulgaria both output and employment in the state sector suffered very large contractions, given the size of the initial shock and subsequent adjustment (due to the absence of buffers), magnified by a large fiscal correction and associated deflationary policies. That has severely constrained the growth of private firms. There has been yet another variant—in private growth environments, such as North East Hungary, private sector growth has been constrained by regional or locational attributes, such as the dominance of single industries in local production.

Elsewhere, the story is brighter. In the Czech Republic, Hungary and Poland, for example, private sector growth has been rapid, promoted by a combination of macroeconomic policies encourag-

ing domestic and foreign direct investment, proximity to strong neighboring markets, and good luck. But in all cases, private sector growth thus far has stemmed largely from filling the gaps, particularly in services, that were inherited from the previous system. The obvious challenge now is to go beyond this phase.

The Mass of Unemployed

Unemployment has grown rapidly out of the interplay between the state sector's decline and the private sector's rise. The unemployment rate has tended to converge across countries, with the exception of the Czech Republic and the economies of the FSU. In the Czech case the surprisingly low—less than 4 percent—unemployment rate can be traced not only to a powerful growth in private activity but also to large movements out of the labor force, in part driven by very restrictive eligibility requirements for unemployment benefits; in most FSU countries soft budgets have allowed firms to continue to hoard, and even hire, labor.

Where unemployment has been higher, we find significant changes over time, as well as across regions. In the Czech Republic, Hungary, and Poland the initial adjustments in employment in the state sector were matched by direct flows to other jobs and by significant movements out of the labor force. Those who entered unemployment tended to be marginal workers or racial minorities, such as Romanies, and had dim prospects of leaving unemployment. In some economies in transition, particularly Hungary, job search by the unemployed was initially deterred by overly generous levels and durations of benefit. But over time the generosity of benefits has declined. Earlier low exit rates to jobs have changed as flows into and out of unemployment, consequent to higher levels of involuntary separations in state firms, have increased. As a result, the majority of job-to-job movements have begun to occur through unemployment.

The available data on gross flows, which can provide some insight into turnover within state and private sectors as well as information on the various transition routes through jobs and unemployment, confirm the impression that involuntary separations and flows have emerged as the dominant feature only quite recently. It is only after softer solutions (primarily involving workers leaving the labor force, say through early retirement) have been exhausted, that employment losses correlate closely with inflows to unemployment.

Unemployment remains a relatively stagnant pool

It is incorrect, however, to see unemployment as purely the sum of those who have lost employment in state firms. In both Hungary and Poland, while the largest component of flows into unemployment is from the state sector, between a quarter and a third of all flows are accounted for by the private sector and the new entrants. But while there are significant flows into and out of unemployment, it is important to recognize that these flows remain small relative to the stock; thus in Poland, for example, the annual exit rate from unemployment to jobs was less than 30 percent in 1992.

Mixed Opportunities

For those entering unemployment, exit rates to jobs remain quite low. This can be explained in a number of ways:

- Job-to-job transitions offer significant competition, as workers search successfully for other employment while continuing in their current jobs.
- Lack of information about workers may deter firms from hiring them from the unemployment rolls.
- The long-term unemployed are becoming discouraged from searching for work at an increasing rate. Furthermore, as duration effects set in, the long-run unemployed will not matter in current wage bargaining, and the conventional feedback mechanism from unemployment to wage claims will be affected.
- There is significant regional mismatch in the labor market, resulting in a large dispersion in regional rates of unemployment. The poorly functioning housing market seems to be a major obstacle to labor mobility. These rigidities are magnified in contexts where employment losses have been highly concentrated because of the regional structure of production.

Factors that now appear *not* to be significant in the exit rates to jobs are the level and duration of unemployment benefits. In general, because average benefits are lower than minimum wages, they are unlikely to be powerful factors restraining job search by the unemployed, expecially since coverage is restricted and of short duration. Indeed, providing satisfactory income support to the long-term unemployed is a priority in almost all countries and, particularly in Russia, there is a clear need to increase unemployment benefits beyond their current desultory levels.

The overall picture that emerges across the majority of countries in transition is that unemployment remains a relatively stagnant pool, at least in comparison with OECD countries. Inflows to unemployment remain quite low, compared with both high- and low-unemployment OECD countries. The steady increase in the stock of unemployed can be traced to the low level of exits from unemployment, and the stock would be yet higher if it were not for the significant numbers leaving the labor force. The length of unemployment spells has increased so that in all countries, except the Czech Republic, more than a third of registered

job seekers have been unemployed for longer than twelve months.

The increase in the length of average spells of unemployment raises the question of the appropriate balance between passive and active labor market policies. In general, with the exception of the Czech Republic, there has been little experience with active labor market policies that might assist in improving the efficiency of the job-matching process.

Policy Options

Clearly, there has been a good deal of heterogeneity in recent experience in Eastern Europe, and prospects are mixed. In some countries—Russia and Romania are obvious examples—the break with the soft budget constraint has yet to be achieved. Hard choices are yet to be made as serious restructuring of the state sector has only just begun.

For other countries, where reforms have gone further, there is still fear that the private sector may not be able to go beyond the phase of stock adjustment, even if the continuing restructuring or closure of newly privatized firms will lead to increases in unemployment. If this proves true, the political viability of reform may be compromised, while the fiscal stability may be compromised by the costs of providing additional benefits to the unemployed.

Such a scenario seems unlikely, however, at least in the Czech Republic, Hungary, and Poland. Here is still a danger that stronger unions and insider pressure will translate into greater wage rigidity, weakening the conventional effect of unemployment on wage claims.

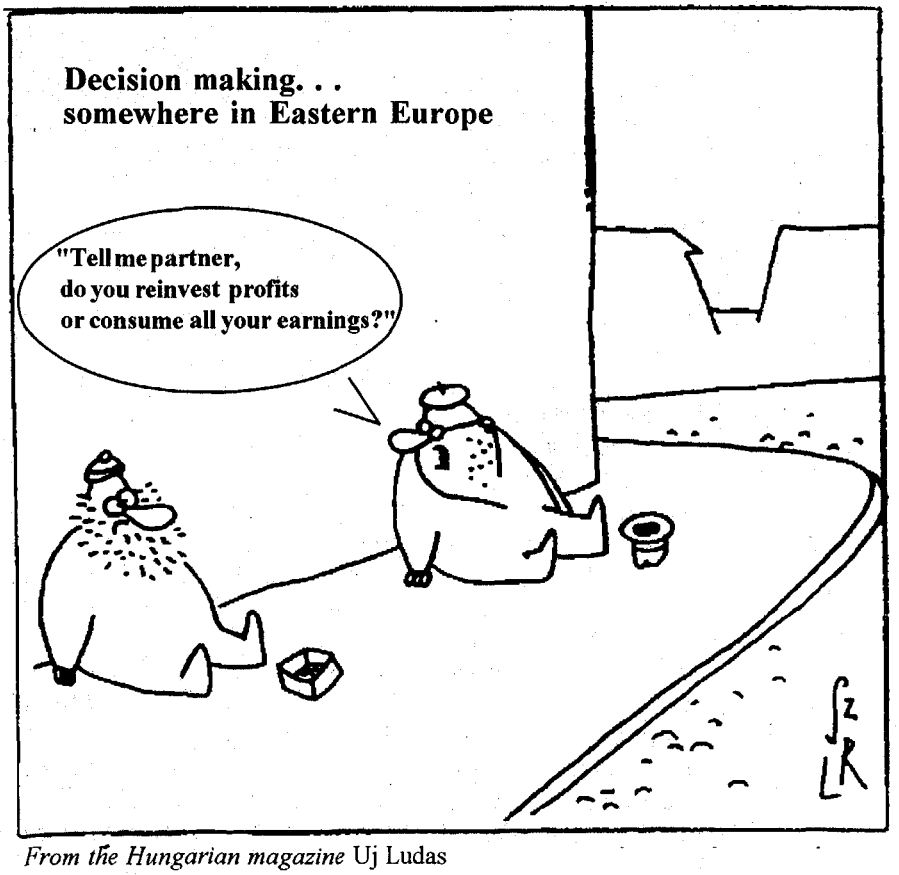
Increases in subsidies enable state firms or privatizing firms to slow down restructuring, rather than simply add to the pool of unemployed. This could have undesirable macroeconomic consequences, depending on the size of the fiscal effect and the manner in which any resulting deficit is financed. To some extent this is already observable in a number of countries.

In Bulgaria and, to a lesser extent, Slovakia, early large declines in state sector employment have swamped any growth from the private sector and at the same time ensured that government revenues remain low as the tax base has evaporated. The pace of restructuring has been slowed as unemployment has climbed, but the fragile fiscal position severely limits the noninflationary policy options open to government, whether in terms of benefits or social assistance for the unemployed or financial support to firms.

It is salutary to remember that, even with large decreases in labor force participation, in many transition economies nearly 15 percent of the work force currently lacks work, with significant shares now comprising people in long-run unemployment. But the need for more training targeted at the long-term unemployed, as well the importance of selective use of public works programs aimed at reintegrating the unemployed, is clear.

Simon Commander, Economic Development Institute, The World Bank

This article is a summary of a recent conference on "Unemployment, Restructuring, and the Labor Market in East Europe and Russia," held at the World Bank in October 1993 and organized by Simon Commander and Fabrizio Coricelli. An overview paper by Olivier Blanchard, Simon Commander, and Fabrizio Coricelli, titled "Unemployment and Restructuring in Eastern Europe," is available from Olga Del Cid, the World Bank, tel. (202)473-6303.



From the Hungarian magazine Uj Ludas

A New Wave of Structural Reforms in China

Managed Unleashing of Market Forces

The economic reform program approved by the Chinese Communist Party's Central Committee at its November meeting in Beijing could have revolutionary consequences when implemented. In China's recent history it is the second time a party meeting has dealt in such a comprehensive way with economic reform. In December 1978 the third plenum of the Eleventh Party Congress approved a reform program that was to transform the Chinese economy in a dramatic way.

Boom and Bust

The 1978 plenum was convened following the reestablishment of power by the reformist faction led by Deng Xiaoping. After the death of Mao in 1976 and the incarceration of the Gang of Four, the reformers were prepared to bring about a sea change in China's political system and economic philosophy. To gain the Party's acceptance for their economic and political reforms, the liberals turned for support to the southern provinces (which had hosted Deng and his associates during the Cultural Revolution). Those provinces, in return, demanded and obtained considerable economic autonomy from Deng and his group. (Provincial authorities, for example, were authorized by the party in 1978 to collect taxes and remit a prenegotiated amount to the center.)

Decentralization unleashed the latent entrepreneurial energies of the Chinese people in the southern provinces, which, in about fifteen years' time, changed the economic landscape of the country: China's gross domestic product (GDP), which increased at an annual rate of nearly 10 percent, quadrupled in size. Some 200 million people have climbed out of poverty. Foreign trade now accounts for almost two-fifths of China's GDP.

This release of energies was accompanied by the emergence of boom- and-bust cycles. Although during bust cycles the economy continued to grow at rates of 3 to 4 percent a year, both the frequency of these cycles and their amplitude increased over time. The rapidly growing provinces in the south and along China's coast invested heavily in their respective regions even if it meant depriving Beijing of badly needed fiscal resources. Since 1978 the central government's share of tax revenues has fallen steadily from close to two-fifths of GDP in 1978, to about one-sixth of GDP in 1992. Currently, the central government receives 38 percent of total tax revenue. There has been no corresponding decline in expenditure. The state financed a good proportion of its deficit by borrowing from the People's Bank of China (the central bank), thus adding fuel to inflationary pressures. And over time the center lost control over the conduct of monetary policy as well.

Provinces versus the Center

What Beijing saw as perverse behavior by the provinces was seen by provincial leaders as a perfectly rational way of conducting business—prevent resources flowing to Beijing by investing them at home. Because of the investment booms, the economy overheated in 1985, in 1988-89, and again in 1991-92. The strain on the economy and on society was exceptionally severe in 1988 and contributed to the 1989 Tiananmen political crisis. The boom-and-bust cycles took their toll in at least three ways:

- They persuaded local leaders—provincial party secretaries and governors—that Beijing did not possess the political will to bring about structural economic and political change.
- They deflected the economy's resources away from sectors whose growth was critical for sustaining long-term development and toward those that provided short-term benefits to provincial managers.
- They undermined foreign investors' confidence in Beijing's ability to consistently pursue long-term economic objectives.

In mid-1993 the government acknowledged that the economy was overheating and that recent annualized growth rates (12.8 percent in 1992, 13.9 percent in the first half of 1993) were unsustainable. In the first quarter of 1993 investments increased by more than 70 percent over to the same period in 1992. Industry reached a 30 percent annual growth rate. In June 1993 the inflation rate in urban areas increased to 24 percent on an annual basis. In July 1993 the government responded with an austerity drive designed to curb growth and rein in inflation. This Sixteen Point Program—which took into account the recommendations of a World Bank-sponsored symposium held in the city of Dalian in June—featured a drastic cut in credit expansion, the use of administrative means (that is, the authority of the Communist Party) to rein in wayward local leaders, and the slashing of expenditures over which leaders in Beijing had direct control.

China's reform-minded policymakers concluded, however, that significant

Beijing's Decisionmakers

In China, the Communist Party Congress of deputies meets about once every five years. Some 2,000 delegates are elected and selected by the local--provincial, prefectural, county, and town--branches of the party. The Congress elects a central committee of some 300 members that meets about twice a year to take stock of the political and economic situation and to provide guidance to the government. The November session was the third to be held by the Central Committee, chosen by the Fourteenth Party Congress.

structural changes were necessary to stabilize the economy. Instead of relying on periodic emergency measures to deal with the runaway economy, the government needed both to develop better instruments for exercising macroeconomic controls and to remove the more glaring structural weaknesses in the economy.

Delegates to the recent plenum engaged in a great deal of political give and take. "Reformers" and "conservatives" in the Communist Party essentially switched sides. Where before reform meant decentralization and the conservative line was to tighten central control over the provinces, reform now demanded greater centralization, at least for reestablishing central authority over the conduct of fiscal, monetary, and industrial policies. And conservatives pushed for maintaining decentralization. The reformers demanded a slowdown of economic expansion, fearing that the breakneck speed of 1992 and 1993 could not be sustained without injuring the economy. The conservative faction, fearing that a heavy foot on the brake pedal would cause unbearable social strains, was now against a sharp deceleration in the rate of economic growth.

What emerged from the Party Conference was a document roughly outlining a program of structural change. The program foresees reform policies in major areas of the economy, most significantly in the tax system, the structure of the financial system, and the conduct of monetary policy (see summary on page 7).

Implementation of the program started on January 1, 1994. Three encouraging factors offer hope that much of the program will be implemented:

•Due to the enormous expansion of the Chinese economy, structural change is not a "zero sum" game. It is possible for all groups in the society to win, some a little more, some a little less. Intelligently implemented, the program need not produce big losers.

•China has rich experience in undertaking social and economic change. It has learned from the tragic experiences of the Great Leap Forward and the Cultural Revolution and is now likely to be cautious and pragmatic rather than irresponsibly bold and ideological.

•China is now at the center of a dramatic change that is transforming all of East Asia. This region—with China at its heart—is emerging as a dominant economic powerhouse for the twenty-first century.

Shahid Javed Burki
East Asia and Pacific,
Regional Office,
The World Bank

Cooling China's Overheated Economy is a Steamy Business

Vice Premier Zhu Rongji's austerity plan was launched in July in a bid to cool the overheating economy and secure a soft landing. The austerity program, at least as far as it applies to the state sector, has been softened, and the Party leadership after initial hesitation has adopted a "fast-track" growth policy. (Again in 1993, for the second year running, growth is expected to be around 13 percent, and in 1994 around 10 percent.) Some of the factors that motivated the course correction are:

•Local officials, particularly in the south, have resisted the center's efforts to bolster its economic control over the provinces, while supporters of the state industrial sector have stressed their concerns about the effects of the credit squeeze. The central government, meanwhile, found its ability to enforce austerity measures constrained by its lack of control over credit sources and its large budget deficit. Thus, Beijing has forsaken its immediate goal of reining in growth in return for the provinces' agreement to some of the measures designed to return macroeconomic control to the center in the long term. This potentially serves the interests of both "reformers" and "conservatives."

•State-owned enterprises have been hit hard by the austerity measures. When the government called for the return of unauthorized loans—meaning funds lent by local bank branches in excess of centrally mandated levels—state enterprises had little choice but to obey. Consequently, state firms simply ran out of cash because new loans, for either working or investment capital, were unavailable. The output of state-owned firms in October rose by just 3.6 percent on an annual basis, compared with 30 percent growth rates earlier in the year. Some heavy industrial sectors actually suffered a decline.

Structural imbalances, an increasing trade deficit, and high capital investment, as well as the strong growth in money supply, suggest continued problems:

•Interenterprise debt is rising again. Since July, state banks have been forced to mount rescue operations for several previously "model" enterprises. Zhu Rongjhi, China's deputy prime minister, acknowledged that Beijing failed to recover two-thirds of nearly US$38 billion in illegal interbank loans by an August 15 deadline. (The deadline was merely extended to the end of the year.) Since September, state banks have again been lending freely. In that month alone, the net increase in working capital loans made by state banks amounted to 72 billion yuan (US$12.6 billion), compared with 3 billion yuan (US$520 million) in September 1992.

•The fundamental difficulties of enforcing central control over the booming periphery remain, as does the risk of social instability resulting from growing economic disparities, particularly between urban and rural areas. The government has implicitly recognized this danger by announcing that from 1994 it will pay 15 percent more for state grain purchases. However, these now account for less than a fifth of the total harvest.

•After three years of healthy trade surpluses, the balance moved into deficit in 1992, and the gap widened to US$7.7 billion in the first eleven months of 1993. Imports are growing rapidly, while export growth has slowed down (in August it actually fell slightly).

•The 50 percent increase in M1 money supply in the first half of 1993 has yet to be reflected in retail prices. For 1993 the nationwide inflation rate is expected to reach 15 percent. Urban inflation edged up to 21.1 percent in October and 21.9 percent in November compared to corresponding months in 1992. In December, price controls were reimposed on twenty-seven major commodities.

(Based on reports of Oxford Analytica, and on various news agency reports)

Rich Menu from China's Reform Kitchen

The Beijing government—in accordance with the November decision of the Communist Party's Central Committee—announced important reform steps effective from January 1, 1994. Other major structural reforms are being prepared so the following is an incomplete checklist.

New tax system. China has issued regulations for new taxes to be imposed on January 1. New taxes include a value-added tax (VAT) of 17 percent and new consumption levies applied mainly to luxury goods, including cigarettes, liquor, and gasoline; a turnover tax of 3 to 5 percent applied to service sector firms; and taxes on real estate, stocks, inheritance, and donations. The central government will collect 75 percent of VAT revenue, with the provinces taking the rest. These reforms are meant to raise the central government share of total tax revenue over the next few years from 38.6 percent in 1992 to 60 percent. Large and medium-size state companies that currently paid 55 percent tax from January 1, would pay a 33 percent rate to be applied to all firms. Income tax will begin at 5 percent on monthly salaries of 800 yuan and rise to a maximum of 45 percent.

•*Bank reform.* China plans to set up true commercial banks, responsible for their borrowing and lending decisions and answerable to their shareholders for the bottom line. A separate accounting system will likely be established for policy loans handled by those banks. The State Development Bank will be entrusted with the task of financing various development projects, raising resources from the capital markets, appraising projects for their economic and financial viability, and supervising project implementation. Establishment of specialized banks for policy loans (including an Export and Import Bank of China), long-term investment, and rural development is also on the way. The People's Bank of China will soon begin to function as a genuinely independent central bank, responsible for the conduct of monetary policy and for the prudent behavior of the financial system.

•*Trade liberalization.* The Chinese government approved draft laws to greatly liberalize its trade regime. The trade law intends to reform China's trade system to meet the requirements of the GATT. The laws will be submitted to the standing committee of the Chinese congress for deliberation. Whereas China has made fundamental changes in its export regime, its import system has continued to concern many of its large trading partners.

•*Unified currency.* China announced that it would unify its two-tier exchange rate system and let the value of the yuan float at market rates starting January 1. This step brings China closer to making its currency convertible. The official foreign exchange certificates (created in 1980 for foreigners) are to be phased out. The unified exchange rate has been set at 8.7 yuan to the dollar. In effect the Chinese currency has been devalued by 33 percent against the former official exchange rate but remains unchanged from the government-sanctioned market rate that has prevailed for months at swap centers.

Chinese enterprises were able to sell part of their hard currency earnings on the "swap markets" where the rate of exchange was fixed on the basis of supply and demand, but was actually pegged by administrative restrictions and open market intervention of the central bank. The new rate will therefore also be a pegged rate.

The Beijing government has also announced that Chinese companies will no longer need to turn over foreign exchange earned abroad and that government banks will no longer retain part of the foreign exchange earned by Chinese companies. But importing companies have to present contracts or other required documents to the authorities to be able to buy foreign currency.

•*Consolidation of state enterprises.* Despite the rapid growth of collective and private industry in recent years, the state-owned sector still employs more than 70 million people, and last year its output accounted for 48 percent of the national industrial total. However, at least one-third of the sector is losing money. This year's losses are projected to reach at least 84.4 billion yuan. This is larger than the government's budget deficit and represents about 4 to 5 percent of GDP.

The new policy governing state enterprises, which is to be implemented over a period of several years, includes the following initiatives:

•Enterprise ownership and management are to be clearly separated. The state will retain at least a controlling stake in larger enterprises, but company managers will be wholly responsible for their own profits and losses. In return, they will be given virtually complete autonomy.

•Nonviable firms are to be forced into bankruptcy.

•Many medium-and small-scale state enterprises are to be privatized, either by selling them outright to individuals, including foreigners, or by contracting out management functions while the state retains legal ownership.

•Large-scale state firms are to be transformed into joint stock companies, with shares held by management, staff, and other state corporations.

•Ministry controls over enterprises are to be scaled back sharply. Eventually, the ministries will be abolished, and their policy and planning functions will be incorporated into the State Economy and Trade Commission and the State Planning Commission.

•A nationwide social security system is to be established. Funded through taxes, it will take over the welfare role now played by the enterprises themselves.

Hungary Needs More Foreign Investment and Less Government Bureaucracy

Head of the Parliamentary Budget Committee Outlines Economic Views

Karoly Attila Soos, Chairman of the Budget, Taxes, and Finance Committee of the Hungarian Parliament, hosted a conference in Budapest in mid-November on Entrepreneurial Development and Structural Change, sponsored by the OECD and the B'nai B'rith Enterprise (Europe). In his opening address Mr. Soos outlined a "strategy for positive transition to the market economy." *Transition* Editor Richard Hirschler asked his views on some of the burning issues of economic transition: the role of foreign assistance, the dilemma of the privatization process, and the outlook for the Hungarian economy.

Q. You made it clear in your presentation that without foreign resources Hungary will not be able to handle its grave social problems and restart economic growth. But you also made it clear that the country's gross foreign debts have reached about $24 billion this year (compared to the $32 billion in GDP expected in 1993), while net foreign debts increased by $2.3 billion in the first half of 1993. Hungary's debt service ratio (annual payment obligation of accrued interest and principal, relative to annual exports) hovered around 34.6 percent last year, and it is on the rise. You conclude that only an increase of foreign direct investment could ease the heavy burden on the Hungarian economy. What about other ways, such as foreign assistance?

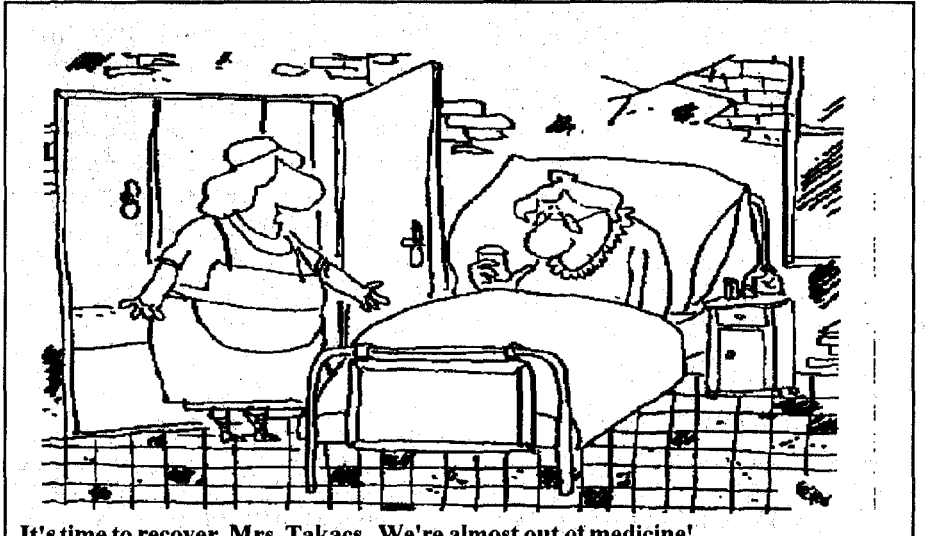
A. At present I see no other alternatives for attracting additional foreign resources to Hungary. Thanks to the Hungarian National Bank's continuous and successful borrowing on the international capital market, official reserves have been replenished to $6 billion, and Hungary will be able to finance its $3 billion current account deficit this year. But we should avoid an increase of our indebtedness. Also, we can forget about an East European Marshall Plan: we would like it, but nobody is willing to finance it. Getting project loans through international finance institutions—the World Bank, the EBRD, and so on—is important, but such loans are expensive, their preparation is time-consuming, and their implementation can be difficult in the face of a thick layer of red tape. Direct foreign investment, on the other hand—which increased by $1.4 billion in 1993, reaching a total of $6 billion—can offer us state-of-the-art technologies and top-notch business management, thus improving our export performance. This is extremely important: in the first eight months of 1993 Hungary's foreign trade deficit reached $2.3 billion, and about 80 percent of this fell on trade with industrialized countries.

Q. According to some horror stories foreign companies bought up Hungarian firms just to let them go bankrupt, be rid of competition, and take over the market of the "deceased."

A. To my knowledge, no serious Western companies would follow that kind of business strategy. In some cases, though, privatized companies reduce the work force, and even close down some sections of the original plant. The intention of a responsible corporate headquarters is not to kill a subsidiary, but to increase its productivity, produce marketable merchandise, and make more money. We need more foreign investment, not less.

Q. In 1991 the Hungarian ratio of incoming foreign direct investment relative to GDP reached 4.5 percent, while the same ratio was only 0.4 percent in South Korea, 1.7 percent in Mexico, 2.2 percent in Thailand, and 3.6 percent in Venezuela. How can Hungary attract even more foreign business capital?

A. The government has a number of options. Taxes and other levies on enterprises are extremely high; and the social insurance contributions paid by employers put more costs on unit-wages. These additional labor costs, which are the highest in Europe, increase signifi-



It's time to recover, Mrs. Takacs. We're almost out of medicine!

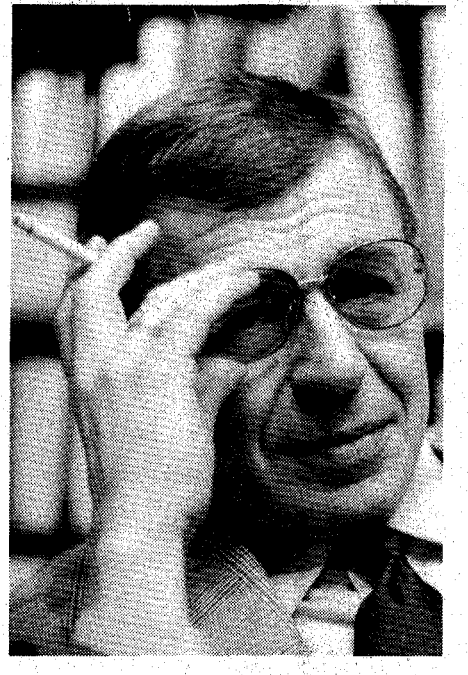
From the Hungarian magazine Uritok

cantly labor costs in Hungary, where wages are relatively low. To give up "in-built" fiscal revenues is not easy: the high public expenditures have to be financed somehow, and the budget deficit in 1993, and in 1994 as well, is expected to exceed 7 percent of GDP. With the possible exception of the Czech Republic this is a dilemma in all transition economies. Financing large fiscal deficits can drive up interest rates and hamper investment growth. Since foreign investors in Hungary can borrow from abroad, they are not much worried about high interest rates. What they are worried about is the menace of accelerating inflation and a deepening balance of payments deficit.

Q. Foreign investors are not necessarily happy with the generally modest level of Hungarian banking services either; they find that payments are slow, that retail banking is—to put it mildly—unsophisticated. The system needs improvement, all the more as the biggest banks are insolvent.

A. That is what the bank consolidation is about. It should be accelerated, together with the privatization of the large commercial banks. Foreign investment flow could pick up if not only state banks, but also public utilities such as regional gas companies and electricity service providers, were open to private investors. The Parliament has at last begun the debate on regulating gas utility companies slated for privatization. The privatization process of MATAV, the Hungarian state telecommunications concern, is also approaching its final stage.

[Since our interview the Hungarian government announced a two-stage operation to bail out ten commercial banks for $1.4 billion and increase their present negative capital adequacy ratio to at least 4 percent by the middle of 1994. By the end of 1993 the state was to inject $1.1 billion to restore solvency to the Hungarian Credit Bank, the Commerce Bank, and the Budapest Bank. Further recapitalization is to follow in 1994. The government is converting the bad debts to twenty-year treasury bonds and increasing the government's stake in these banks correspondingly. The total cost of shoring up the banking system is now almost $3 billion. The hoped-for infusion of private capital should increase the capital adequacy ratios to the standard 8 percent, set by the Basle-based Bank for International Settlements. In another development, a joint consortium of Germany's Deutsche Bundespost Telecom and the Chicago-based Ameritech, after agreeing to pay $875



million for a 30 percent stake in MATAV, has won Eastern Europe's biggest privatization deal. Half of the money will be invested in telephone service and, as a result, the thirteen-year waiting period for a phone line will be shortened to six months by 1996. The other half of the $875 million will be spent on other Hungarian infrastructural projects. The editor.]

Q. Who should manage the privatization process? The insider managers, many of whom are holdovers from the old nomenklatura, or the newcomers, the bureaucrats of the government agencies ultimately responsible for the privatization?

A. In the years 1988 and 1989 spontaneous privatization predominated. The insiders (enterprise managers) were the initiators and executors of their firms' privatization. After a number of irregularities surfaced—for example, some managers shelled out their former enterprises, transferring assets to their own businesses—the government in 1990 formed the State Privatization Agency (SPA) to supervise the process. Following the first state-managed privatization program in late 1990, the agency attempted to "nationalize" the full privatization process. But without the active participation of the enterprise managers, privatization lost its original vigor and almost came to halt. From 1991 to 1992, managers of smaller enterprises were authorized to accomplish privatization in cooperation with a consulting company picked by the SPA. This kind of self-privatization has been suspended (as of the end of 1993). In 1992 the government set up the State Holding, Ltd., which took over 160 large state enterprises with a total capital value of about $12 billion. (To compare: enterprises under the SPA management represent assets of about $8 billion, with a total accumulated debt of $2.5 billion.) Most of the enterprises managed by the State Holding, Ltd., are supposed to remain over the long term in the public sector, even if a minority stake is sold to private investors. According to official thinking, before large enterprises are put on the block they have to be reorganized. Their sale prices at present are falling by around $60 million to $80 million every month.

Q. This is quite a strong argument for intervening and restructuring some of those companies so they can be offered for sale. Wouldn't that speed up the privatization?

A. I would be very cautious about doing that. First, when the state assumes the debts of insolvent state enterprises and bails out a dozen large companies, the opportunity costs have to be realistically assessed. The scarce financial resources

could be better spent—providing targeted tax benefits, building more infrastructure, developing telecommunications and transportation networks, financing credit guaranties; and so on. Second, government agencies, even state-owned banks, have never been ingenious at separating the wheat from the chaff, that is, picking enterprises that could prove viable over time and ignoring those that will fail even with the government's bailout efforts. Officials, whether in the SPA, the State Holding, Ltd., or the Hungarian Investment and Development Bank, are not clairvoyant. Third, the resources spent on reorganizing a state enterprise could hardly be recovered through a proportionally higher privatization price. The assumption, rather, is that the state will be able to use those resources as efficiently as a private owner would after privatization. But if this is so, there is no need to privatize. Last but not least, in the present strained financial situation, the government lacks sufficient resources for a widespread bailout operation. Instead of assuming enterprises' debts, the government should offer state credit guarantees to partly cover the new borrowing of those ailing enterprises. Pre-privatization upgrading is for rich countries that can afford to improve state-owned companies, even if the cost is not proportional with the benefit.

Q. What should be done with the SPA and the State Holding, Ltd.? Some think the two should be merged and radically downsized....

A. This could be justified, as the State Holding is far too big an organization and acts almost as a second government. Management of public sector companies should be more decentralized, and of course the public sector itself should be trimmed. Certain enterprises that have been considered as permanent components of the public sector would be better off privatized, with their stocks—minority or majority stakes, depending on the nature of the enterprise—offered to domestic and foreign investors in open tenders.

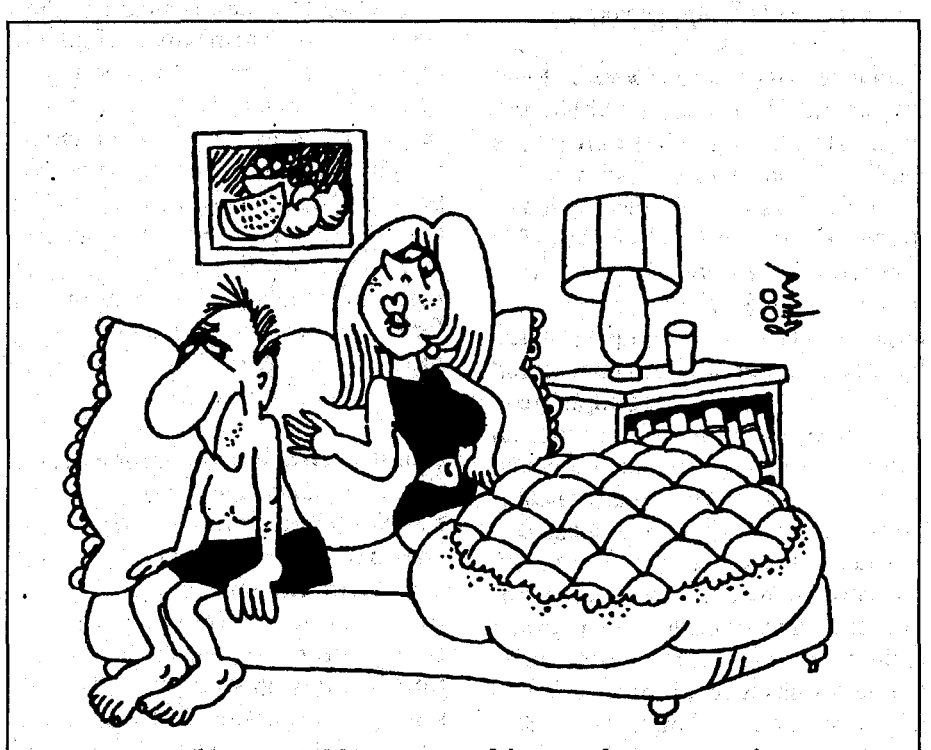
Q. You are in something of a schizophrenic situation—sometimes you might not agree even with yourself.... In your capacity as chairman of the Parliament's Budget Committee, you are part of the administration; but at the same time you are one of the most eminent economic experts of the Alliance of Free Democrats, the leading opposition party. If the Free Democrats assume a role in the next government—elections are to be held probably next May—what would be the main thrust of their economic policy?

A. The postelection government—which I hope will include the Free Democrats in a pivotal position—has to stabilize the economy, cutting budget expenditures across the board. That government has to take care of social problems, but with discretion, that is, it must cut social benefits for the rich and the above-average income categories and concentrate social welfare to the poor. Structural changes that promote economic growth will be necessary. The new government will have to accelerate privatization, consolidate the banking system, and give investment incentives in the form of tax reductions and credit guarantees, for both domestic and foreign investors. The new government should create special development funds for building more infrastructure and will need to mobilize public funds and foreign capital to do this. And it should give guarantees to local agencies for this infrastructural development. Fighting inflation is still on the agenda, but I hope, by 1996-97, the second half of the next government's four-year term, the Hungarian economy will finally be on a path to stable growth.

Observation from Budapest:

What is privatization?

A process whereby public wealth is stashed into private pockets.



Come on. You can't blame everything on the communists.

From the Hungarian Magazine Mai Nap

North Korea: Coping with Economic Decline

Will the Economy Reform, Muddle through, or Collapse?

The economy of the Democratic People's Republic of Korea (North Korea) was already showing signs of serious trouble by the 1980s, but it appears to have entered a steep decline with the "revolutions of 1989" in Eastern Europe. Since the collapse of the Soviet empire, moreover, North Korea has lost nearly all of its international allies. Simultaneously, the gravitational pull of the rival South Korean state has dramatically increased with the success of Seoul's experiment in political liberalization and the rapid economic growth of the past decade. North Korea lost its economic lead over its southern neighbor, although for roughly a quarter of a century—from the late 1940s through the early 1970s—North Korea's per capita GDP in official estimates of both Seoul and Washington was higher than South Korea's.

North Korea is also approaching a transition in its leadership, dictated by biological realities: Kim Il Sung, the supreme political presence since the founding of the state forty-five years ago, turned 81 in April 1993. The designated heir is his firstborn son, supreme commander Kim Jong Il, a reclusive middle-aged man, whose writings and speeches until quite recently revolved around such themes as the inspirational properties of state cinema and North Korea's officially espoused ethic, *juche* (self-reliance).

Self-inflicted Distortions

Meanwhile, economic and structural imbalances, induced by official policies, now interfere with a prime objective of the same regime, the augmentation of power. Some major distortions include:

•***Oversized army***. By the late 1980s noncivilian males apparently accounted for fully a fifth of North Korea's men of working age. This country of barely 20 million people fields an army that is, in the estimate of the London International Institute of Strategic Studies (IISS), the fifth-largest in the world today, with at least 1.1 million men under arms. Though North Korea's soldiers episodically engage in farming, construction, and the like, they are basically nonproductive workers who must draw sustenance and material from other sectors to perform their assigned task. Given North Korea's fertility trends and its government policies, there is no more "surplus labor" in the country. To satisfy its thirst for ever more inductees, the army must deprive state enterprises or universities of their recruits. In this institutional competition, the success of the Korean People's Army (KPA) in amassing its troop base undercuts the training and productivity of the work force as a whole. It is hardly a coincidence that North Korea's economic troubles began to manifest themselves in the early 1970s, exactly when the current tendency toward military buildup accelerated.

•***Compressed consumer sector***. Even by communist standards, North Korea's policies toward consumers were always severe. By one Western estimate, for example, the share of consumption in the North Korean economy in the 1950s was about 20 percent lower than in the Soviet Union. Since then, however, it appears that the share of output claimed by the consumer has been suppressed still further. Personal consumption expenditures, for example, are today an almost peripheral item in the North Korean economy. Very rough calculations suggest that wages and salaries would amount to no more than 15 to 25 percent of the nation's output. (Much of the population's consumption package is allocated directly to the household by the state, outside retail channels.) The austerity may affect "human capital," and thus the potential for augmenting growth. It affects the motivation of the work force. And by decommissioning price signals in the realm of the household—the area where such signals were most likely to function well (at least under socialism)—the North Korean government inadvertently deafened itself to the sounds of its own economy.

•***Increased misallocation and waste***. Civilian technocrats charged with enhancing the efficiency and productivity of the North Korea national economy seem to have suffered two colossal complications of their task in the early 1970s. First, the State Planning Commission was reportedly deprived of access to information about North Korea's huge and growing military economy, leaving technocrats in the dark about much of the overall economy they were expected to rationalize. Second, the statistical blackout imposed on official North Korea publications and media was apparently accompanied by mounting pressures to politicize and inflate internally circulated production figures. By 1990, statisticians in North Korea joked that they were dealing in "rubber statistics." This may help to explain why the regime, at a time when it was increasingly hard-pressed, embraced so many projects of questionable economic merit but extraordinary reported expense. (Preparations for the 1989 World Youth Festival, including the necessary facelift for Pyongyang, were said to cost US$4.7 billion. The West Sea Gate Lock cost....$4 billion to complete.)

•***Stunted science and technology***. Due to indoctrination and information control, North Korea has been shut off from international contact and exchange, shielded from the outside world's information revolution. The country has become a research backwater, lagging ever further behind in virtually all fields of scientific and technological innovation. (In the 1970s students at Kim Il Sung University were spending nearly two-

thirds of their course hours studying *juche*, Kim Il Sung thought, and other political topics, regardless of their field of specialization.) Not even the enormously expensive nuclear drive—the program to replicate an American project completed nearly half a century ago--contradicts this generalization. By the early 1990s North Korea was probably the only country in Northeast Asia incapable of producing the microchip. Such technological obsolescence not only limits the possibilities for economic development, but increasingly undercuts the effectiveness of a military force that would be exposed to high-precision weapons and other advanced systems.

As a result, the North Korean economy—the engine ultimately responsible for underwriting state power—was put on an inauspicious trajectory years ago. By the mid-1980s the national economy may have reached stagnation, or even negative per capita growth.

With the collapse of the Soviet empire, North Korea's trade with those countries—theretofore its principal contacts with the world economy—contracted suddenly and dramatically. China became its largest trade partner, but Beijing now insists on settling bilateral transactions on a hard currency basis. These recent jolts and dislocations have left the North Korean economy even less capable of self-sustained development and growth. How does a regime like that in North Korea cope with the prospect of economic decline? Let us consider three possible adjustments to the pressures facing the state: reform, muddling through, or collapse.

Reform—or Tinkering at the Margin

From an economic standpoint, reform--that is to say the moderation of grievous policy-imposed distortions—would seem to be the most obvious strategy for improving productivity in North Korea and thus ultimately strengthening the sinews of the North Korean state. In 1984 a Joint Venture Law was promulgated, and local enterprises were told to expand consumer goods production. Several port cities have been accorded the status of special economic zones (presumably unencumbered by standard North Korean governance). The Law on Free Economic and Trade Zones has been ratified. The Tumen development project, which would involve international financial cooperation with China, Russia, Japan, and even South Korea, and as envisioned would absorb US$30 billion in foreign capital, is being actively promoted.

Ongoing negotiations with South Korea to secure inter-Korean trade flows and to entice investment and technology through long-term project commitments from Seoul, are under way. The new Foreign Direct Investment Law and the Foreign Exchange Law have been promulgated. Deliberation is occurring over apparently impending legislation on rights to underground mineral and natural resources and on foreign technology imports.

These reformist laws and proposals, however, are inadequate to stem North Korea's ongoing economic deterioration, much less jump-start or rejuvenate its flagging economic system. Their shortcomings include:

- Avoiding completely the subject of military demobilization and conversion of the war industries.
- Making no provision for increasing the share of consumption in the national economy.
- Ignoring any amendment of property relations for the rural or urban working populations.
- Failing to strengthen market mechanisms within the domestic economy or enhance the credibility of the domestic currency.
- Offering no new avenues for information flows or scientific contacts.
- Circumventing all questions relating to the government's longstanding default on its international debt obligations.

Moreover, the halfhearted and marginal efforts that have been made have been undermined by simultaneously enacted policy measures that push the economy in a completely opposite direction. In April 1992, for example, North Korea promulgated a general wage increase of more than 40 percent for its workers. In the context of chronic goods scarcity, a general wage increase can only throw the consumer market into still greater disequilibrium, further undermining the role of currency-based transactions and reinforcing the primacy of state-determined allocations of supplies in household well-being.

In July 1992, furthermore, North Korea issued a new currency. Currency reform, in the context of a command economy, is an occasion to inventory the savings of the populace, to confiscate assets that cannot properly be accounted for, and to garner leads on participants in the unauthorized underground economy. Unlike the new foreign direct investment law (which apparently is still in search of takers) these restrictive measures have already had an impact on the workings of the North Korean economy.

Maintaining Course?

One alternative to policy reform is coping through improvisation, without reconsidering basic strategy or readjusting fundamental policies. Muddling through, which has characterized North Korean government activity since the onset of the revolutions of 1989, is clearly an option that is superior to policy reform. Yet muddling through actually presupposes more flexibility with respect to policy change than North Korea has demonstrated on economic questions in recent years. North Korea's present course of action might just as well be termed "barreling through," for economic policy seems to be informed by a dogged determination to weather the

current storm by battening down the hatches and maintaining course.

Avert Collapse by Going Nuke?

If policy reform is decisively rejected, and if muddling through cannot redress the state's mounting problems, North Korea faces the prospect of an eventual systemic failure or breakdown—a collapse. North Korean policy has begun to deal explicitly with this contingency. The last point of a ten-Point Reunification Program announced in April 1993 reads: "Those who have contributed to the great unity of the nation and to the cause of national reunification should be highly estimated." A recent North Korea broadcast clarifies that point, demanding " special favors to those who have performed feats for the reunification of the country, patriotic martyrs and their descendants." Pyongyang is thus explicitly working to ensure the safety and well-being of the North Korean leadership--and, of course, for "their descendants."

The North Korean leadership may view the acquisition of nuclear weaponry as a means of forestalling collapse—a way of forcing the international community to take an interest in a smooth transition in Korea's leadership and a well functioning North Korean economy.

Nicholas Eberstadt
The author is a researcher with the with the American Enterprise Institute and the Harvard Center for Population and Development Studies. This article is adapted from his study, published in the NBR Analysis Series, vol.4, no. 3, 1993.

For copies: National Bureau of Asian Research (NBR), 715 Safeco Plaza, Seattle, Washington, 98185, tel. (206) 632-7370.

Quotation of the Month: "The Basis for a Sustained Recovery Is Weak"

UN Economic Commission for Europe Is Guardedly Pessimistic about Prospects of Transition Economies

Unlike the West European economies, which are coping with a cyclical downturn complicated by structural changes, the problems of the transition economies of Eastern Europe and the former Soviet Union are predominantly structural and systemic. The exaggerated hopes of many politicians and shock therapists of a rapid transition to prosperous market economies have now been replaced by a more sober appreciation of the problems and the time required to overcome them.

In all the transition economies the move to create decentralized, market economy systems has been accompanied by a *severe slump in output*—although not, as yet, in employment. For Eastern Europe the average decline in GDP between 1989 and the first half of 1993 is around 28 percent, while industrial production has fallen by some 40 percent. In the Commonwealth of Independent States (CIS), net material product (NMP) [value added of the material sphere including depreciation] has dropped more than 40 percent and industrial production somewhat less than 40 percent. In the Baltic states, as well as in the former East Germany, the declines in output have tended to be even larger.

Specific factors have been cited to explain this slump in output: the simultaneous introduction of tight stabilization policies in a number of countries, the collapse of trade among the former CMEA members and especially with the former Soviet Union, the disruption of energy supplies (in some cases), foreign exchange constraints, the disintegration of the former federal states such as the Soviet Union, Yugoslavia, and Czechoslovakia, and so on. There is no doubt that all these factors have played a role; what is remarkable, however, is that all the transition economies have suffered large cuts in output regardless of whether they have followed so-called shock therapy or had already embarked on market reforms before 1989.

Explaining Output Collapse

A more general explanation of the universal collapse of output in the transition economies is the *institutional gap* that resulted when the old coordination mechanism was destroyed more rapidly than the new market system could be constructed. (In this context, institutionst include the conventions of business practice and, more generally, the social and cultural traditions and attitudes that influence the behavior of economic agents.) The result has been significant supply-side disruption.

For most transition economies, 1993 will be the fourth successive year of declining output. In Eastern Europe (including the successor states to Yugoslavia) GDP is expected to fall by an average of 3 to 4 percent this year. In Poland GDP is set to rise by some 4 percent, thus sustaining the recovery in output growth that began in 1992; in Slovenia and Hungary the decline continues, but by a much smaller amount than recorded last year; and in the Czech Republic there appears to be a bottoming out of the recession. In Macedonia and [rump] Yugoslavia output has declined at much the same, rapid rate as prevailed in 1992.

The output collapse since 1989 in the successor states of the Soviet Union, on average has been much more severe than in Eastern Europe. In the first half of 1993 NMP in the CIS was running, on average, at 15 percent below its level a year earlier, while in Russia the same percentage decline is expected for the year as a whole. The rate of contraction may have slowed in comparison with 1992 (when it was 20 to 22 percent), but that is small comfort when the bottoming out of the decline still appears to be some way off.

In the middle of 1993 the *share of the private sector* in East European GDP ranged from 16 percent in Bulgaria to 50 percent in Poland; in Russia it was roughly 15 percent. But for industry the shares ranged from 13 to 33 percent (for Bulgaria and Poland, respectively); in Russia it was 12 percent. In Eastern Europe the private sector has become dominant in construction and retail trade (with shares of 50 to more than 80 percent) and has probably also taken the lead in financial and a few other services. This sectoral pattern of private ownership is likely to be repeated in the countries of the FSU, although the data are less comprehensive.

Private consumption may have picked up this year in four or five of the East European countries—the Czech Republic, Hungary, Poland, Slovenia, and, possibly, Slovakia—and also in some of the CIS countries, including Russia. Public expenditure has probably stagnated or declined, given the efforts being made to reduce government budget deficits. There is still no sign of an end to the decline in fixed investment in the transition economies and, in fact, the available data show an acceleration in the rate of decline for the first half of 1993.

The *volume of exports* in 1993 fell sharply, while imports have continued to rise quite strongly. [This trend was influenced by] the recession in Western Europe and the import restrictions placed on some of the principal exports from Eastern Europe. Many Eastern exports are internationally standardized, intermediate goods, for which demand tends to be more sharply cyclical than is the case for final consumer goods.

The initial boom in Eastern European exports was in part a one-time effect that has now run its course. Initially, exports were driven by the collapse of demand at home, the prolongation of soft budget constraints, and the high premium on foreign currency earnings. But these factors have more or less disappeared. Among other domestic factors now restraining exports are real exchange rate appreciation in the first half of 1993, a lack of fixed investment in manufacturing and other potential export sectors, and weak institutional support for exporters.

The deterioration in trade balances has led to a further worsening of *current account deficits*. In the first half of 1993 virtually all East European countries ran current account deficits—the main exceptions being the Czech and Slovak republics. There is now a very real fear that these deficits will prove increasingly difficult to finance and that, in the absence of financial help from abroad, the introduction of domestic measures to curb the deficits will postpone still further the prospects of a recovery—or, in Poland and possibly Hungary, choke the beginnings of one.

Inflation remains very high in 1993, although the rate varies from country to country. In most East European countries prices were still increasing at double-digit annualized rates during the first three quarters of the year. Inflation accelerated again in Romania and Croatia and (especially strongly) in Yugoslavia (FR), where hyperinflation has continued unchecked in 1993 with monthly price increases of between 99 and nearly 2,000 percent. In most CIS states, inflation continued to run between 18 and 26 percent a month (20 to 25 percent in Russia).

Unemployment is continuing to rise in the transition economies. In mid-1993 there were about 6.5 million persons unemployed in Eastern Europe, 6 percent more than in December 1992. Unemployment rates range from an exceptionally low 3 percent in the Czech Republic to nearly 30 percent in FYR Macedonia. In the CIS countries the registered unemployment rate was generally less than 1 percent, except in Armenia where it was 5 percent. Although these low figures partly reflect technical deficiencies in the statistics, they are also indicative of a general reluctance to accept open unemployment.

Macroeconomic policy in most of the transition economies is still dominated by the need to control inflation and rapidly growing budget deficits. Failure or difficulty in doing so in many respects reflects the underlying structural problems with which the entire transition process is faced. Because the development of effective monetary institutions is a slow process, monetary policy is forced to rely on a narrow range of credit and money supply instruments. Similarly, the worsening of fiscal deficits mainly reflects a decline in revenue, which, in turn, is due to the slump in output, the difficulties associated with introducing new forms of taxation, and the lack of effective tax collection systems.

Net Outflow from the East

Gross financial flows to the transition economies from the West have increased rapidly over the past four years, from US$23.6 billion in 1990 to a preliminary estimate of US$45 billion in 1993. In 1990 about one-third went to the Soviet Union and the rest to Eastern Europe; in 1993 the proportions have been virtually reversed, with two-thirds going to Russia and the other states of the former Soviet Union. The gross flow into Eastern Europe has actually fallen by about a quarter since 1991, mainly because of a fall in multilateral credits and (prob-

ably) in special finance. (Special finance accounts for just over half of the gross inflow in 1993, most of it reflecting rescheduling of the foreign debts of the former Soviet Union.)

More than four-fifths of the current gross flow of funds is debt-creating. Portfolio and foreign direct investment is negligible, as are official aid and grants. In 1991 eastern Europe received aid of US$4.6 billion, and the former Soviet Union US$2.3 billion. (The Marshall Aid Program for Western Europe provided sixteen countries with the equivalent of US$16.4 billion a year [at 1989 prices] over four years, most of it in the form of grants.) For most transition economies the only sources of extra funds are the international financial institutions. However, obtaining funds is a slow process and many countries have failed to qualify. Toward the end of 1993 fewer than half the twenty-six transition economies had negotiated agreements with the IMF and only seven had standby agreements in place.

In 1992 there was a *net outflow from most East European countries*—as was true for some of them in 1991—because of their large servicing obligations on the foreign debts of the previous regimes and, in some cases, because of capital flight. Since the middle of 1992 there has been a general deterioration in the current account positions of the transition economies. Most of them are now in deficit and are having difficulty in financing their debts. And financing is likely to become more difficult in 1994, even for Hungary.

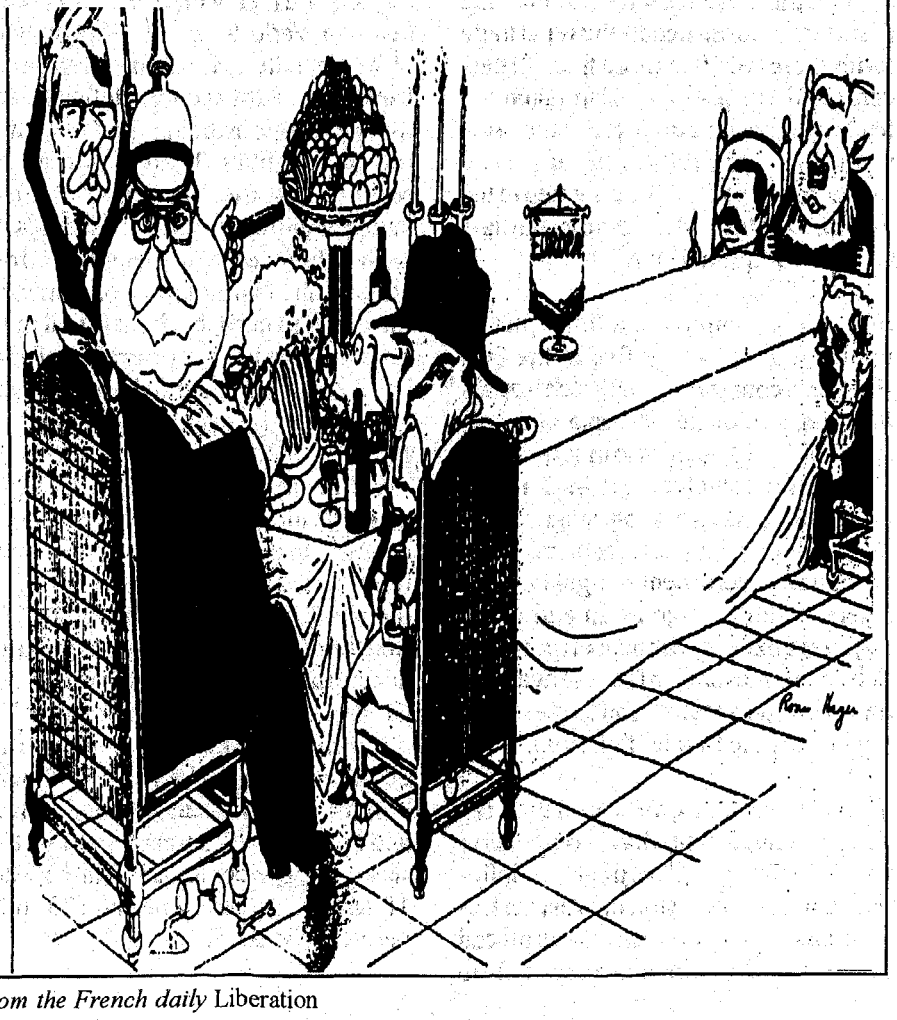
Short-term Prospects

A sustained recovery from depression will depend on how quickly the new, market-based coordination mechanism can be put together to serve as a more stable framework in which producers and, especially, investors can plan for the medium and long term (rather than being dominated by the demands of short-run survival). Prospects appear brightest for Poland, Hungary, the Czech Republic, and Slovenia. In all four countries, governments are hoping for increases in GDP in 1994. Poland expects a continuation of the 4 to 4.5 percent growth rate of 1993, while the other countries are looking at the beginning of a recovery.

For the rest of Eastern Europe the prospects are less positive. There have been repeated expressions of hope that 1993 would be the last year of declining output in Bulgaria, Romania, Slovakia, and Croatia. But the basis for a sustained recovery is weak given the scale of existing macroimbalances, the deterioration in the wider European economy, and the limited supply of financial assistance from abroad. As for the timing of a recovery in Russia and the CIS, political uncertainties and other hurdles are so great that the most one can say is that recovery is unlikely to appear in 1994.

Excerpts from the prepublished version of the Geneva-based ECE's Annual Economic Bulletin for Europe *(volume 45, 1993). Final publication is scheduled for January 1994. Information: UN/ECE Publication Service, Palais des Nations, Office C.115-1, Switzerland, 1211 Geneva 10, tél.(4122) 917-2612, fax (4122) 917-0036.*

Feast at Europe's Table



From the French daily Liberation

Conference Diary

Forthcoming

Trade and Investment Opportunities in Russia's Kola Peninsula
February 2, New York
February 8, Denver, Colorado

A series of roundtables, organized by the Geonomics Institute, to discuss reports of the first U.S. Mining and Metallurgy Trade Mission in the mineral-rich Kola Peninsula. Topics include: long-term development strategy and incentives for American investors (presented by the region's governor); profiles and projects of Kola's major mining and mineral-processing enterprises; regulations and procedures for securing mineral rights and exploiting undeveloped deposits in Russia; and financing and project development support from U.S. government and multilateral organizations. Detailed project prospectuses will be available.
Information: Nancy Ward or Robert Waltemyer at Geonomics Institute, 14 Hillcrest Avenue, Middlebury, Vermont 05753, tel. (802) 388-9619, fax (802) 388-9627.

Centralization and Decentralization of Economic Institutions: The Role in the Transformation of Economic Systems (Fourth Trento Workshop)
February 28-March 1, 1994, Trento, Italy
Information: Bruno Dallago, Department of Economics, University of Trento, Via Inarna, 38100 Trento, Italy, tel. (39-46) 882-211, fax (39-461) 882-222.

World Economic Development Congress 1994 Global Market Series:

•Anticipating the New Cuba
March 17-18, Tampa, Florida

The conference, cohosted by Caribbean/Latin American Action, will focus on Cuba's economy, political environment, capital markets, infrastructure, and investment climate. Expected participants are senior corporate executives, fund managers, directors of global countertrade, investment bankers, and senior government officials. Topics include: Current Investment Climate; Foreign Companies Investing in Cuba; Potential for American Business; Opportunities for Joint Ventures and Strategic Alliances; Financial Transactions: Exchange Controls and Taxation; Role of Development Assistance Agencies; Foreign Claims Settlement; and International Legal Issues.

•Investing in Viet Nam: Understanding Asia's Next Tiger
May 19-20, San Francisco, California

The conference, cohosted by Cura Corporation, will focus on the economic climate, infrastructure, current laws and regulations, industry sectors, and strategic partnerships needed for doing business in Viet Nam. Topics include: Sectoral Overview: Plans and Privatization; Infrastructure and Construction; Industries and Energy, Agriculture and Natural Resources; Services; Banking, Investment, and Trade regulations; Ventures, Leasing, and Realized opportunities; External Assistance.

•Investing in China: Strategies for Sustaining Growth
June 23-24, New York

The conference will examine the special economic zones, capital markets, growth sectors, regional trade flows, partnership prospects, and strategies for successful investment in—what has the potential of becoming—the world's largest economy. Expected participants: senior corporate executives, fund managers, directors of global countertrade, investment bankers, and so on. Topics include: China's Impact on the World Market; Emerging Capital Market Development; Infrastructure Development and Opportunities; Can Growth Be Controlled? Tax Policies and Reforms to Stimulate Investment; Workforce Development; Growth in China's Service Sector; and Special Economic Zones.
Information: World Economic Development Congress 1000 Winter Street, Suite 3700, Waltham MA 02154-9419. tel.(800) 767-9499, or outside the U.S.(617) 487-7900, fax (617) 487-7937/0146.

Annual Bank Conference on Development Economics
April 28-29, Washington, D.C.

Organized by the World Bank, inaugurated by President Lewis T. Preston, with keynote address by Vice President Michael Bruno on Aspects of Adjustment, Transition, and Reform. The theme is "Transition in Socialist Economies" include: Macropolicy: Theory and Practice (Leszek Balcerowicz and Alan Gelb, Stanley Fischer, Janos Kornai); The Economy of the FSU: Retrospect and Prospect (Jeffrey Sachs, Anders Aslund, Maxim Boycko); Property Rights in Transition (Andrei Shleifer, Oliver Blanchard, Roman Frydman); Chinese Reform Experience with State and Nonstate Enterprises (Thomas Rawski, Gary H. Jefferson, Nicholas Stern, Shahid Burki).
Information: Boris Pleskovic, the World Bank, RAD, tel. (202) 473-1062, fax (477) 0955.

The Economy of Ukraine in Transition: Reforms, International Relations, Ecology
May 23-27, Odessa, Ukraine

Second Congress of the International Ukrainian Economic Association. Calls for papers (to be delivered in Ukrainian, English, or Russian).
Information: V. N. Bandera, Economics Department, Temple University, Philadelphia, PA 19122, tel. (215) 204-5039, fax (215) 204-8173.

World Bank/IMF Agenda

Michael Bruno on World Debt

"Private capital inflows dramatically increased recently to a number of developing countries, primarily as a result of their economic reform policies, specifically various measures targeting fiscal consolidation, greater openness to trade, privatization, and more market-orientation." These comments came from World Bank Vice President and Chief Economist Michael Brunoin reviewing findings of on the new *World Debt Tables 1993-94* edition, which has reported that private capital flows to developing countries--foreign direct investment, bond issuance, and equity portfolio investment--will exceed official funding for the second consecutive year. A record $113 billion in private capital is flowing this year into developing countries. China is the leading recipient, with total private capital inflow estimated at $27 billion. More than 60 percent of the total foreign private capital is to be invested in the private sector, and that is an assurance that the new money will be used prudently, Mr. Bruno remarked. He added: "The question is not whether a country incurs more debt or not, but what it does with it." He noted that there is a continuing need to address the debt overhang of two dozen highly indebted poor nations. Their debt load has tripled to $200 billion in the last decade, despite efforts to stretch out repayment. (For more details, see New Books and Working Papers, page 21.)

World Bank Provides Loan to Slovakia...

An $80 million economic recovery loan was approved for Slovakia on December 1 to support the government's structural adjustment program. It will focus on fiscal retrenchment; strengthening and diversifying the financial sector; privatization, private sector development, and enterprise restructuring; and building a more efficient social safety net. The proposed loan will finance imports, excluding luxury goods, military equipment, nuclear reactors and parts, uranium, and tobacco and tobacco-processing machinery. It will also finance oil imports up to a maximum of $20 million.

and to Belarus

A $120 million rehabilitation loan to Belarus, approved on November 16, will support the country's economic reform program; improve access of importers to foreign exchange; finance critically needed imported inputs and essential medicines; and provide a framework for financial assistance from other donors.

Extended Waiver on First Rights Debt Collection

The World Bank has modified the conditions of its negative pledge clause waiver, the Bank's Board of Directors announced in mid-December. (Under the negative pledge clause, the Bank maintains the first rights to collect foreign debt before any other creditors, provided the borrower is in default.) Instead of applying the waiver only to countries "pursuing acceptable macroeconomic policies," the Bank has extended the waiver to countries that are making progress in privatizing industries, moving toward a market economy, and experiencing an improvement in their macroeconomic situation. The Bank explicitly approved waivers for Russia and Uzbekistan. Now other creditors, such as the U.S. Export-Import Bank, can have preferred rights to projects they help finance in Russia, in case of a default. The U.S. Eximbank can go ahead with its planned financing of up to $2 billion worth of U.S. oil field equipment and supplies.

Bank-Fund Credits to Latvia

In supporting Latvia's 1993-94 economic program, the IMF approved credits of about $63 million, divided equally between a fifteen-month stand-by and a Systemic Transformation Facility (STF). The World Bank is working on five new loan programs for Latvia, focusing on agriculture, energy, industry, and the environment. Economic rehabilitation is gaining momentum, and the country is now capable of raising the volume of investments in both the state and private sectors, remarked Basil Kavalsky, Director of the World Bank's Eastern Europe and Central Asia Department, during his November visit to Riga.

Donors' Aid Package to Mozambique

Donors offered Mozambique more than $1 billion in a 1994 aid program, following a recent international donors conference in Paris. The package consists of an economic and social rehabilitation program totaling $869 million, of which $560 million is in grants and $309 million in loans, including $148 million from the World Bank. A further $174 million in grants is for special programs. Donors noted that agricultural recovery in Mozambique has been faster than envisaged and that GDP growth of 5.6 percent has led to the first increase in per capita income since 1989. Prime Minister Mario da Graca Machungo forecast a similar GDP rise for 1994. Mozambique's Parliament on December 16 approved the 1994 budget, which envisages total public expenditure of $466 million, of which $205 million will be met by domestic revenue. The deficit is to be covered by foreign loans.

IMF Makes New ESAF Operational

The renewed and enlarged ESAF (concessional lending to help the world's poorest countries under the Fund's Enhanced Structural Adjustment Facility)—with a capital account of about $7 billion and a subsidy account of about $3 billion—will become operational in early 1994. The commitment period under the present facility will be extended until February 28, 1994, the Fund's Execu-

tive Board announced. The original deadline for replenishing the facility passed on November 30. Terms and conditions will be unchanged, but programs under the new ESAF will put greater emphasis on social safety net measures to ease economic dislocations and on better managed public spending, said Director of the IMF's Policy Review and Development Department, Jack Boorman.

Paris Club Reorganizes Viet Nam's Debt

The Paris Club of Western creditors has agreed on a major reorganization of Viet Nam's foreign debt, the French Ministry of Economics said on December 15. Viet Nam has a hard currency debt of $4.5 billion, most of which it has sought to reschedule. About $3 billion of the debt is owed by the central government and $1.5 billion by local governments and state enterprises. Participants noted Hanoi's implementation of an economic restructuring program backed by the IMF and the very low level of Vietnamese per capita income. The Club favored a cut of up to 50 percent in the country's debt.

Moldova Wins Aid Pledges

Moldova won pledges of financial support totaling $127 million over the next year at a meeting of donor nations in Washington. The pledges of twelve countries and the European Community along with assistance from the World Bank and the IMF, could increase international support to $250 million in loans. A large proportion of the help will be made available soon to allow the former Soviet republic to buy medicine, energy and other key imports. Moldova announced the introduction of a national currency, the leu, on November 29, 1993. Moldova's authorities have bolstered their efforts in support of the new currency and have received IMF assistance for the measure under a stand-by arrangement and STF totaling $103 million.

New FSU Currencies—the IMF Supports Them!

Michel Camdessus, the Managing Director of the International Monetary Fund reiterated the IMF's support for moves in the former Soviet Union toward the introduction of national currencies. These moves, if accompanied by adequately restrained monetary and fiscal policies, as well as liberalization of the trade and payments system, will enable the FSU states to control their financial situation, to make progress toward reducing inflation, and to lay the foundation for sustained economic growth in the framework of close regional cooperation. Mr. Camdessus also welcomed the ongoing efforts to strengthen economic links between FSU states. IMF support is available for those states that introduce their own currencies and face balance of payments problems, provided they pursue the necessary economic reform and stabilization policies, he said, adding that "the IMF is continuing its close contacts with these states and is providing both technical assistance and policy advice to them."

Contract Awards from Russia's Oil Loan

On November 16 the World Bank declared effective a $610 million oil loan to Russia, the largest project loan in World Bank history, which will finance oil production in three producer associations in Western Siberia. Declaring the loan effective will allow the contract award process to begin. Preparation for procurement is already well advanced, and upwards of $400 million in contracts will be let over the next two months. Delivery of equipment and materials to Siberia is scheduled to begin early in 1994. The Bank's loan is part of a $1 billion project. More financing will come from the European Bank for Reconstruction and Development, the Dutch government, and from the producer associations themselves. The project will help slow the decline in Russia's oil production by generating an estimated incremental 240,000 barrels per day (12 million tons per year) of output at peak. This represents a 3 percent increase in national output, which would add $1.5 billion to annual gross revenues.

China Protects Ozone Layer

On November 30, 1993, China signed a grant agreement with the World Bank that will help finance a national effort to eliminate the use of ozone-depleting substances (ODS). The $6.92 million grant will support the introduction of non-ODS technology in five factories, preventing the use of about 16,000 tons of ODS each year. (China currently consumes about 50,000 tons of ODS each year and produces about 30,000 tons.)

From the Hungarian Magazine Uj Ludas

Milestones of Transition

The 1994 budget of the **Czech Republic**, approved on December 7, is balanced, with both the revenues and expenditures set at 381 billion koruny. The Czech army will receive 27 billion koruny in 1994; 42 billion koruny will be spent on education and 139 billion koruny on social welfare and unemployment benefits. Although strict wage controls imposed by the government in June 1993, still apply to most companies, the legislature has approved a salary increase of 24 percent for the legislative branch and other members of government. (Czech consumer prices rose by 1.1 percent in October, bringing the annual inflation rate to 19.9 percent.) In another development, more than 6 million Czechs out (of a total population of 10.3 million) registered for voucher books by the December 8 deadline for the second wave of mass voucher privatization.

Russian President Boris Yeltsin has decreed an increase in the minimum wage for the state sector from 7,740 rubles to 14,620 rubles a month effective December 1. Stipends for students and other transfer payments are to be amended accordingly. Another decree raised the income bracket for the minimum 12 percent tax to three million rubles ($2,440) a year from 1 million rubles ($813) previously. The tax relief would be retroactive for the whole of 1993. Earlier, Russian Minister of Labor Gennadii Melikyan disclosed that the highest wage in Russia is 26 times greater than the lowest—up from a difference of five to six times in 1991. Melikyan claimed that such a broad gap is unknown in developed market economies and said that the government should use tax and minimum wage policy to narrow it. He noted that the minimum cost of living is 40,000 rubles, and compared with an average wage of 100,000 rubles.

Viktor Glukhikh, the chairman of the State Committee of the **Russian Federation** on the Defense Branches of Industry (Roskomoboronprom), addressing a Moscow conference on December 7, claimed that the production of civilian goods now accounts for nearly 80 percent of the output of the military-industrial complex. During the past two years, state orders and financing for military hardware had declined by a factor of 9, and defense items now take up no more than 10 to 15 percent of the capacity previously dedicated entirely to military production. Deputy Chairman Boris Lapshev said that although Russia inherited some 80 percent of the defense industry of the former Soviet Union, it can produce only 17 percent of the military hardware needed without inputs from other states. It will therefore need to collaborate on defense output with other former Soviet republics for another five to seven years. About 4.5 million people were employed in some 2,000 defense factories in Russia. Nearly 75 percent of these factories are scheduled for privatization during the next two years, but about 450 of the plants—including the "most important"—will remain in state hands, he added.

Russia's Finance Minister Boris Fedorov announced that the budget deficit for 1993 could rise to 22.2 trillion rubles, or 14 percent of GDP. The Ministry of Economics estimates a 5 percent decline in GDP in 1994 (against a 12 percent drop in 1993 and 20 percent contraction in 1992), a 6 percent decline in industrial output (against 15 percent in 1993), and a 4 to 5 percent slump in agricultural production. Monthly inflation rates are expected to decline to 16 percent by March, and 5 to 7 percent by the end of 1994 (compared with an average monthly rate of about 20 percent in 1993). The trade surplus for this year is expected to be around $21 billion, after drastic pruning of imports.

Lending by the five multilateral development banks (MDBs) reached a record $52.2 billion in fiscal 1992, according to a new report of the Washington-based Development Bank Associates, published on December 3, 1993. The total includes $37.4 billion in new commitments by the banks, as well as $14.8 billion in associated cofinancing, also a record figure according to the report, "The MDB Data Book 1993." The MDBs consist of **the World Bank, the Asian Development Bank, the Inter-American Development Bank, the African Development Bank, and the European Bank for Reconstruction and Development**. The World Bank committed more than $23 billion—a record—in new loans and credits in fiscal 1993. Another major trend in MDB activity is the sharp increase in environmental lending, which shot up from virtually nothing in fiscal 1990 to $1.9 billion in fiscal 1992, according to the report. New environmental commitments by the World Bank alone in 1993 came to $2 billion—or 66 percent higher than in 1992.

Poland's Parliament approved on December 16 a government proposal to raise tax brackets from 20, 30, and 40 percent to 21, 33, and 45 percent, while at the same time increasing the standard deduction. If the Senate and president also accept the legislation, Poles in 1994 will pay 21 percent on income up to 90.8 million zloty ($4,540); 33 percent on income between 90.8 and 181.6 million ($9,080); and 45 percent on income over 181.6 million. A proposal by the socialist Union of Labor to impose a 50 percent tax on the highest earners was voted down, PAP reports. In the effort to limit the economic "gray sphere," the Sejm also voted to impose a fixed-rate tax on private firms with turnover of less than 1.2 billion zloty ($60,000) a year. This tax will affect about a million private

entrepreneurs. Limits were set on tax breaks for children attending private schools; deductions for home repair were reduced; and, in an amendment supported by the government, church offerings were exempted from income tax.

The **Sejm** voted on December 10 to increase monthly wages for teachers, health care workers, and other public sector employees by an average of 340,000 zloty ($18) in January, with a second, comparable increase scheduled for June 1994. Public sector wages are to keep pace with the rate of increase in industrial wages and outpace inflation by 2 percent, the Sejm ruled. The Sejm also voted to increase minimum pensions from 35 to 39 percent of the average wage; 1.2 million pensioners will benefit from the hike, at a cost to the budget of 5.8 trillion zloty ($290 million). A promised increase in the indexing rate for remaining pensions—from 91 percent to 93 percent of the average wage—was postponed until at least September 1994.

Poland's Main Statistical Office reported on December 8 that consumer prices rose 3.9 percent in November, the sharpest monthly increase since January 1993. Food prices led the way, rising 6.8 percent in November alone.

The European Investment Bank (EIB) has approved a $228 million loan to finance modernization of Poland's 630-kilometer section of the Berlin-Warsaw railway line. The EIB, the long-term finance institution of the European Union, is also providing an Ecu50 million loan to the Polish Development Bank for the financing of smaller industrial projects in Poland. The EBRD is also expected to help fund the project.

Viet Nam's Prime Minister Vo Kan Kiet announced government plans to speed economic growth and to set up trial securities exchanges in Ho Chi Minh City and Hanoi as part of its plan to "get the country out of poverty" Kiet also said that the government's current target was at least 8 percent annual growth in GDP, after reaching an annual average rate of 7.2 percent under its 1991-93 plan, and he affirmed Viet Nam's intention to establish a market economy.

Slovakia's 1994 budget plans for expenditures of 140 billion koruny and a deficit of 14 billion koruny (assuming annual inflation of 12 percent, maximum unemployment of 17 percent, and 0 percent growth in GNP) intends for cuts in all ministries except defense. The budget deficit for 1993 is expected to grow to 19 billion koruny by the end of the year because of extra spending on health care, education and agriculture. (The 1993 budget bill had provided for a balanced budget.) Slovakia's GDP is expected to drop by 5 percent in 1993.

Lithuania's inflation in November was 6.8 percent, a slight drop from the 7.2 percent rate in October, indicating that the tight monetary policy that had reduced inflation to only .9 percent in August had been counterbalanced by continuing increases in wages and pensions. Lithuania plans to hold inflation at 10 percent in 1994. Inflation in **Estonia** increased from 2.6 percent in October to 4.0 percent in November. This was the highest monthly rate in 1993, exceeding the former high level of 3.6 percent in March. In **Latvia** inflation in November was 8.8 percent This is more than double the 3.8 percent rate in October and exceeds the previous monthly high in 1993 of 4.2 percent in January.

Bulgaria's 1994 budget envisages 171.5 billion leva in revenues and 204 billion leva in expenses. The deficit will be 32.5 billion leva, or 6.5 percent of the GDP, which is lower than the 8 percent projected for 1993. The figures are based on estimates that annual inflation will end at 45 percent (the level attained in the first nine months of 1993). While 32.7 percent of all expenses will be used to finance social insurance and relief efforts, 21.6 percent are to cover government debts (4.5 percent of the expenses being slated for repayments of the foreign debt), 10.1 percent is to pay for education, and 9.3 percent is slated for health care.

To facilitate multilateral clearing of **CIS** interstate trade transactions, CIS Interstate Bank was officially established in mid-December, with commitments on the part of the ten CIS member states to contribute 5 billion rubles as starting capital. Contributions are based on the individual members' share in their total "foreign trade turnover" in 1990. Thus, Russia will be contributing 50 percent of the capital, Ukraine 20.7 percent, Belarus 8.4 percent, Kazakhstan 6.1 percent, Uzbekistan 5.5 percent, Moldova 2.9 percent, Armenia 1.8 percent, Tajikistan 1.6 percent, Kyrgyzstan 1.5 percent, and Turkmenistan 1.5 percent. Russian Central Bank head Viktor Gerashchenko was elected chairman of the new bank's board and his former deputy at the Russian Central Bank, Valerii Savanin, became the bank's president.

Hungary's Parliament approved a 1,637.6 billion forint 1994 budget with a deficit of 329.5 billion forint. The Ministry of Finance has forecast a 1 to 3 percent decline in Hungary's GDP in 1993. Exports should attain $8.5 billion-$9 billion, while imports will reach $10.5 billion-$11 billion. The deficit in the current account is expected to run $2billion-$2.5 billion. Hungary's gross foreign debts reached $23.5 billion by the end of 1993, with foreign exchange reserves of $6 billion. Hungary's consumer price index (CPI) is expected to increase to 23 percent in 1993, and 16 to 22 percent in 1994. (Wage costs are expected to increase by 17 to 19 percent in 1994.)

(We appreciate the contributions from the RFE/RL Research Institute.)

New Books and Working Papers

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

World Bank Publications

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Trends in Developing Economies, Extracts: Volume 1, **Eastern Europe and Central Asia**, 1993, 101 p.

Regional issue of extracts from the World Bank's latest yearbook, *Trends in Developing Economies* (TIDE). Provides brief analytical descriptions, data, and graphs on twenty-one countries of Eastern Europe and the former Soviet Union as of May 1993. Each country text (recurrent themes include economic performance and trends, prospects, external finance and debt, government policy initiatives) is followed by newly designed tables of socioeconomic indicators (GDP accounts, social conditions, as well as international transactions, and the like), accompanied by graphs.

Ukraine: The Social Sectors during Transition, a World Bank country study, 1993, 223 p.

World Debt Tables: External Finance for Developing Countries, 1993-94 Volume 1. **Analysis and Summary Tables**, December 1993, 233 p.; Volume 2, **Country Tables**, December 1993, 534 p.

Volume 1, contains analysis and commentary on recent developments international finance in 148 developing countries, points out that the total external debt of all developing countries reached $1.66 trillion at the end of 1992, a $56 billion (or 3.5 percent) increase over the previous year. By the end of 1993, it is projected to reach $1.77 trillion, up 6.5 percent from the end of 1992. East Asia and the Pacific, together with Europe, Central Asia, and South Asia, showed the largest increases in external debt during each of the past two years.

Along with the surge in private capital flows to developing countries, there has been a shift from bank to nonbank sources and from predominantly sovereign to mainly private borrowers. Foreign direct investment (FDI) is now the largest single source of external finance for developing countries, accounting for more than 30 percent of total net flows. China is the largest single recipient—and source—of FDI flows among developing countries, with a projected inflow of $15 billion (or more than a quarter of the projected total) in 1993. Volume 2 contains statistical tables showing the external debt of 129 countries (latest data relate to 1992). For the first time, the long-term debt of states in the FSU, as well as that of Albania and Mongolia, is included. (All states of the FSU excluding Tajikistan are classified as middle-income countries.)

Discussion Papers

Peter Harrold, E.C. Hwa, and Lou Jiwei, eds., **Macroeconomic Management in China: Proceedings of a Conference in Dalian**, June 1993, no. 222, 1993, 45 p.

Hongjoo Hahm, **The Development of the Private Sector in a Small Economy in Transition: The Case of Mongolia**, no. 223, 1993, 48 p.

Soo J. Im, Robert Jalali, and Jamal Saghir, **Privatization in the Republics of the FSU: Framework and Initial Results**, Joint Staff Discussion Paper of the PSD Group, LEGEC and CFSPS, 1993, 72 p.
To order: the World Bank, Rm. Q-5030, tel. (202) 473-1228, fax (202) 477-3045.

Brohdan Wyzniekiewicz, Brian Pinto, and Maciej Grabowski, **Coping with Capitalism: The New Polish Entrepreneurs**, IFC Discussion Paper no. 18, 1993.

Working Papers

Tom Rawski, **How Fast Has Chinese Industry Grown?** WPS 1194, 1993, 44 p.
To order: Ms. Emily Khine, PRDTE, Rm. N11-065, tel. (202) 473-7471.

Mark Schaffer, **The Enterprise Sector and Emergence of the Polish Fiscal Crisis, 1990-91,** WPS 1995, 1993, 32 p.
To order: Ms. Emily Khine, PRDTE, Rm. N11-065, tel. (202) 473-7471.

Milan Vodopivec and Wayne Vroman, **The Armenian Labor Market in Transition: Issues and Options**, WPS 1193, September 1993, 34 p.
To order: Ms. Susana Florez, PRDTE, Rm. N11-017, tel. (202) 473-9075.

IMF Publications

Belarus Economic Review, IMF Economic Review Series no. 11, 1993.
To order: IMF Publication Services tel. (202) 623-7430 or fax (202) 623-7201.

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CERGE Lecture Series, Charles University, Prague

Tomas Jezek, **Privatization and the National Property Fund**, no. 14.

Miroslav Kerous and Barbara Insel, **Privatization of the Czech Banks** no. 17, June 17, 1993.

Ivor McElveen, **Inter-Enterprise Indebtness, Bankruptcy Law, and Possible Solutions for Privatized Companies**, no. 16.

Jan Svejnar, **The Past and Present of Czechoslovak Privatization**, no. 13, January 15, 1993.

Petra Wendelova and Vladimir Bukac, **Investment Privatization Funds as New Owners of Privatized Enterprises**, no. 15.

To order: Institute of Economic Studies, Faculty of Social Sciences, CERGE, Charles University, Smetanovo nabr.6, 110 00 Prague 1, Czech Republic, tel.: (422) 248-108-04.

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I. Abel, **Constraints on Enterprise Liquidity and Its Impact on the Monetary Sector in Formerly Centrally Planned Economies**, CEPR no. 841, September 1993.

I. Abel and K. Gatisios, **The Economics of Bankruptcy and the Transition to a Market Economy**, CEPR no. 878, November 1993.

M. C. Burda, **Modelling Exits from Unemployment in Eastern Germany: A Matching Function Approach**, CEPR no. 800, May 1993.

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M. Dewatripont and G. Roland, **The Design of Reform Packages under Uncertainty**, CEPR no. 860, November 1993.

C. Doyle, **The Distributional Consequences of Russia's Transition**, CEPR no. 839, London, September 1993.

É. Várhegyi, **Key Elements of the Reform of the Hungarian Banking System: Privatization and Portfolio Cleaning**, CEPR no. 826, September 1993.

L. A. Winters and Z. K. Wang, **Liberalizing EC Imports of Footwear from Eastern Europe**, CEPR no. 836, September 1993.

To order CEPR Discussion Papers: 25-28 Old Burlington Street, London W1X 1LB, tel. (44 71) 734-9190, fax (44 71) 734-8760.

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IRIS Working Papers

B. Ickes and R. Ryterman, **Roadblock to Economic Reform: Inter-Enterprise Debt and the Transition to Markets**, WP no. 61, 1993.

Peter Murrell and Y. Wang, **When Privatization Should Be Delayed: The Effect of Communist Legacies on Organizational and Institutional Reforms,** WP no. 41, 1993.

Peter Murrell, **Reform's Rhetoric-Realization Relationship: The Experience of Mongolia**, WP no.45, 1992.

P. Rubin, **Growing a Legal System, with Special Reference to the Post-Communist Economies**, WP no. 63, 1993.

For copies: IRIS, 2105 Morrill Hall, University of Maryland, College Park, MD 20742; tel. (301) 405-3110, fax (301) 405-3020.

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Jan and Elisabeth Winiecki, **The Structural Legacy of Soviet-Type Economy,** CRCE, London, 1993.

To order: CRCE, 2 Lord North Street, London SW1P 3LB, United Kingdom, tel: (4471) 799-3745, fax (4471) 233-1050.

Shafiqul Islam and M. Mandelbaum eds., **Making Markets: Economic Transformation in Eastern Europe and the Post-Soviet States**, Council on Foreign Relations Press, New York, 1993.

Piotr Jasinski, **Regulating the Finances of State-owned Enterprises in Central and Eastern Europe**, Regulatory Policy Institute no. 3, 1993, 30 p.

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Newsletters

CIPE Newsletter, published by the Center for International Private Enterprise, Budapest, Hungary.
To order: tel.fax (361) 111-3372.

Inside Central Asia, weekly newsletter of the BBC World Service, inaugurated January 1994. Covers politics, economics, and social and military affairs of Uzbekistan, Kazakhstan, Turkmenistan, Kyrgyzstan, Tajikistan, Azerbaijan, and the Xinjiang-Uighur province of northwest China.

To order: BBC Monitoring, Caversham Park, Reading RG4 8TZ, tel. (44734) 469-289, fax (44734) 483-823.

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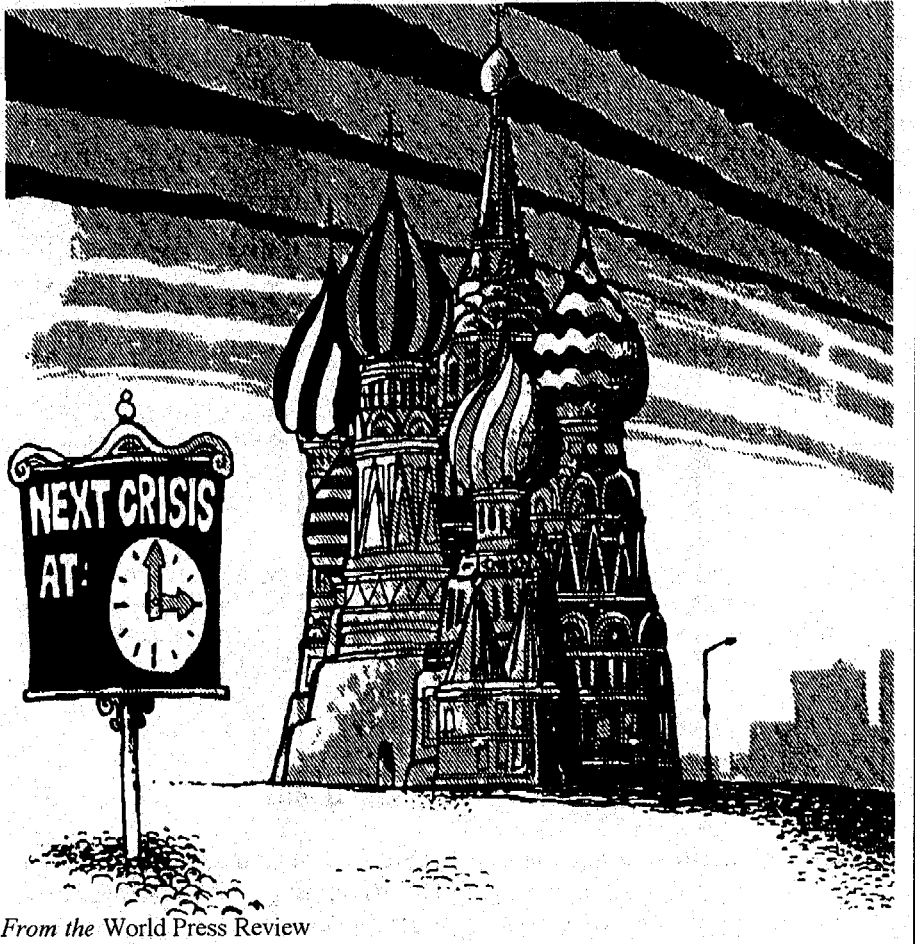

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