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Economic Consequences of the Kosovo Crisis

The first authoritative report on the economic effects of the war in Kosovo, issued by the World Bank and the International Monetary Fund (IMF) in April, contends that the crisis is having a catastrophic effect on the economies of the Balkans. The war and refugee crisis are wiping out growth, destroying commerce, and placing enormous strain on the budgets of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, and Romania. In all of these countries, except possibly Romania, more than 5 percent of GDP will be wiped out this year, plunging the region's economies deep into recession and raising unemployment at a time when hundreds of thousands of refugees must be absorbed. Albania put the 1999 extra costs of the crisis at $820 million, including the care for the 360,000 newly arrived refugees in the country. The FYR Macedonia claims that its economy has already lost some $1.6 billion this year.

Region Under Pressure

As a result of the Kosovo tragedy, the six countries closest to FR Yugoslavia will suffer huge budgetary and balance of payments gaps. The impact will come from various sources:

- ***The influx of large numbers of refugees puts strains on the social and economic infrastructure.*** Albania and FYR Macedonia, both poor countries, will be most severely affected.
- ***Trade is disrupted.*** While the military conflict continues, and perhaps even for some time thereafter, trade with Yugoslavia will remain suspended. FYR Macedonia and Bosnia and Herzegovina, Yugoslavia's main export markets, will be particularly hard hit. A significant portion of transit trade will have to be rerouted. Bulgaria and Romania will need to find alternative and more costly transit routes.
- ***Investor confidence is falling.*** Uncertainty reduces the confidence of both local and foreign investors and of consumers, reducing spending and putting strain on the external current and capital accounts. All six countries, especially those bordering Kosovo, can be expected to experience a decline in foreign direct investment. Some countries (especially Croatia) may be hurt by a loss of tourism receipts. Croatia, Bulgaria, Romania, and other countries in the region may also pay a higher country risk premium on borrowing from international capital markets, and private financing may become more difficult to obtain.
- ***Structural reform may be postponed, adversely affecting development.*** Privatizations may be postponed because of a lack of foreign investor interest or lower sale prices.

As a result of these factors in the six countries, balance of payments gaps will appear in 1999 and probably persist through at least 2000. Moreover, even if the international community provides for all of the basic needs of the refugees, budgetary gaps will arise. Revenues will fall as incomes and customs collections decline, while expenditures will rise as spending on refugees, defense, and

What's Inside

maintenance of public order increases. In the absence of external financing, adjustment could require additional compression of domestic demand and imports as well as cuts in essential social expenditures.

In particular, in Albania, where the GNP per capita is only $760, economic growth is likely to fall 5 to 6 percent this year, from 8 to 10 percent in 1998. In FYR Macedonia, where the 40 percent unemployment rate is already the highest in Europe, about four out of five enterprises have stopped working. Broken trade ties with Yugoslavia, severed transport links with EU trading partners (90 percent of exports and imports with the EU used to go through Serbia) make the situation in this country especially difficult.

How Much Financing?

The World Bank and International Monetary Fund report, "Economic Consequences of the Kosovo Crisis: A Preliminary Assessment of External Financing Needs and the Role of the Fund and the World Bank in the International Response," estimates the 1999 external financing needs of these countries—depending on the duration of the crisis—between 0.8 and 1.8 billion dollars. (Paying for economic reconstruction in the region after the fighting ends could cost as much as $30 billion. That was estimated, at the end of April, by European experts.)

The response to the tragedy, according to the report, must consist of providing immediate aid to relieve the suffering of the refugees and ensuring that the six countries have access to adequate external financing to help them deal with the crisis. The IMF and the World Bank will be able to coordinate the international community's response, with the IMF playing a direct role through policy advice and financial resources and the Bank providing emergency financing assistance to help close the balance of payments and budgetary gaps.

Just how much assistance will be necessary? The report examines two scenarios (see table next page). Under the first scenario, the military campaign is prolonged and the refugee crisis lasts throughout 1999. All official trade with FR

Yugoslavia's Shattered Economy

Already crippled by eight years of international sanctions and decades of economic mismanagement, Yugoslavia's economy is being dismantled piece by piece by the NATO airstrikes, writes the AP-Dow Jones news agency. According to Yugoslav official estimates, $40 billion in damage has been caused since NATO began its operations on March 24. The destruction will shave at least a third off the country's $15 billion GDP this year, according to independent Serbian economists.

Destroyed or heavily damaged so far: Yugoslavia's two largest oil refineries, in Pancevo and Novi Sad; the October 14 plant in Krusevac (the largest heavy machinery plant in the Balkans); the Zastava auto plant in Kragujevac (which employed 38,000 workers and produced the Yugo car); as well as power stations, a domestic appliance factory, chemical factories, airports, bridges, television transmitters and stations.

Factories are working at a low capacity, and agricultural activity has virtually come to a halt. Unemployment has soared to nearly 50 percent. Some 500,000 people have been laid off since the first strike, adding to the more than 1 million previously unemployed. Schools and universities were closed shortly after the first NATO attacks, and fuel rationing has forced municipal authorities to cut public transport by half.

Yugoslavia's economy was struggling long before the airstrikes began. In 1998 both the budget and the current account showed large deficits, and inflation had returned to high levels. The budget deficit reached about 10 percent of GDP in 1998, financed largely by monetary emissions. Wage and pension arrears were mounting, and inflation had reached an estimated 50–70 percent, up from 18.5 percent in 1997.

Exports of $2.1 billion dollars and imports of $3.5 billion during the first eight months of 1998 showed virtually no growth from the previous year. Lack of foreign capital made financing the trade deficit difficult, and foreign trade transactions were already being carried out almost exclusively on a cash or barter basis. Foreign currency reserves had fallen to about $200 million by the end of 1998.

Privatization had ground to a halt, hindered by the high level of indebtedness of large state-owned enterprises and increased uncertainty. Privatization revenues in 1998 barely reached $100 million dollars—far from the target of $1.5 billion. Meanwhile, enterprise insolvencies rose to a cumulative total of 27,888 companies, with total liabilities of more than 20 billion dinars by mid-1998 ($2.0 billion at the official exchange rate). The banking sector remained weak, and no reforms were planned. Nineteen of the 104 banks recorded losses, which totaled 460.3 million dinars ($46 million) in 1998.

In Kosovo, out of 1.7 million ethnic Albanian residents, an estimated 1.5 million were displaced as of early May, reports the U.S. State Department. At least 600,000 people were displaced internally, in addition to the more than 700,000 Kosovo Albanians who have been driven into neighboring states since March 1998, the report said.

Additional External Financing Needs of the Six Most Affected Countries[1] in 1999—World Bank and IMF Estimates
(In millions of U.S. Dollars)

	Scenario A "Prolonged Military Campaign"	*Scenario B "Crisis Quickly Resolved"*
Refugee cost[2]	311	139
Balance of Payment gap	1,515	668
Total financing need	1,826	807
In percent of GDP	2.5	1.1
Memorandum item:		
Budgetary gap	652	308
In percent of GDP	0.9	0.4

1. Albania, Bosnia and Herzegovina, Bulgaria, Croatia, former Yugoslav Republic of Macedonia (FYRM), and Romania.
2. Additional cost for displaced persons in Montenegro estimated at $43 million under scenario A and $22 million under scenario B.
Source: IMF and World Bank staff estimates.

Yugoslavia is suspended, although limited transit trade to third countries resumes in the second half of 1999 (at 25 percent of the precrisis level and at a higher cost). Required humanitarian assistance for covering the basic needs of the refugees reaches more than $300 million in 1999. The combined balance of payments gap of the six countries reaches $1.5 billion, with the worst hit countries in the region—FYR Macedonia and Bosnia and Herzegovina—experiencing increases in their balance of payments deficit of 7-8 percent of GDP. The aggregate budgetary gap for the region reaches $652 million.

Under the second scenario, the crisis is resolved quickly. Official trade with FR Yugoslavia returns to 75 percent of its precrisis level in the second half of 1999, and transit trade through FR Yugoslavia reaches 50 percent of its precrisis level. About three-quarters of the refugees return to Kosovo during the third quarter of 1999, and all return by the end of the year.

THE WASHINGTON POST

The Washington Consensus

The international community's response to the Kosovo crisis was discussed during a high-level meeting of governments and international agencies held in Washington April 27, 1999. The meeting was cochaired by World Bank President James Wolfensohn and IMF Managing Director Michel Camdessus. Representatives of 7 international agencies and 33 countries, including the six Balkan countries immediately affected by the crisis, participated in the conference.

Conference participants agreed that donors should act swiftly; that quick disbursing assistance over and above earlier planned aid programs will be needed to cover affected countries' external and budgetary gaps for 1999; that financing on concessional terms is critical; that strong donor coordination will be essential, as most aid will continue to be channeled on a country-by-country basis; and that affected countries should maintain the momentum of adjustment and structural reform and ensure good governance.

The medium-term development of the region will be discussed during a meeting in Bonn at the end of May. In the coming weeks donor meetings, cochaired by the World Bank and the European Union, will seek pledges to close the funding gaps for individual countries.

World Bank Support to the Region

The Bank has taken a number of steps to assist countries in the region.

- Albania—through speedy delivery—received emergency budget support of $30 million. The credit will finance extraordinary budgetary needs (social services, civil administration, public infrastructure, and domestic security) and compensate for revenue shortfalls caused by the crisis. Two $1 million postconflict grants will provide Albania with institutional support to assist refugees arriving at the border area from Kosovo. Several new credits, worth $40 million, are also expected to be approved soon. The new projects will fund microcredit programs, irrigation and flood prevention efforts, support reform of the judiciary and civil service, and privatization of banks and strategic state-owned enterprises.
- For FYR Macedonia the Bank has provided a $50 million emergency IDA credit to finance critical imports. A $1 million postconflict grant is being prepared to support refugees and help local nongovernmental organizations administer and direct inflows of other aid funds. The World Bank played a major role to organize a donors meeting in Paris on May 5, that pledged $252 million financial assistance to FYR Macedonia. The meeting of 46 countries and multinational organizations, chaired by the Bank and the European Commission, promised additional financial assistance. Donors agreed to meet again in the second half of 1999.

Supporting Economics Education in Transition Economies—A World Bank–Initiated Partnership

Interview with Boris Pleskovic

On March 30 President Wolfensohn, Senior Vice President and Chief Economist Joseph Stiglitz, and other top officials of the World Bank met principals of foundations such as: the Aga Khan, Carnegie, Eurasia, MacArthur, Soros, and Starr, as well as representatives of the European Union and the U.S. government, to discuss further support of economics education and research in transition economies. (With the help of the World Bank these donors have already built several successful institutions of higher education in transition economies.) Transition editor Richard Hirschler asked Boris Pleskovic, Acting Administrator of the World Bank's Research Advisory Staff and one of the "founding fathers" of what has become an extraordinary international partnership, to explain the goals and future directions of this unique enterprise.

Q. Why is the Bank getting involved in economics education and research in the transition countries?

A. The Bank is aware that well-trained economists and high-level research are key to the continued growth and stability of transition economies. It is no secret that educational and research institutions in many transition economies are struggling with declining wages and diminishing budgets, and as a result the best professors and researchers are leaving—either for positions at foreign universities or jobs in the private sector. Essentially, in transition countries there is a lack of Western-trained economics professors, researchers, and professionals who can develop the policies needed to achieve sustainable economic growth and stability.

The World Bank recognizes that spectacular results can be achieved by forming a partnership with private foundations, international financial institutions, and education specialists to invest in Western graduate economics education and research. Thus the Bank is functioning as a catalyst—bringing together such prominent figures as George Soros, William Bader, John Roberts, James Wolfensohn, Stanley Fischer, Charles William Maynes, and Joseph Stiglitz to form a partnership for capacity building in transition economies.

Q. What has happened so far?

A. It all started in May 1994 when William Bader—then president of the Eurasia Foundation—and I initiated a meeting in New York between the World Bank and U.S. foundations and universities to discuss ways to strengthen economics

education and research capabilities in the new independent states. Within a year we were able to set up the Economics Education and Research Consortium in Ukraine and Russia (EERC). The EERC has been implemented and managed by the Eurasia Foundation on behalf of the donors. Consortium members currently include the Carnegie Corporation of New York, the Eurasia Foundation, the Ford Foundation, the Open Society Institute (Soros), the Starr Foundation, Sweden's and Norway's Foreign Ministry, and the World Bank. Other founders—Citicorp Foundation, Digital Equipment Corporation, the government of Finland, the International Monetary Fund, and the Pew Charitable Trusts—have provided significant direct or in-kind support to the project. [More details on page 8. The Editor].

Foundation principals, economists, representatives of international lending institutions, and government officials met for a second time in June 1997, in New York, where we discussed expanding funding for Moscow's New Economics School and also discussed the state of economics education in Central and Eastern Europe and the countries of the former Soviet Union.

In December 1998 we had another meeting, sponsored by the Eurasia Foundation, the Open Society Institute, the Starr Foundation, and the World Bank, and chaired jointly by George Soros and Joseph Stiglitz. With some modifications, this meeting reaffirmed the findings of a report we had commissioned earlier [see page 6]. We agreed that in the short term it is vital to train many top-notch economics professors—a task best done abroad or at high-quality regional centers. In the longer term, however, the goal must be to develop strong economics education and research in the transition countries themselves. We would like to have an institution like Harvard in every country. However, funds are limited, and we believe that this aim is best achieved

by first creating a critical mass of economics education and research on a regional basis and only later in each country.

Q. What major recommendations arose from the March 1999 meeting?

A. Two major recommendations to cover the gaps in foreign funding and assistance were accepted. First, we have proposed funding three regional centers of graduate economics education that will start at the M.A. level but eventually develop into Ph.D. programs. We aim for one center to be set up in Central Asia, one in the Caucasus, and one in southeast Europe, possibly in Slovenia. To get these centers off to a strong start, each should be funded for at least three years, at a cost of about $1 million a year per center.

New Western-supported economics education institutions that have recently been set up in the region can serve as models for our proposed centers. Such institutions include the Central European University (CEU) in Budapest, the Economic Education and Research Consortium (EERC) in Kiev, the EERC research network and New Economics School (NES) in Moscow, and the Center for Economic Research and Graduate Education (CERGE) at Charles University in Prague—which has a Ph.D. program.

Second, we have proposed that a research center be established for transition countries that do not yet participate in an international economics research program. With the Action for Cooperation in the Field of Economics (ACE) program already covering East-Central Europe and the Baltics, and the Moscow EERC research program covering Russia, research in the remaining countries of the former Soviet Union should be funded by extending the Moscow EERC research program. The EERC can develop a new network for professional economists, fostering high-quality, policy-relevant economic research while providing professional development for local researchers. This extension of the Moscow-based economic research program should receive $1 million a year in funding—the same amount that the EERC currently spends in Russia. Thus EERC could become the research network hub for the whole region.

Q. What other proposals have been accepted based on the report?

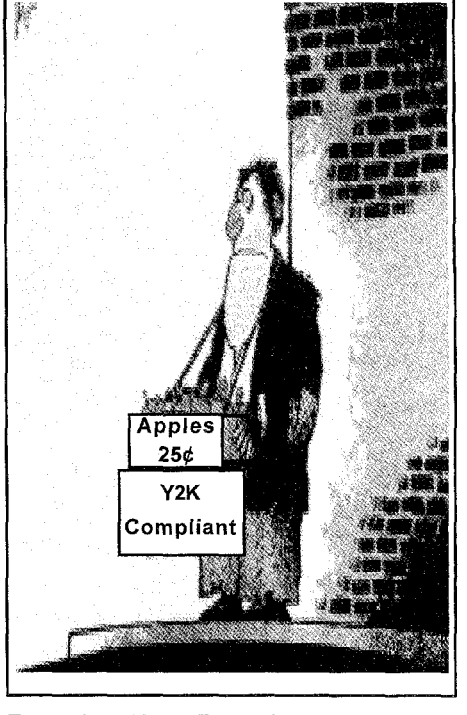
A. Transition countries urgently need more teachers with up-to-date economics knowledge. To create a critical mass of professors teaching at international standards, resources need to be concentrated in a few of the most promising institutions in each country; these programs can become models for other programs throughout the country. Short-term study tours should be cut back in favor of longer-term stays in both directions; our study has found few positive benefits from brief-visit programs, which amount to little more than academic tourism. More teaching fellowships for European and North American professors—through Fulbright and other U.S.- and European-sponsored programs—will improve the situation. And a fund should be started to augment the meager salaries of Ph.D. graduates who return to their countries from abroad to teach or work at local universities or research centers; such a fund would both strengthen these graduates' incentives for returning and promote the retention of skilled analysts.

Other important recommendations include supporting internet access and upgrading libraries. The Open Society Institute has already greatly improved Internet connectivity in the region, but more could be done to take advantage of the Internet and CD-ROM technology. Electronic resources for teaching and research could allow countries to offset some of the shortcomings that arise from their weak library systems. The Internet is a powerful tool for increasing reach and leverage of the proposed regional education and research centers. And libraries will still need attention—most notably, better access to scholarly journals and better management and administration of their existing resources.

Finally I would like to mention corruption—which is still a big problem in most of the region. Much has been done to reduce corruption in the past few years, primarily through the introduction of private universities. But the root solution to corruption is to provide adequate salaries so that teachers can live without side payments. And it is important to promote tuition-based education systems and abolish oral examinations—which provide ample opportunity for fraud.

I am sure that these initiatives will yield visible improvements in economics education and research in the region.

Ready for the Millenium Bug



From the *World Press Review.*

An Assessment of Higher Education in Transition Economies

"Proposed Strategy to Address Critical Economics Education and Research Needs in Transition Economies" (1999), a new report authored by Boris Pleskovic, Anders Aslund, William Bader, and Robert Campbell and sponsored by the World Bank and the Soros, Eurasia, and Starr Foundations, reveals a mixed picture of the state of economics education and research at universities and other institutions in 20 transition countries. (The countries are Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Croatia, Estonia, Georgia, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, FYR Macedonia, Moldova, Romania, Slovakia, Slovenia, Tajikistan, Turkmenistan, and Uzbekistan.The report is available on request from Boris Pleskovic: email bpleskovic@worldbank.org.)

A great deal has happened since March 1995 when the Eurasia Foundation and the World Bank completed their report "Critical Economics Education and Research Needs in Russia and Ukraine." Most countries in the region have since undertaken major reforms of higher education, moving from a Soviet-type education system to a more international (Western) system. Institutions of higher education have more autonomy, and the Western-style university and degree system (granting B.A., M.A., and Ph.D. degrees) is gaining ground.

Business administration is developing at a rapid pace, with more students, better business schools, and higher tuition fees than ever before. But while some business programs include elements of basic economics—microeconomics, macroeconomics, statistics—business administration is often more of an impediment than a boon for economics. Light, applied business courses are often preferred to more serious, theoretical economics courses. And business training—rather than economics—attracts many of the best students because low-paying academia has little appeal. Foreign assistance also goes predominantly to business administration training.

Enrollment levels are rising, but public funding of education, including higher education, is falling in much of the region. About 10 years ago most countries in the region spent 5-6 percent of GDP on education, and while countries in East-Central Europe and the Baltics have not radically reduced education spending, most countries of the former Soviet Union have. In countries of the former Soviet Union public funding of education appears to have fallen to about one-third of its real level 10 years ago. Where public education funding has fallen sharply, teachers' wages have also plummeted. Economics seems to have suffered the same proportional cuts as higher education in general.

Private financing, meanwhile, has proliferated. Almost all new institutions are financed by relatively high tuition fees. Tuition fees are spreading to public institutions as well, especially in countries of the former Soviet Union, although public higher education remains essentially free in East-Central Europe. Public financing is heavily focused on undergraduate and business education and much less on graduate education. There seems to be minimal demand for economic research, which is suffering from sharply falling public funding across the region—East Central Europe included—and attracts little private funding.

While institutions of higher education have multiplied, the number of university teachers has declined almost everywhere, including in economics. The teacher to student ratio has fallen sharply—to about half of what it was 10 years ago. Teachers are overburdened by classroom teaching, with hardly any time left for research or career development. Their salaries have plummeted, and are especially low in Belarus, Moldova, the Caucasus, and Central Asia. (Salaries are comparatively decent in Slovenia, Croatia, and the Baltics.) Private business schools pay teachers up to 10 times as much as public universities do, but they tend to pay only for teaching and not for research.

Thus the quality of economics education is generally low throughout the region. Domestic capacity for economics research remains institutionally weak throughout the region, with institutions still staffed by professors trained in the Marxist tradition and lacking analytic or quantitative training. And many universities need to be rebuilt from the bottom up to eliminate the strong vested interests of insiders.

Foreign donor organizations spent an estimated $35 million in 1997-98 to support economics education and related activities in the 20 countries that this new report covers. The largest donor was the European Union, through its PHARE program—covering Eastern Europe—and TACIS program—covering countries of the former Soviet Union; these programs cost about $14 million. The Open Society Institute spent about $12 million in aid, and the U.S. Information Agency (in association with IREX, ACTR/ACCELS, and other U.S. organizations) spent about $4 million. Other major donors included the U.S. Department of Education ($2.5 million), the Pew Charitable Trusts, the Eurasia Foundation, the British Council and the Foreign Commonwealth Office, and several Scandinavian countries.

Funding for research comes mainly through the European Union's economics research program, Action for Cooperation in the field of Economics (ACE). This program allocates funds on a competitive basis; PHARE ACE covers Central and Eastern Europe, including the three Baltic states, and TACIS ACE covers countries of the former Soviet Union. PHARE ACE has been allocated $11 million for 1999, although funding will be scaled down to $7.5 million for the period of 2000-2003. ACE will probably set aside 1 million euros for Russia alone for the period 1999-2002.

Brain Drain Reverse—Repatriating Russian Academics

by Oleg Glebov

Since the exodus of Russian academics began in the early 1990s, a significant number of young Russian students have enrolled in graduate programs at some of the best economics departments in the United States and Europe. For the next five years, bringing these students back to Russia will be the core element of the strategic plan of the Economic Education and Research Consortium (EERC) in Moscow (see box next page).

The EERC and a number of Moscow's leading research and teaching institutions—New Economic School (NES), the Higher School of Economics, the Russian-European Center for Economic Policy, the European University (St. Petersburg), the Bureau of Economic Analysis—have discussed launching a joint retention initiative. All have agreed to join in designing and implementing a comprehensive initiative that will meet the professional needs of talented young Russian economists.

But before such an initiative can be launched, we must address the reasons for the exodus of these economists. Many Russian postgraduate students—and obviously the best ones—have good chances to stay in the West by finding either an academic or nonacademic job. And the current economic situation in Russia is hardly conducive to a homecoming; Russian investment firms and Western companies that were operating in Russia before the crisis are not going to hire anybody for a long time to come. Economics in Russia lacks any state support or commissions. So how realistic is it to expect young economists to come back from other countries, and how can we convince them to return?

To answer these general questions, more specific questions must first be asked. What is the exact size and composition of the expatriate community of Russian economists? What are the goals of students as they approach the end of their studies abroad? Do they want to work in academia or the private sector? Do they prefer teaching, academic or policy research, or both? Are they professionally interested in Russia? In the process of economic transition? What financial and professional incentives would make them likely to come back?

To answer these and many other questions, EERC has been carrying out a pilot survey among Russian students in about 50 top economics departments in the United States, Canada, Europe, and Australia. The survey's findings should help in designing a retention initiative and in forming a wide coalition of institutions that can work to reverse Russia's brain drain of the early 1990s. The survey is being conducted by Lyudmila Ledeneva of the Institute of Economic Forecasting and Elena Tyuryukanova of the Institute for Social and Economic Problems of Population, both of the Russian Academy of Sciences in Moscow.

Surveys were sent to 85 students—nearly all of the Russian economics graduate students abroad. Of these, 39 students completed the questionnaire, 20 from the United States and the rest from the United Kingdom, the Netherlands, Spain, Denmark, Japan, and Australia. Respondents' average age was 28; most had studied in Moscow.

About half of the completed questionnaires were received in May 1998, before Russia's crisis; the rest arrived in September, when one could already assess the crisis' consequences. Nevertheless, there were no significant changes in the respondents' attitudes. Many felt that demand for their professional skills in the West was stronger than in Russia. The reasons for this are obvious: uncertain

New Economics School: Teaching Modern Economics

The New Economics School (NES) was founded in 1992 through a partnership between the Central Economics and Mathematical Institute (CEMI) of the Russian Academy of Sciences, the Hebrew University in Jerusalem, and Moscow State University, with financial support from the Soros Foundation, the Eurasia Foundation, the Ford Foundation, the MacArthur Foundation, Citicorp Foundation, and the World Bank. NES offers a two-year M.A. program in modern economics, to which it admits about 50 students a year.

During the first six years of NES, nearly 80 of the 180 students that graduated from NES have pursued Ph.D. studies, primarily at the best universities in the U.S. and Western Europe. The remaining one hundred NES graduates have accepted positions as professional economists in the Russian government, the Central Bank of Russia, as well as foreign and Russian companies. A few among them assumed teaching jobs at NES and in other universities.

In the future NES plans to further diversify its curriculum, develop its research and outreach, and expand its admissions to 100 students a year. NES also plans to launch an in-house policy-oriented group. And as graduates who have received Western Ph.D.s return, NES will develop a permanent faculty and start its own Ph.D. program.

professional prospects in Russia (such as absence of viable teaching or research opportunities), weak ties between Russian and Western research centers, and poor integration of Russian economic tradition into the international academic community.

The results of the survey brought some surprises. They showed that the traditional concept of migration based on a return or no return dichotomy may be inadequate, as intellectual human capital becomes increasingly mobile. In addition to the "pure" strategies of permanent residence and work in Russia or abroad, we could discern "mixed" strategies that included the options of permanent residence in Russia and temporary work abroad, or vice versa. Career choices were determined more by purely professional factors than financial factors; respondents were willing to settle in either the East or the West if offered professionally satisfying positions (preferably in academia). Respondents said they would stay in an environment that could help them make contacts, raise funds, and develop research projects. (Such an environment can exist in Russia; in 1998 three young graduates came back to Russia and were inundated with job offers in Moscow. They are now teaching and working on a number of international research projects supported by overseas foundations.)

Survey responses confirmed the need to provide professional, financial, and orga-

EERC: Consortium with a Good Cause

The Economics Education and Research Consortium (EERC) was founded in 1995 to improve economics education and research in the former Soviet Union, with an initial focus on Russia and Ukraine.

Ukraine: Spreading the Word of Modern Economics

The Ukraine Economics M.A. Program, which began offering classes in September 1996, is an internationally-recognized graduate teaching program conducted in cooperation with the University of Kyiv-Mohyla Academy (UKMA). The M.A. program started with the admission of 50 students a year; since then the number has increased, and in fall 1999 it will reach its full capacity of about 100 students a year. The program's two-year full-time curriculum prepares graduates to work as economists in policymaking positions in Ukraine or to pursue Ph.D. studies abroad—which will enable them to further the economics discipline in Ukraine through teaching and research.

For their first year, students at the Ukraine M.A. program take the core economics courses—microeconomics, macroeconomics, statistics and econometrics, and mathematics—all instructed in English. The second year offers a range of courses in applied economics, in areas such as financial institutions and markets, economics of the public sector, international finance, market failure and regulation, labor economics, industrial organization, and the economics of transition. During the second year each student completes a research project related to Ukraine's transition to a market economy.

The Ukraine program has cost about $900,000 a year to operate, including significant capital expenditures in the first year. As the student body grows to its full capacity, the operating budget will have to grow too, but the operating cost per student per year be kept under $11,000.

Russia: Policy Oriented Research

Launched in the Summer of 1996, the Economic Education and Research Consortium's (EERC) program in Russia provides individual grants, training, and technical assistance to Russian economists engaged in original policy-oriented research—and complementary publication and dissemination services for EERC-sponsored research. During 1996-97 EERC has carried out three rounds of research grant competition, holding three research workshops for economists to present new proposals and report on work in progress. The competition has resulted in more than 50 individual grants to Russian researchers.

A series of methodological seminars provides training, technical assistance, and publication of research results. The first such seminar, "Panel Data Analysis: Theory and Practical Applications," was held in May 1998 in cooperation with the Moscow's New Economics School. EERC's first annual conference, "Economic Transition in CEE and Russia: Theory and Empirical Evidence," convened in December 1997. EERC's semiannual newsletter, "Research in Transition," started publication in December 1997. In 1998 EERC has introduced its Working Paper Series.

In its first two years the program has provided research funding for more than 150 Russian economists—who have now become the nucleus of a nationwide academic network. More than 250 young Russian economists have received training at EERC research workshops and methodology seminars.

CERGE: Ph.D. Program Offered in Prague

The Center for Economic Research and Graduate Education (CERGE) was founded in 1991 as an American-style Ph.D. program and research center of Charles University in Prague. The center's chief mission is to educate the next generation of leading economists in former Soviet bloc countries. Since 1992 CERGE has cooperated closely with the Economics Institute (EI) of the Academy of Sciences of the Czech Republic.

This joint initiative has become known as CERGE-EI. The two founders of CERGE-EI are Jan Svejnar, professor at the University of Michigan, and Josef Zieleniec, professor at Charles University.

CERGE-EI provides a full-fledged American-style Ph.D. program, stimulates academic and policy-oriented research, and disseminates research and policy information to a wide global audience. CERGE-EI now admits approximately 25 students each year—accepting only about 1 in 12 applicants. About 30 percent of students in CERGE-EI come from the Czech Republic; most of the rest are from various post-communist countries. CERGE-EI's annual budget for teaching and research is $2.5 million—about $1.4 million for education and $1 million for research. The average annual cost per student (both on- and off-campus students) is $13,500—for teaching expenses and scholarships.

nizational incentives that will encourage Russian postgraduate students studying abroad to return to Russia despite the country's social and economic instability. Proper compensation and a high-quality research environment are the most important incentives. Incentives should also include job independence, a flexible work schedule, the possibility of rapid career advancement, prospects of international professional contacts, and travel abroad.

While continuing to collect data and surveys from Russian graduate students abroad, EERC is developing strategies to repatriate human capital. EERC has recently received a grant from the government of Sweden to fund an economics professorship in Russia; the appointment of a highly qualified young Russian economist to this post will be finalized in late May. EERC is working to procure funding for professorship positions at Russian regional education centers such as Novosibirsk and Khabarovsk—where many members of the growing EERC economics research network have their offices. The EERC's current primary task is to organize an 'orientation office' that can support and guide the consortium in developing and implementing repatriation strategies.

Oleg Glebov is Deputy Program Director of the EERC-Russia. He can be reached by mail at EERC-Russia, 3 Kochnovskii Proezd, Suite 420, 125319 Moscow, Russia; by telephone or fax at 7095-152-0601/0121; or by email at glebov @eerc.ru. The EERC-Russia website is http:/www.eerc.ru.

When Bad Debts Hurt

From the *Hungarian Economy.*

The Benefits of Open Trade and a Realistic Exchange Rate: World Bank Experts' Useful Insights in Kazakhstan

On April 2, 1999 Kazakhstan devalued the tenge, its national currency, and announced the elimination of the protectionist policies that had been introduced to support the overvalued exchange rate. This decision was partly instigated by constructive discussions in mid-March between the government and a team headed by World Bank Lead Economist David Tarr—discussions that helped sway the country's trade and exchange rate policy in a more market-oriented direction. A recent policy paper by Tarr and Howard Shatz, "Kazakhstan: Appropriate and Inappropriate Trade and Exchange Rate Policies in Response to Adverse External Shocks"—which incorporates comments from discussions with Bank and IMF Kazakhstan country teams—was well received by Kazakh economic policymakers. Highlights from Tarr and Shatz's paper are presented here.

The series of shocks that adversely affected the Kazakh economy in 1998—the East Asian crisis, the fall in commodity prices, the Russian crisis—demanded a response from policymakers. This response could take one of two forms: either increased protection or progressive liberalization of the country's trade regime, integrating Kazakhstan into the world trading community and improving its growth prospects for the medium to long term.

Why an Open Trade Regime?

Cross-country experience over the past 50 years has demonstrated the benefits of open trade regimes. The OECD countries, which have reduced trade barriers through successive GATT-WTO negotiations, have experienced sustained growth in trade and incomes. And virtually all recent development success stories—Chile, Hong Kong (China), Malaysia, Mauritius, the Republic of Korea, Singapore, and Taiwan (China)—have been based on strong industrial export growth and relatively low or falling barriers to imports. The industrial sectors in these economies have experienced higher export and employment growth, and trade reforms have usually been accompanied by increased flows of foreign investment. Over the past 10 years, evidence has accumulated that open trade regimes are more conducive to growth than protective regimes, thus developing countries that favored trade protection have reassessed their policy.

The Overvalued Tenge

Kazakhstan's trade protection increased in recent years mainly because of the country's overvalued currency. Although the tenge has depreciated in real terms against the dollar—by 15 percent between July 1998 and January 1999—and many other Western currencies, it has

David Tarr

significantly appreciated in real terms against the Russian ruble—by 68 percent between July 1998 and January 1999. The overvaluation led to a loss of competitiveness relative to partners in the region, especially Russia, and difficulty in defending the exchange rate.

Although imposition of trade controls in response to an overvalued exchange rate has consistently had disastrous consequences for economic growth (see box next page), in Kazakhstan there were concerns about the other option—devaluation. Policymakers worried that devaluation would lead to an unstable downward spiral of the exchange rate and possibly a Russian-style financial crisis. But the Russian banking crisis was mostly triggered by the government's default on ruble-denominated debt—which dramatically reduced the assets of many Russian banks overnight. These conditions are not present in Kazakhstan. Moreover, worldwide experience, Russia's experience, and recent experience in Ukraine and Moldova have shown that defending the exchange rate has no medium-term benefits, because falling reserves will eventually force devaluation. It is better that the devaluation be accomplished sooner, without further debilitating losses in reserves and lost productivity due to import controls. And worldwide experience with devaluations shows that after a devaluation the exchange rate will reach a new equilibrium, strongly influenced by the policies of the central bank and the government.

Prohibitive protection of selected products or from selected countries will be ineffective in reducing the demand for foreign exchange. Such protection can mean increased imports through informal channels. And while some sectors will be protected, the costs of adjusting to the overvalued exchange rate will be borne by the unprotected sectors, the export sectors and those sectors that

are more susceptible to informal or illegal imports (a significant problem in Kazakhstan).

Conclusion

It is recommended that Kazakhstan make a quick return to the more liberal trade policies and competitive exchange rate policies of its recent past, while continuing to open its trade regime to international competition. The best industrial policy for the growth of Kazakhstan is to avoid picking winners and losers among industries and firms, and instead provide uniform tariffs, a stable macroeconomic environment and a regulatory regime that provides for the rule of law and does not place excessive burdens on business.

David Tarr is Lead Economist with DECRG, the World Bank, and Howard Shatz is a consultant, also with DECRG.

Overvaluation Hurts—Learning From Others' Mistakes

An overvalued real exchange rate impedes economic growth because:

- Overvaluation discriminates against exports. Because exporters receive relatively less in domestic currency for the foreign currency they earn, and a significant portion of the costs of production are paid in domestic currency, exporters have reduced incentives and ability to compete in foreign markets. This chokes foreign exchange receipts and damages a country's ability to purchase the imports needed for economic activity.

- Import-competing domestic industries face increased pressure from foreign companies, causing industrial and agricultural lobbies to increase their calls for protection against imports. The political pressure for protection eventually proves overwhelming, and governments give in by increasing the tariffs on imports. This closes the economy to international competition and reduces access to needed imported inputs and technology—causing growth to decline.

- Productivity advances are less rapid because the export sectors and the import competing sectors are disadvantaged by an overvalued exchange rate, and it is in these sectors that productivity advances are often most rapid.

- Overvaluation induces capital flight, as domestic citizens anticipate a devaluation. As a result, less foreign exchange is available to finance imports.

- Foreign exchange may be rationed by the government—and allocated inefficiently.

- Efforts to defend an overvalued exchange rate through very tight monetary policy may plunge the country into severe recession. (In Kazakhstan monetary and fiscal policies were under too much pressure to defend the exchange rate, resulting in very high real interest rates and a risk of adverse effects on investment and output.)

Developing economies that followed a classic import-substituting industrialization strategy after World War II provide good illustrations of the negative effects of an overvalued exchange rate combined with trade controls. In the 1950s and 1960s Argentina, Chile, and Uruguay all followed import-substituting industrialization policies that led to a bias against exports, extremely uneven protective tariff rates in trade across sectors, and controlled financial systems. By the early 1970s they experienced recurrent balance-of-payments crises, accelerating inflation, bottlenecks in production, slow export growth, and capital flight (capital flight being especially pronounced during the 1979 to 1982 period when all three used the exchange rate as a nominal anchor). Between 1950 and 1980, Turkey also had three episodes of overvalued exchange rates defended by high import protection. In each case export earnings crashed, severely retarding economic activity; in 1958 Turkey did not have enough foreign exchange to buy the gasoline needed to move the harvest to port. The devaluations that followed these crises led to expanded exports, imports, and economic growth.

Chile provides a good illustration of how a country can get out of this vicious circle. After its 1982-83 crisis in which real GDP fell 15 percent, Chile tried to increase tariff rates so its people would buy domestic products. But the strategy was not sustainable; by 1985 the government had embarked on the export-oriented structural adjustment strategy it maintains to this day. This strategy included a devaluation and a staged lowering of uniform tariffs from 35 percent in 1984 to 11 percent by 1991. Improved incentives for exporters led to an expansion of nontraditional exports and efficient import substitution. Macroeconomic stabilization, tax reform, and cuts in government spending helped to promote savings and investment. Privatization of state-owned firms and rehabilitation of the financial sector through recapitalization and the strengthening of bank regulation combined to spur private business activity. Chile's average annual rate of real GDP growth has been more than 7 percent since 1984. And in 1998 the Chilean legislature approved further lowering the uniform tariff—in stages—to 6 percent.

Kazakhstan Devalues the Tenge and Prevents a Trade War

On April 4 the Kazakh government and National Bank announced a free float of the tenge's exchange rate—in other words, devaluation of the national currency. They also announced an end to highly protective trade measures against Russia, Uzbekistan, and the Kyrgyz Republic. At first, the tenge slumped to around 150 to the dollar, but by mid-April it had stabilized between 110-120 to the dollar—not too far above the pre-devaluation rate of 88 tenges to the dollar. The float was intended to boost Kazakh exports and to allow the National Bank to cease its costly efforts to support the tenge, which have depleted hard currency and gold reserves to $1.7 billion, down from $1.9 billion in January.

In recent months Kazakhstan has come under pressure; foreign investment inflows have waned as low oil prices have reduced interest in the country's hydrocarbon reserves. In addition, the Russian financial and economic crisis hit demand for Kazakh metals, the other main export revenue-earner. The trade deficit tripled from $627 million in 1997 to $1.8 billion in 1998. Real GDP contracted 2.1 percent in 1998, compared with growth of 4.0 percent the previous year. Industrial output in the first two months of 1999 was down about 5 percent from the same period last year.

Commenting on the government's actions, Prime Minister Balgimbayev said that devaluations among neighbor countries had made Kazakhstan-produced goods non-competitive, causing Kazakhstan's industry to suffer, its enterprises to stop operating and its unemployment to increase. The prime minister said that foreign trade turnover of Kazakhstan was reduced almost 9 percent, or $1.3 billion, with exports reduced by $1.25 billion. Kazakhstan's urgent measures, according to the prime minister, were due to purely external factors and economic policies of neighbor countries. The trade protection was a response to those pressures.

Balgimbayev said that from now on the dollar exchange rate will depend on supply and demand on the foreign exchange market. The National Bank of Kazakhstan (NBK) will not substantially intervene in this process. Before, the NBK was spending its gold and foreign currency reserves to keep the exchange rate at a certain level. This will not happen any longer. Balgimbayev said, "We have no doubts regarding economic stability and our ability to manage the economic situation....NBK has significant gold and foreign currency reserves, but what is the reason to give the currency away and support an excessively expensive tenge?"

Regarding the removal of highly protective trade measures against Russia, Uzbekistan, and the Kyrgyz Republic, Balgimbayev noted that Kazakhstan's borders with those countries are open for thousands of kilometers. Cheap goods from those countries easily compete with local producers and take foreign currency out of the country. It is practically impossible to close the borders, and it is also wrong from both economic and political points of view. "Russia and Central Asian neighbors are our friends, and there is no reason to develop trade wars. From this point of view, the only solution is to introduce a floating exchange rate regime." The IMF and the World Bank have supported the move (see lead article).

Based on reports from news agencies and from Oxford Analytica, the International Research Group (Oxford, UK).

Financial Planning

From the Russian daily *Komsomolskaya Pravda.*

China's Rural Reform—The "Rights" Direction

by Wang Jingxin

Since the introduction of the Contract Responsibility System in the late 1970s and early 1980s, China's systems of rural land management have improved considerably. New policies allow rural households to lease land for longer periods of time than before, and the rural population has been granted increased land rights. As a result of these land policy changes, China's rural production has increased impressively. But land policies still need reform in some key areas.

Collective Ownership

China's three-tier system of collective ownership was inherited from the old commune system in which land was owned through a top-down hierarchical structure that included:

- The commune.
- The production team.
- The production group.

With the collapse of the commune system, these levels were changed. Communes disappeared and were replaced by townships, which are not economic units but administrative units representing the lowest level of government administration. Production teams were replaced by administrative villages, which govern a number of villagers' groups. And production groups were replaced by villagers' groups.

Although land in China is still collectively owned, its three-tier system of collective owners—townships, administrative villages, and villagers' groups—is changing. The top tier, townships, has lost its usefulness, since it now represents the government more than the farmers.

New Agricultural Policies

In recent years China has developed several new thrusts to its agricultural policies:

- Land leases are being extended to ever-longer periods. Many of the 15-year leases that were drawn up in 1984 are being renewed for 30 more years. At its Third Plenum in October 1998, the Communist Party Central Committee reaffirmed the government's commitment to preserving the autonomy of household decisionmaking in farm production and related activities through household-based and output-related contract responsibility systems.
- The 1998 Plenum stressed stability and guaranteed land use rights. The Plenum also emphasized the need to further develop socialized services—access to large machinery, technical extension services, the provision of credit.
- Peasants' land rights have been expanded. Where once they could only farm on leased land, now farm households have acquired partial land disposal rights, and farmers can trespass neighboring collective land—if necessary leading watering trenches and subsurface pipes through this land. Rural collectives may auction off the land use rights they own for wasteland, waste hills, and mountainous areas. Through the transfer of land use rights, large-scale farming and land concentration develop; land-related profits gradually shift from the collective to individuals.

As a result of these new features, the agricultural sector expanded about 6.7 percent a year during 1979-97, and food grains output increased 2.7 percent. (Population growth during this period averaged just 1.3 percent). The value-output of animal husbandry increased fivefold. Since 1978 the share of crop farming in agricultural gross value-output has fallen from 80 percent to 56 percent, while the share of animal husbandry has risen from 15 percent to 31 percent and the share of fisheries has risen from less than 2 percent to more than 9 percent. Meanwhile the rapid expansion of rural nonagricultural production has triggered a sharp fall in the contribution of all agricultural activities—including crop farming, forestry, animal husbandry, and fisheries—to rural gross value output, from 74 percent in 1978 to 33 percent in 1996. (About 70 percent of China's approximately 1.2 billion people are still classified as rural residents.)

Although the current land policies have brought significant progress, they also carry with them a number of problems:

- It has not been clarified which collective units may claim ownership rights. Although ownership rights should generally be assigned to local villagers' groups, bureaucrats of administrative villages often appropriate the rights to contract out land and to collect proceeds from its use.
- The law defines contractual rights ambiguously; as a result these rights are neither clear nor stable. The vague term "overall stability with small readjustment" in land policies offers an excuse for many local bureaucrats of administrative villages to make unilateral changes in land use contracts.
- The land taxation and fee collection systems lack clearly-defined rules.
- A compensation mechanism has not been clearly defined for conversions of agricultural land to land used for other purposes.
- A market for land transfer has not yet been developed.

Where to Go from Here?

The three-tier system of ownership is no longer rational, as townships now represent the government rather than the

farmers. So the government should put an end to townships, and land should be owned by administrative villages and villagers' groups.

In order to boost farmers' confidence, future agricultural reform measures should be phrased in clear language, and based on improved and stable rules. Peasants' rights—especially their contractual rights—should be precisely defined and firmly established, with long-term guarantees. Farmers should be granted negotiating rights so they may protect their own interests without having to depend on the rule of law.

The relationship between equity and efficiency should be properly handled; agricultural reform must strike a balance between long-term stability and egalitarian possession. Opinions differ on how equity is achieved. Some scholars believe that an equal start is enough, whereas others argue that "equity in the process" should be maintained. Some proponents of the latter view suggest that 5 percent of local land should be held in reserve, for maneuvering purposes. Other scholars disagree, warning that equity should not be maintained in small individual communities at the cost of the whole country's efficiency. Instead—these scholars argue—efficiency should be given a higher priority in agriculture than in any other sector, because land is the rarest production factor in China.

Wang Jingxin is Head of the Research Department at the China Institute for Reform and Development, Haikou, Hainan Province, China.

Correction: In our February 1999 issue, the sentence on page 18— "An earlier version of this article appeared in the Far Eastern Economic Review (February 19, 1999)," was mistakingly placed at the end of Mr. Chi Fulin's article. Its proper location should have followed the exerpted article by Kathy Willhelm on page 19.

EU Accession Process—How Long Will It Last?

Views from a Conference

by Wladimir Andreff

"Stop delaying the expansion process!" was the most important message at the recent meeting of the European Association for Comparative Economic Studies (EACES). The meeting, held in Paris in March, examined the question of how fast expansion of the European Union (EU) should proceed. Most of the speakers, from both Eastern and Western Europe, expressed their strong opposition to stalling accession negotiations between the EU and the five countries identified in the Agenda 2000 for membership consideration (the Czech Republic, Estonia, Hungary, Poland, and Slovenia), all of which are eager to accede to EU membership. Resentment about the stalling of the process is also building among the five other potential candidates (Latvia, Lithuania, Slovakia, Romania, and Bulgaria).

No Timetable Yet

The Amsterdam and Hague Councils of 1997 failed to agree on most of the reforms required for EU expansion, as southern EU members (Greece, Italy, Spain, and Portugal) vetoed changes in requirements. The Vienna Council of December 1998 failed to agree "to cap the CAP," in other words contain spending of the common agricultural policy, as the keynote speaker, Hungarian economist Laszlo Csaba, put it. The recent Berlin Council (March 1999) also failed to come to an agreement. The EU harbors an implicit preference for lengthy case-by-case negotiations and remains reluctant to fix a timetable for accession of new members, claiming that the EU is already unmanageable at its present size of more than 20 members.

Dividing the Central and Eastern European (CEE) countries into two groups is a way of delaying accession. Short-term economic calculations, driven by narrowly focused cost considerations, are beginning to overshadow the historical dimension of EU expansion. An analysis of trade arrangements in the EU and the CEE countries has shown that trade liberalization by the EU remains restricted while the export competitiveness of CEE countries is taken into account in both sensitive and nonsensitive commodities.

The disappointment that characterized the conference arose from the eroding willingness of the EU to allow new members on board, its increasing aversion to making sacrifices, and the attitude of the political elites in the EU, most of whom see expansion as an opportunity for the new members to claim additional support from Brussels. Current members are more interested in responding to the concerns of the average voter and to various interest groups than to increasing the size of the EU.

It seems unlikely that the EU will endorse a series of internal reforms that call for reshaping the CAP and streamlining the structural and social cohesion funds. The general mood has become one of lack of urgency. Expansion may have to wait for yet another decade or a new external shock like the the fall of the Berlin Wall. Notwithstanding EU rhetoric, "deepening" has unambiguously taken precedence over "widening." Loss of illusions and enthusiasm by Western policymakers has allowed the popular perception that accession is a negative sum to gain ground.

Measuring the CEE candidates' degree of compliance with the accession conditions with the so-called *acquis communautaire* (defined in Copenhagen in 1993) has been a very time consuming and bureaucratic process. And it is a moving target, covering a wide range of measures, from free movement of capital and competition policy to such important issues as animal welfare and boiler temperatures. Verifying compliance with the acquis, initially scheduled for completion by end 1998, is likely to be postponed by at least six months.

Candidates Seek Exemptions

The slowdown is not entirely the responsibility of the EU: the CEE countries, with their impressive growth performance, low environmental standards, low labor costs, and concentration of exports in a small number of sensitive sectors, increasingly appear as dangerous new economic competitors. Their farming lobbies and industrial interests resist tough environmental standards, their banking circles want to preserve protected local markets or even repeal earlier liberalization. The new democratic governments of the CEE countries are—either deliberately or out of weakness—adopting policies that favor special interests.

Examples include the restructuring of the Polish steel industry and the concessions recently granted to protesting Polish farmers. Even before the start of the accession negotiations, Poland asked for several waivers from the acquis, for environmental protection, foreign investment in specific sectors, and the sale of land in rural areas and areas bordering EU countries. The Czech Republic revoked rules on gambling and announced statist restructuring plans for Czech industry that will postpone the privatization of large companies. Hungary asked to exempt 23 items from EU environmental legislation, exempt the Hungarian-Kazakh free trade agreement from common commercial policy, and start a new free trade agreement with Croatia. Requests for various other exemptions are also expected, in particular, from the health and safety norms of the social acquis.

While current EU members are concerned that these exemptions will force them to compete on unfair and unequal conditions, many in the CEE countries believe that the EU requirements, particularly the social ones, are motivated by protectionism. They have also noted that several member countries failed to implement parts of the acquis and expressed doubt that the exemptions will be accorded at all.

Some speakers at the workshop came up with specific recommendations for speeding up the expansion process and avoiding the Russian-style economic meltdown that is still possible in some CEE countries. Their motto (formulated before the first NATO bombs fell on Yugoslavia): A long-lasting peace in Europe requires an expanded Europe.

The Costs of Nonexpansion

Participants proposed that the costs of nonexpansion be calculated (as they were in the 1988 Cecchini Report, which estimated the costs of nonintegration). Such a calculation might well conclude that although the costs of expansion exceeds the benefits, the costs of nonexpansion are even higher. These costs include the threat of conflict and instability in the CEE countries.As to the costs of EU expansion, some—such as the cost of imports of farm products from the East or the threat of Eastern and Central European job-seekers undercutting wages in Western Europe—have been overestimated. Labor cost differences, which are already narrowing, have also been exaggerated. Meanwhile, the benefits of EU expansion have been underestimated.

Studies of the economic and social impacts of EU expansion have indicated a slightly positive effect on EU members' economic growth and significant improvement in the trade balance with CEE countries, translating into a sizeable export surplus for Western Europe. Imports from the EU can help CEE countries catch up with other EU members while providing a growing outlet for EU commodities.

As a result, an estimated 1.2 million jobs could be created in the EU over a five-year period. Expansion is not a gift but an investment in peace and prosperity that will restore Europe's status as a prominent world economic and political power and increase European competitiveness. Expansion is thus in the EU's own interests, indicating negotiations should be accelerated and new CEE members approved without delay.

Speakers noted that trade exposure to Russia is lower in the five EU front-runners than in other CEE countries. Moreover, the contagion effect of the August 1998 collapse of the Russian stock market was milder in the more advanced transition countries than elsewhere. As a result, the former socialist camp is now divided into a group of "converging" and a group of "emerging" economies. The Russian crisis might trigger a fall of output in the emerging transition economies, followed by lower foreign capital inflows, provoking further slowdown in the second round of accession.

The author is professor of economics at the Université de Paris I-Sorbonne. Email: andreff@univ-paris1.fr or richet@univ-miv.fr.

The EACES workshop, organized by the research teams ROSES and GASI at the University of Paris 1, Panthéon Sorbonne. was held on March 22–23, 1999.

New DHL Customs Report Brings Mixed Results—Red Tape Curtain Partially Raised

The "red tape curtain" preventing Western investors from trading in Central and Eastern Europe has only been partially raised, according to the second and most recent customs report by DHL, the leading air express operator in Central and Eastern Europe. DHL Customs Report 1999 *reveals that although some reforms have been implemented, customs problems remain throughout the region—causing as much aggravation to multinationals in Central and Eastern Europe as currency fluctuations or corruption. The report also shows a polarization between most of Central and Eastern Europe and the Commonwealth of Independent States (CIS). Businesses claim that free flow of goods in the CIS, especially in Russia, has become particularly difficult.*

Through the Industrial Research Bureau, DHL approached the 100 multinationals—most with a turnover of more than $2 billion—that took part in the first survey in November 1997. DHL's goal was to see whether Western companies are experiencing a more business-friendly trading environment in the region.

General Survey Results

Customs delays are still a major concern for most Western multinationals operating in Central and Eastern Europe and the CIS. However, investors feel that the situation has improved in certain areas. Sixty-two percent of businesses still experience customs difficulties in the region, down from 89 percent 18 months ago. Thirty-one percent of businesses have lost revenue due to customs delays, down from 54 percent in 1997. One in five shipments are held up due to customs delays; one in three were held up in November 1997.

The multinationals were asked whether the customs situation had improved or gotten worse in different areas of Central and Eastern Europe. The responses confirmed reports that the region has split into three tiers:

- ***The first wave of EU applicants.*** For these countries—the Czech Republic, Poland, Hungary, Slovenia, and Estonia—only 2 percent of respondents said that things had gotten worse, while the majority (52 percent) felt that things had improved. The Czech Republic, Hungary, and Poland again topped the list of Central and Eastern European countries deemed to have the most straightforward customs procedures (see table).

- ***Other Central and Eastern European countries.*** Twenty-seven percent of respondents said things had improved in these countries, while only 4 percent thought that the situation had worsened. Slovakia was seen as having the fourth most straightforward customs procedures (in November 1997 it was ranked seventh), while 8 percent of the multinationals now consider Romania straightforward to trade with, up from only 1 percent in November 1997.

- ***The CIS countries.*** In the CIS countries other than Russia, 14 percent of respondents said customs procedures had improved and 18 percent said they are now worse. Russian customs procedures were identified as problematic; only 9 percent said that Russian customs had gotten better, while 34 percent felt that the situation had deteriorated. No multinational described Russian customs procedures as straightforward.

Are customs procedures straightforward in the given country? Percentage of respondents who answered "yes":

	Apr 99	*Nov 97*	*Difference*
Czech Rep.	48	41	+7
Hungary	34	34	0
Poland	27	12	+15
Slovakia	10	7	+3
Estonia	8	12	-4
Slovenia	8	12	-4
Croatia	8	5	+3
Latvia	8	7	+1
Romania	8	1	+7
Bulgaria	6	3	+3
Lithuania	5	11	-6
Ukraine	3	3	0
Bosnia and Herzegovina	2	1	+1
Kazakhstan	1	3	-2
Moldova	1	0	+1
FR Yugoslavia	1	1	0
Uzbekistan	1	0	+1
Turkmenistan	1	0	+1
Russia	0	0	0

Harming Customs Procedures

The DHL customs report highlights areas where excessive bureaucracy and outdated customs procedures are harming business.

When asked why they felt there were still delays and logjams at customs points around the region, 43 percent of the multinationals in the study said that the rules and regulations changed too frequently, making it difficult for them to

plan ahead. Sixteen percent said that in many cases the rules were applied too zealously.

The multinationals gave a number of examples where the letter of the law was deemed more important than the spirit of the law. At one border crossing, the computer printout of the shipment details was in the wrong color, so the whole shipment had to be returned. Another exporter was asked to declare his consignment of potatoes in Latin.

Forty-two percent of multinationals now feel that customs authorities at least partially realize what businesses are trying to achieve. In November 1997 the figure was 22 percent. This shows that while customs problems are still severe, customs authorities are starting to address some of the issues raised by Western investors in the region.

Twenty-eight percent of multinationals still describe customs authorities in Central and Eastern Europe as "barriers" (from 35 percent in 1997), 23 percent see them as "duty collectors" (from 33 percent), and 18 percent as "policemen" (from 23 percent). Ten percent now see them as "partners" (from 4 percent in 1997) and 4 percent as "facilitators" (from 5 percent).

Some Conclusions

Commenting on the report, Doug West, the DHL Commercial Director for Eastern and Central Europe, said, "This *DHL Customs Report 1999* shows that the red tape curtain has been raised slightly. However, with six out of ten multinationals still experiencing regular customs problems, there is a lot that needs to be done. Constant rule changes and a piecemeal approach to reform remain a cause for concern. The situation is particularly bad in Russia and a lot of the CIS. Working alongside other express carriers, we are doing our utmost to persuade the authorities there that raising customs barriers in response to the current economic crisis will in the long-term actually do more harm than good."

For further information contact Richard Kanareck or Dirk Singer at The RED Consultancy, tel. 44-171-465-7700. Email: dirks@redconsultancy.com.

The DHL Story in Eastern Europe

DHL was the first express distribution company to establish operations in the Eastern and Central European region. It entered the Central and Eastern European market in 1983 by opening offices in the former Yugoslavia. The following year it opened offices in Hungary, Poland, Bulgaria, and the CIS. By 1986 the other countries in the region had also established a service.

Business was more restricted before communism fell. Due to the shortage of available office space, offices were often started from apartments or houses converted into DHL offices. Legislation only allowed DHL to operate via government-appointed agents or through joint ventures. But after the fall of communism (and as the law allowed), DHL quickly established wholly owned subsidiaries throughout the region, and it has continued to grow. Today DHL has 160 offices and over 3,000 staff throughout Eastern and Central Europe. In the CIS alone DHL has 37 offices and serves 200 more cities than any other transportation company. Major clients include high-tech companies, banks, consultancies, agencies, law firms, shipping companies, and heavy industries that produce automotive chemicals, coal, steel, textiles, oil, and gas.

Realizing that Central and Eastern Europe need fast and reliable communications and distribution services, DHL has invested nearly $100 million in the region since 1989. Half of that has gone into developing facilities and a proper working infrastructure; the other half has been invested in aircraft, vehicles, staff training, and state-of-the-art computer technology. DHL is linking up all its offices in the region with a combination of leased lines, satellite links, and dial-up facilities. DHL has also invested heavily in its airport facilities where shipments are handled and sorted by their destinations. Many such facilities—known as "gateways"—have been opened, most recently in Budapest, Bucharest, Katowice, and Gdansk. DHL already uses its own flights to connect most of the countries with its international network. This system of connections is being expanded extensively over the next two years.

DHL is making a strong effort to integrate into Central and Eastern Europe and to have an overall positive impact on this region. The company invests 7 percent of its revenue in staff training; 99 percent of its 3,000 employees in the region are locals. Senior management teams, including general managers, are mostly local people. DHL supports local initiatives in the communities, providing financial and skills support for regeneration projects across Central and Eastern Europe. As DHL management put it: "Alongside an uncompromising focus on quality, cultural empathy and real understanding of the differences between countries are prerequisites for success in the region."

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Monetary Policy in Transition: Can Inflation Targeting Work?

by Josef C. Brada and Ali M. Kutan

A number of transition economies—including the Czech Republic, Hungary, and Poland—have seemingly stabilized their economies, built up the institutions required for the functioning of a modern market economy, privatized the greater part of their productive assets, restructured their industries, and integrated themselves into the global economy. These countries have apparently succeeded not only in bringing about this great change in their economic system but also in introducing democracy and generating rates of growth of economic output well above those they experienced in the last decade of central planning and in the first years of the transition. One of the fruits of this success is that these countries have been able to sign Association Agreements with the European Union (EU) and are in beginning stages of negotiating toward membership in the EU.

The convergence of prospective member countries' inflation rates with inflation rates of the EU countries participating in the EMU would increase the benefits of joining the EU. There is no requirement that Eastern European countries joining the EU meet the Maastricht criteria, but by doing so they will gain a measure of exchange rate stability in relation to the euro that will intensify the benefits of economic integration with the EU. Moreover, the current deflationary climate in world markets—marked by low interest rates and falling energy and raw materials prices—is one that seems favorable for successful disinflation policies. Recent rates of inflation in the Czech Republic, Hungary, and Poland have imposed some costs on these countries in terms of resource allocation, problems faced by policymakers, and behavior and expectations of economic agents—such that policymakers already have some desire to see inflation reduced below the moderate levels of 10–20 percent a year.

Whatever the institutional and environmental obstacles monetary authorities face in their efforts to reduce inflation to single-digit levels, they also have to decide what kind of monetary policy to implement. In the early transition period monetary policy was implemented within the context of an unorthodox stabilization program using multiple nominal anchors. However, the use of nominal anchors, especially for the nominal exchange rate, was discarded fairly early in Poland, later in Hungary, and finally in 1997 in the Czech Republic. The abandonment of the nominal exchange anchor meant that central banks had to determine a new target for monetary policy. The money stock was regarded as an unsatisfactory target because its velocity of circulation was perceived as being too variable. Interest rates were problematic, in part because of the tenuous links between exchange rates and the behavior of economic agents and because of the constraints on interest rates. So the Czech National Bank (CNB) and the Polish Central Bank adopted inflation targeting. This approach may also be adopted by Hungarian monetary authorities in the future.

In this paper we examine whether a program of disinflation intended to reduce inflation to single-digit levels, or even to low single-digit levels, is feasible in the policy and institutional environment of these countries. When we consider the instruments of monetary policy in these countries, it seems clear that the transition has not progressed sufficiently far for indirect instruments of monetary policy to reduce inflation to the levels being sought. Moreover, we are not optimistic about the ability of monetary instruments to root out moderate inflation, in part because monetary policy seems overburdened by having to pursue multiple objectives and because it is inadequately supported by fiscal policy. Finally, we investigate the core causes of inflation in transition economies and conclude that much of the problem of inflation seems to be beyond the control of the monetary authorities.

Effectiveness of Indirect Tools

The effectiveness of indirect methods of monetary control now employed in the three countries under consideration depends on the effectiveness of monetary institutions, including capital markets and the banking system. Monetary policy in the three countries still rests on relatively weak financial markets and institutions and operates in an environment where the agents the policy seeks to influence may react to it in undesirable ways or not at all. Moreover, monetary policy is not supported by fiscal policy and has a multitude of objectives that often conflict. The fact that monetary policy is to some extent dictated by the need to encourage the restructuring of firms, to recapitalize the banking system, and to enable the government to finance its deficits suggests

that monetary authorities in these countries are likely to face severe conflicts in the formulation of monetary policy.

Main Causes of Inflation

Our empirical investigation of the determinants of inflation is based on a data set consisting of monthly observations for M2, the broad nominal money supply, the Consumer Price Index (CPI), nominal average wages, and import prices. Changes in M2, nominal wages, import prices, and past inflation are tested as the determinants of inflation, defined by CPI.

Our empirical results indicate that import price changes had a significant but largely transitory impact on inflation, while the past inflation rate was the main source of permanent changes in the inflation rate in all three countries we investigated. Compared to import prices and past inflation, the relative contribution of nominal wage and broad money to movements in the inflation rate was small. This result holds regardless of what specifications are employed.

Our finding that nominal wage growth and the money supply are quantitatively unimportant contributors to the inflationary process suggests that monetary authorities in these countries will find it difficult to reduce inflation using traditional indirect monetary policy instruments; nominal wage growth and the money supply are the two factors that monetary authorities can influence relatively easily.

Policy Lessons

We also found that changes in import prices brought about by changes in the nominal exchange rate are the principal source of transitory shocks to the rate of inflation. This may explain why the Czech Republic, which maintained a nominal peg the longest and which, by virtue of the peg's design, actually experienced significant periods of appreciation against the Deutsche mark, has the lowest inflation rate of the three countries. At the same time, our finding of the predominance of the exchange rate in causing inflation suggests that nominal appreciation or at least a fixing of the nominal exchange rate is the appropriate policy. This result causes some problems for monetary authorities. First, such a policy stance would hardly differentiate a forward-looking inflation targeting policy from the old one of a nominal exchange rate anchor. Second, it implies a real appreciation of the transition economies' currencies, an appreciation that seems incompatible with current account equilibrium, with promoting export-led growth, and with preventing massive capital outflows.

Long-term Implications

The longer-term implications of our findings seem equally disappointing for monetary policy advocates. Our finding that past inflation rate behavior has a permanent impact on future inflation rate implies that the effects of past inflation shocks on the current inflation rate do not decay quickly; there is a great deal of persistency in the inflation rate. In other words, the main source of current inflation is its past path, which can be interpreted to represent the population's inflationary expectations. Among causes cited in the literature for the persistence of inflationary expectations are symptoms of fiscal dominance, meaning the government's use of the central bank or of commercial banks to finance its deficit; poor starting conditions, especially levels of inflation in excess of 10 percent; and a failure to eradicate the fiscal roots of inflation.

These factors can be found to a greater or lesser extent in each of the three countries we have examined. Moreover, none of them can be resolved by the monetary authorities. Indeed, with the exception of the second factor, the responsibility for creating appropriate conditions to lower inflation rests squarely with the governments of these countries. Given the importance of foreign prices and the current deflationary trend in these countries, a window of opportunity now exists. Due to global deflation, inflation rates in all three countries fell to single-digit rates at the end of 1998 or in early 1999. This should lower inflationary expectations so that both foreign prices and inflationary expectations work in favor of efforts toward disinflation. Nevertheless, these efforts need to be supported not only by a measure of independence for monetary authorities but also by fiscal policy; to a large extent, the ability to capitalize on the current opportunity to end moderate inflation is in the hands of the governments rather than in the hands of the central banks of these countries.

This article is based on William Davidson Institute Working Paper 225 by Josef C. Brada, Arizona State University, and Ali M. Kutan, Southern Illinois University, Edwardsville and Federal Reserve Bank of St. Louis. The authors are grateful to the National Council for Eurasian and East European Research for support of the research underlying this paper.

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Combating Unemployment in Transition: Are Active Labor Market Policies Effective?

The following set of four Davidson Institute Working papers appear in the March issue of the Journal of Comparative Economics, *vol. 27, no. 1. They were presented at a conference called "Labor Markets in Transition Economies" held at the William Davidson Institute in October 1997.*

These papers examine the impact of active labor market policies (ALMPs) in four Central and Eastern European economies: the Czech Republic, Poland, Slovakia, and Slovenia. ALMPs help unemployed people find a job through a variety of programs, including public works, self-employment start-up grants, and direct job creation programs in the form of subsidies to employers. They may also include specific training and job search assistance and counseling in the form of scheduled interviews, back-to-work plans, and job clubs. Given the high and persistent unemployment that has resulted from the transition process, the Central and Eastern Europe (CEE) countries have invested significant resources on programs for the unemployed. Evaluation of these programs is necessary to ensure efficient allocation of scarce government resources.

As with studies of similar programs in Western Europe, the four papers find both positive and negative outcomes for the unemployed. Consistent with evidence from EU countries, Terrell and Sorm, studying the Czech Republic, find that job search assistance and counseling have a positive impact with limited use of resources. Training programs have more mixed results in terms of increasing employment and earnings prospects, although Kluve, Lehmann, and Schmidt find positive outcomes in Poland. Most economists would argue that subsidized employment is only warranted if the policy objective is to redistribute opportunities to the target groups. Although this view seems justified in the Czech Republic, subsidized employment has not been as successful in Poland and Slovakia. Several studies are concerned with potential stigmatization effects of public works employment; if employers perceive that labor offices select the least employable people for public works programs, they may not hire such people. Kluve, Lehmann, and Schmidt conclude that such stigmatization is not occurring in Poland and Lubyova and Van Ours reach the same conclusions for Slovakia, but Vodopivic does not rule it out for Slovenia.

Active Labor Market Policies in Poland: Human Capital Enhancement, Stigmatization or Benefit Churning? *William Davidson Institute Working Paper Series Number 215,* Jochen Kluve, University of Heidelberg, Hartmut Lehmann, LICOS Center for Transtion Economics, and Christoph M. Schmidt, University of Heidelberg

This paper provides microeconometric evidence on the effectiveness of active labor market policies in Poland. The authors evaluate whether, after participating in an active labor market policy (ALMP) program, a person finds himself or herself better positioned in the labor market than if he or she had not taken part in the program. They do this by comparing employment and unemployment rates of persons who have undergone treatment (the ALMP program) with the corresponding rates of persons who were not subjected to the treatment ("controls"). To ensure that their results reflect the true impact of the program, they compare participants and nonparticipants who have the same observable characteristics and an identical labor market history before the treatment took place. This ensures that differences in unobservable characteristics of the participants and the controls are minimized. To prevent the results from being biased by differences in the macroeconomic environment, the authors restrict their comparisons to people in the same phase of the transition cycle.

How effective are Polish ALMP programs? Training and retraining is the one policy measure that performs well. Post-treatment employment rates for both female and male participants who have been trained are higher than they would have been had these individuals not participated in the program. In contrast to training, employment creation programs in Poland seem burdened by major distortions. Despite their intention to enhance or rebuild the human capital of the unemployed, there is no measurable benefit for women who participate in the public works intervention, while there is a strong negative effect on the employment rate of men who take part in the public works intervention.

The negative results from intervention and public works have two possible explanations. The first is stigmatization. Employers may have a bias against hiring people who have participated in public works—perceiving them as low-productivity workers. A competing explanation is "benefit churning." Polish employment programs may be the intermediate stage between two spells of receiving unemployment benefits. Citing some statistics on this phenomenon, the authors conclude that while stigmatization might play some role, benefit churning explains most of the negative effects of these programs. Since the authors find that officials in local labor offices deem male heads of household particularly worthy of prolonged income support from the state, they conclude that Polish employment programs would benefit from eliminating the interactions between the unemployment compensation system and public works programs.

Effects of Active Labor Market Programs on the Transition Rate from Unemployment into Regular Jobs in the Slovak Republic

Davidson Institute Working Paper Series Number 213

Martina Lubyova, Slovak Academy of Sciences, and Jan C. van Ours, Tilburg University

To a large extent, active labor market policies in the Slovak Republic consist of creating short-term subsidized jobs in the private and public sectors. The authors of this paper analyze to what extent it is beneficial for unemployed workers who want a regular job to accept a temporary active labor market policy (ALMP) job or enter a retraining program.

The data that the authors use in their analysis enable them to describe the flow of workers from unemployment to regular jobs and ALMP programs, and the flow of workers from ALMP programs to regular jobs. The authors determined the effects of the programs by comparing the percentage of ALMP program participants who got a regular job with the percentage of nonparticipants who got a regular job.

A striking result of their analysis, contrary to the findings for the neighboring Czech Republic, is that workers who were in a better position to find regular jobs were also more likely to find a subsidized job in the private or public sector. The jobs created by active labor market policies seemed to complement the regular labor market rather than compensating for bad labor market characteristics.

Unobserved heterogeneity—and therefore selectivity—were important in the transition to ALMP programs. For both male and female workers, the authors found that if they had not accounted for selectivity they would have erroneously concluded that entering an ALMP program stigmatizes individuals. Accounting for selectivity in the flow of workers into ALMP programs yielded the finding that workers entering these programs benefit from them; after entering an ALMP program, the exit rate to a regular job increased by 150 percent.

Labor Market Policies and Unemployment in the Czech Republic

Davidson Institute Working Paper Series Number 216

Katherine Terrell, William Davidson Institute and Vit Sorm, CERGE-EI

This paper was discussed in the December 1998 issue of *Transition.* It is summarized here so its findings on active labor market policies in the Czech Republic may be compared with the findings of the other papers.

To what extent have district labor offices—which carry out active labor market policies—helped people find employment faster than they would have on their own? To what extent are the hard-to-employ targeted for ALMP assistance? The authors compare the estimated probability that someone finds employment in a given week with the help of the district labor offices with the probability that someone finds a job on his or her own. They find that ALMPs lower the unemployment duration of groups that tend to have longer unemployment spells: women, Romanies, handicapped people, less-educated people, and those who have been unemployed before. Labor offices assist more people who receive unemployment benefits than people who do not receive unemployment benefits. And the incidence of labor offices assistance is higher for those who have been unemployed longer.

Does the Slovenian Public Work Program Increase Participants' Chances To Find a Job?

Davidson Institute Working Paper Series Number 214

Milan Vodopivec, The World Bank and GEA College of Entrepreneurship

This paper analyzes the impact of the Slovenian public works program on helping its participants find employment during the years 1992-96. It shows that participants often find a job immediately upon completing the program, but in the longer run the program's positive effect dissipates and its impact becomes negative. Some of the employment gains upon completion of the program can be attributed to converting temporary public job positions into permanent ones. The longer-term negative impact on finding a job may be related to stigmatization of the participants. The study also shows that public works reduce the exit rate to inactivity, perhaps by providing moral support to the unemployed, and thus boosting their workforce attachment. In comparison with public works programs in other transition economies, the Slovenian program seemed to be more innovative. By shifting the focus from manual to intellectual work, it succeeded in attracting younger and more educated participants. The author found that positive effects on employability were particularly great for younger workers.

Cuba's Economy: Twilight of an Era

by Carmelo Mesa-Lago and Jorge Pérez-López

Cuba's economy in the late 1990s remains depressed, unable to overcome the economic malaise that began around 1990. During 1997-98 nominal growth rates fell substantially short of official targets. The external sector continued to be under heavy pressure; Cuba's merchandise trade deficit widened and the country continued to have very limited access to international credit markets. Foreign direct investment stagnated, and sugar production sank to a 50-year low. The only significant bright spots in an otherwise gloomy panorama have been tourism, nickel and oil production, and private remittances.

In 1997 Cuba's GDP grew 2.5 percent overall and 1.9 percent per capita, far less than the official target of 4-5 percent growth. Cuban officials blamed this poor economic performance on the failed sugar harvest, difficulties of borrowing from foreign capital markets, the heavy burden of debt repayment, bad weather, and crop devastation by pests.

Lackluster Growth

In 1998 Cuba's GDP grew just 1.3 percent—0.7 percent per capita—compared to a planned growth rate of 2.5-3.5 percent. Jose Luis Rodriguez, Cuba's Vice President and Minister of Economy and Planning, said this low figure was due to the U.S. embargo and the global financial crisis that has reduced international credit and driven down commodity prices for Cuba's exports—particularly sugar and nickel. He also attributed the low figure to the excessive rainfall associated with Hurricane Georges and the severe drought that followed.

GDP per capita reached 1,100 pesos in 1998; at 1998 rates of increase it would take nearly 26 years to raise this to even Cuba's meager GDP per capita level of 1,989—1,861 pesos.

In 1997 gross domestic investment as a percentage of GDP reached 10.3 percent and in 1998 it reached 10.9 percent—still about 60 percent less than the1989 level. The inflation rate peaked at 25.7 percent in 1994 then practically disappeared in 1996. It slowly picked up after that, reaching 5 percent in 1998.

Weak External Sector

Cuba's imports expanded faster than its exports in 1997-98, mainly due to weak world prices and a decline in the quantity of sugar exports. In 1997 the value of exports reached 1.8 billion pesos—66 percent less than the 1989 level—but it fell again in 1998, to 1.6 billion pesos. Imports in 1997 totaled 3.7 billion pesos—54 percent less than the 1989 level—and rose to 3.9 billion pesos in 1998. With fewer exports in relation to imports, the merchandise trade deficit widened, as it had in the 1980s. At that time, however, the Soviet Union routinely paid for the additional imports that Cuba needed.

Cuba's terms of trade dropped 40 percent in 1989-97 as the prices of sugar and nickel, two key export commodities, fell. In 1993-97 declining volume and price of sugar caused its share of total exports to decrease from 66.2 percent to 46.6 percent. The overall decline in terms of trade was partly offset by a fall in the world price of oil—Cuba's principal import commodity—that reduced the share of oil in total imports from 35.4 percent in 1994 to 26.4 percent in 1997 (compared to 32.0 percent in 1989).

The external hard currency debt rose from 6.2 billion pesos in 1989 to 10.5 billion pesos in 1995 and declined to about 10.1 billion pesos in 1997. Because Cuba had very little access to capital markets during this period, changes in the value of hard currency debt were due mainly to accumulated debt service and fluctuations in the value of the dollar compared to the currencies in which the debt is denominated. Cuba's hard currency debt includes a substantial debt to Russia—which assumed the debt of the former Soviet Union. (Because Cuba's official exchange rate is 1 peso=1 dollar, the government often reports external sector statistics in pesos or dollars, interchangeably. In reality, one dollar was traded for 8 pesos in 1989, roughly 78 in 1993, 95 in 1994, 19 in 1996, 23 in 1997, and 20 in 1998.)

Cumulative foreign investment—as officially reported—reached 2.1 billion pesos by 1995 and rose to just 2.2 billion pesos by August 1998, suggesting that foreign direct investment was stagnant over this period.

Economic Bright Spots: Remittances and Tourism

Private remittances from friends and families living abroad have become the most dynamic element of the balance of payments. Remittances grew from about 18 million pesos in 1991 to 255 million pesos in 1993, and—after Cuban citizens' use of foreign currencies was decriminalized—to 744 million pesos in 1996 and about 761 million pesos in 1997. Revenues from remittances were substantially higher than revenues from exports of sugar or nickel, or net revenue from tourism.

Gross revenue from tourism steadily rose from 168 million pesos in 1989 to nearly 1.5 billion pesos in 1997 and in 1998 to

1.9 billion pesos—more than ten times 1989 gross tourism revenue. Net tourism revenue was about one-third of the gross value, however, due to a high share of imported inputs. Net tourism revenue rose 405 percent during 1989-97.

Agriculture's Weak Spots

In 1998 sugar production sank to 3.2 million tons, 61 percent less than the 1989 level, and lower than it had been in 55 years. (The previous production low was in 1943 when 2.8 million tons of sugar were produced.) Average annual sugar output during 1993-98—3.9 million tons—was about half the 1982-89 annual average of 7.4 million tons.

The nonsugar agricultural sector has also performed poorly and its recovery has been sluggish and unsteady. 1997 output levels for export commodities were below 1989 levels; fish and citrus were down 36 and 20 percent, respectively. And production of key domestically consumed commodities was also well below 1989 levels; milk was down 51 percent, eggs were down 45 percent, and rice was down 27 percent from 1989 outputs. The same trend characterized output of noncitrus fruits, poultry, beef, and pork. Only corn and plantains had higher output in 1997 than in 1989.

The new cooperatives created in 1994 are inefficient and highly dependent on the state; the state directs their production and buys virtually all of their output at below-market prices, creating severe disincentives. In 1997 these cooperatives' share of cultivated land was 57.6 percent but their share of total sales to the public in free agricultural markets was 3.6 percent. The private sector's shares of land and market sales were 16.9 percent and 72.7 percent while the state farms' shares were 25.5 percent and 23.7 percent, respectively.

Oil and Nickel Production on the Rise

Nickel production decreased 43 percent in 1989-94 but shot past 1989 levels in 1996 and kept climbing to reach a record high in 1998 of 68,000 tons—44 percent more than 1989 production. This was mainly a result of Canadian investment.

Foreign investment has also boosted oil production; international oil companies are engaged in numerous production partnership agreements with the Cuban government. Production of domestic oil—which accounts for about one-fifth of total consumption—is a national priority since it helps reduce Cuba's very high dependence on imported fuels and large oil import bill. Domestic oil extraction steadily rose in 1992-95 to reach 1.5 million tons. Production was virtually stagnant in 1996-97 but recovered in 1998 when about 1.6 million tons of domestic oil were reportedly produced—a new record.

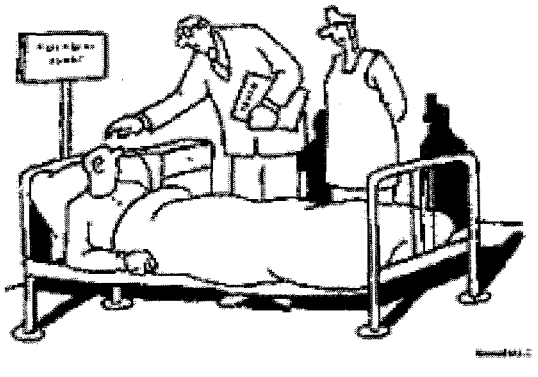
Overall manufacturing output decreased during 1989-93 but began to recover thereafter. In 1997 output was below 1989 levels for electricity (-12 percent), cement (-55 percent), and cigars (-32 percent).

Disquieting Social Indicators

Employment declined from about 4.4 million workers in 1989 to 4.1 million in 1996, rising to 4.2 million in 1997. The "open" unemployment rate decreased from a 1995 peak of 7.9 percent to 6.9 percent in 1997. Equivalent unemployment—adding those who are temporarily displaced and receiving unemployment compensation—peaked at 35.2 percent in 1993 and decreased to 27 percent in 1996. No estimates are available for 1997.

In 1995 the government announced that it would dismiss 0.5-0.8 million redundant workers in the state sector. Three years later these dismissals were largely abandoned, likely due to a lack of job creation in the private sector. The private sector could not expand because of government interference—increasing the cost of business permits 300 percent, and increasing the various fees for the self-employed 650 percent. As a result, in 1996 the number of legally registered self-employed people dropped 18.5 percent—to 170,000—increasing to just 175,000 by the end of 1997. Average real wages in urban areas fell steadily in the early 1990s—by 1995, to 58.5 percent of their 1989 level. They rose slightly in 1996, to 61.2 percent of the 1989 level.

When the Health Care Budget is Tight...



"That man who's telling you to get up isn't a miracle healer but a clerk from the health insurance company."

From the Czech daily *Slovo*.

Overall health standards in Cuba deteriorated during 1989-96; the rate of reported cases of contagious diseases per 100,000 inhabitants rose 160 percent for tuberculosis, 75 percent for hepatitis and syphilis, 53 percent for chicken pox and 22 percent for acute respiratory diseases. Surprisingly, the reported infant mortality rate decreased during this period, from 11.1 per 1,000 live births in 1989 to 9.0 in 1996 and 7.2 in 1997.

In 1996/97 university enrollment dropped to 112,000 students—significantly less than the 242,000 students enrolled in 1989/90. Enrollment levels in economics and education fell 63 percent and 66 percent, respectively. A major reason for the overall drop has been the lack of incentives for university graduates, who are usually unable to find jobs in the state sector and who are prohibited from self-employment. The ratio of extreme income inequality in 1995 was 800:1, as compared to 4.5:1 in 1987; official figures released in mid-1998 reveal that a teacher makes 143 times the salary of a restaurant operator. Rationing has been extended to nearly all consumer goods, but is no longer an effective equalizer because monthly rations cover less than two weeks of minimum food requirements. Food and other necessities for the rest of the month have to be bought in dollar shops or on the agricultural and black markets, at very high prices affordable only to those who earn or receive hard currency from abroad.

What to Expect in 1999

In 1999 it is expected that GDP will grow 2.5 percent, domestic investment will grow 11.5 percent, and the budget deficit will be under 3 percent of GDP. Sugar output is expected to reach only 3.6 million tons and oil production may exceed 2 million tons for the first time.

These very modest predictions for 1999 contrast with the ambitious targets for the medium term—1998-2002—that the Fifth Party Congress set in October 1997. Those targets called for:

- GDP to grow 4-6 percent a year. (GDP actually grew 2.5 percent in 1997, 1.2 percent in 1998, and an average of under 3 percent in 1994-98.)
- Sugar output to increase to 7 million tons. (Actual output was 3.2 million tons in 1998 and an average of 3.9 million in 1993-98.)
- Nickel production to reach 100,000 tons—a 47 percent increase over the 1998 level—and tobacco 50,000 tons—a 59 percent jump over the 1997 level.
- Attraction of 2 million tourists, bringing a gross revenue of $2.6 billion—70 percent more than 1997 levels.
- Oil needs met increasingly through domestic production, conservation, and savings in private consumption and public transportation.
- 50,000 dwellings built each year, mostly in the countryside. (This goal is difficult to achieve because little cement is produced domestically, and part of it is earmarked for exports.)
- Health care to continue to partly rely on traditional and herbal medicine (a stopgap measure but not a solution to the current problem).
- State pensions supplemented by individual savings accounts and life insurance. (The question is how many people can save enough to finance such pensions.)
- Income inequalities to be curtailed through taxation. (This would however, reduce incentives in the nonstate sector.)

The severe drought of 1998—attributed to El Niño and reportedly the worst since 1941—will likely affect both the 1999 sugar harvest and the grandiose target of 7 million tons of sugar envisaged for 2002. The sowing of new cane for the 2000 harvest has been delayed significantly; only half of the target crop has been sown.

To reverse Cuba's economic crisis, Cuban authorities need to embrace more profound political and economic reforms. They must reform prices, permit and encourage private property and private sector activity, privatize the large and inefficient state sector, create capital and labor markets, and create a social safety net for the most vulnerable groups of the population. The inflexibility of the regime on staying the course does not bode well for a meaningful and sustainable economic recovery in Cuba in the near future.

Carmelo Mesa-Lago is a professor of economics at the University of Pittsburgh and a professor of international relations at Florida International University.

Jorge Pérez-López is an international economist at the U.S. Department of Labor.

A Truly Small Farmer

From the *Hungarian Economy.*

Selected Cuban Economic Indicators: 1989–98

Indicators	1989	1993	1994	1995	1996	1997	1998	1997/1989[a] (%)
Macroeconomic (%)								
GDP growth rate[b]	1.2	-14.9	0.7	2.5	7.8	2.5	1.2	
GDP per capita growth rate[b]	0.2	-15.1	0.0	1.9	7.1	1.9	0.7	
Gross domestic investment/GDP[b]	26.7	5.4	5.5	7.2	8.2	10.3	10.9	
Inflation rate[c]	n.a.	19.7	25.7	11.2	0.5	2.9	5.0	
Monetary liquidity/GDP[d]	21.6	73.2	51.8	42.6	42.0	41.1		
Fiscal balance/GDP[d]	-7.2	-33.5	-7.4	-3.5	-2.5	-2.0	-2.5	
External (billion pesos)								
Exports (goods)	5.4	1.1	1.3	1.5	1.9	1.8	1.6	-66
Imports (goods)	8.1	2.0	2.1	2.8	3.6	3.7	3.9	-54
Trade balance (goods)	-2.7	-0.9	-0.8	-1.3	-1.7	-1.9	-2.5	-30
Terms of trade (1989=100)	100.0	57.5	79.7	70.5	61.0	60.0		-40
External debt (hard currency)	6.2	8.8	9.1	10.5	10.5	10.1		+63
Foreign investment	n.a.	n.a.	n.a.	2.1	n.a.	n.a.	2.2[g]	
Exchange rate (pesos per US$1)[e]	7	78	95	32	19	23	20	+229
Tourism gross revenue (millions)[f]	168	720	850	1,100	1,380	1,546	1,886	+820
Tourism net revenue (millions)[f]	101	240	280	363	455	510		+405
Physical output (thousand metric tons)								
Sugar	8,121	4,280	4,000	3,300	4,450	4,252	3,200	-48
Nickel	47	30	27	43	54	62	68	+32
Oil	718	1,107	1,299	1,471	1,475	1,462	1,600	+104
Electricity (billions kwh)	16	11	12	12	13	14		-12
Cement	3,759	1,049	1,085	1,456	1,438	1,702		-55
Fish catch	192	94	94	106	120	123		-36
Cigars	308	208	186	192	194	210		-32
Citrus	1,016	644	505	564	662	808		-20
Rice	532	177	226	223	369	388		-27
Milk	1,131	585	622	608	640	554		-51
Eggs	2,673	1,512	1,561	1,415	1,282	1,460		-45
Labor and social indicators								
Employed (thousands)	4,356	4,313	4,195	4,131	4,106	4,183		-4
Open unemployment (% EAP)	7.9	6.2	6.7	7.9	7.6i	6.8i		-14
Real wages (1989=100)	100.0	81.8	63.4	58.5	61.2	n.a.		
Infant mortality (per 1,000)	11.1	9.4	9.9	9.4	9.0	7.2		-35
University enrollment (thousands)	242	166	141	122	112	n.a.		

a. This column compares performance in 1997 and 1989.
b. At constant 1981 prices.
c. GDP deflator.
d. At current prices.
e. Unoffical rate, annual average.
f. Gross revenue includes costs of inputs; net revenue deducts costs of inputs (authors' estimate).
g. Information released by Osvaldo Martínez, Director del CIEM, EFE, Havana, May 17, 1998.

Sources: In 1998, after a hiatus of seven years, the Cuban government resumed publishing a comprehensive statistical yearbook, *Anuario Estadístico de Cuba 1996*, which has partially filled the economic data vacuum that existed during 1990–96. Selected statistical data for 1997 are available in reports issued by the Central Bank of Cuba and the Ministry of Economy and Planning and a handful of statistics for 1998 released by top government officials. These data are supplemented by statistics published by the U.N. Economic Commission for Latin America and the Caribbean (ECLAC), presumably based on information provided by Cuban government agencies. Based on these sources, the above table summarizes Cuba's major economic and social indicators starting in 1989, the year before the current economic crisis began. The last column compares performance in 1997 and 1989.

Readers' Forum
Who Is to Blame for Russia's Economic Woes?

by Ivan Szegvari

In the past few months a number of sweeping—and in my view unfortunate—statements have been made to try to explain the causes of Russia's economic collapse. The essence of these statements is captured in the following statements:

1. Market reforms failed in Russia.
2. The international finance institutions—and the international community in general—paid too little attention and afford too little respect to the national history, culture, and characteristics of borrower countries.
3. The International Monetary Fund (IMF) imposed its narrow-minded, uniform policies on Russia, an approach doomed to failure from day one.
4. Privatization (mainly the voucher scheme and the loans-for-shares schemes) was ill-conceived and unsuccessful in Russia.
5. The sequencing of reforms the West proposed in Russia, including the precipitate liberalization of capital transactions, was ill-conceived and ill-advised.
6. Institutional reforms are by their nature long-term tasks, something that should have been taken into account upfront in designing policy.
7. Lack of liquidity in the system was the main problem underlying the nonpayment culture and the prevalence of nonmonetary transactions (barter) in Russia.
8. Russia has made very little progress in its transition to a market-based democratic society.

Let us now turn to each statement:

1. Market reforms failed in Russia. Market reform or capitalism per se did not fail in Russia. What failed was the manner in which market reforms and capitalism were pursued. Even the current Russian government recognizes—and is keen to assure foreigners—that market reforms should continue. Having experienced the alternatives and observed the differences between their economy and the economies of successful market economies, the Russians understand that the real challenge is to make market reform work.

The Russian government has emphasized that reforms must be combined with a strong state. Unfortunately, even in its latest program, the government did not articulate how it perceives the role of the state. If a strong state means strengthening the government's role in ensuring the rule of law, providing basic social services, enforcing regulations, and, yes, intervening in matters that the markets handles inefficiently or nor at all, the government is absolutely right. If it means using administrative interventions to replace market mechanisms, especially regarding prices, exchange rates, or interest rates—in other words, controlling key market functions and instruments—the government is fundamentally wrong.

2. The international finance institutions—and the international community in general—paid too little attention and afford too little respect to the national history, culture, and characteristics of borrower countries. In each of the transition economies there was a long and heated debate about how the transition was to proceed. Initially, an attempt was made to adopt only those changes that combined the advantages of capitalism and socialism. Relatively quickly this third way was shown not to work. Policymakers then sought ways of combining capitalism with a country's national characteristics, culture, history, and anything else that makes a country a place worth living in. The trouble is that nobody knows what this actually means.

3. The IMF imposed its narrow-minded, uniform policies on Russia, an approach doomed to failure from day one. To confront the above statement let us first clear up some misunderstandings:

- The G-7, not the IMF, made key decisions in recent months.
- An emphasis on fiscal and monetary policies was hardly misplaced given the role of fiscal weaknesses in Russia's macroeconomic ailments.
- Since early 1996, the IMF's Extended Fund Facility program has combined stabilization targets with an impressive set of structural reform requirements. These reforms are badly needed regardless of the political leaning or composition of the actual Russian government.
- These reform requirements were worked out jointly by the Russian government, the IMF, the World Bank, and to some extent the European Bank for Reconstruction and Development (EBRD).
- The tough and sometimes unrealistic deadlines or other implementation details of the program originated in many cases not from the Western partners but from the Russian government, which wanted to ensure that even if the targets were softened during the approval and implementation process, progress would still be tangible and significant. Finding an institutional bogeyman (the IMF) that reformers could blame played to the domestic audience.

The idea that the West, in conjunction with a handful of Russian reformers, imposed a skewed policy package on Russia that

led to disastrous results does not have merit. Since the onset of the transition process, Russia's track record in implementing any kind of program has been poor. Between late 1991 and early 1999, none of the almost 30 officially endorsed macroeconomic programs (with the partial exception of the 1995 IMF stand-by agreement) was implemented. Designing Russia's economic policies and programs has always been highly overpoliticized, and policymaking has responded only loosely to economic realities. Russia's economic policies have evolved as a continued series of forced reactions to emergencies and short-term windows of opportunities. Actual economic and reform policies consistently and fundamentally differ from declared policies and programs.

4. Privatization (mainly the voucher scheme and the loans-for-shares schemes) was ill-conceived and unsuccessful in Russia. Effective control over medium and large-scale companies was handed over to enterprise managers during the perestroika period, while formal ownership and the inherent need for subsidizing inefficient industrial giants remained with the state, creating an unsustainable drain on the budget.The voucher privatization (carried out between 1992 and 1994) simply formalized what had already happened. Russia's reformist government realized early in 1992 that to cut this Gordian knot they needed to privatize as soon and as quickly as possible, give managers and workers stakes in the privatized enterprises (in order to make privatization politically feasible and palatable), and depoliticize decisionmaking at the enterprise level.

The idea was that once voucher (insider) privatization was over, product competition and hard budget constraints would bring about the concentration of shareholding. And, if supported by a new round of cash-based privatizations, the corporate governance problem would be solved.

Voucher privatization was inevitable—there was no other feasible option at that time—and the outcome was a success. In contrast, postprivatization reforms—in particular, efforts to impose hard budget constraints and establish efficient corporate governance—faltered.The loans-for-shares scheme was a blunder. The idea for the scheme did come from the West, although in a very different version. It called for transparent tenders, open to everyone, including foreign bidders. Russian adaptation of the scheme banned foreign participation and eliminated the requirements for transparency. Many supporters of reform, including the EBRD, protested. EBRD even wrote a letter to the authorities, asking them to revise the new rules, but to no avail.

5. The sequencing of reforms the West proposed in Russia, including the precipitate liberalization of capital transactions, was ill-conceived and ill-advised. Since mid-1996 the local authorities (in full agreement with the West) have gradually liberalized foreigners' access to the GKO (Russian Treasury bond) market. The objective of the move was to lower the extremely high real interest rates, thereby encouraging lending to the enterprise sector and mitigating the debt servicing burden of the state, and to build confidence by increasing the openness of Russia's capital markets, thereby providing a self-imposed disciplining factor for policymaking in order to speed up long overdue fiscal adjustments. In most aspects, the strategy worked remarkably well. GKO yields fell to 16-18 percent by October 1997, bank lending to the real sector started to grow, and Russia was on the verge of qualifying for an investment grade from the rating agencies.

At that stage, the Asian crisis began to play havoc with investor confidence, sharply intensifying Russia's fiscal woes. The sharp and sustained fall in commodity prices exacerbated the situation in terms of both macroeconomic performance and investor confidence. After some initial hesitation, the government and the Russian central bank reacted to the crisis in a professional and market-oriented manner. To shore up weakened investor confidence, they fully liberalized the exit mechanism for foreign GKO holders and took decisive measures to improve the government's finances (tax offsets were banned from early 1998 and the primary budget balance was turned into a surplus throughout the first half of 1998). Russian policymakers also renewed and strengthened their commitment to the stability of the ruble by introducing a flat exchange rate corridor for 1998-2000. Although that move proved to be excessively risky, it was not ex ante a mistake.

This policy package worked well for several months. Massive outflows of foreign portfolio investment did not occur. The monetary reform of early 1998 was carried out in a smooth and orderly fashion. GKO yields fell again, albeit not quite to the precrisis level. What really brought down the Russian financial markets was neither the liberalization of capital account transactions nor the Asian crisis but shattered investor confidence provoked primarily by President Yeltsin's still unexplained sacking of the Chernomyrdin-Chubais-Nemtsov government in March 1998 and the weakening of the policy implementation capacity of the executive branch.

6. Institutional reforms are by their nature long-term tasks, something that should have been taken into account upfront in designing policy. Proposing a carefully structured policy sequencing requires a well thought-out and comprehensive policy program and a committed government with strong policy implementation capacity. Reforms in Russia have always been made as emergency reactions to crisis situations. Moreover, the implementation and enforcement capacity of the government

has been very weak throughout the transition process. Establishing a rule of law takes a long time, perhaps even generations. Should the government, then, slow stabilization and other reforms—even the thinking process—and permit the authorities to operate with administrative controls (thereby inducing even more corruption), or should it push ahead vigorously with institutional reforms?

Russia's problems are exemplified by the way it has dealt with bankruptcies. The inability to enforce bankruptcies has been one of the single greatest institutional failures in the Russian transition process. The few thousand bankruptcies have been insignificant, largely providing a channel for embezzlement. What was missing? Definitely not the legal framework, as Russia has adopted two full-fledged bankruptcy laws since 1993 and an amended third law was recently sent to the Duma. The necessary legislative and regulatory framework for implementation is also in place. A federal agency for insolvency and bankruptcy exists, and its qualified staff understands what should be done. Courts, receivership, and other institutional players have also been set up. What has been lacking throughout the reform process has been the political resolve to allow this market selection mechanism to operate in earnest. Political resistance to bankruptcy has become more and more explicit. A series of decrees and government resolutions came out recently to prevent the bankruptcies of defense enterprises, energy distributors, other strategic enterprises, and agricultural farms. Is this problem related primarily to the time-consuming nature of institutional reforms? Hardly so.

7. Lack of liquidity in the system was the main problem underlying the nonpayment culture and the prevalence of nonmonetary transactions (barter) in Russia. The value of money is based on confidence—confidence in contracts, interest rates, exchange rates, regulations, government policies, and everything else that matters in economics. It must be frustrating to see that the more money you pour into the system, the less confidence (money) you really have.

8. Russia has made very little progress in its transition to a market-based democratic society. Let me contradict this statement with a surprising assertion: Russia has already become a market economy and a democratic society. True, it is a badly built, badly managed, and hence badly operating market economy and a chaotic democracy. Even so, what has happened in Russia is an extraordinary development of historic proportions. What Russia needs now is a stronger state (but not more civil servants, as there are currently more than there were under the Soviet regime), reform of the civil service, institution and authority building, and firm establishment of the rule of law. An environment must be created in which profit is a measure of success; the incentives for creating small and medium-size enterprises, primarily in the official economy, are strong; and bankruptcies represent a credible threat to inefficient managers.

How to start? By providing strong political backing for those who know what can and should be done. Russian citizens will have a great opportunity to do so, perhaps in a few months, when the joint parliamentary and presidential elections take place.

The author is senior economist at the Office of the Chief Economist, European Bank for Reconstruction and Development (EBRD). The views expressed here are the author's and do not reflect the official view of the EBRD.

"Why Are Russian Enterprises Not Restructuring?"

In response to the question, "Why Are Russian Enterprises Not Restructuring?" (Clifford Gaddy and Barry Ickes, *Transition*, August 1998), the short answer is that restructuring is impossible under existing macroeconomic and microeconomic conditions and with old managers, locked in by the current privatization policy.

I traveled across Russia in 1995 as a consultant to regional governors and encountered strong efforts to restructure. This desire was translated into an intense search for foreign investors, not only for their capital but also for import and export contacts and restructuring advice. (In Western Siberia, German consultants received $1,000 an hour to write business plans). But foreign investors have been repelled by the same conditions that make it impossible to restructure.

In Poland in 1989-90 employee councils replaced "martial law managers" with more market-oriented ones. The public sector recovered as from 1993 because successive governments lowered taxes, instituted an active restructuring policy, and closer oversight of state-owned enterprises. Economic growth, in turn, attracted foreign investors. Such a policy is missing in Russia.

Lucja Swiatkowski Cannon, Center for Strategic and International Studies, Washington, D.C.

Data published on Slovenia's unemployment rate in the *Transition Newsletter*, February 1999, page 38, indicates registered unemployment which is a much broader definition than the one internationally accepted. Slovenia's comparable unemployment figures for 1996, 1997, and 1998 are 7.3, 7.1, and 7.7 percent instead of 14.4, 14.8, and 14.1 percent indicated in your newsletter.

Borut Repansek, Executive Director's Assistant, the World Bank.

World Bank/IMF/EBRD Agenda

World Bank Guarantees Funds *Raised on Private Capital Markets*

The World Bank is introducing a policy-based guarantee to help member countries raise money—for example issue bonds—on private capital markets. The Bank is offering to guarantee a part of the borrowed amount in support of agreed structural, institutional, and social policies and reforms. A pilot program will have $2 billion available in credit guarantees. Other new operational instruments include Learning and Innovation Loans, Adaptable Program Loans, and Special Structural Adjustment Loans. New loan and hedging products will enable IBRD borrowers to better manage their market-related risks and offer greater scope to tailor loan maturities to project needs. These products are planned for introduction September 1, 1999.

IMF's Contingent Credit Lines to Help Prevent New Crisis

As a precautionary line of defense, readily available against future balance of payments problems that might arise from international financial contagion, the IMF will provide contingent credit lines (CCL) to member countries with strong economic policies. Commitments under the CCL would be expected to be in the range of 300-500 percent of the member country's quota. Approval of financing under the CCL will signal the IMF's confidence in the member's economic policies and its determination to adjust those policies as needed, should contagion hit. The CCL is being established for a two-year period and will be reviewed after one year's experience.

Romania Closer to IMF Standby, Expects No Default

IMF representatives signed a memorandum of understanding in Bucharest April 20 for a standby loan of $475 million to Romania. The agreement must be approved by both the IMF's board and Romania's parliament by June. The loan will help Romania avoid defaulting on its foreign debt obligations, which total about $2 billion for the rest of this year.

The IMF expects the government to make significant progress on economic reform if it is to secure the quarterly disbursement of tranches. Romania's deputy central bank governor, Cristian Popa, expressed hope that $315 million will be available this year and that the first tranche—worth more than $100 million—can be drawn after an IMF board meeting in June. Privatization receipts are expected to reach $1.4 billion this year.

On the back of the IMF agreement, Romania hopes to tap $600-800 million in financing this year, including financing through private placements and bridge loans. It also hopes to issue a new sovereign bond by the end of the year, according to Mr. Popa. Utility and other companies may also seek to issue bonds with sovereign cover.

Early last year the IMF froze a $430 million standby agreement after criticizing Romania's center-right coalition for its sluggish progress on privatization and other economic reforms. While Romania's privatization effort has gained steam in recent months, worries about the country's solvency have intensified since the beginning of NATO's bombing campaign in neighboring Yugoslavia. The conflict has disrupted transit links with Western Europe and will cost Romania an estimated $175 million this year.

EBRD Shifts Russia Strategy

The EBRD is adjusting to the Russian financial crisis by shifting its focus from long-term project finance toward short-term working capital for Russian exporters. Speaking at the bank's annual meeting, held in April in London, EBRD Chief Economist Nicholas Stern said the bank would continue to invest in Russia but that the volume of its investment would depend on the business climate. Citing the role of Russia's central bank, EBRD President Horst Köhler said that the EBRD will become more involved in helping to set up a regulatory framework for Russia's banking sector. "We have to be aware that the transition is a much longer process than we had thought," he is quoted as saying. The bank had underestimated the importance of building sound financial institutions in countries like Russia.

A report prepared by the bank's economists before the outbreak of war in Yugoslavia points out that the region's GDP fell 1.3 percent last year and is forecast to decline another 1 percent this year. But while in Russia, along with the rest of the Commonwealth of Independent States, output fell by 3.5 percent in 1998 and is expected to drop a further four percent in 1999, output in Central and Eastern Europe increased 2.3 percent last year and is expected to grow 1.9 percent this year.

IMF Official Sees No Growth in Czech Republic in 1999

The International Monetary Fund estimates that GDP growth in the Czech Republic in 1999 will at best be zero," said IMF European I Department Deputy Director Jacques Artus, who recently visited the Czech Republic as head of an IMF delegation. The Fund expects Czech inflation to remain low, reaching 4 percent a year by the end of 1999. "The immediate priority is to stop the deterioration in the economy and to

foster recovery through tackling the structural problems that have accumulated for a number of years in the banking and industrial sector," he warned.

MIGA Doubles Capital to $2 Billion

Delegates of the 149 member countries representing MIGA's shareholder base have voted to double MIGA's capital to a little more than $2 billion. The boost in reserves will allow MIGA to substantially increase its guarantee services to

Russia Resumes Borrowing from World Bank and IMF

Our newsletter went to print on the day that President Yeltsin dismissed Prime Minister Yevgeny Primakov and named Sergei Stepashin as acting prime minister. Stepashin has pledged to implement all the agreements reached with the IMF. World Bank President James Wolfensohn confirmed that the Bank's lending to Russia is continuing.

On April 28 the World Bank and the Russian government finished negotiating a revision of the third Structural Adjustment loan, and the International Monetary Fund (IMF) agreed to lend $4.5 billion to Russia pending the country's execution of previously agreed actions. Disbursements from the revised World Bank loan could begin in the summer—once it is approved by the Bank's Board of Directors. The IMF program will begin after Russia takes measures to bring down its budget deficit and strengthen its loss-plagued banking system, and the program is approved by the IMF's executive board.

The Bank's revised loan brings its total pledges in Russia to about $2.3 billion for 1999-2000. Russia's net gain would be slightly more than $1 billion considering debt service obligations the country will assume as grace periods on the older loans in the Bank portfolio begin to expire over the next two years. Priority in lending to Russia for the fiscal year 2000—which starts in July 1999—would be given to operations that are socially targeted and support the development of basic institutions. World Bank representatives stated that a successful resumption of adjustment loans will depend "on the progress of the Russian government in implementing the reform programs to which it has committed itself."

The original third Structural Adjustment Loan (SAL 3), for $1.5 billion, was approved by the World Bank's Board in August 1998, and its first tranche, for $300 million, was disbursed at that time. The original loan supported reform of infrastructure monopolies, development of the private sector, improvement of fiscal management, and reform of the financial sector (banks and the capital market). The August crisis has interfered significantly with this and other Bank projects: $1.2 billion of the SAL 3 remains undisbursed, as do $400 million of the $800 million Second Coal Loan and $250 million of the $800 million Social Protection Adjustment Loan.

The collapse of the banking system resulted in the freezing of Special Accounts—accounts opened in commercial banks to disburse the Bank's loans—and lines of credit. The ruble devaluation reduced the repayment capacity of the final borrowers, including local governments, and weakened availability of counterpart funds—funds that match World Bank loans in domestic currency.

Despite the uncertainties in Russia, the Bank continues to supervise ongoing operations, meet payment requests if they are underpinned by active contracts, and review procurement documentation of implementing agencies. From 1992, when Russia joined the World Bank, until April 1, 1999, Russia has received cumulative disbursements of $6.55 billion—$2.12 billion in investment loans and $4.4 billion in quick-disbursing adjustment loans. The Bank currently has 35 active projects in Russia with a budget of $11.8 billion.

The International Monetary Fund's agreement to lend $4.5 billion to Russia—completed on the same day as the World Bank's loan negotiations—resumed the IMF's support for Moscow, eight months after the IMF halted a previous rescue that ended with a collapse in the ruble. The April accord, which must be approved by the IMF's executive board, would be "a new step in the cooperation between the IMF and Russia," IMF Managing Director Michel Camdessus said in a statement issued after meetings with Russian First Deputy Prime Minister Yuri Maslyukov and Finance Minister Mikhail Zadornov.

The agreement aims primarily to keep Russia's economy from declining further; the amount the IMF agreed to lend is just enough to prevent Moscow from defaulting on debts that will be due to the IMF itself in the next couple of months. Of the $4.5 billion the IMF intends to lend over the next 18 months, $3 billion is to be disbursed in the first year, meaning that during the term of the loan Russia would receive less from the IMF than it owes the IMF; to pay the full amount it owes, Moscow has to use some other reserves of foreign currencies that it holds. However, the new IMF loans will unlock additional Western aid and allow Moscow to reschedule much of its other debt to foreigners, giving the Primakov government considerably more financial breathing space.

Anton Surikov, Maslyukov's spokesman, said Russia must take "prior actions," including the enactment of a legislative package. After these actions are completed, the IMF board of directors will convene to consider the memorandum and start providing credits.

foreign investors interested in investing in the agency's 127 developing member countries. Under recently revised operating guidelines, MIGA increased the amount it can guarantee in a single investment project from $75 million to $200 million; its exposure in each host country rose from $350 million to $620 million. The recent capital increase will allow MIGA to expand these levels further in the future.

MIGA was formed in 1988 to act as the World Bank's political risk insurance arm for investors. The agency estimates that it has issued $4.6 billion in insurance covering $27 billion in foreign direct investment in 63 countries.

Euro: CEE Costs and Benefits

The April issue of the *IMF Survey* reports that the benefits of adopting the euro are likely to outweigh the costs for countries lining up to join the European Union. Candidate countries—the Czech Republic, Estonia, Hungary, Poland, and Slovenia—would enjoy lower interest rates and higher trade, investment, employment, and growth by meeting the terms needed to adopt Europe's single currency. But would-be new members would lose the ability to use exchange rates or monetary policy to absorb external shocks, the report said. This could be costly if countries faced pressure to cut costs to meet European budget targets.

World Bank to Lend $350 Million to Kazakhstan in 1999

The World Bank will lend about $350 million to Kazakhstan in 1999, including $100 million to support reform of the social security system. Traditionally, the Bank lent Kazakhstan about $300 million a year, according to Bank Country Director Kadir Yurukoglu. Since the crisis in Russia last August, however, efforts have been stepped up to support the resource-rich but cash-strapped Central Asian state. The loans include support for reform in public sector management, civil service and pension reform, and road and irrigation projects.

Among the loans is a $42.5 million loan to finance health care reform. The loan is the first of three Adaptable Program Loans totaling $162.5 million over eight years to finance improved health care in Kazakhstan. The first loan will finance institutional arrangements that will pay health care providers on the basis of quality and efficiency, make continuous progress on "priority health status targets," and allow patients to choose their primary doctor. The health care loan is repayable over 20 years, with an initial grace period of five years. Since 1992, when Kazakhstan joined the World Bank, it has borrowed $2.1 billion for 18 projects.

World Bank Resumes Loans to Ukraine

The World Bank agreed to offer $150 million in loans to Ukraine following the IMF's decision to resume disbursements of a frozen $2.2 billion loan. The Fund had suspended its aid to Ukraine last autumn over Ukraine's stalled reforms, as did the World Bank because its projects are dependent on sound economic policies endorsed by IMF funding. Of the World Bank's loans, $100 million was allocated to support Ukraine's enterprise development program, while $10 million will go to support financial system reform. Furthermore, a new $40 million tranche of a previously approved $300 million Coal Sector Adjustment Loan has been disbursed on April 29, 1999. It will help alleviate the social and environmental consequences related to the closure of 24 loss-making mines.

Ukraine could secure as much as $3.2 billion in financing from the World Bank and the IMF in 1999 and 2000, if the government achieved real economic reforms, John Hansen, World Bank economic adviser in Ukraine, said. The country's National Bank had only $685 million in foreign debt, $1.17 billion of which falls due this year. The government estimates that it needs $2.2 billion in external financing this year to cover debt oglibations and replenish dwindling bank reserves.

IFC Invests in Moldova's Telecoms Sector

The International Finance Corporation, together with German and French banks, finalized the largest private financing ever undertaken in Moldova. The beneficiary is Voxtel, a private cellular operator that will establish a nation-wide cellular telephone network in Moldova. Voxtel was granted a 15-year GSM (Global Systems for Mobile Communications) license by the Ministry of Transport and Communications. The IFC put together a $40 million debt financing package that will cover the company's three years of investment program and the IFC is also investing 5 percent in Voxtel's share capital. To date, the IFC has mobilized investments of $2.3 billion in telecommunications projects worldwide, of which $1 billion was the IFC's own investment.

Vietnam Donors to Hold Mid-Term Meeting in June

Vietnam's major donors will hold a mid-term meeting this June to discuss with the Vietnamese government the speeding up of economic reform and ways to better coordinate aid. The consultative group meets every December to announce its pledges to Vietnam for the following year. Last year the World Bank also organized a mid-term meeting in Hue in June in order to review the progress of reforms. Private sector representatives attended last year's meeting and will attend again this year, when the group meets in Haiphong. Last December donors pledged $2.2 billion in aid for Vietnam and offered another $500 million if Vietnam accelerated reform.

Milestones of Transition

Central and Eastern Europe

Growth in the Baltics slowed in 1998. Preliminary data released April 1 show that in 1998 Latvia's GDP grew 3.6 percent—down from 8.6 percent in 1997—and Lithuania's GDP grew 4.4 percent—down from 6.1 percent in 1997. Forecasts for economic growth this year have been lowered; Latvia expects GDP growth of 2.0-4.0 percent, down from 4.0 percent, and Lithuania expects growth of 4.0-4.5 percent, down from 5.5 percent. The economic slowdown in the Baltic countries was due largely to the impact of the Russian crisis.

Wages rose in the Baltics in 1998. The average monthly wage was $292 in Estonia, $225 in Latvia, and $252 in Lithuania. During 1998 average monthly wages denominated in dollars rose 13.3 percent in Estonia, 9.1 percent in Latvia, and 23.4 percent in Lithuania.

Czech Republic

The cabinet approved a final version of the industrial revitalization plan in mid-April. Fifteen to twenty firms will likely be involved in the program; prime candidates are the chemical conglomerate AliaChem and the engineering companies Skoda Pilsen, ZPS Zlin, CKD Praha, and Tatra Koprivnice. It is estimated that about $200 million in total capital will be needed to help these companies survive. The restructuring will be controlled by the Revitalization Agency, which is staffed by deputies of the state-owned Konsolidacni banka and representatives from the financial sector. The Revitalization Agency will also find new strategic partners for selected companies or for their viable parts. Key decisionmaking for the agency will be delegated to a pre-selected, internationally recognized investment company. The industrial revitalization program will help improve the positions of Komercni banka and Ceska sporitelna, the largest two Czech banks that remain state-owned. These two banks currently have the greatest share of bad debts in the country's economy.

The Czech government will issue bonds worth 29.3 million koruny ($825 million) this year to cover the 1998 budget deficit—which was increased by the government's bailout of Ceska sporitelna. Similar plans this year to inject capital into banks slated for privatization will likely bring the budget deficit to 35-40 billion koruny in 1999. Debt write-offs may be critical in making banks attractive to foreign investors.

Estonia

The Estonian government endorsed an austere budget. On May 4 the cabinet approved a negative supplementary budget that will reduce this year's overall budget by 1.03 billion kroons (about $70 million) from last year. Subsidies to farmers—which were to have been cut by almost one-sixth—have been left intact, while the biggest reductions were made in the reserve fund and in administrative costs. Budget expenditures currently exceed revenues by some 900 million kroons, and less than one-quarter of the year's revenue target has been collected. Prime Minister Mart Laar warned that further cuts may be necessary later this year; under Estonian law, the budget must be balanced.

In 1998 Estonia's current account deficit narrowed to EEK 6.3 billion ($452 million)—8.6 percent of GDP—from last year's figure that was 12 percent of GDP ($563 million). Meanwhile, foreign direct investment in Estonia more than doubled in 1998, to EEK 7.9 billion ($567 million). Foreign investments were led by Swedish banks seeking to increase their presence in the Estonian banking sector.

Hungary

Hungary aims to revitalize exports by boosting productivity. Next year's economic plan foresees economic growth of 4-5 percent, consumer inflation of 6-7 percent, and a central budget deficit of 2.5-3.5 percent of GDP. The government expects this deficit to fall to 2-3 percent by the end of the current parliamentary cycle. If annual inflation drops below 5 percent, Hungary's finance ministry will abolish the country's crawling-peg devaluation regime. The balance of payments deficit is expected to remain in the $2.3-2.8 billion range. Foreign capital inflows are predicted to reach about $2 billion in the year 2000. And gross average wages are expected to rise 8.5-9.5 percent next year—a 2-2.5 percent increase in real terms.

On average, male employees in Hungary earn 25 percent more than their female counterparts, according to a 1998 survey of 2,000 households conducted by the Tárki research group. This pay difference is distinct in most occupations and positions, regardless of age group, education, or region. In March 1998 women earned an average of 32,500 forints while men earned an average of 40,740 forints ($1=235 forints). The biggest gap between men and women's salaries was at the executive level, with men earning an average of 95,000 forints—1.7 times the average salary of their female counterparts. Wage differences were insignificant among agricultural laborers, unskilled, and semi-skilled workers.

Poland

Over the next 10 years Poland is scheduled to receive 650 million dollars from NATO to upgrade the country's military infrastructure. This money will be used to refurbish airports, marine bases, and fuel distribution stations.

Slovakia

The government plans to reduce the number of strategic enterprises that by law cannot be privatized—from 35 to 6 or 7, Prime Minister Mikulas Dzurinda announced on April 21 Natural monopolies—including energy distributors and railways—will remain under state ownership. The government hopes that by opening the door to greater privatization it will attract foreign investment and raise much-needed revenues.

The Slovak government expects to collect 155.7 billion crowns in taxes, assuming parliament approves the necessary legislative amendments. Slovakia's 1999 budget projects a deficit of 15 billion crowns ($361 million)—down from 19.2 billion crowns last year. If the slowdown continues in Central and Eastern Europe—especially in the Czech Republic—the Slovak government may need to alter its budget.

CIS

Kazakhstan

Kazakhstan's GDP was 4.0 less in the first quarter of 1999 than in the first quarter of 1998, and industrial output was down 4.1 percent, according to the National Statistics Agency. In the first quarter of this year industry suffered major market losses due to last year's Russian financial crisis, and key exports were hurt by falling world commodity prices. On April 2, in an attempt to boost export competitiveness and increase industrial output, the government allowed the tenge to float freely (see article on page 12).

Russia

$12-14 billion flows out of Russia each year estimates the tax ministry. It submitted proposals for tightening control of hard currency, based on recent international experience. According to [former] Prime Minister Yevgeny Primakov, much more foreign currency leaves the country every year—as much as $20-25 billion.

In 1998 inflation soared to 84.4 percent from its 1997 figure of 11.8 percent, according to a Finance Ministry report. GDP shrank 4.6 percent in 1998, while industrial production dropped 5.2 percent. Exports dropped to 87 percent of their 1997 level, while imports fell 15.1 percent. Meanwhile, Russia's foreign debt exceeded its GDP—by 18.7 percent—and its domestic debt—by 19.4 percent.

Reforming the country's banking system will cost at least 100 billion rubles ($4.2 billion), according to Russia's Central Bank. The recently established Agency for Restructuring of Credit Organizations (ARCO) has a charter capital of 10 billion rubles—enough, experts say, to help perhaps 20-30 troubled banks. ARCO, which started operations in April, has released a listing of 16 regions targeted for assistance. ARCO aims to help:

- All banks that have broad importance in their region.
- Certain Moscow banks. (Moscow banks account for 86 percent of payment transfers frozen in the banking system.)
- One or two banks critical to the payment system.

ARCO can provide assistance to restructuring banks as a creditor, a shareholder, an external regulator, or an advisor on financial and regulatory issues. The agency will only help a bank restructure with the bank owner's approval. Overall, about 1,000 banks will survive while 400 close their doors, according to Central Bank chairman Viktor Geraschenko.

Two U.S. companies, John Deere and Case Corporation, plan to invest $400 million in Russia and establish farm equipment leasing enterprises there. John Deere will invest $200 million in Rostelmash in the Rostov Oblast, and Case will invest $200 million in Kirov Works in St. Petersburg. The companies plan to raise an additional $2 billion from U.S. investment banks.

Ukraine

Ukraine's GDP in the first quarter of 1999 was 4.8 percent lower than in the first quarter of 1998, worse than the 4.0 percent drop predicted, First Deputy Economic Minister Viktor Kalnyk disclosed. It is expected that GDP will recover slightly in the second quarter and be about 2.4 percent lower for the year as a whole.

Ukraine's government has ordered 12 of the country's industrial giants to prepare immediately for sale to private owners. According to the Ukrainian News Agency, the country's cabinet ordered the State Property Fund to finalize a schedule for selling stakes of up to 53 percent in the 12 enterprises—which include metallurgical plants, oil refineries, and several big exporters. The government needs foreign investment to revive the economy and help pay off mounting debts. (In March the parliament rejected a draft of a 1999 privatization program, submitted by President Leonid Kuchma, calling for the sale of over $200 million in state assets this year.)

Asia's Reforming Economies

China

The private sector needs more support, Yi Gang, deputy secretary-general of the

State Council's Monetary Policy Commission, pointed out. "The government should narrow the area of investment for state-owned enterprises and focus on expanding investment areas and channels available to the private sector," Yi said, as quoted in *Xinhua*. Yi, who is also deputy director of monetary policy at the Central Bank, added that the private sector should be allowed to invest in areas dominated by the government, including infrastructure and public projects. In order to create rational competition, private businesses should be allowed to enter sectors monopolized by state-owned enterprises. This would lead to the demise of loss-making state-owned enterprises and ensure China's sustainable economic development.

Yi also called for equal treatment of enterprises in financing, regardless of ownership type. He said government intervention in capital markets must be halted and stock market listings for enterprises decided by the market rather than the government. Yi added that the commercialization of state-owned banks should be accelerated to ensure their improved management and services and lending of profit-making loans.

We appreciate the contributions of Radio Free Europe.

Conference Diary

Investment Management in the Transition Economy
May 26-28, 1999, Novopolotsk, Belarus

Organizer: Polotsk State University Finance Department.
Languages: English, Russian.
Information: Polotsk State University, Blokhin str. Novopolotsk, Belarus, tel. 375-2144-56395, fax 375-2144-54263, Email: admin4@psu.belpak.vitebsk.by.

Third International Conference on Enterprises in Transition
May 27-29, 1999, Split, Croatia

Organizer: Faculty of Economics, University of Split.
Information: Faculty of Economics Split, Radovanova 13, Hr 21000 Split, Croatia, tel. 385-21-366033 or 362465, fax 385-21-366026.

Germany and the Baltic Countries in the New Europe: The Experiences of One Decade of the New "Neighborhood"
May 28-30, 1999, Kiel, Germany

Organizer: Ostsee Akademie.
Language: German.
Information: Ostsee-Akademie, Travemuende, Europaweg 3, 23570 Lubeck, Germany, tel. 49-4502-803-203/205, fax 49-4502-803-200, Email: ostseeakademie@tonline.de, Internet: http://www.balticnet.de/Ostsee-Akademie/Ostseeakademie-Info.html

Tax Administration: Institution Builging in Transition—Tax Evasion, Compliance Costs, and Taxpayers' Rights
June 3-5, 1999, Zagreb, Croatia

Organizer: The Institute of Public Finance, Zagreb, Croatia in cooperation with International Bureau for Fiscal Documentation, Amsterdam, the Netherlands and Center for Public Affairs Studies, Budapest University of Economics, Budapest, Hungary.
Information: Natalija Spehar, Institute of Public Finance, Katanciceva 5, P.O. Box 320, HR-10000 Zagreb, Croatia, tel. 385-1-481-9363, fax 385-1-481-9365, Internet: http://www.ijf.hr.

Cultural Standards in Business and Society in the European Union
June 7-10, 1999, Vienna, Austria

Organizer: Institute for the Danube Region and Central Europe; supported by the European Commission.
Topics: Culture and management; similarities and differences in management styles in Europe; European management; global management; culture-sensitive management—costs and benefits.
Information: Research Institute for European Affairs, Wirtschaftsuniversitat Wien, Althanstrabe 39-45, A-1090 Wien, tel. 431-31336-5084, fax 431-31336-752, Email: Meierewe@fgr.wu-wien.ac.at.

The World Bank's First ABCDE Europe Conference
June 21- 23, 1999, Paris, France

Keynote addresses by *Lionel Jospin*, Prime Minister, France; *James D. Wolfensohn*, President, the World Bank; *Jean-Louis Beffa*, Saint-Gobain; *James A. Mirrlees*, University of Cambridge; *Joseph E. Stiglitz*, and *Jean-Francois Rischard*, the World Bank. Session one: *The New Comparative Economic Systems*—Roundtable: *Institutional Infrastructure* (Oliver Hart, Mustapha Nabli, Katharina Pistor, Jean Tirole); Paper: *Transition—The First Ten Years* (John S. Flemming). Session two: *Market Organization*—Roundtable: *Capital and Labor Markets* (Isher Judge Ahluwalia, Masahiko Aoki, Rudiger Dornbusch, Assar Lindbeck); Paper: *Poverty and Inclusion* (Anthony Atkinson, Francois Bourguignon). Session three: *The New Global Economy;* Papers: *Global Financial Markets* (Richard Portes), *Global Externalities* (Domenico Sinscalco), and

Global Governance (Michael Camdessus, James D. Wolfensohn). The first two afternoons will each have five parallel workshop sessions. June 21st: *New Thinking on Security In Labor Markets, Knowledge and Development, Gender Economics, Expertise, Rrational Decision Making and Democratic Accountability,* and *Capital Flows and Development.* June 22nd: *Social Insurance and Social Security Reform, Trading Blocs and Regional Integration, Global Environment, The Global Financial Crises* and *Debt and Debt Relief.* Participation by invitation only. The conference is sponsored by Pierre-Alain Muet, Conseiller auprés du Premier Ministre, France; and Joseph E. Stiglitz, Senior Vice President Development Economics and Chief Economist.
Information: Boris Pleskovic, Research Advisory Staff, World Bank, 1818 H Street, N.W., Room MC4-391, Washington, DC 20433, e-mail: bpleskovic @worldbank.org tel. 202-473-1062, fax 202-522-0304.

Fifth Annual Conference of the Centre for Research into East European Business and Transforming Economies: The Impact of Transformation on Individuals, Organizations, and Society
June 22-23, 1999, Bucks, United Kingdom

Organizer: Buckinghamshire Business School.
Information: Margaret Levell, CREEB, Buckinghamshire Business School, Buckinghamshire Chilterns University College, Newland Park, Gorelands Lane, Chalfont St. Giles, Bucks HP8 4AD, United Kingdom, tel. 44-1494-603159, fax 44-1494-874230, Email: creeb@ buckscol.ac.uk, Internet: http://www. buckscol.uk.

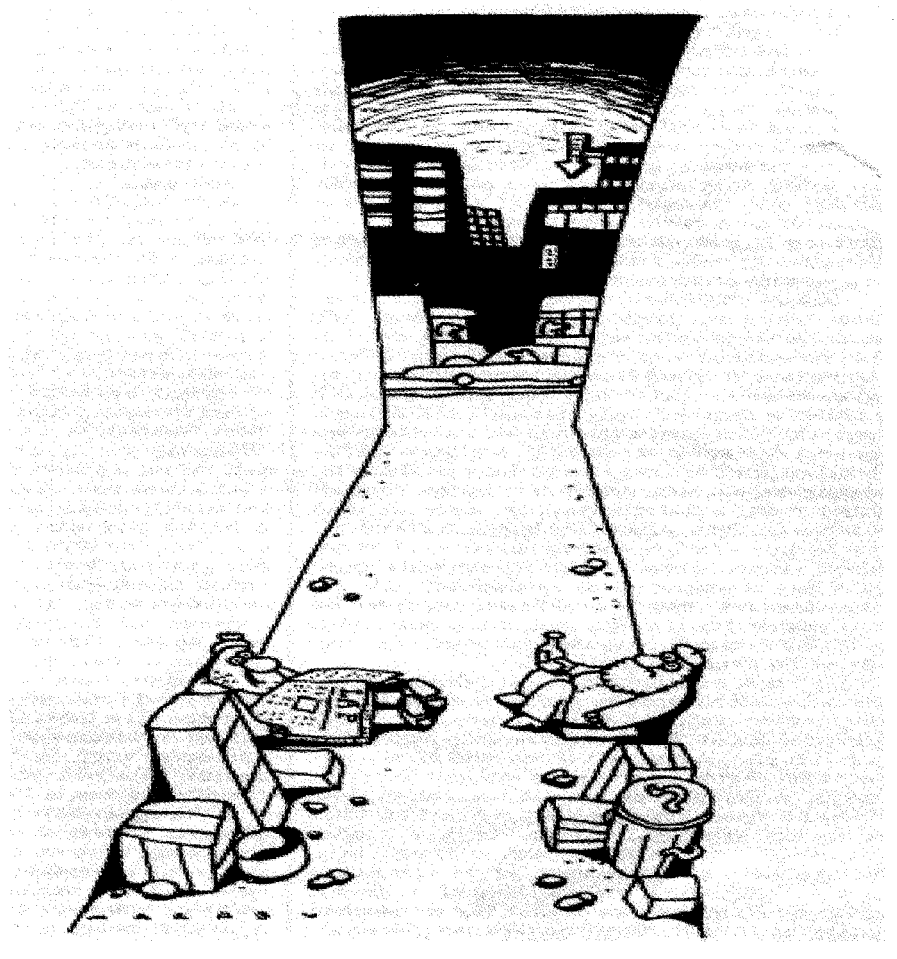
Fifth Bruehl Conference for Young Experts on Eastern Europe
June 24-26, 1999, Bruehl, Germany

Organizers: Ost-West-Kolleg der Bundeszentrale fuer politische Bildung, Deutsche Gesellschaft fuer Osteuropakunde, Bundesinstitut fuer ostwissenschaftliche und internationale Studien (BIOST).
Language: German.
Purpose: To bring together young researchers in the social sciences (graduates, Ph.D. candidates, and recent Ph.D.s) to discuss current research on Eastern Europe.
Potential topics: Aspects of the social, economic, political, and legal transformation in Central and Eastern Europe and the countries of the former Soviet Union.
Information: Hans-Henning Schroeder, Bundesinstitut fuer ostwissenschaftliche und international Studien, Lindenbornstrasse 22, D-50823 Koeln, tel. 49-221-5747-151, fax 49-221-5747-110, Email: rogo01@ mail.unikoeln.de.

Econometric Evaluations of Active Labour Market Policies in Europe
June 25-26, 1999, Mannheim, Germany

Organizer: ZEW Centre for European Economic Research.
Information: Michael Lechner, University

Anniversary



"Tell me friend, do you remember why we were so damned eager for capitalism 10 years ago?"

From the Hungarian magazine *Hócipõ*

of St. Gallen, Dufourstr. 50, CH-9000 St. Gallen, Switzerland, Email: Michael. Lechner@vwl.uni-mannheim.de, and Friedhelm Pfeiffer, Centre for European Economic Research (ZEW), P.O. Box 103443, 68034 Mannheim, Germany, Email: pfeiffer@zew.de, Internet: http://www.eval.zew.de.

Third Budapest European Association for Comparative Economic Studies (EACES) Workshop
September 3-4, 1999, Budapest, Hungary

Language: English.
Information: Zoltan Bara, Budapest University of Economic Science, Department of Comparative Economics, Fovam ter 8, 11, em. 212, H-1093, Budapest, Hungary, tel. 361-217-6320, fax 361-217-7940, Email: h8065bar@ella.hu.

Regional Potentials in an Integrating Europe
September 18-21, 1999, London, United Kingdom

Information: Myriam Erro, Conference Officer, Regional Studies Association, 15 Micawber Street, London, N1 7TB, United Kingdom, tel. 44-171-490-1128, fax 44-171-253 0095, Email: sa@mail box.ulcc.ac.uk, Internet: http://www.regional-studies-assoc.ac.uk.

Annual Meeting of the Association for Social Policy–Society for Economic and Social Sciences: Enlarging the EU
September 28-October 1, 1999, Mainz, Germany

Organizer: Eberhard-Karis-Universitat, Tubingen.
Language: German.
Information: Prof. Dr. Wolfgang Wiegard, Eberhard-Karis-Universitat, Abteilung Volkswirtschaftslehre, Mohlstrabe 36, D-72074 Tubingen, Germany.

The Emergence and the Structuring of Corporate Groups in P.R. of China in an International Perspective
November 6-7, 1999, Hong Kong

Organizer: Center of Asian Studies, Hong Kong University and the Centre Francais d'Etude sur la Chine Contemporaine (Hong Kong) et le GASI.
Information: Maison des Sciences Economiques Universite de Paris I, 106-112, boulevard de l'Hopital, 75647 Paris cedex 13, France, tel. 01-55-43-41-87-41-90, fax 01-55-43-41-91, Email: roses@univ-paris1.fr.

31st National Convention of the American Association for the Advancement of Slavic Studies
November 18-21, 1999, St. Louis, Missouri, United States

Organizer: AAASS (American Association for the Advancement of Slavic Studies)
Information: http://fax.harvard.edu.

Eastern Transition Trajectories: Measurement, typologies, differentiations, interpretations
December 10-11, 1999, Grenoble, Europe

Organizer: International Conference GTD-Espace.
Topics: Transition typologies and policies: History, culture and economic behaviours; Diffusion of innovations of norms of behaviours; and Irreversibilities, thresholds and pawl effects.
Information: I Samson (Director), L. Bensahel, E.Brunat, V. Lamande, A. Tretyak, F. Coulomb, R. Ponsard, Ivan.Samson@upmf-grenoble.fr, Secretariat: Zinab : tel +334 76 82 55 92 fax : +334 76 82 58 62, Keo : tel/fax 76 82 59 46.

Association for Comparative Economic Studies (ACES) Meeting
January 2000, Boston, Massachusetts, United States

Language: English.
Information: President Dwight Perkins, Department of Economics, Harvard University, Cambridge, MA 02138, United States, fax 617-495-2911, Email: dperkins@hiid.harvard.edu.

Sixth ICCEES World Congress
July 29 - August 3, 2000, Tampere, Finland

Organizers: The International Council of Central and East European Studies, Finnish Association for Russian and East European Studies (FAREES), Finnish Institute for Russian and East European Studies (FIREES), and the University of Tampere.
Call for Papers: Proposals for panels and roundtables are invited, presenting the results of new research on countries of Central and Eastern Europe and the former Soviet Union. Deadline is January 1,1999.
Information: Sixth ICCEES World Congress Secretariat, Finnish Institute for Russian and East European Studies, Annankatu 44, FIN-00100 Helsinki, Finland, tel. 358-9-2285 4434, fax 358-9-2285 4431, Email: iccees@rusin.fi, Internet: http://www.rusin.fi/iccees. Addresses of Program Committee members responsible for Economics: Dr. Franz-Lothar Altmann, Suedost-Institut, Guellstr. 7, Muenchen, Germany, tel. 49-89-74613320, fax 49-89-74613333; Professor Urpo Kivikari, Institute for East-West Trade, Turku School of Economics and Business Administration, Box 110, FIN-20521 Turku, Finland, tel. 358-2-3383570, fax 358-2-3383268, Email: urpo.kivikari@tukk.fi; Academician Nikolai Shmelev, Institute of Europe, Russian Academy of Sciences, Mohovaja ul. 8, dom 3, RU-103873 Moscow, Russia, tel. 7-095-2037237, fax 7-095-2004298.

We appreciate the contributions of the Cooperation Bureau for Economic Research on Eastern Europe, Koenigin-Luise-Str. 5, D14195 Berlin, Germany, tel. 4930-8977708-68, fax 4930-897708-99, Email: tribakova@diwberlin.de or dbowen@diw-berlin.de.

Conference Announcements of the Davidson Institute

Human Resource Conference
May 10-12, 1999, Prague, Czech Republic

The Davidson Institute is sponsoring a 3-day conference in Prague May 10 and 12 for human resource managers with regional responsibilities for business operations in Central and Eastern Europe. The conference, entitled "Ten Years of Transformation: Lessons Learned from Managing Change in Transition Economies," addresses how to transform organizational cultures, implement change and best practices in human resources, and face future challenges. Sessions will include panels of participating companies moderated by Davidson Institute faculty with expertise on organizational change and issues affecting firms in transition economies.
Information: Ms. Keven Burchfield, Program Manager, tel. 734-763-5020, Email: burchk@umich.edu.

General Management Program: A Course for Senior Managers from Transition Economies
June 28-July 8, 1999, Zagreb, Croatia

The General Management Program (GMP) is an intensive two-week program designed for senior managers from firms in transition economies. In its second year, the program is geared toward individuals with an interest in general management concepts that apply to more than one functional area of their firm. The courses combine both theory and practice. Many of the cases and examples used in the classroom are based on the Institute's experience with companies operating in Central and Eastern Europe and the countries of the former Soviet Union. The program is conducted by leading business faculty who have experience teaching in top-rated executive education programs and have worked with companies operating under new market conditions. Adept at facilitating discussion and creating a learning climate, faculty are skilled at making each session flexible to meet the needs and expectations of the participants.

Participants come from a wide variety of organizations and countries and typically establish policy at corporate or divisional levels. They should be familiar with basic business functions and be ready to adopt new perspectives on these functions. Instruction is in English and all participants are expected to have sufficient fluency in the language to contribute to class discussion and group work.

The program fee is US$5,300. Tuition includes instructional materials, lunches, and coffee breaks. Fee is payable upon registration.
Information: Ms. Jasminka Vlaic, Program Administrator, Ekonomski Institut, Zagreb, tel. 123-35700, fax 123-35165, Email: vlasic@ekist.eizg.hr.

Equity Market Development in Emerging and Transition Economies
December 12-14, 1999, Amsterdam, the Netherlands

Organized by: The William Davidson Institute at the University of Michigan Business School, in cooperation with CIFRA (the Amsterdam Center for International Finance Research), the Tinbergen Institute, and the International Review of Finance.
Call for papers: Southeast Asia, Central Europe, and the countries of the former Soviet Union are all going through a period of financial transition and reform, spurred by systemic transformation, financial crisis, and globalization of financial flows. This conference will examine the evolution of financial markets and corporate finance practices in these emerging and transition economies.

In the context of pressure for internal reform, important structural questions are being addressed in these economies. Are financial practices in emerging markets the cause of existing crises? Is fundamental reform of the legal and governance framework taking place? Will the new financial systems develop as market-centered or bank-centered systems? Will corporate groups remain, and will they expand as a form of governance? Can the transition economies learn from the Asian economies' experience, or vice versa?

The conference calls for submissions of theoretical or empirical papers along the lines of these issues. Topics may include new issues, privatizations, corporate governance and financing, corporate groups, and the impact of reform policy.

The conference committee consists of Professor Enrico Perotti of the University of Amsterdam, Dr. Anna Meyendorff of the Davidson Institute, and Professor Sheridan Titman of the University of Texas in Austin. Professor Titman is also editor of the *Review of International Finance.*

Travel and accommodations for invited speakers will be paid by the sponsors. Papers must be sent by July 15 to: Professor Enrico Perotti, Universiteit van Amsterdam, Roeterstraat 11, 1018 WB Amsterdam, United States, the Netherlands, enrico@fee.uva.nl., or Dr. Anna Meyendorff, Department of Financial Management, The William Davidson Institute, University of Michigan Business School, Ann Arbor, MI 48109, ameyen@umich.edu.

If you would also like your paper to be considered for publication in the International Review of Finance, *please send three copies to Sheridan Titman, Department of Finance, College of Business Administration, University of Texas, Austin, Texas 78712-1179, titman@mail.utexas.edu.*

New Books and Working Papers

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

World Bank Publications

To receive ordering and price information for World Bank publications, contact the World Bank, P.O. Box 7247-8619, Philadelphia, PA 19170, United States, tel. 202-473-1155, fax 202- 676-0581, Email books@world bank.org, Internet http://www.world bank.org or http://www.worldbank.org/html/dec/Publications/Workpapers/tranecon.htm, or visit the World Bank bookstore in the United States, at 701 18th Street, NW, Washington, DC, or France, at 66, avenue d'Iena, 75116 Paris.

Working Papers

http://www.worldbank.org/html/dec/Publications/Workpapers/home.html

Peter F. Orazem and Milan Vodopivec, **Male-Female Differences in Labor Market Outcomes During the Early Transition to Market: The Case of Estonia and Slovenia,** WPS 2087, March 1999, 41 pp.

Estonia adopted liberal labor market policies. Slovenia took an interventionist approach. Relative wages for women rose in both countries (real wages fell for both men and women, but women lost less than men did). Certain factors favored women:

- Returns to human capital rose during the transition.
- Relative labor demand shifted away from traditionally male sectors (agriculture, manufacturing, mining, transportation) toward predominantly female sectors (health, education, financial services, retail trade).
- Women with low wages had a disproportionate incentive to exit the labor market, especially in Estonia.

Women were less mobile in both countries, however, allowing men to disproportionately fill new jobs in expanding sectors. Women who remained employed had higher average education levels. Women's relative immobility will tend to reduce their early relative gains. Their relative wages will also continue to fall if their share of the expanding sectors continues to fall.

To order, contact Sheila Fallon, Room MC3-638, tel. 202-473-8009, fax 202-522-1153, Email: sfallon@worldbank.org. The author may be contacted at mvodopivec@worldbank.org.

Grzegorz W. Kolodko, **Ten Years of Post-Socialist Transition Lessons for Policy Reform,** WPS 2095, April 1999, 29 pp.

A new post-Washington consensus is developing, based on lessons from experience . Post-socialist experience is also reorienting development policy. Among the realities policymakers must recognize:

- Appropriate institutional arrangements are needed for growth.
- Institution-building by its very nature must be gradual.
- The size of government is less important than the quality of government policy and how the government changes.
- If the formation of institutions is left to spontaneous forces unleashed by liberalized markets, the vacuum will be filled by informal institutions.
- The judiciary system must be transformed to serve the market economy.
- Deregulating the post-socialist economy requires shifting competence and power from central to local governments.
- Development of nongovernmental organizations must be accelerated.
- Government concern about equitable growth and income policy is important during the transition.
- With the support of international financial institutions, countries must monitor and control short-term capital liberalization.
- The Bretton Woods organizations should reconsider their policies toward transition economies, providing more support for institution-building and equitable growth.

To order, contact Jennifer Prochnow, room MC3-378, tel.202-473-7466, fax 202-522-1152, Email:jprochnow@world bank.korg. The author may be contacted at gkolodko@imf.org.

Estelle James, Gary Ferrier, James Smalhout, and Dimitri Vittas, **Mutual Funds and Institutional Investments: What Is the Most Efficient Way to Set Up Individual Accounts in a Social Security System?** WPS 2099, April 1999, 60 pp.

A social security scheme based on individual accounts invested in the institutional market, with constrained choice among investment companies, appears to reduce administrative and marketing costs, allow significant worker choice, and provide more insulation from political interference than a single centralized fund or individual investments in the retail market.

To order, contact Marianne Leenaerts, room G2-030, tel. 202-458-4264, fax 202-676-0961, Email: mleenaertsk @worldbank.org. The authors may be contacted at ejames3k@worldbank.org or dvittas@worldbank.korg.

Lev Freinkman and Plamen Yossifov, **Decentralization in Regional Fiscal Systems in Russia: Trends and Links to Economic Performance**, WPS 2100, April 1999, 50 pp.

Local governments' relative share of Russia's consolidated budget, although substantial at roughly a quarter of the total budget, did not expand after 1994. Local governments collected more revenues in 1996 (6.4 percent of GDP) and spent more than regional governments. They also substantially increased social financing (including spending on health, education, and social protection). Given the positive impact decentralization has had on regional economic performance and expenditure structure, the federal government should protect local self-governance and budget autonomy, make intergovernmental fiscal relations more transparent, develop universal models of interactions between regional and municipal governments, and impose stricter limits on total debt and budget deficits of subnational governments.

Fiscal decentralization seems positively related to the share of education spending in regional budgets. Moreover, regions with more decentralized finances tend to experience less economic decline. But budget control is weaker in more decentralized regions. Instability and lack of transparency in intergovernmental fiscal relations provide subnational governments little incentive for responsible fiscal policy. Further decentralization without greater transparency could bring greater debt and deficits.

To order, contact Zakia Nekaien-Nowrouz, Room O4-150, tel. 202-473-9057, fax 202-522-3607, Email address: znekaiennowrouz@worldbank.org. The author may be contacted at lfreinkmank@worldbank.org.

Other World Bank Publications

World Development Indicators 1999, Third Edition, April, 1999, 400 pp. (Also CD-ROM Single-user or Network version)

After a generation of declining poverty, longer lives, and better health for millions of the world's poorest people, efforts to improve key areas of human development are in danger of stalling on the threshold of the new millennium. Faltering growth in Asia and Latin America, uncertain prospects for the transition economies of the former Soviet Union, and the continuing spread of HIV/AIDS in Africa will make it increasingly difficult for the international community to achieve a series of key development goals for the early twenty-first century.

In Eastern Europe and the countries of the former Soviet Union, millions of people have seen their living standards deteriorate sharply during the difficult transition to modern market economies. In 1989 about 14 million people in the transition economies of the former Soviet Union were living under the poverty line of $4 a day. By the mid-1990s that number was about 147 million, or about one out of every three people.

Inequality has increased rapidly in Eastern Europe and the former Soviet Union since the collapse of Communism. In Russia and Ukraine the richest 20 percent of the population receives more than half the country's income, while the poorest 20 percent earns less than 5 percent. At the same time, adult mortality has increased as a result of smoking, high-fat diet, excessive alcohol use, and the stressful psychological conditions of economic transition.

World Bank Atlas 1999, 31st Edition, April 1999, 64 pp.

A special table provides estimates of purchasing power parities (PPP) and data on relative prices. Per capita GNP figures are converted at PPP for better international comparability and are available for almost all countries. Economic data also include GNP and the shares of exports, agriculture, and investment. Social data include data on life expectancy, infant mortality, female labor, child malnutrition, girls' school enrollment, access to safe water, and private consumption per capita. Population statistics are provided in absolute terms and as growth rates for 1985-97. Environmental data are presented on land area, forest coverage, water use, energy consumption, and carbon dioxide emissions. The section on states and markets includes data on private investment, stock market capitalization, government deficits, and infrastructure. Global Links covers trade, private capital flows, foreign investment, and international tourism.

Severin Kodderitzsch (ed.), **Reforms in Albanian Agriculture: Assessing a Sector in Transition,** Technical Paper No. 431, 1999, 71 pp.

Sixty percent of the Albanian population depends on agriculture for its livelihood. Although it is still fairly unsophisticated and will probably never ensure self-sufficiency in major agricultural commodities, agriculture in Albania represents a useful shock absorber in the current situation. Since it started its transition to a market economy in 1991, Albania has carried out major reforms in the sector, achieving remarkable increases in both output and total factor productivity. More needs to be done, however, to reduce rural poverty, stop environmental degradation, and increase integration with regional and international economies.

World Bank Country Studies

Czech Republic: Capital Market Review, 1999, 211pp.

The Czech Republic implemented major reforms in the early 1990s and achieved impressive economic results. Macroeconomic performance started faltering in 1996, however. The regulatory framework for enterprises and financial institutions contained several flaws. Minority shareholder rights were weakly protected, and other important elements of internal governance were absent.

These regulatory failures prevented sound management and active restructuring and allowed large shareholders and managers to abuse the system.

Slovenia: Economic Transformation and EU Accession, March 1999, Volume I (Summary), 19 pp.; Volume II, World Bank Country Study, 209 pp.

Michael M. Cernea (ed.), **The Economics of Involuntary Resettlement: Questions and Challenges,** March 1999, 198 pp.

Emerging Stock Markets Factbook 1999, IFC, May 1999, 350 pp.

The 13th annual survey of emerging stock markets, prepared by the Emerging Markets Group of the International Finance Corporation (IFC), covers the latest developments in 45 stock markets included in the IFC's global, investable, and frontier index series.

Guy P. Pfeffermann, Gregory Kisunko, and Mariusz Sumlinski, **Trends in Private Investment in Developing Countries: Statistics for 1970-1997 and Perceived Obstacles to Doing Business,** IFC Discussion Paper 37, 1999, 56 pp.

The 10th annual edition of **Trends in Private Investment in Developing Countries** notes that 1997 was a record year for private investment, while public investment declined to its lowest level since 1975 in the 47 countries covered. For the first time, China has been included in this series.

Based on country-specific results of a 1996/97 worldwide survey of business executives, the paper analyzes obstacles to doing business in each of the 74 countries (including industrial economies) and the correlation between obstacles and levels of private investment. Factors found to be of particular importance to private investment decisions include the real exchange rate, the rule of law, predictability of judiciary systems, and the extent to which financing is available to enterprises.

Boris Pleskovic and Joseph E. Stiglitz (eds.), **Annual World Bank Conference on Development Economics 1998,** April 1999, 411 pp.

The tenth conference dealt with four difficult topics in development: the role of geography in countries's success, with Paul Krugman, John Luke Gallup and Jeffrey Sachs; the role and design of regulation and competition policy, with Paul Joskow and Jean-Jacques Laffont; the causes of financial crises and ways to prevent them, with Bruce Greenwald, Asli Demirgüç-Kunt and Enrica Detragiache; and how ethnic conflicts affects democracy and growth, with Paul Collier and Donald L. Horowitz. This volume also includes insights from Nobel Prize winner James Tobin, Stanley Fischer, Joseph E. Stiglitz, and World Bank President James D. Wolfensohn.

Christopher Gibbs, Claudia Fumo, and Thomas Kuby, **Nongovernmental Organizations in World Bank-Supported Projects: A Review,** 1999.

The Bank's guidelines on working with NGOs are sound, but the guidelines need to be used more effectively. The report makes recommendations to improve partnerships with NGOs and increase the benefit to development projects.

Project Finance in Developing Countries: Operations Evaluation Studies, 1999, 92 pp. (IFC's greenfield project finance activities over the past decade.)

Louis Y. Pouliquen, **Rural Infrastructure from a World Bank Perspective: A Knowledge Management Framework,** March 1999, 64 pp.

Nicholas Prescott (ed.), **Choices in Financing Health Care and Old Age Security, Proceedings of a Conference Sponsored by the Institute of Policy Studies, Singapore, and the World Bank, November 8, 1997,** July 1998, 111 pp.

Conference participants discussed the implications of financing medical care and income security for rapidly aging populations and examined Singapore's unique approach to managing social risk based on mandatory individual savings accounts.

Caroline M. Robb, **Can the Poor Influence Policy? Responding to the Challenge of Inclusion through Participatory Poverty Assessments,** 1999, 148 pp.

How can the poor, so removed from the powerful, influence national policy? Participatory Poverty Assessments (PPAs) are responding to the challenge of inclusion by directly presenting to policymakers the views of the poor as part of a national dialogue to influence policy. This monograph summarizes the World Bank's experience in using PPAs over the past five years.

The poor can identify dimensions of poverty other than income and consumption. These include vulnerability, physical and social isolation, powerlessness, and undermining of self-respect and dignity. If broad policy dialogue on poverty includes civil society groups, the constituency of reform is widened, ownership increases, and the resulting policy is more likely to be implemented.

Rick Stapenhurst and Sahr Kpundeh (eds.), **Curbing Corruption: Toward a Model for Building National Integrity,** February 1999, 264 pp.

Corruption is the abuse of power, most often for personal gain or the benefit of a group to which one owes allegiance. Attempts to measure the eco-

nomic cost of corruption suggest that corruption adds 3-10 percent to the price of a given transaction to speed the delivery of a government service. The prices of goods are by as much as 15-20 percent as a result of corruption, and diverted tax revenues can cost the government as much as 50 percent of its tax revenues. An effective anti-corruption strategy needs to be multi-faceted, combine economic reforms, and strengthen national integrity institutions. Political commitment is key to sustaining this effort.

Financial Institutions—IFC: Lessons of Experience Series, No. 6, 1999, 136 pp.

Michael M. Cernea (ed.), **The Economics of Involuntary Resettlement: Questions and Challenges**, March 1999, 198 pp.

IMF Publications

To order, contact IMF Publication Services, 700 19th Street, NW, Washington, DC, 20431, United States, tel. 202-623-7430, fax 202-623-7201, Email: publications@imf.org, *Internet: http://www.imf.org.*

Oleh Havrylyshyn and Donal McGettigan, **Privatization in Transition Countries: A Sampling of the Literature,** WP 99/6, 1999.

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Production Manager: Jennifer Prochnow
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701 Tappan Street, 9th Floor
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Editor: Anna Meyendorff
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Associate Editor: Sharon Nakpairat
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