Dramatic Population Trends in Countries of the FSU
by Timothy Heleniak

The radical transformations of the fifteen countries of the former Soviet Union (FSU), along with those of the transition economies of Eastern Europe, are producing demographic trends never before seen in developed countries. These include declining birth rates in all fifteen countries, plunging some of them to among the lowest levels in the world and the lowest levels ever measured for populations of these sizes. Death rates have risen in all 15 countries, causing declines in life expectancy, a reversal of the trend found in most countries of the world, developed or developing. Also, the dissolution of the U.S.S.R. set off a great stream of migration. When the fifteen states became sovereign countries, there were 43 million persons who found themselves living outside the country of their titular nationality.

The combination of declining crude birth rates and rising crude death rates has led to a decline in population ("negative rates of natural increase") in the low-fertility transition economies, as the number of deaths exceeded the number of births. In 1994 there were only ten countries in the world whose population declined because of negative rates of natural increase. Five are former Soviet republics—Belarus, Estonia, Latvia, Russia, and Ukraine—and five are in Europe—Bulgaria, Croatia, Germany, Hungary, and Romania. All these countries are either partly or entirely former planned economies.

These demographic trends, which include steep declines in marriage rates, are tangible evidence of societies' responses to the great uncertainty brought about by the breakup of the Soviet Union and the difficult transitions to market economies. Previous societies have responded to periods of economic depri-
vation and social upheaval with a reduction in childbearing but not to the extent that some of the FSU countries are experiencing.

Variations Within Overall Decline

One reason for the breakup of the Soviet Union was the great cultural diversity found within its borders. This was partly reflected in demographic differences found among the former Soviet states. Cultural traditions for developing large or small families, for example, existed prior to the creation of the Soviet Union and were only partially influenced by policies of the Soviet government.

Countries of the FSU, when considered in light of their current patterns of natural increase and migration, can be broadly classified as follows (table 1):

- The three Slavic countries—Belarus, Russia, and Ukraine—all have net immigration, offset in Russia and Ukraine by negative rates of natural increase. Over the six-year period from the last Soviet census in January 1989 to the beginning of 1995, the net immigration to Russia offset the negative natural increase by two times so that Russia's population increased over the period, though over the last three years it has been declining. Ukraine's negative natural increase over the period just about equaled the positive immigration so that the total population declined slightly during the same period, although its population growth has also been negative recently.

- The three Baltic countries—Estonia, Latvia, Lithuania—have experienced negative natural increase coupled with outmigration, largely of Russians. Estonia and Latvia have both had negative rates of natural increase since 1989. Lithuania, with its more rural population and a smaller Russian population than the other two Baltic countries, has only recently shown a negative natural increase and had a smaller rate of outmigration.

- Five countries with large Muslim populations—Azerbaijan, Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan—continued to have high rates of natural increase, though slightly lower than before 1989 and, with the exception of Turkmenistan, experienced net outmigration. Since 1989 Uzbekistan, the most populous of the Central Asia countries, grew most in absolute terms of any of the FSU countries, adding nearly 3 million persons. Turkmenistan continues to have the highest rate of natural increase and the highest rate of total population growth of any state of the FSU.

- Two countries—Georgia and Kazakhstan—had a total natural increase that was roughly offset by outmigration to produce stagnant growth.

Birth Rates Slump

In some western FSU countries, populations have responded to the pervasive uncertainty following the breakup with a rapid decline in childbearing to levels never before recorded in populations of this size. Just before the breakup, the Soviet Union had a birthrate slightly higher than levels in the industrialized nations, due primarily to a range of pronatalist social policies. But, since 1989 the crude birthrate has declined by 25 to 42 percent in the European countries of the FSU and between 10 and 20 percent in the Central Asian countries (table 2).

A more telling statistic is the total fertility rate (TFR)—the number of children a woman would have if she passed through her childbearing years and had

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**Table 1. Population Change in the Former Soviet Union, 1989-95**  
*(beginning of year)*

<table>
<thead>
<tr>
<th>Country</th>
<th>Population (thousands)</th>
<th>Change</th>
<th>Reason for Natural increase</th>
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<tr>
<td></td>
<td>1989</td>
<td>1995</td>
<td>Percent</td>
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<tr>
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<td>3,455</td>
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<td>7,038</td>
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<td>10,200</td>
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<td>1,573</td>
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<td>Russia</td>
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Sources: CIS Statistical Committee, national statistical offices; and UNICEF.
children at the rate of the current age-specific birth rates. A TFR of about 2.1 indicates that the population is just exactly replacing itself. In 1990 the Baltic and Slavic countries had TFRs at or just below replacement level. (The average TFR for Europe was 1.7 and for the United States 2.1 in the same year.) Since then the TFRs of nearly all FSU countries have fallen, with the rates falling by as much as 30 percent or more in a few countries. It is not just the rate of decline that is astonishing but the levels to which the rates have sunk. At present the Baltic and Slavic countries are well below replacement level, with Russia's rate of 1.4 in 1993 placing it alongside such other low-fertility countries as Germany, Greece, Italy, and Spain.

Reasons for the plunging birth rates in transition economies include:
- Uncertainty about economic conditions and social policies that affect family welfare and childbearing.
- Changing relative cost of having and raising children.
- Increased poverty.
- Dismantling of pronatalist income and welfare policies.
- Increasing availability of modern contraceptive means other than abortion.
- In the western FSU countries, a smaller cohort passing through the childbearing years (see box).
- The marriage shock. The number of marriages has declined precipitously in most FSU countries, with declines of more than 30 percent in the Baltic countries during 1990-93.

Although the availability of modern contraceptives is increasing, abortion remains the most prevalent means of birth control, and is on the rise. In six countries—Belarus, Estonia, Kazakhstan, Latvia, Russia, and Ukraine, there are more than 100 abortions performed for every 100 births. Russia continues to have one of the highest abortion rates in

**Kinks and Echoes in Russia's Age Pyramid**

The January 1, 1994 age-sex pyramid of Russia's population graphically illustrates both the past and future of the Russian population. The recent plunge in birth rates is clearly seen at the bottom with each of the last seven, single-year cohorts being smaller than the one immediately preceding it. The general shape is that of a steep pyramid, an indication that the population is growing, but growing slowly.

Many of the "kinks", or sharp contractions in the pyramid reflect either great losses of life or periods where fertility declined. Each of these relatively small cohorts in turn produces a smaller cohort as it passes through its own reproductive years, producing an "echo" effect in later generations. This is part of the explanation for the most recent cohort being relatively small compared with that immediately before. The cohort currently in the prime childbearing years, those centered around age 25, are relatively small. This group in turn was the product of the cohort in the echo centered around age 50. Those currently age 50 were born during World War II, another period of high mortality and reduced family formation.

The current, newly born cohort will have various effects on society and the demand and supply of social goods as it passes through the life cycle. For instance, the number of children in preschools has declined from a high of 9.8 million in 1988 to 6.8 million in 1993, a decline of more than 30 percent. This obviously means a smaller demand for classrooms and teachers. If pedagogical institutions had been training new teachers based on the expected upward trend implied by the increasingly large cohorts from about age 30 to age 10, there would be a vast oversupply of preschool and primary school teachers. Twenty years from now the newly born, very small cohort will have far fewer entrants into the labor force and, while in their own childbearing years, will in turn produce a smaller cohort.

If this pyramid were folded in half vertically, one would clearly see the high ratio of females to males in the older ages. This is true in most societies but is especially pronounced in Russia where the males have felt the brunt of the demographic disasters throughout the country's history. In the cohorts over age 70, there are more than three females to every male.

The other Slavic countries and Moldova exhibit the same general shape to their population pyramids with roughly similar growth rates and the same kinked pattern resulting from World War II and its echoes. The Central Asian states' pyramids are shaped more conventionally with a wider base indicative of both a faster-growing population and a much larger portion of their populations in the younger cohorts.

**Russian Age Composition, January 1994**
the world with 216.5 abortions recorded for every 100 live births.

### Death Rates Surge

Crude death rates have increased in all FSU countries, but especially in the western FSU countries, where the death rate has increased on average by around 25 percent over the past five years (by 35 percent in Latvia and 45 percent in Russia). Ten FSU countries saw a decline in male life expectancy and five recorded decreases in female life expectancy. Male life expectancy in Russia declined by over six years, from 64.4 to 57.3 years, while female life expectancy declined by over three years, from 74.4 to 71.9 years. The current life expectancy for males in Russia is on a level with that in Indonesia, Nicaragua, and Pakistan—all countries with significantly lower per capita income. The male-female gap in life expectancy widened over this period in every country of the FSU—region already marked by high gaps in male-female life expectancy.

Middle-age men have shown the highest increases in mortality over the period. Nearly half of the increase in the death rate in Russia over the period was due, according to the UNICEF report, to as "an epidemic of heart and circulatory diseases." External and other causes (including murder, suicide, accidental deaths, and poisoning) explain most of the other half.

### Split Along Ethnicity Lines

The former Soviet Union broke apart along its ethnic seams, sociologist Michael Sacks has observed. When the Soviet Union dissolved, 43 million persons were living outside their ethnic homelands, a figure that includes only members of the titular nationalities of the new states. The size of the migration streams could change dramatically the result of "homegrown" demographic trends. The changing ethnic composition of the new states could have a lasting impact on their political development.

At the beginning of 1989 Russia and Ukraine had the largest numbers of their titular nationalities—25 million Russians, 6 million Ukrainians—residing in other states of the "near abroad." Armenia, Belarus, Kazakhstan, Tajikistan, and Uzbekistan each had more than one million members of their majority nationality living elsewhere. Armenia had the highest percentage, with one-third of all Armenians living outside of Armenia.

### Table 2. Population Statistics in the Former Soviet Union, Selected Years

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<td>72.4</td>
<td>1990</td>
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</table>

with the countries of Central Asia being the largest sources of the outmigrants. It is important to note that these trends did not begin with the breakup of the FSU but were certainly accelerated by it. The trends of outmigration from Central Asia and the Transcaucuses and immigration to Russia and Ukraine were going on during the 1970s and 1980s. The only states that incurred a reversal of migration trends were the Baltic states which had immigration during the past two decades but are now experiencing outmigration. To date, about 10 percent of all Russians living in the "near abroad" have returned to Russia. The same is true of most other ethnic groups.

Great Depression Dwarfed

The situation in the FSU can be compared to that of the United States in the early 1930s during the Great Depression when:

- Crude birth rate declined some 15 percent between 1930 and 1933.
- The cohort of women whose prime childbearing years coincided with the Great Depression had only slightly fewer children, 2.4 on average, than the cohorts immediately preceding and following, which each had about 2.8 children.
- The crude death rate did not show any perceptible increase and continued on the gradual decline it had been on since the beginning of the century.
- Life expectancy did decline but not until the Depression was over. It climbed from 1929 on, reached a peak of 63.3 in 1933 and declined to a low of 58.5 years in 1936.

The demographic shock experienced in the FSU countries greatly surpassed that seen in the U.S. population in the 1930s. In the FSU countries crude birth rates have fallen by 25 to 40 percent.

In analyzing these differences, it can be argued that the U.S. loss of output was much less (about 30 percent between 1929 and 1933), than the declines suffered by some FSU countries. And in the United States. Although the free market system was certainly questioned during the Depression and emerged in a very different form, it was not discarded entirely as were central planning and the one-party system in the FSU countries.

Temporary Aberration or Permanent Trends?

Are these demographic trends a temporary response to economic depression or do they represent a shift to new, permanently lower levels under the market system? Russia has already shown some signs of reversing the downward slide of negative natural increase as the number of births increased slightly in 1994 (to 1,397,000 from 1,379,000 in 1993). However, as Nick Eberstat stated in his analysis of Eastern Germany's demographic response to the fall of the Berlin Wall, "the path back from Communism is terra incognita" (Transition, February-March 1994.)

Population projections are a necessary input into labor force predictions, social security financing, and other types of economic planning. Russia's current trends will have the effect of initially lowering the dependency ratio, but it will rise again in the next century as the smaller, young cohorts enter the work force. Whether these demographic trends will persist has a lot to do with prospects for recovery in FSU.

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Subsistence Level

"We need just a very thin slice—it's only for sniffing."

From the Hungarian daily Népszabadság
Poverty in Russia—An Assessment
By Jeni Klugman

Poverty in Russia is not new. The country began its transition with extensive hidden unemployment and at least one-tenth of its population below the then subsistence level (based on a "social minimum" consumption basket). Since then, however, the number of poor households has risen, and by 1993 some 32 percent of the population was living below the revised official poverty line. At that time, some 12 percent of the Russian population was very poor (below 50 percent of the poverty line). In early 1994, an estimated 26.8 percent were poor, and 10.4 percent were very poor. Real earnings have halved since their end-1991 peak and remain somewhat lower than the 1987 level. Reductions in work hours have been widespread; workers have been placed on short-time work status or had to fake involuntary leave. During 1993 and 1994 only 40 percent of the workforce was being paid fully and on time. High inflation has adversely affected the poor, especially those whose administered income, such as minimum pensions and unemployment benefits, has been adjusted with a lag.

The income distribution between population groups and regions has widened, and inequality has reached levels that are comparable to Argentina and the Philippines. Regional disparities, inherited from the Soviet period, have wid-

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**Development of the minimum subsistence basket in Russia and the importance of the poverty line**

In the late Soviet period, a minimum consumption basket (MCB) was developed to guide policy on social payments. It was introduced in 1975 at R50 per month, then raised to R70 in 1984—which happened to equal half the average per capita income. After the 1992 price liberalization and transition from a command system began, such a large proportion of the population fell below the minimum consumption level that the concept became irrelevant for policy. Local MCB estimates were often not published for fear of unduly raising expectations about social benefit levels.

During 1992, technical assistance was provided to the Russian government to refine the food portion of the basket. A revised food basket corresponding to World Health Organization nutritional guidelines was subsequently adopted by the Ministry of Labor (MOL). Under the MOL methodology, the poverty level is assumed to equal a percentage of the food basket, and reflects the different cost requirements of different age groups.

The subsistence minimum income, as defined by the Ministry of Labor, is the poverty threshold used in the Bank's report, "Poverty in Russia: An Assessment." It is preferred because it now has wide acceptance and usage among government agencies. The revised MOL methodology is consistent with earlier World Bank recommendations. This poverty line is not an absolute physiological minimum, however, in that significant numbers of Russians are living below 50% of the level.

While income dispersion has increased during the transition, households seem to be fairly evenly distributed around the poverty line. In other words, although the distribution has become much more unequal, households in the lower income brackets were not particularly concentrated around the poverty line in summer 1992 or summer 1993. This is revealed in the figures below:

**Sensitivity Analysis of Poverty Measures**

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<th>20% higher</th>
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<table>
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<tbody>
<tr>
<td>1992</td>
</tr>
<tr>
<td>1993</td>
</tr>
</tbody>
</table>

A subjective evaluation of the minimum income needed to keep an individual or family out of poverty leads to very different results about the extent of poverty. The Russian Center for Public Opinion Research (VCIOM) includes a block of questions on this topic as a part of its monthly, nationally representative public opinion surveys. Typically, the VCIOM survey includes at least these two queries: What minimum income does a person need to live normally? What income is necessary to provide for a minimum existence? The level of income estimated by respondents as necessary for a "minimum existence" significantly exceeds the official poverty line. In June 1994, the official per capita poverty line was 92,000 rubles while the VCIOM subjective poverty line was 194,000 rubles. The share of the population under this subjective line leaps to 88 percent.

The subjective poverty measure is not the only measure of poverty presented in the Russian press which exceeds the official poverty line. For example, some so called "poverty lines" include allowance for consumption of cigarettes, alcoholic beverages, and a "normalized" or "normal" rate of savings. These measures obviously do not define a common-sense minimum existence, as captured in the methodology of the official poverty line.
Risk of Poverty in Households with Selected Characteristics 1993 (percent)

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<th>Very poor*</th>
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<td>49.0</td>
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<td>≥ 3 children</td>
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<td>9.2</td>
</tr>
<tr>
<td>Has unemployed member</td>
<td>48.1</td>
<td>23.0</td>
</tr>
<tr>
<td>Has disabled member</td>
<td>45.8</td>
<td>20.0</td>
</tr>
<tr>
<td>Head works in:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Forestry</td>
<td>51.8</td>
<td>26.8</td>
</tr>
<tr>
<td>Agriculture</td>
<td>46.5</td>
<td>18.5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>32.6</td>
<td>10.2</td>
</tr>
<tr>
<td>Construction</td>
<td>32.0</td>
<td>9.9</td>
</tr>
<tr>
<td>Trade</td>
<td>21.6</td>
<td>6.5</td>
</tr>
<tr>
<td>National Average</td>
<td>31.9</td>
<td>12.0</td>
</tr>
</tbody>
</table>

*Very poor households are those with expenditures at less than 50 percent of the poverty line.

Poverty indicators focused earlier on income data, which are problematic, especially during high inflation, and relied on unrepresentative survey sources. The Russian Longitudinal Monitoring Survey (RLMS), an initiative jointly financed by Russia's Goskomstat, the World Bank, USAID, and the University of North Carolina, created a nationally representative data set that allows investigation of trends in household welfare. Individual and household expenditures are measured against the Russian government's official poverty line, redefined in 1992.

In Russia, as in other European transition countries, the working poor pre-dominate. About half of the poor live in households where the head of household is employed. The largest subgroup is composed of households with children, including in particular single-parent and young households: generally, the younger and more numerous the children, the more likely that the family is poor. Nearly 62 percent of families with three or more children under six years are poor. Single-parent households are much more likely to be poor than other types of families. More than 90 percent of such households are headed by women.

Unemployment is strongly linked with poverty. Unemployment benefits and income from informal jobs are often insufficient to raise recipient households out of poverty. Unemployment is still mainly short-term (averaging less than six months), but average duration is steadily increasing. Women figure disproportionately among the unemployed in the early stages of the transition, having borne the brunt of job losses as firms preferred laying off clerical and auxiliary workers first, the vast majority of whom are women.

Minimum pensions have frequently fallen below subsistence levels, due to high inflation and erratic indexing. Average pensions have tended to be better protected against inflation. About one-quarter of the elderly live alone, with little if any support from other family members, and with means hardly enough for obtaining basic goods and services. Pensioners represent a large (36 million) and growing share of the population.

The poor should not be thought of as a stagnant pool—a significant share of poor households rose above the poverty level during 1992-93, even while poverty was increasing overall. Nearly one-half of households that were very poor in summer 1992 were not considered as such a year later, while one-quarter of nonpoor households became poor over the same period. Since 1992 rural areas have become relatively worse off than cities, because subsidies to agriculture have been scaled back and local governments have been unable to take over the role of social provider from the crumbling collective farms. Regional differentiation of welfare indi-

![Day Dreaming](image)

"Believe it or not, I wouldn't mind paying some capital gains tax."

From the Hungarian magazine Hőcipő
The World Bank/PRDTE

cators dramatically increased in the period 1992-94: the ratio of per capita real income between the top (Magadan or Tyumen) and bottom (North Caucasus) oblasts rose from about 8 to 42. Coefficients of variation for life expectancy widened from 2.7 to 3.9, and for infant mortality from 18.4 to 20.4, over the same period.

Systemic Cracks

The introduction of market principles from 1991 onward has seriously undermined the social support system of the Soviet period (based on low, administered prices for food, rent, household utilities and other basic goods and services, along with the virtual guarantee of a job). The inherited structure of social benefits, comprising both social insurance (pensions and unemployment benefits) and social assistance programs (including family allowances), is not adequate to deal with the needs created by the transition. Social insurance is largely financed through payroll taxation and federal extrabudgetary funds, whereas social assistance is largely the responsibility of local authorities. Local authorities also finance and deliver the bulk of education and health services and subsidize housing and domestic utilities. Enterprises still provide a wide array of social benefits for their workers and local communities, encompassing housing, health care, and child care.

While the number of poor has increased, social assistance has become inadequate both in quantity and scope of benefits:
- Social expenditures relative to GDP, excluding utilities and housing, have so far remained more or less constant but output itself has declined significantly. Pensions, employment programs, and social assistance together amounted to 7.6 percent of GDP in 1994.
- Minimum benefits are low and often insufficient to lift poor families over the poverty threshold. Unemployment benefits average only some 15 percent of the average wage, and the minimum pension has been allowed to fall far below the level of minimum subsistence for elderly people.
  - Many poor households do not receive benefits at all (three in ten households are classified as very poor, and one in five as poor), yet almost four out of five nonpoor families receive public transfers. Even local social assistance benefits tend to accrue largely to nonpoor households.
  - There is no regular federal support to help equalize local authorities' poverty alleviation programs, thus poorer oblasts with the greatest needs have little available resources. Unemployment benefits are paid from regional employment funds, but these funds are being strained to the limit, because their source of major revenue, payroll taxes, is drying up while joblessness increases. Local fiscal burdens will increase further as state enterprises divest themselves of responsibilities for social services.

As a consequence, only 5 percent of Russians would rely primarily on government agencies if they were in need, whereas 42 percent would rely primarily on friends and family, according to a June 1994 opinion poll. About one in five households was a net recipient of private support, which averaged about 20 percent of the household's income. The recently emerged nongovernmental organization sector is rapidly becoming an important part of the social safety net, from Moscow to the Far East.

Implications for Policymakers

The transition from a command economy in Russia has taken place alongside increases in the scope and depth of poverty. Moreover, restructuring in such sectors as coal, chemicals, metallurgy, machine-building, and agriculture—will likely entail a significant number of layoffs, further increasing hardship. Thus, many people will likely be unable to generate incomes above the poverty line for some time.

The adverse effects of transition and the risk of severe chronic poverty strengthens the case for better-targeted assistance. A series of key changes would make social protection more cost-effective and affordable and help reduce poverty in the immediate future. The World Bank has proposed reforms to improve the efficiency of antipoverty programs, with the following elaborations:

· Adequate protection while avoiding welfare dependency. Revise minimum unemployment and pension benefits upward to a point where work is still attractive. Minimum unemployment benefits should be increased toward oblast minimum subsistence levels (from the present 20 percent to about 60 percent). The rules governing receipt of benefits should be tightened to exclude those with wage earnings, and benefits should be linked to training and job search support. Targeted temporary employment schemes should be expanded, possibly with federal support for high-unemployment regions. The minimum pension should be set at about the minimum subsistence level. To finance increased minimum benefit levels, pension adjustments to inflation could be shifted to a flat basis and pension eligibility could be tightened for pensioners with wage income.

· Strengthened targeting. A poverty benefit could be introduced, targeted at the very poor and sets at a level below the revised minimum pension and unemployment benefits. Such needs-based social assistance should be developed and implemented at the local level, underpinned by federal guidelines for targeting, and by federal financial support. (The only significant distinction between
the poor and the nonpoor for targeting purposes is income. Although poverty status is related to certain readily observable attributes, such as number of children, the correlation is not significant enough to support a comprehensive approach to poverty reduction.

Alongside the poverty benefit, a system of tax credits could be introduced for the working poor.

Address regional disparities. Federal allocations to reduce poverty could be based on per capita income in individual oblasts and on estimates of the poverty gap (resources required to elevate the income of the poor above the poverty line) in lack oblast. Federal grants preferably should be matched by local financing. The matching rate should vary across oblasts, depending on local fiscal capacity.

Increasing social spending targeted to the very poor would cost an estimated equivalent of 0.7 percent of GDP, including administrative costs and leakage to the nonpoor. Additional administrative costs would arise from targeting spending for employment schemes (about 0.4 percent of GDP), as well as raising unemployment benefits and minimum pensions. But these increases in efforts to reduce poverty would be affordable provided that the other cost savings, such as reduced housing and utility subsidies and cuts in overall pension spending, are also implemented. These measures would relieve subnational budgets of a significant and otherwise increasing fiscal burden, thereby creating greater scope for local financing of targeted social assistance.

The article is based on the author’s report, "Poverty in Russia: An Assessment," to order: Ms. Annie Minofu, room H3165, the World Bank, tel. (202) 473-6199.

Jeni Klugman is an economist in the Human Resources Division, Europe and Central Asia Department III, the World Bank.

Government Office Somewhere in Eastern Europe

"Boss, our popularity is on the rise. The people are constantly calling us names."

From the Hungarian magazine Hócipő
Letters to the Editor
Checklist for Action in the Russian Economy
by Michael D. Intriligator, with Robert McIntyre, Marshall Pomer, Dorothy J. Rosenberg, and Lance Taylor

1. The Russian federal government should play a major role in developing a modern, mixed economy, similar to those in France, Sweden, and the United States. Besides monetary and fiscal policies, it should formulate policies for investment, trade, competition, and technological development.

2. The government should engage in an expansionary economic policy, support enterprise restructuring, and implement trade and regulatory policies—policies that would attract foreign investors, bringing expertise and capital into the country. It should maintain tolerable control over inflation and balance of payments deficits to avoid recurrent stability crises. Judicious price and wage regulation would help assure relative price stability in a way that is consistent with overall growth, rather than relying entirely on monetary and fiscal policy. Export growth and access to foreign borrowing are essential to external balance. Restrictions on capital movements would help check capital flight and reduce trade imbalances. For a limited time import tariffs, quotas, or nontariff barriers might be introduced to support the establishment and expansion of domestic production. These policies should be accompanied by measures to prevent foreign loans from financing luxury consumer goods imports.

3. Agreements with the International Monetary Fund and the World Bank—formulations that have provided relatively little financial support to Russia, but have prevented active and expansionary macroeconomic and trade policies—should be renegotiated, and the restrictions lifted. The policies required by the IMF and World Bank were developed largely to deal with structural inflation in Latin America. (The policies have encountered problems there, as well, as seen in Mexico.) But the challenges facing Russia, is of a different nature. Russia needs to be able to engage in expansionary fiscal policy in dealing with inflation, and it should be able to control imports and capital flight.

The assistance of the international financial institutions can be more than made up for by limiting capital outflows. Foreign direct investment, pouring into a receptive and growing economy stimulated by expansionary policies, would easily offset the loss of international financial assistance.

4. Russia's legal system, including its laws, procedures, enforcement, and judiciary, should be reformed and modernized in such a way that it protects property, enforces contracts, and eliminates the criminal underworld. Enforcement agencies should be strengthened in terms of status, funding, personnel, and equipment. The authorities must take strong action to reverse and halt the growing criminalization of the Russian economy. Shock therapy has destroyed much of the structure of the old socialist economy, but it has failed to create the institutions necessary for a market economy. As a result, criminals have been able to create their own institutions.

5. The tax code should be fair, it should promote investment and the formation of new enterprises, and it should be enforced effectively. A well-funded streamlined tax system would encourage compliance and put government finances on a more stable footing, thus reducing inflation and accelerating economic growth. Tax revenues should be fairly distributed to provide sources for both public investment and the provision of social services.

6. The banks should lend working capital to their client enterprises, as commercial banks do, or they should operate as investment banks, instead of being short-term investment pools, as most are today. If necessary, the government should set up its own banking institutions. (During the Great Depression in the 1930s, the U.S. Government set up the Reconstruction Finance Corporation to replace failed banks. State development banks have also been a key part of successful industrial policy in South Korea and other countries.) The government should also set up, or encourage an interenterprise payments mechanism to prevent a further arrears crisis and to avoid the various inefficient forms of barter payment that firms now use to survive.

7. Federal and local governments should work together to set up market institutions, including codified property rights modern systems in accounting and finance; advertising; insurance; and development of labor, capital, energy, and other input markets. They should also provide performance-based support to private and state-owned enterprises—with performance criteria including investment, exports, job creation, growth, and productivity. Privatizing state enter
prises has resulted in private, unregulated monopolies, and asset stripping and price gouging are prevalent. The government should regulate monopolies or break them up, if necessary. It should also provide appropriate resources to support the training of managers.

8. The government should revitalize the agricultural sector, through limiting food imports and temporarily providing fuel and fertilizer subsidies. Only those collective farms whose members specifically agree on the redistribution of assets should be disbanded. The ultimate goal should be a mixed agricultural system, which should include the surviving collective and state farms.

9. Governments at both the federal and the local level should assume social responsibilities that were previously assumed by state-owned enterprises. A social security system could make up for the pensions lost as state-owned enterprises collapsed and for the private savings eaten up by inflation. (In the United States, during the 1930's, the Social Security system replaced lost corporate pensions and failed private pension plans.) The poverty issue must also be addressed because more and more people are sinking into absolute poverty, including pensioners, displaced workers, and military personnel. Job creation for displaced workers is a major government responsibility. (In the United States the Works Progress Administration was established during the 1930s to provide public work for the unemployed.)

10. The government should rebuild the health system to reverse the trend of deterioration. The steady loss of highly qualified specialists and the continuous deterioration of health facilities and supplies should be halted. Similarly, programs are needed to address the environmental catastrophe facing Russia. Ecological devastation will increase health hazards and further erode Russia's natural resources.

11. The government should support the educational system, which is declining as teachers and administrators, under financial pressure, seek other careers and as facilities decay. Rebuilding educational assets, human and physical, would have a substantial payback over time. Similarly, scientific and technological research should be revitalized through renewed government support to prevent the loss of talent. These skilled professionals are capable of turning out products that are competitive in worldwide markets, so they should be encouraged and helped to participate in the market economy.

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Dmitri Tulin of the IMF and John Nellis of the World Bank comment on the "Checklist for Action in the Russian Economy."

The IMF and the World Bank Prevents What?
by Dmitri Tulin

The policy measures proposed in the Checklist for Action in the Russian Economy, can in no way be regarded as a direct alternative to the recommendations made by the International Monetary Fund. A major part of the proposed actions, especially those having to do with structural policy and social security safety net, would undoubtedly win the unanimous support of the Fund's Board. Furthermore, similar measures (although in an abridged version, since the Fund is not specialized in such policy issues) are traditionally recommended by the Fund to its program countries, including Russia.

It is common knowledge that financial stabilization policies in transition economies may not be sustainable unless they are supported by adequate structural and social policies, and unless the transformation of the legal and institutional frameworks of the society has kept pace with the rising austerity on the fiscal and monetary sides. It is likewise understood that disinflation by itself—however important this policy objective might be—does not necessarily guarantee sustainable economic growth and prosperity, if not accompanied by a number of other factors and policy actions.

Opinions at the IMF would be split on some of the actions suggested by Mr. Intriligator, such as direct administrative control of commodity prices and wages, the foreign trade regulations, and the foreign exchange restrictions. Nonetheless, the Fund has never been excessively aggressive or obstructive in imposing its views on a member country if the country has proved its ability to succeed in disinflationary efforts while preserving some of its unique policy features.

There is, at least, one point on which the Fund would strongly and unanimously
disagree with authors of the "Checklist," namely, on the allegation that the agreements with the IMF and the World Bank "have prevented active and expansionary macroeconomic policies" and, thus, "should be renegotiated and the restrictions lifted" (point 3 of the Checklist). The latter statement by Mr. Intriligator is too general and is too poorly supported by facts to require a detailed critical analysis. Nonetheless, the Fund has a number of weighty arguments with which to challenge the author's assumptions.

First, prudent and well-balanced monetary and fiscal policies do not prevent healthy economic growth, at least, not in the medium-term perspective. Conversely, we have all witnessed an explicit positive correlation between the strength of stabilization programs and the general economic performance of economies in transition.

Second, in it programs with the IMF, Russia was given full discretion in the selection of "active" or less active macroeconomic, trade, and investment policies. Moreover, the Russian authorities followed much of Mr. Intriligator's advice, putting in place active trade and foreign exchange controls and restrictions, desperately fighting capital outflows, selectively applying administrative control on prices and wages, inviting foreign investment, subsidizing the agricultural sector, and trying as much as possible to secure the existence of collective and state farms.

Third, Russia has failed so far to accomplish any of the stabilization programs agreed with the Fund, which places the Fund's critics in an awkward tactical position, since in such a case any unbiased observer would be inclined to attribute Russia's unsatisfactory economic performance to noncompliance with the Fund's policy recommendations, rather than to the deficiencies of these recommendations.

Finally, the author's comparison of the size of the multilateral financial assistance to Russia with possible capital inflows—given the establishment of better economic policies—does not seem fully relevant and free of contradictions. It might seem that the author opposes Russia's reliance on the Fund for external financing and favors instead the alternative source of private capital inflows. But in reality, the resources of the Fund and the World Bank can never be substitutes for funds from capital markets. Although, arrangements with the IMF do provide member countries with access to Fund resources, a more important benefit is improvement in their international credit ratings. The IMF and the World Bank are recognized world-wide as "rating" agencies and catalysts for capital markets. It is probably for this reason—in acknowledgment of the role the Fund and the World Bank play in the markets—that the author urges Russia to "renegotiate," but not to break, its arrangements with the multilateral financial institutions.

Mr. Tulin is Executive Director in the IMF Russian Office.

**Dangers of Dirigisme**

by John Nellis

No one should be pleased with the route, the pace, or the social consequences of transition in Russia. Stabilization has not yet been achieved. Production has plummeted. Living standards have fallen; average incomes are estimated to have declined by 43 percent from 1991 to 1993 alone. A recent calculation puts a third of the population below a poverty line. Inequity is rising. Diseases previously controlled have resurfaced. Life expectancy is reported to have slipped by an astonishing six or seven years since 1989 (though this involves many non-economic factors). These are exceedingly grim, facts and numbers. Thus, it is not surprising—indeed, it is welcome—that concerned observers conclude that the present state of affairs is intolerable, and ask yet again, what is to be done? The question is perfectly legitimate. The problem with the "Checklist" is the answer, which in every case is, "the government should...."

What is it that the government of Russia is being asked to do? It must change, say the authors, it must take a more active and direct role in the economy. Government should intervene more, both to create and nourish the policies, institutions, and firms that contribute to economic growth, and to suppress those activities that detract from it. In part, what is suggested is sensible in the extreme: Government should do more to impose macroeconomic stability and enforce public order; it should seek to enhance competition, increase the stability of the business environment, and encourage foreign investment. Well and good—though the details of precisely how one goes about this are lacking.

The sticking point, however, is the many instances where the Checklist's recommended interventions go far beyond macrostability and public order questions, and espouse a pervasive governmental role in just about all aspects of the economy. The Checklist calls for price and wage regulation, restrictions on capital movements, protection of fledgling domestic industries, expansionary fiscal policy, the setting up of development banks, direct state financial sup-
port to public and private enterprises, limiting food imports, and providing fuel and fertilizer subsidies. These and a number of similar actions proposed, say the authors, will lead to the creation of a "modern mixed economy." These tasks are in addition to the exhortation to government to modernize the legal system, eliminate the criminal underworld, and set right the banks, the tax code and collection procedures, the subnational governments, and the health and the education systems.

Would that it could all be done. Would that it could all be done quickly. And would that it could all be done by government.

But the sad fact of the matter is that if it could all be done quickly by government, then socialism would have worked, and Russia would not be in its present sorry situation. The authors of the Checklist certainly do not see it that way; they assert that it was "shock therapy that destroyed the institutions of a socialist economy." They recommend in response an approach based on the implicit assumption that "government" is a neutral, competent defender of the public interest, possessed of a long-term perspective. I believe the authors are fundamentally wrong on both counts. It was the contradictions—to borrow a second term—and inefficiencies of the Soviet system of planning that set in motion the demise of Gosplan, the CPSU, the KGB, and the other institutions of socialism, well in advance of any economic shock therapy program. More to the point, the Russian government simply does not have the resources, the capacity, or the motivation to undertake the daunting array of intensive and expensive interventions called for.

Even if government could undertake the recommended actions, why should one believe that wage and price controls will be "reasonable," that protection for fledgling industries (the most troubled of which, by the way, have been in existence for decades) will be "temporary," that directed credits will be "performance-based?" The experience of many if not most other countries that have attempted these interventionist methods has shown that the approach works rarely, with successes being partial and attributable as much to structural circumstances as to chosen instruments. There are any number of instances where interventions, no matter how well-intended, have provided rents for the few at the expense of the many, and to the clear detriment of economic growth.

The authors' answer is that Russian circumstances "are of a different nature" than those prevailing elsewhere, so external experience, at least of the negative sort, cannot be used as a guide—but why this is the case is not explained.

So then, is nothing to be done? Should one assume that what the Russian government is presently doing is either optimal or not likely to be improved? Clearly not; there is much that government can and should change, along the lines advocated in the Checklist, in terms of imposing stability, both economic and social, and laying the foundations of the legal basis for capitalism. But many other desirable government actions are withdrawals from, rather than additions to existing activity. For example, a recent survey of 439 Russian firms (reported on in the July-August Transition) showed that government presently allocates much of its aid to industry to firms that have both large numbers of workers and large losses. The Checklist authors would, presumably, agree that keeping large loss-makers alive was precisely the wrong approach, and recommend that the resources be shifted to assist firms with high potential. They might argue that this latter policy has been seen to work in several Asian countries, which have used targeted, performance-based subsidies and directed credit to further industrial development. There, government intervention has been associated with beneficial outcomes.

However, the "conditions for effective intervention" are numerous and stringent. To borrow a few lines from Adam Schwarz's article published in the Far Eastern Economic Review (August 24, 1995; p. 42), who is evaluating a new volume (edited by Andrew McIntyre), Business and Government in Industrializing Asia, (published by Allen & Unwin, 1995), these conditions include:

- A strong state able to resist social and personal pressures.
- A disciplined and relatively noncorrupt bureaucracy capable of implementing government policies effectively.
- A stress on export promotion and international competitiveness.
- Institutions that allow government and business to communicate.
- Stable and prudent macroeconomic policies.
- Strict reliance on economic criteria in selecting particular forms of intervention.
- A relatively limited role for foreign direct investment.

Russia does not presently meet these conditions.

My fear is that were Russia to adopt an approach that requires institutional capacity that it does not yet possess, the likely outcome would not be an economic turnaround, but rather the entrenchment of rent-seeking, anti-market forces, further sub-optimization of growth, and the prolongation of misery. Russia should certainly be attempting to put in place the institutional base for a
strong and competent, market-promoting state, and Russian economic policies will certainly from time to time deviate from the pure market model—perhaps now and then to quite good effect. But for Russia to adopt this panoply of interventionist methods would do more harm than good. Some years ago, Jeffrey Sachs said words to the effect that the event to fear most in postcommunist countries was not a return to central planning—a most unlikely occurrence—but rather slippage into Third World dirigisme of the type practiced in Argentina until so recently. I fear this would be the likely outcome of Russia adopting the recommendations of the Checklist.

John Nellis is Senior Manager in the World Bank's Private Sector Development Department, working this year on the 1996 World Development Report.

We Have Our Own Mafias
by Cyril Appleton

Once again (Transition, no. 5-6, 1995), your contributors ascribe unmerited virtues to Western economies. This time they have failed to recognize that the collapse of a state command economy will inevitably result in a market command economy simply because the structure is still in place for the political creatures of an unregulated market to occupy.

Corruption, fraud, theft, misappropriation, and violence continue to be contributors to the scene as manifestations of the driving force of unregulated markets, human greed. There is no other honest way of describing the accepted guiding principle of "maximizing profit." The same thing applies, of course, after revolutions in the opposite direction.

It would also be a hopeful sign if the practical differences between a planned economy, ordered markets and unregulated markets were recognized. To use a boxing analogy, the first is a contest having one man with his hand tied behind his back, the second is a bout under the Queensberry Rules, while the third is a combat with one contestant wearing iron-spiked gloves—not an unreasonable description of transnational corporations and their tame governments hammering the poverty-stricken peasantry and exploiting child labor.

The banner chapter heading for the heroic figure facing down the dreaded Russian Mafiya would have been awe-inspiring had not shadows been cast by the western Mafiya, assorted drug barons, and vice kings laughing in the background. Perhaps they were reflecting upon the different responses made by the Western establishment to Iraq's threat to Kuwaiti and Saudi oil supplies and to the murder, rape, and pillage that have drenched Yugoslav soil with innocent blood.

The author is Trustee, CADET Development Centre Whitstable, Kent, UK.

Do Not Neglect Economies East Of Urals
by Richard Pomfret

Your report (Transition, May 1995) on the contributions to the Annual Bank Conference suggests a Eurocentric view of transition. The reform process began in China a decade and a half ago, and the Chinese and Vietnamese economies have been growing for some time, the former spectacularly so. Ignoring the Asian transition economies is even less justified when their populations are considered; China dwarfs all other transition economies, but also the three Indochina countries contain more people than the nine countries spotlighted [during the conference].

Both Eastern Europeans and East Asians have a tendency to consider their own cases special, with little to be learned from the other group. Maybe that is correct, but surely it is the role of the multilateral institutions to question that nationalistic reaction. The past record of both the Bank and the Fund rests precisely on drawing general economic lessons that can be applied, with modifications, across diverse countries; the old Third World was at least as varied as the formerly centrally planned economies are today, so now is not the time to abandon the global approach in favor of a narrowly regional view of comparability.

Especially as the 1996 theme of the influential World Development Report will be the transition process, it is to be
Transition

hoped that the analysis will not be restricted to the subset of transition economies west of the Urals.

Announcement:

The International Centre for Privatization, Investment, and Management in Kiev publishes a Russian version of our "Transition" newsletter. If you wish to subscribe please write to 20, Ezhena Pottier Street, 252057 Kiev, Ukraine, tel. (044) 230-2624, fax (044) 446-8277.

Quotation of the Month: "The IMF's Role in the Transition Has Come under Increasing Scrutiny"

The Economist Intelligence Unit Introduces Aggregate Policy Indicators

O
of all the international financial institutions involved in theseconomies in transition, the International Monetary Fund (IMF) has been the most significant, both because of the amount of financing that has been made available ($15 billion disbursed to the region since 1990) and because of the conditionalities that have shaped policies, especially at the initial stages following the collapse of communism.

The IMF's importance derived from the crucial role of general-purpose funding, again especially at the initial stages of the transition, to absorb the impact of economic liberalization on the external balance and to at least mitigate the deterioration of living standards. The IMF has also been closely involved in debt restructuring undertaken by a number of countries in the region. Finally, the IMF sometimes fulfilled a useful political role familiar from developing country experience—as a convenient scapegoat, or lightning rod, for governments that had to sell the need for harsh policies to restive domestic constituencies.

It would be an exaggeration to attribute to the IMF a decisive causal role in stimulating change. The commitment to the transformation sprang from the internal processes in the transition economies, and above all from the failure of central planning and of models of limited market (socialist) reform. Nonetheless, it could be equally misleading to underestimate the role of the Fund in influencing the policy mix, the intensity of particular policies, and their sequencing.

Because of the economies' acute need for outside support and the catalytic role of an IMF imprimatur in generating funding from other institutions and from Western governments, the IMF has had considerable leverage in dealing with most of the region's governments, although the east European regimes' general commitment to change represented a propitious circumstance for cooperative relations between governments and the Fund.

Price liberalization was the cornerstone of the reformist model. The freeing of prices was a sine qua non for the move toward a market economy. Freed-up prices would signal producers on what output to produce and what inputs to purchase. Incentives to enterprises would come from sharply reduced subsidies, tightened financial discipline (and dear credits), and competitive pressures following the liberalization of foreign trade. Access to imports and incentives to export would be enhanced by a liberalized foreign exchange regime.

Price and trade liberalization were complemented by elements of a standard IMF demand management package, designed to deal with inherited macroeconomic imbalances, and to contain the adverse impact of the reform-induced price shocks. This included subsidy cuts, controlling domestic credit expansion, interest rate hikes, and usually, but not always, devaluing the currency.

The increasing involvement of the IMF in the region, with signing of various arrangements occurring almost monthly, has meant that the Fund's role in the transition has come under increasing scrutiny. On the one hand, the IMF has been criticized for straying too far outside of its area of expertise, by focusing on policies such as privatization and institutional change. The opposite, more frequent criticism has been that it has not done so sufficiently—that the specific circumstances of the transition economies would have required an even greater emphasis on the microeconomics of the supply side of the economy (as opposed to the standard demand management package), which determines the effectiveness of available policy instruments. It has now been acknowledged even by IMF staff members that the early period of Fund involvement in the region was accompanied by a series of unexpected developments: output decline was much deeper and more prolonged than had been expected, fiscal...
balance was much more difficult to achieve than had been thought, and inflation was higher than predicted.

Five years into the transition, there is now a considerable body of evidence available that allows a more rigorous evaluation of the IMF’s impact on the performance of the region’s economies. The main difficulties in evaluating the impact of IMF policies will be:

- To assess what would have occurred in the absence of an IMF program. It is clearly misconceived to ascribe developments to the IMF if it can be argued or demonstrated that the events in question would have occurred anyway—for example, an upsurge in inflation or an external shock precipitating a contraction in income. (This means that any investigation of IMF policies must allow for something that roughly approaches a controlled environment—usually a comparison with countries affected by similar external variables that did not have IMF programs.)
- To identify to what extent countries comply with IMF conditions. If compliance for one reason or another is low, events cannot be attributed to IMF influence.

There are two ways to measure compliance:

- Directly, by comparing IMF-agreed macroeconomic policy targets with actual policies where such information is available.
- Indirectly, by evaluating the extent to which actual policies conform to an "IMF-type" policy mix. The indirect method relies on the construction of a synthetic or aggregate policy indicator that takes into account exchange rate policy, the real interest rate, monetary expansion relative to consumer price growth, the budget, real wage growth, and the share of general government expenditure in GDP. Policies are simply assigned scores of 1 or 0, according to whether they are in the "orthodox" direction, that is, in accord with IMF precepts. For example, real wage growth is compared with productivity growth, fiscal policy is scored according to whether there is a year-to-year improvement in the fiscal balance by at least 2 percentage points of GDP, government expenditure is evaluated according to whether there is a decline in its share of GDP.

### Aggregate Policy Indicator of the Economist Intelligence Unit

(average policy scores out of a maximum of 6; for 1990-94 unless otherwise indicated)

<table>
<thead>
<tr>
<th>Country</th>
<th>Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Slovakia (1993-94)</td>
<td>4.5</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>4.2</td>
</tr>
<tr>
<td>Czechoslovakia (1990-92)</td>
<td>4.0</td>
</tr>
<tr>
<td>Lithuania (1992-94)</td>
<td>4.0</td>
</tr>
<tr>
<td>Poland</td>
<td>3.6</td>
</tr>
<tr>
<td>Romania</td>
<td>3.6</td>
</tr>
<tr>
<td>Czech Republic (1993-94)</td>
<td>3.0</td>
</tr>
<tr>
<td>Estonia (1992-94)</td>
<td>2.7</td>
</tr>
<tr>
<td>Hungary</td>
<td>2.4</td>
</tr>
<tr>
<td>Slovenia (1991-94)</td>
<td>2.3</td>
</tr>
<tr>
<td>Latvia (1992-94)</td>
<td>1.7</td>
</tr>
</tbody>
</table>

Note: Scores are for 1990-94 unless otherwise indicated.

**Source:** Economist Intelligence Unit.

Two findings stand out:

- The aggregate policy indicator (derived by simply summing the components) is not significantly related to whether a country had an IMF program in place or not. Part of the weak correlation could result from our failure to distinguish between higher conditionality facilities, such as standby arrangements, and softer Systemic Transformation Facility (STF) loans.
- Some of the countries that are associated with having virtuous policies do not score consistently well on the indicator (for example, Poland in 1991, 1992, and 1994; the Czech Republic in 1993; Slovenia, Estonia, and Latvia since 1992), while perceived slouches such as Bulgaria, Slovakia, and even Romania, score comparatively high on the orthodoxy scale. (An orthodox policy approach, which in some developing countries has been maintained for years, has rarely been sustained in two successive years in any country in this region).

In countries of Central and Eastern Europe, inflation has been falling, current account deficits are now mostly under control (with notable exceptions such as Hungary), and a fragile recovery is under way. The IMF has become concerned that complacency should not set in after initial successes and has seized on the opportunity provided by economic recovery and favorable external conditions to press hard for ambitious financial and fiscal targets to be met, for faster progress in institutional reform, and for further price liberalization, especially in the energy sector. The IMF has stated that the region's priority now is to "maintain tight macropolicy, possibly supported by wages and exchange rate policies."

**Conclusions:**

- Countries find it difficult to sustain orthodox policies. Unlike the experience in some developing countries, where virtuous policies have been sustained for long periods (or have even become the norm), in the transition countries pressures for a relaxation arose without exception.
- The relationship between growth and IMF involvement was significantly negative in the early reform years and positive in later years, according to the empirical investigation of performance in Central and Eastern Europe. There was an indeterminate impact on inflation and a positive effect on the current account. Orthodox policy, measured by an aggregate policy indicator and only weakly related to the IMF’s presence, is shown to have had a significantly positive effect on inflation.
- The failure rate of early programs at the start of reform was generally high.
However, the chances of success pick up significantly in later transition years, as both the IMF and the East European governments move up their learning curves. Furthermore, at least some of the institutional changes creating an environment more conducive to the success of orthodox policies are likely to have taken place after several years of experience with a market economy.

In an environment of exogenous shocks such as the breakup of federations and regional trading areas, and the sharp terms of trade losses, the application of the standard medicine may not yield the desired results.

Trade Performance Depends on Bold Reform
by Bartlomiej Kaminski, Zhen Kun Wang, and L. Alan Winters

Despite a common legacy of central planning, transition economies have differed widely in their foreign trade performances. With the dissolution of the communist trading system (CMEA) and the demise of the Soviet Union, intraregional trade declined dramatically. Attempts to reorient trade relations have succeeded in varying degree. The countries that have advanced the most in their economic transition—stabilizing their economies, liberalizing prices, redirecting foreign trade, and liberalizing exchange rate regimes—have been the ones that have had the greatest success in improving their export performance, and in reorienting their foreign trade in line with comparative advantages.

Ranking Trade Performers

This conclusion is drawn from an export performance index, based on 1989-93 data in twenty-one transition countries: Bulgaria, the Czech Republic, Hungary, Poland, Romania, and Slovakia, and the fifteen states of the FSU. The index consists of four indicators:

- Change in total exports.
- Change in the share of CMEA (for the Central and East European countries) or intrastate trade (for the countries of the former Soviet Union) in total exports.
- Increase in manufactured exports to OECD countries.
- Ratio of OECD-oriented manufactured exports to GDP.

The indicators reflect different dimensions of performance and, when combined, offers a relevant picture of export reorientation. Countries are ranked according to the four criteria (see table). "Good" export performers, among them Poland, Hungary, the Czech Republic, and the Baltic countries, recorded a substantial reorientation on their trade (the share of CMEA or interstate exports in total trade fell by an average of more than one third) and, measured against GDP, produced a significantly large share (on average, around 14 percent) of OECD-oriented manufactured exports. Early predictions that primary commodities or simple manufactured goods would be the only source of export expansion for transition economies, even for the good export performers, proved only partly true: labor-intensive manufactures, especially footwear and clothing, accounted for the bulk of export growth, although capital-intensive manufactures also figured in the increase.

In several countries of the former Soviet Union, foreign trade regimes retained major traits of earlier central planning, including the application of either direct export controls (as well as foreign exchange surrender requirements), or indirect export taxes. Import regimes appeared to be liberalized, but in many cases administrative controls and foreign exchange allocation hampered imports and helped shield domestic producers from international competition. These implicitly protective policies worked against timely restructuring and adjustment, lessened exports earnings, encouraged capital flight, and fostered corruption and rent-seeking.

The countries that applied market-based foreign trade regimes have also liberalized domestic prices. Those that failed to move in this direction usually retained control over an important array of prices. Such administrative controls kept domestic prices of tradable goods below world market prices, thus creating a strong incentive to divert the goods from domestic to international markets. This then legitimized export controls over these goods and impeded genuine trade liberalization.

Market-based foreign trade regimes and credible stabilization policies usually also work in tandem. Persistent expectations of macroeconomic disequilibria can discredit a domestic currency and encourage hoarding of hard currency. Both macroeconomic disequilibria and export restraints tend to further depreciate an already undervalued domestic currency, and thus to further reduce opportunities to import high quality inputs and consumer goods from abroad. They deplete international reserves and

make current account convertibility a remote possibility.

**Doubts and Assurances**

Critics who have questioned that progress in transition would improve foreign trade performance have usually advanced the following arguments:

1. Inherited dependence on interrepublic or CMEA trade would preclude domestic producers from expanding exports. But: Inherited levels of trade distortions have not had a decisive impact on countries' ability to reorient their trade. Estonia and Latvia, for example, have made great strides in reorienting their trade despite their exceptionally high level of integration into the Soviet economy.

2. Opening up the economy would destroy domestic production. But: Competition from imports has not devastated the economies of good export performers. In the early stages of stabilization programs, the pressure of competition was weakened by undervalued domestic currencies and in the later stages, fears that rapid real appreciation would curtail export growth and boost imports to unsustainable levels, therefore undercutting import-competitive industries, did not materialize. Nor did export growth nor domestic industrial output suffer unduly. The availability of imports stimulated efficiency and helped sustain export expansion.

3. The improved foreign trade performance of Central and East European countries was only the result of preferential market access. But: Market access was improved for all such countries, so the removal of discriminatory measures in OECD markets cannot explain the varying pace of

### Export Performance and Trade Regimes

<table>
<thead>
<tr>
<th>Country</th>
<th>Change in share of CME (1989-93)</th>
<th>OECD-oriented manufactured exports as a share of GDP, 1990-92</th>
<th>Exports of manufactured goods 1993, 1991=100 for CEECs; 1990=100 for Poland</th>
<th>State trading 1989=100 for 1993</th>
<th>Export controls introduced</th>
<th>Year CPI increase</th>
<th>Inflation: Did current account convertibility introduced during at least two consecutive years?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GOOD EXPORT PERFORMERS</strong></td>
<td>-38</td>
<td>14</td>
<td>208 very small No 1991 No</td>
<td>1993</td>
<td>Extensive Yes limited-1993 Yes</td>
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<td>Former Czechoslovakia</td>
<td>-41</td>
<td>23.7</td>
<td>208 very small No 1991 No</td>
<td>1993</td>
<td>Extensive Yes limited-1993 Yes</td>
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<td>-63</td>
<td>11.9</td>
<td>233 very small No 1990 No</td>
<td>1994</td>
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<td></td>
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<tr>
<td>Hungary</td>
<td>-44</td>
<td>17.8</td>
<td>179 very small No 1991 No</td>
<td>1994</td>
<td>Extensive Yes limited-1993 Yes</td>
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<td>-23</td>
<td>13.6</td>
<td>155 very small No 1992 No</td>
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<td>18.4</td>
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<td>1994</td>
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<td>1994</td>
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<td>187 very small No 1993 No</td>
<td>1994</td>
<td>Extensive Yes limited-1993 Yes</td>
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<tr>
<td><strong>AVERAGE</strong></td>
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<td>14ăr 208 very small No 1991 No</td>
<td>1993</td>
<td>Extensive Yes limited-1993 Yes</td>
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<td><strong>POOR EXPORT PERFORMERS</strong></td>
<td>-13</td>
<td>3</td>
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<td>3.8</td>
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<td>-21</td>
<td>3.1</td>
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<td>-11</td>
<td>2.0</td>
<td>314 extensive Yes No 1993 Yes</td>
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<td>-6</td>
<td>1.8</td>
<td>224 moderate Yes No 1993 Yes</td>
<td>1993</td>
<td>Extensive Yes limited-1993 Yes</td>
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<td>Russia</td>
<td>-18</td>
<td>7.7</td>
<td>89 moderate Yes No 1993 Yes</td>
<td>1993</td>
<td>Extensive Yes limited-1993 Yes</td>
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<td>Belarus</td>
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<td>1.3</td>
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<td>Extensive Yes limited-1993 Yes</td>
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<td>0.5</td>
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<td>1993</td>
<td>Extensive Yes limited-1993 Yes</td>
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<td>Moldova</td>
<td>-6</td>
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<td>426 extensive Yes No 1993 Yes</td>
<td>1993</td>
<td>Extensive Yes limited-1993 Yes</td>
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<tr>
<td>Azerbaijan</td>
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<td>1.6</td>
<td>176 extensive Yes No 1993 Yes</td>
<td>1993</td>
<td>Extensive Yes limited-1993 Yes</td>
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<tr>
<td>Armenia</td>
<td>-2</td>
<td>0.2</td>
<td>26 extensive Yes No 1993 Yes</td>
<td>1993</td>
<td>Extensive Yes limited-1993 Yes</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

the trade reorientation. Slow and vacillating reformers were incapable of using this advantage.

4. Liberalizing international trade should be preceded by privatization and domestic liberalization. But: If budget constraints for state-owned enterprises are significantly hardened, then in the short run at least privatization is not necessary for strong export performance. In the long run, however, privatization, liberalization, and realistic exchange rates are crucial to assure an efficient response to improved market signals.

Conclusions

To sum up, those countries that liberalized prices quickly, cut subsidies, and dismantled state trading systems, and then stayed on their reform course, generally became good export performers. Liberal import regimes often disguise extensive export controls designed to keep subsidized products at home, while artificially undervalued domestic currencies effectively insulate domestic producers and consumers from international markets. It is extremely important to open up the economy to international market forces during the initial stages of transition. But it is also true that trade reforms also important for exporting success, but they are largely ineffective without macroeconomic stabilization, price liberalization, proper exchange rates, and wide-ranging enterprise reform, but to do effectively requires action on a broad front.

Electricity Consumption and Output Decline—An Update
by Istvan Dobozi

Our recent article (I. Dobozi and G. Pohl, "Real Output Decline in Transition Economies—Forget GDP, Try Power Consumption Data!," Transition, vol. 6, no. 1-2, p. 17) has provoked considerable response and demand for an update. Our updated statistics on power consumption confirm the earlier findings (see table).

To recapitulate our assertions, electricity consumption is a suitable proxy for guesstimating real output trends in Eastern Europe's transition economies (with the possible exception of the Czech Republic where official output statistics grossly undervalue the booming service sector). In these countries for the past five years of economic restructuring, the average, cumulative decline in power consumption closely matches the drop in GDP, yielding an electricity-GDP elasticity of about 1 (meaning that a 1 percent GDP fall produced about 1 percent drop in electricity consumption). Even in those East European countries where the economic structure and product lines changed drastically, as in Poland, the correlation between power use and economic activity remained fairly close.

In most FSU countries, however, the reported output declines are completely inconsistent with the power consumption trends; thus, the reliability of official statistics has to be seriously questioned. The gap between increasing electricity consumption and falling GDP can only be explained by gross underreporting of GDP. In the period between 1989 and 1994, output downturn in Russia and Ukraine may have been inflated by more than twofold, in Azerbaijan by as much as threefold, and in Georgia, Kazakhstan, Latvia, and Moldova by 50 to 90 percent.

Factors distorting official statistics include:
• Widespread underreporting of output in order to avoid high taxes.
• Overrepresentation of large state-owned industrial enterprises that are undergoing major retrenchment.
• Shortcomings of data collection in capturing ever increasing private activities

Although our article was generally welcomed as being on the right track, to obtain more reliable—and certainly low-cost—estimates of the extent of output retrenchment during the systemic transition, some skeptics argued that while power consumption and economic activity tend to move in tandem in market economies, it may not be relevant for
### Milestones of Transition

Cuba's GDP has declined by 34.3 percent since 1989, with the steepest decline taking place after the breakup of the Soviet Union in 1991, according to statistics published in Gramma. The data showed a 0.7 percent rise in GDP in 1994. Fidel Castro, in a state-of-the-nation speech, said Cuba will avoid the former Soviet Union's "disastrous" embrace of capitalism and follow instead the example of China and Viet Nam by combining socialism with gradual economic reforms.

Romania's government in mid-August published a list of 3,907 state-owned enterprises it hopes to sell in a new wave of privatization. Nearly 25 percent of the firms on offer were loss-makers, and some were virtually bankrupt. Iacob Zelenco, the head of the National Privatization Agency, claimed that most of the loss-making firms faced minimal or temporary financial difficulties. Romania's Parliament in June adopted a law to speed up privatization of nearly 6,200 state enterprises, based on a coupon system. Distribution of the nominative coupons started on August 1. Romanians may trade the coupons for 60 percent of the shares in 3,000 state-owned companies; foreign and domestic investors may buy the remaining 40 percent for cash.

Czech Prime Minister Vaclav Klaus forecast the country's economy would grow 4.4 percent next year after a growth rate of 4.0 percent in 1995. Industrial production grew by 7.7 percent in the first six months of this year, compared with the same period in 1994.) In its deliberations over the election-year 1996 budget, according to Klaus in a statement on August 30, the cabinet began debate on a proposed balanced budget of 588 billion crowns ($21.8 billion) next year, up from 412 billion ($15.3 billion) in 1995. The budget assumed annual inflation of 9.3 percent in 1996. That would be down from year-on-year inflation of 9.7 percent in July. Klaus said the proposed budget includes increases of 18 percent for the Interior Ministry and 15.5 percent for education, the two biggest areas of growth. Most of the money will be used to increase state employee wages in these sectors. The Czech cabinet has approved three consecutive balanced budgets since becoming an independent state.
for school, rail, and health workers. All three categories of workers had threatened to strike or take other industrial action if their demands for higher wages were not met. (Although the average monthly wage in the Czech Republic is $274, teachers' average pay, for example, is only $263.) The extra wages will be financed from the state budget surplus, which stood at 10.1 billion koruny at the end of July. The government originally awarded public sector employees a 10 percent raise, but they demanded further increases.

The Czech government has agreed to subsidize home mortgages, paying 4 percent of the loan rate in the first year of the state-run program, and 3 percent in the following years. The government expects to spend about $5.78 million on the mortgage subsidies program in the first year. First-time home buyers without existing fixed assets will be able to qualify for loans. Parliament earlier this year passed legislation setting up a long-term mortgage bond market. Czech banks have projected unsubsidized mortgage loans, on 20-year credit, at annual rates ranging from 9.75 to more than 14 percent. (Government directives will be published in September.)

Hard currency reserves held by the Czech National Bank amounted to $10.1 billion as of August 1. The total reserves in the Czech banking system were $12.6 billion, representing a modest rise in the past few weeks.

Slovak exports in the first half of 1995 rose 22.2 percent to 123.95 billion koruny. The biggest share of exports went to the Czech Republic (35.8 percent), followed by Germany (18.9 percent), Italy (4.8 percent), Austria (4.7 percent), Hungary (4.5 percent), Poland (4.0 percent), and Russia (3.3 percent). The share of exports to EU member countries reached 37.7 percent. Meanwhile, imports totaled 125 billion koruny, bringing Slovakia's six-month trade deficit to 1.1 billion koruny.

China will allocate more development projects and funds to provinces in central and western China, asserted Vice-Premier Zou Jiayhua following a five-day inspection tour in the remote Qinghai. While provinces along the eastern seaboard will continue to strengthen economically the Midwest provinces will have priority in obtaining low-interest loans from the international financial institutions.

Growth of the Chinese economy during the eighth five-year plan (1991-95) is projected at an annual 11.7 percent, or 3 to 4 percent higher than targeted, and nearly 4 percent higher than in the previous five years, the State Statistics Bureau said. The government report estimated that China will see total investment of $470 billion in fixed assets during the five-year period, an annual growth rate of 15 percent. China created 47 million nonfarm jobs in the five years through 1994, boosting urban employment 8.3 percent, but the government expects official unemployment, now at 3.5 percent, to grow to 5 percent in the next few years.

China's industrial production was up 13.6 percent in July over July 1994. The People's Daily said losses incurred by state-owned companies were up 21 percent from January through July and total profits were down 25.4 percent.

In China fiscal power must be restored, some economists are urging the government. The shift must take place, they say, as part of a "recentralization" of authority. China's central budget revenue represented 32.9 percent of total revenue in 1994, down from 33.4 percent in 1993. Local and national government tax revenues equaled 9.1 percent of GDP last year, with national revenues amounting to 5.1 percent of economic output—in percentage terms, less than one-third of the national tax haul in India and just a quarter of what the U.S. government raises. China's budget deficit is expected to hit 1.5 percent of GDP in 1995, although some economists estimate the real deficit, including the bad debts of the state banking system, to be as high as 4.5 percent of GDP.

Mongolia's stock exchange began public trading August 28. Offering equities in 451 companies worth $156 million. Unlike other Asian emerging markets, there will be no restrictions on foreign ownership.

The Central European Free Trade Agreement (CEFTA), embracing the Czech Republic, Hungary, Poland, and Slovakia, agreed to abolish duties on most industrial products two years earlier than planned. The move paves the way for setting up a free-trade zone on January 1, 1997. Slovenia intends to join the group later this year, and the future membership of Bulgaria and Romania is also on the table. Tariffs for so-called medium-sensitive goods (chemicals, paper, and timber) will be lifted as of 1996. Trade in more sensitive goods (textiles, steel products, and electrical equipment) will be fully liberalized in 1997 (their tariffs will be halved from the beginning of 1996). Tariffs for selected textile, steel, and paper goods, as well as cars, will remain effective until 2000-2002. The CEFTA ministers also agreed that customs duties for most agricultural goods should be cut in 1998 but said more talks were needed on this issue.

Five of Russia's largest banks pledged to resume interbank trading in a bid to restore confidence in the paralyzed short-term loan market, effective end-August. The two national banks, Sberbank (savings bank) and Vneshtorgbank (foreign trade bank), as well as Inkombank, Imperial, and Most-
Bank, signed an agreement to resume loan operations among themselves with the aim of slowly opening up the market to other operators. Earlier, the announcement that the ruble corridor against the dollar had been extended from October 1 until the end of the year caused turmoil on the Russian money market. (The corridor zone, established on July 5, allows the ruble to fluctuate between 4,300 and 4,900 to one dollar.) Overnight money market interest rates soared on August 23 from 300 percent to 1,000 percent. Many institutions were desperate for cash, but banks were reluctant to lend, fearing they would not get their money back. Fears of insolvency created a domino effect, prompting nearly all Russia’s banks to suspend operations amid a general cash shortage. Tatiana Paramonova, acting chairwoman of the central bank, said up to 100 Russian banks were likely to be shut down soon. Many analysts in Moscow believe Russia has reached the beginning of a long-expected shakeout involving bankruptcies and consolidations among the country’s more than 2,500 banks.

Russia’s government has approved a plan to restructure the country’s military-industrial complex; President Yeltsin’s aide for military and technical cooperation, Boris Kuzyk, announced on August 25. The plan involves the formation of Financial-Industrial Groups (FIG) made up of weapons designers, and producers, banks, and insurance and investment companies. Two or three FIGs will be formed as early as this year—one involving the main designers and producers of MiG-29 fighters. It will consist of 20 to 35 aviation enterprises and five banks. Kuzyk said that other CIS and foreign companies might participate in future FIGs but added that the government would exert strict control over the new groups’ activities.

To support small and medium-size businesses, the Russian government will allocate more than 1.8 trillion rubles ($408 million) to building a network of information and training centers in 1996-97, Russian First Deputy Economy Minister Andrei Shapovalyants said in mid-August. Small enterprises, employing about 9.5 million Russians, produced 12 to 14 percent of total industrial output this year, according to government figures. The state holds no more than a 25 percent stake in each of the small enterprises covered by the government aid. (There are one million small enterprises in Russia.) The European Bank for Reconstruction and Development will lend Russia $300 million to support the country’s small enterprises. Under the plan, the enterprises must have no more than 50 workers to receive a maximum of $50,000 for two years.

The wages of Russian teachers, researchers, and medical workers were raised on September 1. The increase will be implemented in two stages: wages increased by about 50 percent on September 1 and will increase by another 50 percent on November 1. The lowest salary for a school teacher at the start of the academic year will be about 350,000 rubles (about $79) a month and for a teacher at a higher educational establishment, 450,000 rubles ($102). Education and health care, professions in which women predominate, have traditionally been two of the lowest-paid sectors.

Cutting from 30 percent to 5 percent the proportion of funds that Russian enterprises can retain for wages without being subject to tax, as required by the Ministry of Finance, will decrease wages paid out, economist Pavel Bunich warned on August 15. Even more Russians will fall below the poverty line, especially as inflation is still high. In contrast to 1993-94 when the subsistence minimum set by the state as a basis for determining welfare payments was growing in real terms, the minimum level has fallen 7 percent over the past six months and is expected to continue to fall. Meanwhile, Finansovye Investiya reported on August 15 that many firms are now subject to taxes greater than 100 percent of their overall income, forcing many businesses into the arms of organized crime. And wage arrears continue to grow: Russian firms now owe their workers back wages of more than 7.15 trillion rubles, an 11 percent increase in July alone, Russian radio reported on August 16.

Russia, facing its worst grain harvest in 30 years, may be forced to turn to grain imports despite a drive for food self-sufficiency. Obshchaya gazeta (no. 33) reports that experts at the Ministry of agriculture now believe that the grain harvest may amount to only 45-50 million tons, far lower than the 79 million tons they had predicted a month ago and well below the 81 million tons harvested last year and the 99 million tons harvested in 1993.

Shareholdings in some of Russia’s biggest oil companies and its national grid will be offered for sale by the end of the year, including 15 percent of the giant Lukoil, and share in 135 other major firms in the telecommunications, transport, mining, and forestry industries. The shares will be sold at cash auctions and investment tenders. The Russian government has also drawn up a list of 3,000 companies, including leading defense contractors and transport ventures, whose sale will be banned for strategic reasons.

Privatization of Ukraine’s agro-industrial enterprises has been proceeding very slowly, State Property Fund officials revealed. Only 14 percent of enterprises slated for privatization since 1993 have been transferred to private ownership, including 274 food-processing plants, grain elevators, and other.
agriculture-related enterprises. The officials blame the poor financial situation of the enterprises, as well as resistance by local authorities, for the slow pace of privatization.

Ukraine's currency, the karbovanet, stabilized in early September, following a plunge in early August when its value dropped from 152,000 to 167,700 to one dollar, and on the black market, to 200,000 to one dollar. Enterprises and individuals started panic-buying of dollars following the government's announcement that monetary reform and the introduction of a new permanent tender, the hryvna, were imminent. Beginning August 1, Ukraine banned the use of foreign currency for cash retail and service transactions. Deputy Interior Minister Yuri Vandin said that some $4 billion was in circulation on the black market. Volodymyr Radchenko, chief of Ukraine's security service, said the black market serves as the primary source of income for some 2.5 million people, including up to 40 percent of youths in big cities. The value of the litas will remain stable because of "more than sufficient" reserves of gold and hard currencies, Lithuanian Prime Minister Adolfas Slezevicius said on August 10. The reserves are worth almost $700 million, exceeding by $130 million the amount necessary to cover all the litas in circulation. Slezevicius also noted that Lithuania's per capita reserves were larger than Poland's.

Estonia and Lithuania are expecting economic growth this year. Estonia's exports soared 63 percent year on year in 1994. Lithuania's GNP could grow by 5 to 7 percent this year. But Latvia is undergoing a banking and budget crisis, after its largest commercial bank, Banka Baltija, collapsed in May. Latvia's economy may slide by 4 to 5 percent this year, independent analysts predict.

Tajikistan's state property will be 100 percent privatized in 1996. Tajik Radio reported on August 25. Prices for all kinds of goods and foreign trade have been completely liberalized, with the exception of cotton. Cotton producers have the right to dispose of 30 percent of the crop in 1995; in 1996 the entire crop is to be at their disposal. Bread prices were freed as of August 20, with the poor to be compensated for the price rise. The country's economy contracted by 20 percent in the first half of 1995, with industrial output down 23.3 percent against in the first half of 1994.

Poland will raise pensions by 17 percent in December. State sector wage growth (to which pensions are indexed) has not run high enough to mandate a third-quarter increase. The tripartite commission representing unions, employers, and the state agreed on August 28 to increase public sector wages this year by 6 percent in real terms (for teachers, health-care workers, and public administration workers). The commission also agreed to raise public sector wages next year by 5.5 percent over inflation.

A detailed report on Poland's untaxed shadow economy and measures to curb it has been prepared by the Ministry of Finance. The ministry estimates the turnover of companies evading taxes last year at about 20 billion zlotys ($8.1 billion) and the amount of lost taxes at two billion zlotys ($810 million).

Poland's gross domestic product will grow by 6.5 percent this year, according to a Central Planning Bureau has forecast. Exports are expected to rise by 20 percent to $27.5 billion and imports by 27.5 percent. Industrial output is forecast to rise by 10.5 percent, with growth slowing slightly as a result of the zloty's appreciation. Spending on fixed investment will increase by 10 percent, following last year's 7.1 percent rise. The latest inflation forecast is 22 percent at year-end and 28 percent as an annual average. In another indication of strong growth, Poles bought nearly 155,000 new cars in the first half of 1995. Sales were up by 19 percent for domestic models and 13 percent for imports over the same period in 1994.

Bulgarian electricity prices went up 25 percent for households and 38 percent for industrial users on September 1. The rate hikes are to match production costs and revenue. As of November 15, electricity prices will be adjusted to take inflation into account. Pensioners will receive a monthly compensation equivalent to the price of 500 kilowatt hours. The Bulgarian daily, Trud, reported that the government expects inflation to go up by 2 percent as a result of the hikes.

Bulgaria's industrial production in July was 9 percent higher than the same month last year. For the first seven months of 1995, the GDP growth rate was 2 percent compared with 1994, same period. More than 75 percent of Bulgaria's GDP is generated by foreign trade. The national bank's reserves amounted to $1.5 billion on August 1, up from $889 million in January.

Bulgaria's mass privatization based on the Czech coupon privatization model will start soon, according to Deputy Prime Minister and Minister for Economic Development Rumen Gechev, who noted that the government on August 7 had adopted the related regulations. Companies will be on sale for both vouchers and cash. Up to 200 enterprises will be included in the first round of mass privatization, which is scheduled to start by the end of 1995. Between 31 and 70 percent of state-owned enterprises will be privatized with vouchers, depending on investor interest. Some 20 percent will be offered to the enterprise employees at a preferential price, while 10 percent...
will be kept in reserve for possible restitution claims.

Bulgaria paid part of its debt to Paris Club creditors on August 19, according to Ministry of Finance officials. The next regular debt payment of around $10 million is slated for September 30. Total repayment on the principal in 1995 amounts to $50 million, while another $5-6 million is due in interest payments.

Hungary in 1996 will slow the devaluation rate for the forint, cut back its current account deficit, and target export-led growth, Finance Minister Lajos Bokros said on August 30. The government anticipates GDP growth of 2 percent both this year and next, and expects the current account deficit to drop from some $3 billion at the end of this year to just over $2 billion by the end of 1996. In 1994 Hungary recorded a current account deficit of $3.9 billion. Bokros said the government and the National Bank of Hungary had fixed the monthly crawling peg devaluation rate of the forint for next year at 1.2 percent. The budget deficit by the end of August 1995 reached HUF 194.7 billion (US$1.5 billion), which was a HUF 3 billion increase over July, the slowest monthly budget deficit growth in years.

Hungary is still a preferred target for investors. Some $416 million of annual foreign direct investment entered Hungary through May of this year, compared with $402.5 million through June for the Czech Republic. The UN European Economic Committee reports that between 1990 and July 1, 1994, $8.3 billion of working capital came to Hungary, $2.7 billion to Poland, $2.5 billion to the Czech Republic, and $0.5 billion to Slovakia. A breakdown of $9 billion in foreign direct capital investment in Hungary, by top contributing nations (Ministry of Industry and Trade figures), shows the following shares: United States, 40 percent; Germany, 25 percent; Austria, 12 to 15 percent; and France and Italy (each), 7 percent.

Tenders for the privatization of Hungary's electricity sector were issued in early August, with more than 30 international firms already having purchased the tender documentation. Final decisions on the sales, which average 47 percent stakes in Hungary's regional electricity supply companies, are to be announced before the end of the year. Hungary's privatization agency launched the sale of majority stakes in the country's gas supply companies August 24. Minister for Industry and Trade Imre Dunai said he believes the government can raise $1 billion before the end of 1995 with scheduled sales of the electricity works, the Hungarian Oil and Gas Corp. (MOL Rt.), and the nation's gas utilities.

Hungary is radically simplifying its privatization process. The Hungarian privatization authority, APV, announced in mid-August that it is going to give 275 firms to the highest bidder. APV will publish two lists, one in September and the other in December, naming the companies and minimum acceptable offers. Anyone will be able to submit a bid within a set period. As of the end of April the state had majority stakes in 475 firms and minority stakes in 302.

Minimum monthly subsistence-level net income for a Hungarian family of four increased in July to HUF 73,981 (US$592), according to the Subsistence Foundation (Lethataron Alapitvany). Average monthly gross wage in Hungary is about HUF 40,000. Natural gas and electricity prices will rise 8 percent as of September 1. With two more hikes in store in 1996, energy rates will rise by 100 percent by 1997. With the doubling of energy rates, one-third of the population will be paying 35 percent of their incomes toward housing utilities, according to the GKI economic research institute.

The Hungarian suicide rate is the highest in Eastern Europe, according to study results released at a recent conference on suicide prevention in Venice. The rate of 39 suicides per 100,000 is down from its peak in the late 1980s, although the figure has been rising again since 1993.

Sanctions have cost the economy of the FR Yugoslavia (Serbia/Montenegro) up to $50 billion in lost earnings, with per capita income falling from $3,000 in 1990 to $1,000 in 1995 and 800,000 of 2 million public sector workers unemployed, reports USA Today. Outside investment is nonexistent, and the country cannot borrow money on the open market or get loans from the World Bank or the IMF.

North Korea's government has asked for emergency rice supplies. A visiting North Korean delegation told Japanese political leaders that the 22 million people of North Korea will face serious food shortages again this year unless Japan and other countries increase their shipments of food and other aid. South Korean officials have stated that North Korea has been affected by cutbacks in food aid from China, North Korea's longtime ally, which has been demanding full payment for food.

(We appreciate the contributions of Open Media Research Institute's Daily Digest.)
**World Bank/IMF Agenda**

**Romania—World Bank Power Deal**

The World Bank on August 29 approved a $110 million loan to rehabilitate and upgrade Romania's power sector on standard World Bank terms with a maturity of 20 years, including a five-year grace period. The loan—aimed at reducing inefficiency in Romania's troubled power sector—will underpin a broader $364 million project to support reforms in the power industry. It will also help rehabilitate Romania's thermal power generation capacity, develop a legal framework to attract private investment to the power sector, and restructure the country's electricity authority, Renel RA. The remaining $254 million will come from other international lenders: the European Bank for Reconstruction and Development, $54.4 million; and the European Investment Bank, $23.1 million. Money will also come from the U.S. Agency for International Development and the European Union's PHARE program. Local costs for the project, estimated at $125 million, will be funded by Renel. Western companies may be interested in the project, which has almost $400 million on offer for rebuilding and upgrading coal-and gas-fired power stations and thermal plants and will provide consultant work.

**Microloans to the Poor**

The World Bank, as major participant of the Consultative Group to Assist the Poorest (CGAP), will soon provide funds for microloans to the world's poor, to start their own businesses. In an initiative that blends business and development, the group will allocate some $200 million—through nongovernmental organizations, lending institutions, and banks—as small loans, some for as little as $10. The microloans could reach the beneficiaries directly, without the requirements of collateral and extensive paperwork. For further information about the CGAP, call (202) 473-9594, or fax (202) 522-3944, or point to CProject@worldbank.org.

**World Bank Loan for China's Ertan II . . .**

The World Bank on August 23 approved a $400 million loan to help China build the huge Ertan II hydroelectric power plant, in its southwestern Sichuan province. The plant will supply electricity to some 120 million people. (The region's annual per capita income of $212 is just 60 percent of the national average.) The loan, and a $150 million World Bank guarantee for commercial funding for the project, is the second tranche of Bank support for the $2.5 billion investment, to be constructed over nine years. The Bank's first loan in 1992 totaled $380 million. Some 35,000 people will be relocated under the project, with village committees playing a key role. An independent panel of international experts has also been involved.

...and the Shanghai-Hangzou Highway

A World Bank loan—$260 million approved August 10—will finance 36 percent of the construction cost of a 130 kilometer, four-lane, access-controlled highway, upgrading the overcongested Shanghai-Hangzhou roadway.

**World Bank Profits Rise**

The International Bank for Reconstruction and Development, the World Bank's principal institution, announced that it had registered a net income of $1.35 billion in the 1995 fiscal year ending June 30, marking a 30 percent rise over the previous year's $1.05 billion total. Out of its net incomes, the Bank will distribute $350 million to support IDA, $90 million for development in the Gaza Strip, and $634 million will be kept in World Bank reserves. The Bank borrowed some $9 billion worth of medium and long-term capital in the past financial year, up from $8.91 billion the previous year. Short-term borrowing totaled $3.9 billion, up some $600 million. Combined disbursement of the IBRD and the IDA amounted to $18.5 billion. The reserves were boosted to $17.23 billion by June 30 from $14.81 billion the previous year, while the reserves-to-loans ratio rose to 14.25 percent from 13.88 percent. Bosnia-Herzegovina, FR Yugoslavia (Serbia and Montenegro), Iraq, Liberia, Sudan, Syria, and Zaire are behind on their debt payments to the Bank.

**IMF Approves Temporary Capital Controls?**

Drawing lessons from Mexico's financial crisis and its global effects, the IMF said that developing countries might consider placing temporary controls on inflows of foreign capital to avoid unwelcome disruptions to their economies. The IMF's International Capital Markets report written by IMF economists David Folkerts-Landau and Takatoshi Ito, said that during times of surges in capital inflows a country might introduce taxes on short-term bank deposits and restrictions on borrowing from abroad. IMF First Deputy Managing Director Stanley Fischer emphasized that the IMF views controls as a transitional device. Attracting too much short-term foreign money too soon can hurt an economy and undermine its banking system, Fischer said. U.S. Deputy Treasury Secretary Lawrence Summers said the absolutist religion against capital controls anywhere, anytime, is mistaken. But, he warned, measures to control capital flows become easier to evade with the passage of time and are
The World Bank/PRDTE

no substitute for strong policy fundamentals.

**IMF Expected to Double GAB**

International financial sources said the IMF would double its General Arrangements to Borrow (GAB) by asking Australia, Austria, Singapore, South Korea, Spain, and others to take part in the scheme. The proposal is expected to be approved at a meeting of finance ministers and central bank governors to be held in Washington in October, coinciding with the IMF Annual Meeting.

**IMF Surveillance Upgrade**

Following Mexico's financial crisis, the message being driven home, mostly by industrial countries, is that more uniform standards of disclosure are needed, particularly among those countries that want to tap international capital markets for cash. Countries are airing their views on the issue within the confines of the IMF, which has been charged with developing disclosure standards in cooperation with its members. The idea, according to senior international financial officials, is ultimately to let market forces drive macroeconomic policies. Disclosure practices in Argentina, Brazil, China, Hungary, India, Indonesia, Mexico, Poland, South Korea, and Thailand are being reviewed. Analysts believe that countries will be inclined to maintain more appropriate economic balances, given rapid market reactions to misalignments; the question is, what should financial markets know—and when should they know it—about government economic data (both "input" data, or information that fiscal and monetary authorities use in setting policies such as internal debt, and hard currency reserves, and central bank balances; and "output" or "outcome" data that reflect the result of policies such as inflation, trade balances, and growth rates).

**Russian Standards in Line**

The World Bank and the Russian State Standards Committee signed a protocol on August 10 that sets the stage for bringing Russian standards in line with international trade requirements. The project provided for extending to Russia a credit of $24 million under which the State Standard Committee would receive the necessary equipment for increasing the committee’s ability to certify Russian products meant for export and products imported by Russia. The World Bank will grant Russia the credit for 17 years with a five-year deferment.

**Ukraine Meets Reform Targets**

Ukraine is broadly carrying out its commitment to economic reform and the IMF continues to support the country, IMF First Deputy Managing Director Stanley Fischer said in Kiev. Fischer led an IMF delegation to Ukraine to discuss a $350 million tranche of an IMF standby agreement approved in April. He told a press conference that in talks with ministers and officials there was no significant wish to diverge from the IMF-backed program, noting performance on inflation had been better than expected so far this year, and that there were other encouraging signs, including export growth, a slowing of the rate of decline in output, and prompt payment of external debt. (The budget deficit is limited at 7.4 percent of GDP and inflation now stands at 4.8 percent, compared with 72 percent last November.) President Leonid Kuchma said Ukraine will introduce its new currency, the hryvna, no later than October and will follow a strict monetary policy.

**World Bank to Help Insure Exports to Ukraine**

The World Bank is to set up a $70 million fund to help insure Western firms providing goods and services for the Ukraine farm sector. The fund, to be set up by the end of 1995, is primarily aimed at suppliers of goods to agricultural producers, such as herbicide and fertilizer. Firms unable to obtain payment in cash or goods because of "political risk,"—frequently meaning bureaucratic tangles caused by local officials—would be able to apply to a government agency. A bank would be authorized to pay damages to the Western firm if the government proved unable to resolve the difficulty.
Kyrgyz Commission to Coordinate World Bank Aid

Kyrgyzstan has set up a national commission to coordinate World Bank aid for the worse-off economic sectors. The 13-member commission, headed by Zafar Khakimov, minister of labor and social protection, will first deal with the $15 million IDA credit, supporting private businesses. The commission will also advise small businesses and help employment services to find jobs for the unemployed.

Albania Reschedules and Draws IDA Credit

IDA in late August approved a $4 million credit to help Albania develop a five-year program to boost jobs and small-scale private businesses in urban areas. About half the money will go to give technical assistance to alleviate the 30 percent urban jobless rate through restoring markets, schools, waterways, hospitals, roads and other infrastructure, while most of the rest will be disbursed as loans to some 2,000 prospective small enterprises. In another development, Albanian Finance Minister Dylber Vrioni signed an agreement cutting the country’s commercial bank debt and restructuring the remaining portion. The deal reduced the debt to $100 million from $500 million and requires Albania to pay them by the end of August. Vrioni said once that was done, the country would be free from further obligations. He said various international organizations had promised to contribute toward the $100 million, with the World Bank granting $25 million, and the G-24 countries contributing $43 million.

Polish Ministry on World Bank Loan

The Polish Construction Ministry has proposed to the World Bank that it should reduce the Polish loan for the housing construction finance program from $200 million to $50 million, the Polish news agency reports. Katarzyna Szarkowska, deputy head of the ministry's budget department, said the ministry wants a reduction of the loan to a level that is possible to service in real terms and has proposed an interest rate reduction.

Public Sector Loan to Croatia?

The World Bank signed a 75.6 million yen ($780,000) financial aid deal with Croatia. The money will provide technical support to the country's public sector reform, a finance ministry official said. The Japanese grant is to cover financing of the technical support in the budget and public spending programming. The World Bank is negotiating a public sector adjustment loan for the former Yugoslav republic, which could be concluded by November.

IFC Invests in Vietnamese Companies...

The IFC has approved financing for a steel project and a flour mill in Vietnam. The IFC will lend $15 million for the $70 million plant, which will have a 300,000 tons a year bar-and-wire rod production capacity. Investors include the state-owned Viet Nam Steel and Kyoei Steel, a leading Japanese steel maker. IFC will also arrange $11 million in financing for a $26 million wheat flour mill, a joint Malaysian-Vietnamese venture.

...and in an Uzbek Leasing Company

IFC financing totaling $5.6 million will help establish Uzbekistan's first specialized leasing company, Uzbek Leasing International. The $5 million loan and $600,000 equity investment, approved August 28, is IFC's first investment in the country's financial sector and is expected to give a boost to small and medium-size enterprises.

IDA Credits to Azerbaijan

The World Bank in late August established a resident mission in Azerbaijan to underpin Bank- and IDA-supported economic development programs. A $65 million IDA credit, approved August 24, will help sustain Azerbaijan’s economic stabilization and structural reforms. The credit will be used primarily for reforms in the enterprise sector, with special emphasis on privatization, restructuring, banking, and policies to encourage competition and limit monopolies. (Azerbaijan's transition to a market economy has been disrupted by regional conflicts; almost one million people, of a population of 7.5 million, are refugees or internally displaced.) A week later the IDA approved another credit of $18 million to strengthen the Ministry of Finance, modernize the country's Central bank, and bolster the legal and regulatory framework.

Donors Resume Aid to Tanzania

Aid donors will soon release $215 million in balance of payments support to Tanzania. (The funds had been held up late last year because of a tax evasion scandal and economic mismanagement.) Finance Minister Jakaya Mrisho Kikwete said Tanzania’s traditional donors, including the Nordic countries, have eased their earlier stance and pledged to disburse the withheld funds soon.
Conference Diary

Lessons from the Best-run Companies
September 14-16, 1995, St. Petersburg, Russia


Topics of presentations and discussions include: Relating the university to new business needs; Lessons from the best-run postcommunist enterprises; Implications for management education.

Information: (MAC @MAINE.MAINE.EDU) or Michael Minkov (CEEMAN@IEDC-BRDO.SI) at the CEEMAN office in Slovenia.

Central Europe: Economic and Political Status and Prospects for EU Membership
September 21-24, 1995, Esbjerg, Denmark

Conference organized by Thorkil Kristensen Institute/Centre for Russian and East European Studies, Birmingham.

Information: Thorkil Kristensen Institute (TKI), South Jutland University Centre, Niels Bohrs Vej 9, DK-6700, Esbjerg, Denmark, tel. (45) 7914-1111, fax (45) 7914-1199.

Russian Economy in Transition
September 25-26, 1995, Helsinki, Finland

The Working Group on Technology, Economy and Society of the Finnish-Russian Scientific-Technological Commission will be arranging the fourth seminar on the Russian economy in transition in Helsinki. The aim of the seminar is to provide a Western audience with first-hand information from high level sources on recent developments in the Russian economy and society.

The principal subjects will include: the general economic situation and financial stabilization in Russia, the functioning of financial markets and the role of foreign investors, regional aspects of transition, and the current political situation.

The key speakers at the seminar will come from Russia, with comments on their lectures given by Western specialists. Speakers at past seminars have included cabinet ministers and leading scholars from Russia, as well as high-level experts from Western universities and international organizations.

Information: Dr. Pentti Varti, Managing Director, the Research Institute of the Finnish Economy, Lonrotinkatu 4 B, FIN-00120 Helsinki, Finland, tel. (358) 060-9900, fax (358) 060-1753.

Regional and Company Problems in the Transformation Process: An International Perspective
October 4-5, 1995, Munich, Germany

Eleventh Joint Symposium of the Ifo-Institute for Economic Research, Munich and the Institute for World Economy and International Relations, Moscow.

Topics include: Regional convergence structural policy; Regional aspects of the labor market; Company financing problems (debt, overindebtedness, and bankruptcy); Government stimulation of business investment. Conference languages: German and Russian.

Information: Ifo Institut fuer Wirtschaftsforschung, Frau Ilse Wallner, Poschingerstr. 5, D-81967 Munich, Germany, tel. (4989) 9224, fax (4989) 985-369, (E-mail: >INET: 100064.232@compuserve.com.)

Enterprise in Transition
October 4-6, 1995, Split, Croatia

International conference organized by the Faculty of Economics at the University.

Analysis of the changes occurring in a modern enterprise, with special focus on the enterprises in transition countries; Analysis of the transition processes in Croatian enterprises and identification of optimal patterns; Suggestions of reconciliation mechanisms for contradictions between transition processes in Croatia and abroad.

Conference language: English.

Information: Dr. I. Pavic, Chairman of the Organizing Committee, Faculty of Economics, University of Split, Radovanova 13, 58000 Split, Croatia, tel. (385-21) 341-866, (E-Mail: pavic@oliver.efst.hr)

4th World Economic Development Congress Chief Executive Officer Summit
October 5-6, 1995, Washington, D.C., United States

Summit session roundtables include: State of emerging markets; Investment strategies for Central and Eastern Europe and South Africa.

Keynote address: "Increasing domestic savings and meeting the world's capital needs," by Laura D'Andrea Tyson, National Economic Advisor to the President of the United States; and Afshaneh Mashayekhi Beschloss, Director, Pension Department, the World Bank.

Information: Greg Kerr, CEO Summit Coordinator, 70 Blanchard Road, Suite 4600, Burlington, Massachusetts.
Different Approaches to Market Reform: A Comparison between China and the Central and East European Countries
October 6-7, 1995, Budapest, Hungary

A CEPR/CEPI/OECD Development Centre conference, hosted by the Institute for World Economics. Topics include initial conditions and the political economy of the reform strategy, monetary and exchange rate policies; fiscal policy and fiscal systems; enterprises reform and privatization.


Economic and Monetary Transformation in Central European Countries
October 11-13, 1995, Bratislava, Slovakia

Organized by the University of Economics in Bratislava, celebration of its 55th anniversary. The conference is being held to analyze the problems and opportunities of the current restructuring process in transition economies.

Topics include: Problems of transition; creation and development of a functioning financial and banking system; development of trade; analysis of economic transformation processes and informatics; management of enterprises; international communication.

Information: Professor Dr. Zlatica Ivanicova, Conference Secretariat University of Economics, Odbojarov 10, 83220 Bratislava, Slovakia, tel. (42-7) 526-2219, fax (42-7) 566-2125, (E-Mail: ivanic@euba.sk)

World Bank/IMF Annual Meetings
October 10-12, 1995, Washington, D.C., United States
Information: Tel. (202) 473-1782.

Commercial Development of the Energy Sector in Central and Eastern Europe
October 18-19, 1995, Vienna

Conference organized by the Adam Smith Institute, London; Languages: English, German.

Information: Maria Weidenhiller or Louise Pasha, Adam Smith Institute, Conference Division, 11-13 Charterhouse Buildings, London, EC1M 7AN, United Kingdom, tel. (44171) 490-3774, fax (44171) 4908-932, (E-mail: 100451.31228@compuserve.com)

Hungary: Towards a Market Economy
October 19-20, 1995, Budapest, Hungary

Conference organized by Institute of Economics, Budapest.

Information: L. Halpern, tel. (361) 1853-770, fax (361) 1851-120.

European Integration Towards 2000
October 27-29, 1995, Lodz, Poland

Conference organized by Foundation for European Studies/European Institute, Lodz.

Information: M. Karasinska-Fendler, tel. (4842) 370-593, fax (4842) 370-586.

Economic Restructuring under Transition
November 14-15, 1995, Perm, Russia

International conference, with topics to include: Reform strategy in transition; analysis of the process of economic restructuring; Models of economy restructuring; Marketing in transition; Regional and social aspects of economic restructuring; International experience of economic systems development and possible applications for Russia.

Information: Yuri K. Persky, Perm State University, Economic Theory Department, Bukareva 15, 614600 Perm GSP, Russia, tel. (73422) 396-588, and 396-286, 396-326 fax (73422) 338-014, (E-mail: mvu@pgu.perm.su)

Enterprise Restructuring in the Visegrad States
November 16-19, 1995, Poznan, Poland

Organizer: University of Economic Science in Poznan.

Information: Bohdan Gruchman, tel. (4861) 525-722, fax (4861) 483-582.

Friendly Advice to a Debtor Nation

"Come on, you are not doing so well that you can refuse to service your debt!"

From the Hungarian daily Magyar Hirlap
New Books and Working Papers

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

World Bank Publications

Policy Research Working Papers


Replacing a pay-as-you-go pension system with a fully funded scheme could eliminate the incentives to informal production and employment. Long-term growth could increase substantially as a result of such reform. Econometric evidence suggests that Chile's pension reform, introduced in 1981, could contribute to a large increase in private savings.


The authors focus on three fundamental requirements for debt to function as a control device: information, proper incentives for creditors (including banks, suppliers, and government), and an efficient legal framework for debt collection (including collateral, workout, and bankruptcy regimes).

To order: Laura Lewis, room S6-109, tel. (202) 473-0539.


Dominique van de Walle, Public Spending and the Poor: What We Know, What We Need to Know, PRWPS no. 1476, June 1995, 49 p. To order: Cynthia Bernardo, room N10-053, tel. (202) 473-7699.

Alain Bertaud and Bertrand Renaud, Cities without Land Markets: Location and Land Use in the Socialist City, PRWPS no. 1477, June 1995, 15 p.

The Soviet city is characterized by rusting factories in prime locations and high-density residential areas in distant suburbs. Such a structure tends to maximize the economic and social inefficiency of the socialist city as well as its environmental ill effects. With market-oriented urban reform, real estate prices are now emerging.

To order: Emily Khine, room N11-061, tel. (202) 473-7471.


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Alain Bertaud and Bertrand Renaud, Cities without Land Markets: Location and Land Use in the Socialist City, PRWPS no. 1477, June 1995, 15 p.
To order: Grace Evans, room N11041, tel. (202) 438-5783, fax (202) 522-1151.


Programs that subsidize household energy prices in the transition economies help the rich more than they help the poor. Not only do the wealthy consume more energy in absolute terms than the poor, but they also spend a larger portion of their income on energy. To solve this problem, the first-best response would be to raise energy prices while targeting cash relief to the poor through a social assistance program. This is far more efficient than the present go-slow price adjustment policies, which imply energy subsidies that provide across-the-board relief to all consumers. But if governments want to provide some relief for consumers to ease the adjustment, in-kind transfers to the poor, vouchers, cash transfers, and lifeline pricing for a minimum amount of electricity, combined with significant price increases, are the possible options.


**Other World Bank Publications**

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The authors analyze the causes of the steep output and trade decline in the 15 new states of the former Soviet Union and identify policy options to cure the economic ills and to promote international trade in these countries. The volume includes eight country studies, analysis of the obstacles to expanding exports to OECD markets, and an enterprise survey of Ukraine.


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On July 28, 1994, after more than two years of intense negotiations with a steering committee representing creditor banks (the "London Club"), Bulgaria completed a market-based Debt and Debt Service Reduction (DDSR) operation. Over 300 commercial banks participated in the deal on a voluntary basis. The DDSR package was in line with the basic tenets of the so-called Brady Plan and was the first with an Eastern European country. About $8.3 billion of outstanding bank debt was restructured, resulting in substantial debt relief and a repayment schedule spread over a 30-year period.

Under the Bulgarian debt deal, the gross debt and debt service reduction was about 46 percent in present value terms (about 38 percent net of the resources used to complete the deal), which will significantly alleviate the balance of payments. However, even after the deal, the external debt stock remains high.

Owing to rising obligations on the restructured bonds and in part to a smaller than-targeted allocation to the buyback option, sustained policy efforts will be required over the medium term to bring the remaining debt stock to a more manageable level. Looking ahead, upfront fiscal action is needed not only to break the adverse debt dynamics, but also to reduce uncertainty by sending an early signal that debt problems have been resolved in a lasting manner.

Restoring credibility to monetary and exchange rate policies will, in turn, help stem capital flight, avoid an unduly weak exchange rate (thus lessening the domestic costs of external debt service), and allow a lowering of domestic interest rates (thereby reducing the internal debt burden). Accelerated structural reforms will be vital to bolster productivity—especially foreign exchange earning potential—before heavy repayments start to fall due after the turn of the century.


Continued real appreciation of the Baltic currencies is to be expected as part of the transition process toward higher income levels, due in part to differential productivity growth rates in the tradable...
and nontradable sectors. In the absence of an appreciation of the nominal exchange rate, this real appreciation will occur through inflation rates that are higher than in industrial countries. Provided that the current prudent economic policies are continued, such higher inflation will not threaten macroeconomic objectives and may indeed be viewed as an indication that the transition process is progressing as expected.


IER Working Papers, Ljubljana, Slovenia

Emil Erjavec, Miroslav Rednak, and Jermaj Turk, Main Issues of Slovene Agriculture, no. 11, 1994, 16 p.


To order: Institute for Economic Research (IER), Kardeljeva ploscad 17, 61000 Ljubljana, Slovenia, tel. (38661) 1328-151, fax (38661) 342-760, (Email: iermail@uni-li.si)

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Radek Laptovik, Restructuring of Firms under Transition: The Czech Case, WP no. 80, April 1995.


Radek Laptovik, Privatization and Restructuring under Transition, WP no. 82, April 1994.


Companies managed by funds outperform the ones with dispersed ownership, and the market's preference—evident in longer-term trends of share prices—is for funds that behave as strategic investors.


In the former CSFR and in the Czech Republic between 1991 and 1994, some of the institutions that were set up to oversee the industrial-financial reform have been converted into instruments of indirect, selective credit allocation. Government authorities have provided favored enterprises with loans at below-market interest rates, under pressure both of the economically nonviable firms and their large bank creditors struggling with bad debt. Reformers—fearing that bankruptcies of the largest firms will send unemployment figures soaring and thus strengthen the hand of the opposition—have been unwilling to make drastic changes in the economic bureaucracy. Instead, they have designed institutional structures that allocate credit to vital industries, swap bank debt for equity, and generally enable government discretion in corporate finance.
OECD Publications


To order: OECD Press Division, 2 rue André-Pascal, 75775 Paris Cedex 16, France, tel. (331) 4524-8088, fax (331) 4524-8003.

Other Publications


Peter Havlik and others, Wachstum in Osteuropa, Weiterer Rückgang in der GUS, WIIW no. 159, May 1995.

To order: WIIW, Vienna Institute for Comparative Economic Studies, P.O. Box 87, A-1103 Vienna, Austria, tel. (431) 782-567, fax (431) 787-120.


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[The Pattern of Transformation and Its Microeconomic Dimension, pp. 95-109] For transition to succeed it has to take root at the microeconomic level. The general expectation was that enterprises, once permitted to do business as they saw fit, freshly motivated by a desire for profit and impelled by competition, would introduce innovations in their product lines, seek new suppliers that would be a better business fit than those prescribed earlier by central planning authorities, shed labor to make production more efficient, and aggressively seek new markets. In short, the formerly planned enterprise would become a "firm." In many cases, however, this has not yet happened.

It is important that privatization policies lead to proper corporate governance structures. Some big loss-making state-
owned enterprises are simply "unprivatizable." However, postponing the day of reckoning tends to aggravate the negative effects of the loss-making giants. Restructuring such enterprises, if indeed it is at all possible, requires a closer involvement of the authorities; but in the end, many of them will have to be liquidated.


Newsletters, Special Publications


The study focuses on the sharp decline of saving and investment ratios in the transition countries of Central and Eastern Europe and the former Soviet Union since 1989. It also looks at the issue of whether transition countries' external financing needs will exert additional pressures on international capital markets in the future. It is argued that, although external capital will continue to play an important role in the transition process, the future recovery of investment rates in these countries is likely to be financed mostly by an increase in domestic saving, particularly corporate saving. This is consistent with the high correlations between national saving and investment rates generally found by the empirical literature, and with the fact that the recent recovery of corporate investment in the most advanced Central European countries is being largely self-financed through an improvement in enterprise profitability.

The Supplement concludes with some policy recommendations:
- Pursue policies conducive to a stable macroeconomic environment and sustainable growth.
- Increase public saving.
- Reform the pay-as-you-go public pension systems while developing complementary private schemes based on the principle of full funding.
- Proceed with the restructuring of the banking systems.
- Develop the capital markets.

Transition countries should think twice before adopting any tax reform aimed at encouraging household saving. As the experience of other countries suggests, while the impact of tax incentives on household saving is at best moderate and of medium-term duration, the fiscal costs can be high.

To order: Commission of the European Communities, Directorate-General II-Economic and Financial Affairs, Rue da la Loi 200, B-1049 Brussels, Avenue de Beaulieu 1, B-1160, Brussels, Belgium, tel. (322) 296-1858, fax (322) 295-7619.

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From the Hungarian magazine Hócipő

Review of Central and East European Law, a bimonthly journal dealing with various aspects of law in Central and Eastern Europe published in cooperation with the Institute of East European Law and Russian Studies of Leiden University. Kluwer Academic Publishers Group, P.O. Box 322, 3300 AH Dordrecht, Netherlands; or P.O. Box 358, Accord Station, Hingham, Massachusetts, United States, Leiden Institute: tel. (31)71-277814, fax (31) 71-277732, (Email: jfoerv@ruljur.leidenuniv.nl.)

Russia and Commonwealth Business Law Report, a biweekly newsletter from the former Soviet republics and the Baltics.
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The Slovak Economic Sheet, a monthly periodical containing briefs on recent developments in Slovak economic policy.
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