TRANSITION
THE NEWSLETTER ABOUT REFORMING ECONOMIES
Volume 4, Number 8, October-November, 1993
Transition Economies Division • Policy Research Department • The World Bank

Lessons and Consequences of the Left's Victory in Poland

Interview II with Leszek Balczerowicz

Since Leszek Balczerowicz gave an interview to Transition *in September 1992, the political landscape has changed a lot in Central and Eastern Europe.* Transition *editor Richard Hirschler revisited Poland's "shock therapist" to ask his views on the causes and repercussions of the Left's victory in Poland.*

Q. Since your first interview with *Transition* (p. 4, September 1992) postcommunist parties in Poland have won a landslide victory in the elections; in Lithuania reform-communists are solidly at the helm; and in Hungary the Socialist Party is waiting for the next election (to be held probably in May 1994), as the second most popular party. Millions of voters all over the region are yearning for the lost benefits (subsidized prices, free education, free health care, job security, stable purchasing power of pensions, and so on) and want change, this time for more social stability. Many Polish citizens initially convinced that transition offered an easy ride toward democracy, economic affluence, and social safety, now find themselves losers and have become angry, frustrated, and disillusioned. They are ready to vote into power former communist officials, who have become the guardians of economic well-being overnight. Is the pendulum of history swinging to the left again in Central and Eastern Europe?

A. I do not want to speculate. Democracy can be shortsighted, but dictatorship is often blind. In Greece, for example, the Socialists won the elections this year, although the very same team was voted out of office four years ago on the grounds that it had ruined the economy. In Poland specific circumstances contributed to the victory of the present ruling coalition: parties that were represented in the former government were badly split, while opponents of radical reform were able to organize themselves and profit from the new electoral law. That law, by the way, is much better than the previous one in that it prevents the excessive fragmentation of the parliamentary system.

What's inside. . .

Non economic issues—the overbearing role of the Church and the related anti abortion legislation, which has been adopted by the Sejm even though it is disliked by the majority of the population—also contributed to the victory of the parties of the left.

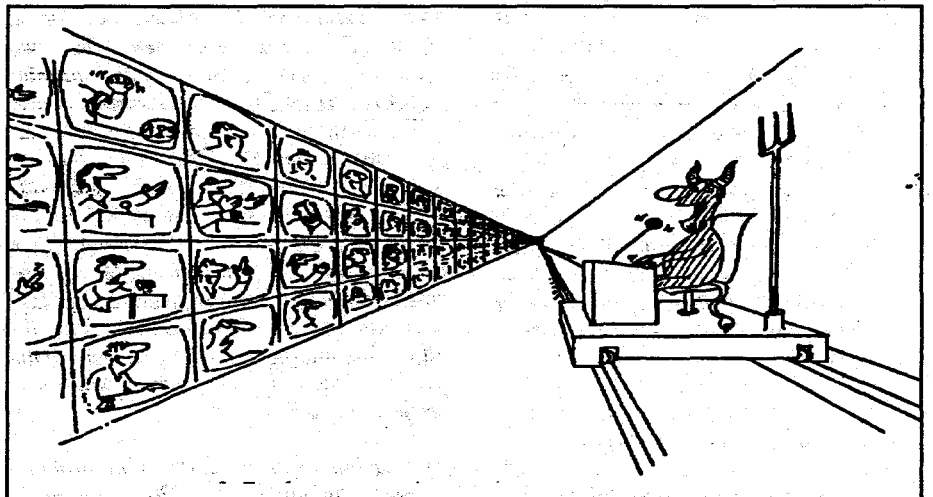
As to the economic and social issues, in 1989—Poland on the brink of total economic collapse, experiencing hyperinflation and pervasive shortages—we had no choice but to introduce a radical economic reform program. It was clear that the job security and social services provided by the old communist regime were unsustainable. But such reform transforms hidden unemployment into open unemployment and produces shifts in the relative pay and prestige of many groups. Although many take advantage of the newly established economic freedom, others, such as miners and steel workers, are resentful as they see their wages and prestige decline in relative terms. Those who feel they are in limbo often look with envy at the new winners. Still, I do not think radical economic reforms should be rejected because of these consequences.

Q. Why not?

A. Because even if one can show that radical economic reform inadvertently helped the political opposition to gain influence, who is to say that other policy solutions (such as delaying crucial economic decisions and necessary adjustment) would not have been even more hazardous to social well-being and economic development? Also, radical economic reform creates safeguards to make the transition process irreversible. It rapidly introduces a number of economic and institutional changes that act as policy constraints on any new government taking over, whatever their basic ideology and value system: independence of the central bank, currency convertibility, a strong private sector, and independence of the commercial banks. In Poland these banks are still controlled by the state, but we have succeeded in separating them from the political influence of the ministries and have introduced independent supervisory boards. Privatization of the commercial banks will, of course, be the real built-in safeguard. Although the constraints I have mentioned are not absolute guarantees, they could help preserve the reform. The effects of slow reform, on the other hand, are much easier to erase as there is not much to erase.

Q. Economic decline is history in Poland—if one believes the statistics. But the other former socialist economies still struggle with recession or, even worse, inflationary recession. Macrostabilization means placing the growth issue on the back burner. But without economic growth, the economy stagnates, inflation accelerates and, in a worst-case scenario, there is political upheaval as social tensions become unbearable. Can the new governments in Central and Eastern Europe focus on growth and at the same time achieve macrostabilization?

A. It is not enough to just speak glowingly about growth. The question is, what kind of economic strategy is best to put the country on the path of long-term growth? Only concentrated supply-side measures supplemented by a stable macroeconomy will bring the situation under control. The basic structures in the economy have to be changed. Concentrating on demand is wrong—demand management policies fail everywhere. They are inefficient in most socialist countries, not only in those that inherited a high inflation rate, such as Poland. Our basic task is to restructure the economy in two ways: we have to change the institutions, that is, the economic system itself; and, at the enterprise level, we have to change the composition of industry (product ranges and the like). It is absurd to stimulate demand in the shadow of a high inflation rate and a huge budget deficit. It is a popular notion, of course, because politicians are either ignorant or would like to avoid difficult measures. But ultimately the key to growth will be to radically re-



"Boiler room? Preheat a cauldron for the politician on screen 183!"

From the Czech magazine Dikobraz

structure on the supply side and to stabilize prices on the demand side.

Q. In some of the reforming economies, foreign and domestic investors are simply not inspired with confidence by government actions. The radical structural changes that you just mentioned aren't getting through. Ambitious projects to develop infrastructure and services become mired in the government bureaucracy, casualties of the turf war between different government agencies and political organizations. Something else, then, is necessary for a successful economic strategy, don't you think?

A. Yes. It is true that much depends on the particular circumstances of a country—the political situation, the stand taken by those who oppose radical reform, and the professionalism, dedication, and leadership qualities of the reformers. Their political skills and the kind of strategy they are able to draft and implement are crucial elements in the success of the transition process. Thus, postsocialist economies with roughly similar initial economic and political conditions will differ widely in a few years. Some will be in much better shape than others—no question about it.

Leszek Balczerowicz, Poland's finance minister and deputy prime minister between 1989 and 1991, is the author, among other works, of the books **800 Days: Managed Shock** and **Eastern Europe: Economic, Social and Political Dynamics**, *1993, University of London. He is currently in Washington, D.C., doing research on financial reform and macropolicy in the transition economies at the behest of the Policy Research Department and Financial Sector Development Department of the World Bank.*

Poland: expanding an already stretched budget?

The first left-wing Polish government since the collapse of communist rule was sworn in on October 26. The twenty-one-member cabinet of Prime Minister Waldemar Pawlak seeks to maintain economic growth but also "ensure that it is felt in each Polish household" (Pawlak). Meeting on November 2, Poland's new government decided to ask the parliament to postpone until December 29 the deadline for submission of the draft budget for 1994. The statutory deadline is November 15, but the new cabinet called this timetable unrealistic. The cabinet also reviewed 37 of the 55 pieces of draft legislation submitted to the lomei house of parliament (the Sejm) by Hanna Suchocka's outgoing government and resolved to resubmit most of them, including a copyright protection bill and five of the six bills constituting the "pact on state firms" negotiated with the trade unions in 1992-93. But the cabinet decided to withhold for revision the bill on the privatization of state firms that is the heart of the "pact." A communique indicated that the cabinet will undertake a "broad analysis of privatization." Education Minister Aleksander Luczak said a pay raise for teachers is under consideration, but not before 1994.

Pawlak has also ordered a halt to a pilot program designed to devolve powers from the central government to elected self-governing bodies in major Polish cities. The program is part of a larger plan to decentralize the state administration; it was set in motion by the former government of prime minister Hanna Suchocka. Pawlak said he wished to acquaint himself with the program and its potential fiscal consequences and that a decision would be made by December 20 about whether to restart it. In a statement to parliament, the prime minister committed the government to following stringent monetary policies supported by the International Monetary Fund (IMF), which is unlikely to approve any increase in next year's budget deficit over this year's target of 5 percent of GDP. Pawlak said policies would aim "at reducing inflation." (Poland is set on maintaining good relations with the IMF with a view to achieving further reductions in its $47.2 billion foreign debt.)

In the September 19 general election, a third of voters supported the two "postcommunist" parties—the Democratic Left Alliance (SLD) and the Peasant's Party (PSL). Together, they won a two-thirds majority in the Sejm. The SLD is a loose coalition of 27 parties, associations and trade unions, formerly attached to the Polish Communist Party. The PSL is essentially a farmers' lobby. It received nearly 50 percent of the rural vote. In agricultural policy, it is much more interventionist than the SLD, demanding state-imposed minimum prices on agricultural products and limits on food imports.

The electorate that voted the coalition into power included some 4 million state enterprise employees, 2 million employees of the social sector, 2.9 million unemployed, 8.7 million pensioners, and 4 million farmers. The 80 farmers now holding seats constitute the largest occupational group in the Sejm (23 in the Senate). Other significant interest groups include 70 teachers, 20 medical doctors, 30 journalists, and around 50 lawyers. These can be expected to add their voices to calls for an expansion of an already stretched budget. Although the new government is pledged to continue the reform process, it will face pressure from its electorate to cushion the consequences. Many of the public sector workers, the unemployed, and pensioners have seen little benefit from economic restructuring. They, like other segments of Polish society, acknowledge the necessity of further economic reform but demand better protection against its negative social effects.

The postcommunist parties have inherited the most dynamic economy in Europe: GNP increased by 3.9 percent in 1992, and industrial output by 9.4 percent. Poland's economy is expected to grow 4.5 percent this year, industrial output to increase 7 percent, and inflation to slow to 37 percent from 43 percent last year. The private sector now employs 60 percent of the work force and accounts for more than 50 percent of GDP. Poland sold off 2,385 (28 percent) of 8,441 state enterprises for a total of $473 million in the past three years.

(Based on reports of Oxford Analytica and the RFE/RL Research Institute)

Financing the Storm: Russia's Inflation Crisis

Russia has had high inflation since the collapse of the communist economic system at the end of 1991. At the same time, major reforms have been undertaken, most notably an unprecedented privatization effort and an ambitious, if incomplete, bout of price and trade liberalization. Russia now faces the issue of how to accelerate structural change, attract foreign capital, and advance the conversion to a market economy while dealing with high inflation.

Money Supply Ebbs and Flows

After an initially tight monetary policy in the first quarter of 1992, the Central Bank of Russia loosened credit for the rest of the year. The floodgates truly opened in the third quarter of 1992, fueled by huge credits to enterprises under a scheme for unraveling enterprise arrears. The flow of new credits to the government also reached large-scale proportions in the second half of 1992. Credits to other republics to finance their deficits in trade with Russia added fuel to the fire.

Monetary policy was tightened, if only moderately, as the Russian economy approached hyperinflation at the end of 1992 and beginning of 1993. In the spring of 1993 the Ministry of Finance and the central bank agreed on the credit targets. Although direct credit—mainly for enterprises—was sharply reduced, credit to government and to other republics was only modestly checked.

The agreement was short-lived. As the 1993 summer harvest season approached, the central bank initiated a new wave of agricultural credits. And the Credit Policy Commission—the government's watchdog organization—approved large concessionary credits to favored enterprises under the conversion and public investment program.

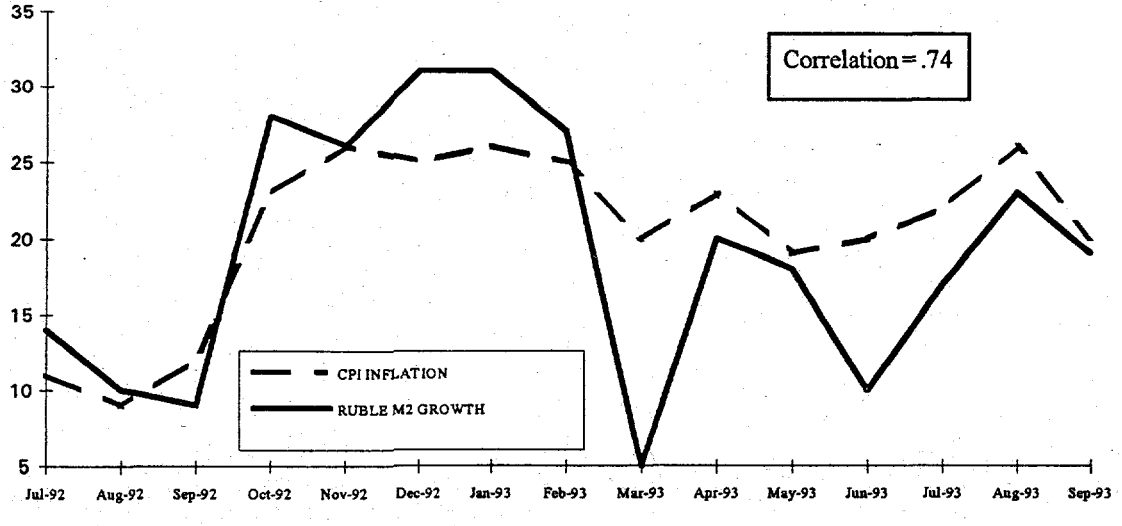
The inflation pattern has roughly followed these ebbs and flows of monetary growth with a lag of about four months (see figure 1). For example, the ruble printing presses went into high gear in the summer of 1992, and by the fall of that year, inflation had accelerated. Following the introduction of modest monetary restrictions in late 1992, price increases abated in early 1993. Then, money supply rose again during the summer months, and inflation was ready to take a ride—keeping the four months' lag.

There is an even closer link between printing money and the dollar rate of the ruble (see figure 2, p.5). The rapid monetary expansion through October 1992 was associated with a sharp decline in the ruble; the slower monetary growth since then corresponds to a real appreciation of the Russian currency. The connection between the exchange rate and ruble money balances is plausible in the increasingly dollarized Russian economy. Monetary expansion helps finance—directly or indirectly—the purchase of foreign exchange by enterprises or households, driving up the dollar against the ruble. The links between money growth and inflation and between money and the exchange rate support the view that the 1992–93 inflation in Russia has been a classic monetary phenomenon.

Inflation Taxes

Inflation in the presence of low nominal interest rates redistributes wealth from ruble asset-holders to ruble borrowers. The decline in the real value of loans, due to negative real interest rates is a boon to the borrower, who is at the receiving end of the "inflation tax" paid by the asset-holder. Calculating who loses and who benefits can be done by calculating the decline in real value of each group's ruble assets and liabilities, considering also the interest paid (see table1).

Figure 1: Inflation follows money growth with a four-month lag



Of the enormous inflation tax collected, the Russian government received only about 4 percent of GDP after netting out its own deposits. Other governments in the former Soviet Union received about 2 percent of GDP as inflation tax.

A large part of the inflation tax was received back by enterprises in the form of highly negative real interest rates on subsidized credits, not to mention the negative real interest rates that were determined by the supposedly free financial market. Enterprises were net borrowers in rubles from the Russian banking system; this financing helped them to accumulate foreign currency deposits in the banks (and presumably abroad as well). Dollar-denominated asset holdings helped protect the enterprises against the inflation tax.

On balance, the enterprises had most of their inflation tax payments offset by inflation tax receipts, although there was probably redistribution between enterprises. The main losers were households holding deposits at the Savings Bank (Sberbank) who on their financial, assets paid an inflation tax corresponding to 12 percent of GDP, which represents about a quarter of household income.

As high inflation continues, there is every reason to believe that the demand for rubles will decline further. The inefficient payments system has propped up money demand by forcing enterprises and households to keep deposits tied up in the banks for months at a time. But enterprises and households are fast learning the lesson of high inflation and—by using dollars in transactions and engaging in barter or payment in kind—they are bypassing the payments system.

As the experiences of other countries indicate, ruble money demand can still decline further in Russia (table 2, p.6). In most other countries that have experienced episodes of severely negative real interest rates, M2/GDP ratios have been below the level in Russia. Argentina in 1976 had an M2/GDP ratio that was only slightly smaller than Russia's, but the Argentine ratio was elevated by domestic price controls. Of the two countries with M2/GDP ratios higher than Russia's, Yugoslavia in 1982–84 was an obvious case of prereform monetary overhang, while Turkey in 1979–80 appears to have been a genuine outlier (perhaps Turks anticipated—correctly—that stabilization was beginning in 1980).

Table 1: Inflation tax paid and received on ruble assets and liabilities

(February 1992-January 1993 percentage of GDP)

Asset-holder	*Inflation tax paid*	*Inflation tax received*	
Total	30.90	30.90	
Households	12.04		
Enterprises	18.86	16.31	
Government (net)		4.07	
on loans(+)			7.19
on deposits(-)			3.13
Other republics		2.19	
Residual (monetary system profits)		8.34	

Of those countries with real interest rates nearly as negative as Russia's, Bolivia and Chile had M2/GDP ratios as low as 5 to 6 percent of GDP. While the Russian M2/GDP ratio has so far held steady because of inertia from the old system, we can expect that it will fall to match the low M2/GDP ratios Bolivia and Chile experienced with severely negative real interest rates. Several countries (see table 2) later produced extreme inflation (defined as greater than 2000 percent a year), a point that Russia has not yet reached Financial systems, weakened by highly negative real interest rates, are vulnerable to extreme inflation.

Shrinking Tax Base

The base for the inflation tax is the ruble money supply (M2): this "tax base" is falling. Not surprisingly, enterprises are holding more and more foreign currency deposits to protect themselves against inflation. Households are shedding ruble deposits and reducing their monetary assets to a core of currency holdings necessary for transactions.

Figure 2: Intimate links between money supply and the real exchange rate

(Ruble real exchange rate, April 1991=100)

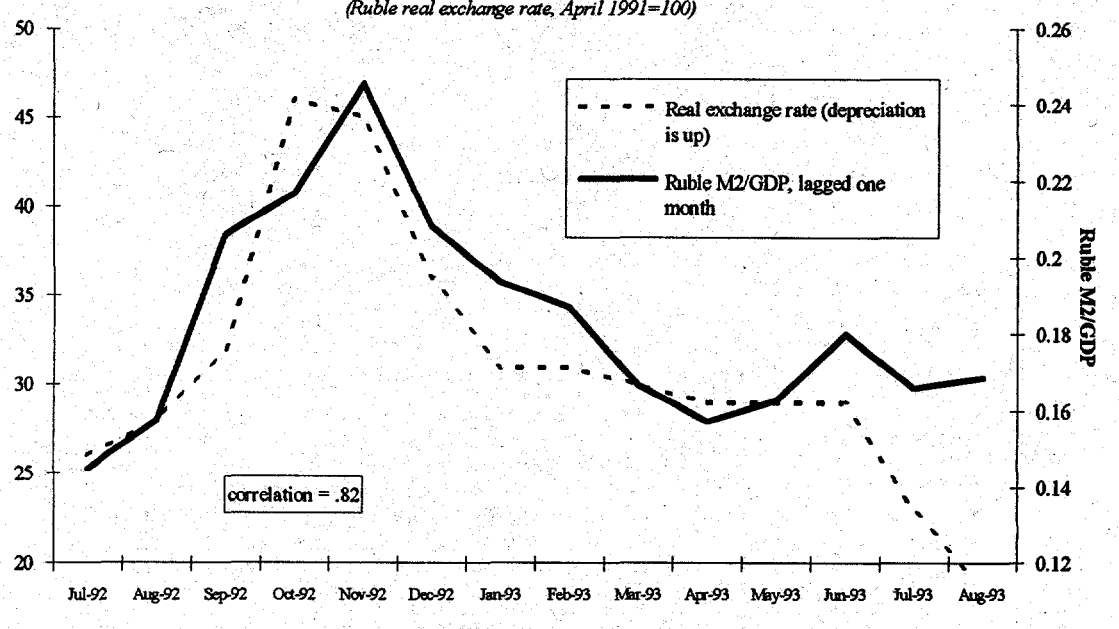


Table 2: International comparisons of high-inflation periods, Russia in 1992 and other selected countries

Country	Year	Average real interest rate during period	Ratio of M2 to GDP in final year of period	Year of extreme inflation (if any)	Yearly rate of extreme inflation
Russia	(second half of 1992)	-78	17%		
Periods with severely negative real interest rates (lower than 20% for two or more consecutive years)					
Developing countries					
Argentina	1975-76	-69	13%		
Argentina	1982-84	-32	9%	1989	4923%
Bolivia	1982-84	-75	6%	1985	8170%
Chile	1972-74	-61	5%		
Peru	1978-79	-22	13%		
Peru	1983-84	-28	9%	1990	7650%
Turkey	1979-80	-35	19%		
Eastern Europe					
Poland	1988-89	-46	9%		
Yugoslavia	1982-84	-23	31%		
Yugoslavia	1986-88	-24	15%	1989	2685%

High inflation is often easier to explain than moderate or low inflation. Russia's inflation crisis appears to be almost purely a monetary phenomenon. Resolving the crisis would mean addressing the roots of monetary growth—budget deficits and subsidized credits to enterprises.

Russia's high inflation has already lasted for twenty-two months, and some may conclude that the country can live with high inflation indefinitely. This conclusion would be a mistake. As the monetary authorities tax ruble money through rapid money growth and inflation, the base for that tax—the demand for ruble money—is disappearing. Inflation will accelerate if the current rate of monetary financing of enterprises and government continues. The clock is ticking: monetary financing will have to be reduced if the economy is to avoid full-scale hyperinflation.

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[Financing the Storm: Russia's Inflation Crisis paper can be requested from Rebecca Martin on (202) 473-9026 or write the World Bank, Room N11043, 1818 H Street, N.W., Washington, D.C. 20433.]

Russia—inflation on the run

Russia's gross domestic product (GDP) fell by 11 percent in the first nine months of 1993 compared with the same period in 1992, according to official figures. Industrial production declined by 17 percent and capital investment by 10 percent, while interenterprise debt grew to R11,300 billion (to be converted into tradable short-term notes in November under a new presidential decree). GDP for the full year could decline by as much as 18 to 20 percent from 1992. The trade surplus for this year is expected to be around $21 billion (even after drastic pruning of imports).

Runaway inflation has continued to rock the Russian economy, rising to a monthly rate of 24.5 percent in October, compared with 21 percent in September. Inflation for the year should peak at 1300 percent, however, well below last year's rate, according to Viktor Gerashchenko, chairman of the central bank. (In the first nine months of 1993, prices in Russia rose 478 percent.) Prime Minister Chernomyrdin foresees a decline in inflation to 16 percent by next March and to around 5 percent by the end of 1994. Finance Minister Boris Fedorov is even more optimistic, predicting a 15 percent inflation rate in December 1993, 10 percent in February 1994, and a monthly price expansion of 1 to 3 percent by December 1994.

Finance Minister Fedorov on November 10 submitted to the government the finalized budgets for the fourth quarter of 1993 and for the year as a whole. Planned expenditures are set at R43.9 trillion. The projected maximum deficit of R17 trillion is said to be equivalent to 10 percent of GDP. The envisaged fourth-quarter deficit of R5.5 trillion will be financed by central bank borrowing and by the issue of short- and mid-term government bonds, and gold certificates. The finance ministry warned that the 1993 budget deficit could widen to 14 percent of GDP without action to cut fourth-quarter spending.

Fedorov said recently that there would be no more subsidized credits from the central bank to industry. He also set a ceiling of R6 trillion on total central bank credits in the fourth quarter of 1993, of which R4.6 trillion would go to the government. In 1992, central bank credit expansion was equivalent to about 40 percent of nominal GDP. A fifth of this credit went to the government, more than half went to industry, and a quarter went to support purchases from Russia by other former Soviet republics.

The central bank will raise its key discount rate to a new high of 210 percent. Under Russia's complicated way of calculating interest rates, banks will actually pay an annual rate of almost 700 percent for funds from the central bank. Russia unveiled a foreign exchange control system designed to force exporters to repatriate their dollar earnings. The new scheme will go into effect in January for exporters of strategic commodities and in March for all other exporters. Export duties for raw materials and agricultural produce will rise in the new year, but export duties for industrial products will be reduced. The new export tariffs were given in a draft list circulated by the Russian Ministry of Foreign Economic Relations.

(Based on news agency reports)

Land Ownership in Russia

President Yeltsin on October 27 signed a decree legalizing the purchase and sale of land. The decree marks another step toward the privatization of agriculture. (Currently, more than 90 percent of Russia's 620 million hectares of farmland is still in the state sector. See *Transition*, September 1993, p. 9.)

A law on private property passed in March 1990 formally ended the state's monopoly on ownership of land in the former Soviet Union. The Russian parliament adopted a land code in April 1991 that reiterated the rights of citizens to acquire and resell land. In spite of some subsequent amendments, the legislation suffered from serious defects:

- In order to prevent "speculation," landowners were prohibited from selling their land freely for a ten- year period if the land was given to them by state or collective farms, or a five-year period if it was purchased from a local council. In the initial period, land could only be left to relatives or returned to local authorities.
- State and collective farms could effectively block the transfer of land to members wishing to leave. In the case of collective farms, those desiring to break away were often offered money instead of land, at grossly undervalued rates.
- State and collective farms retained control over machinery, creating numerous problems for underfinanced individuals.

In the summer of 1993 private farmers accounted for only 600,000 of the 9.9 million agricultural work force, covering 3.8 percent of stock farmland and 2 percent of sown land. Private farms and small family plots, which together constitute about 8 percent of agricultural land, produce as much as one-third of the nation's agricultural produce. The small family plots in particular have long served as a key source of food, given the regular shortages in state-owned shops. Small plots average only 0.06 hectares (about 0.15 acres), while large state and collective farms average 8,000 hectares.

Earlier this year, a new decree by President Yeltsin allowed the sale of small plots and took other far more important steps:

- Landowners have the right to buy, sell, lease, or transfer land, as well as to use it as collateral for loans.
- Workers on state and collective farms will be given a land-share certificate that will, in effect, make them landowners.
- Foreign investors can purchase land through a joint venture and, although the decree is not clear, will apparently have the right to buy out their Russian partners.
- The state can lay claim to land only for strategic purposes and is required to pay market prices for that land.

The decree also permits local authorities to transfer land from agricultural to commercial use. This is important because of the growing demand for land for manufacturing and storage.

The decree, however, is not without problems. It did not establish any process to allocate land from collective farms. Furthermore, the decree will be in force only until the new parliament institutes permanent legislation. And because of high inflation and the absence of land banks and mortgage institutions, it will be difficult for farmers to obtain the long-term loans necessary for the effective use of their land.

Initial steps are also being taken to speed the breakup of state and collective farms. Just prior to Yeltsin's decree, the International Finance Corporation and Russian First Deputy Prime Minister Yegor Gaidar announced a pilot program on six collective farms in Nizhniy Novgorod. The program allocates land and property certificates to farm members on the basis of job and seniority. The certificates are then used in an auction that determines which farmers get what land. Gaidar indicated that policies to break up state and collective farms should spread across Russia.

The moves to privatize land and increase agricultural output are important for the reform process. Russia is the world's largest purchaser of grain, importing approximately 15 percent of its annual grain needs. This drains precious foreign currency reserves. Although estimates at the beginning of the season predicted a bumper grain harvest of 125 million tons, this figure was revised down by the Ministry of Agriculture to last year's level of approximately 107 million tons. The most recent figures are even worse, however—the total harvest as of November 1 is only 96.7 tons, with only a fraction of crops still to be gathered. Bad weather and farmers' financial problems have been blamed for the low output.

Based on reports from Oxford Analytica, the Oxford (U.K.)-based research group.

Joke from the Brezhnev Era

Soviet agricultural experts are discussing the latest appalling grain harvest figures.

"We have identified four major foes of Soviet agriculture," claims one.

—?

"The spring, the summer, the fall, and finally, the winter!"

State Enterprises in China: Down to Earth from Commanding Heights

China's economy is one of the fastest growing in the world. Between 1978 (the year reforms were introduced) and 1990, real GNP (gross national product measured at constant prices) grew by 8.8 percent a year and industrial output by 10 percent a year. Between 1984 and 1990 industrial production increased by 13.5 percent, and in 1991–92 by 16.5 percent a year. (Figures quoted in this article are based on official statistics. The editor.) The question is, how has China managed to achieve such exceptional results in transforming its economy? What specific policies have contributed to this success?

Reforming State-owned Enterprises

At the start of its reforms, China's industrial sector was dominated, as in all centrally planned economies, by state ownership of industrial enterprises supervised through vertically organized industrial ministries or bureaus at central or provincial levels. China's state-owned enterprises (SOEs)—defined as those "owned by the whole people"—are variously affiliated with central, provincial, prefecture, or county governments. These accounted for 80 percent of industrial output in 1978. In 1991 there were some 104,700 SOEs in China, which accounted for 52 percent of industrial output and more than two-thirds of industrial investments.

Enterprise reforms were experimental, gradual, and phased. Between 1978 and 1982, state-owned enterprises were granted the right of self-management (along the lines of the Yugoslavia model), and the state started to share profits with them. The grant of expanded autonomy over investment, wages, and bonuses contributed to "investment hunger," due in part to the soft budgets inherent in the arrangement and pressure to raise wages and bonuses. This led to endless bargaining over profit sharing, state investments, bank credits, prices, for inputs and outputs, state deliveries of essential inputs at controlled prices and so on. State revenues declined.

From 1983 to 1987, the state moved from profit sharing to taxation through a series of fiscal reforms designed to assure enterprise contributions to declining state revenues and to put all state enterprises on an equal footing. All large and mediumsize state-owned enterprises—which constitute the bulk of the state sector—were required to pay a 55 percent share of their profits as tax. Since after-tax profits were divided through a government-enterprise bargaining process, there were large disparities in after-tax profit remittances. The state then levied additional adjustment taxes to level the playing field. But since the state remained the owner of assets and continued to interfere with key managerial decisions—mainly through its control over planned investment credits—the differentiation between profitsharing and taxation became meaningless. Decentralization did, however, grant managers considerable autonomy in running their enterprises.

Since 1987, attempts have been made to separate ownership and management in state-owned enterprises:

. The Contract Management Responsibility System specified profit targets and profit remittance quotas and technological improvements in negotiated contracts with managers, in order to provide incentives for better performance.

. Joint-stock companies were set up with shares for employees and sometimes local residents (Shenyang province is a leader in this regard).

. Enterprise groupings were formed as the state intervened to enforce closures, mergers, and restructuring in the same product groups.

Enabling Policies

Enterprise reforms in China have been supported by a number of enabling policies that have transformed the environment in which enterprises operate:

•*Gradual price reforms.* A two-tiered price system was used as a transitional device. Starting with a system dominated by controlled prices, the state has gradually allowed a larger share of goods to be traded at market prices, thus allowing production and consumption decisions at the margin to be based on market prices. As a consequence of the gradual price reforms, price distortions persisted and rents and arbitrage in the system were tolerated. However, producers gained time to adjust and the shock to producers and consumers (inherent in a rapid price reform) was cushioned. Currently, only 6 percent of state industrial production is transacted at controlled prices, instead market prices play the central role in allocating resources in the economy.

• *"Open door policy" in trade.* In 1979 China rapidly liberalized its trade regime by decentralizing exports from a dozen or so highly centralized foreign trade corporations to over 3,500 companies (still within the public sector). Specific measures include:

• Liberalizing access to inputs for exports.

• Aggressively promoting direct foreign investments and labor intensive exports. Hong Kong played a critical role in 1992, providing 70 percent of foreign direct investment (of nearly $10 billion) and purchasing or transhipping 50 percent of China's exports of over $85 billion.

• Gradually allowing exporters to keep a larger share of their foreign exchange earnings and allowing a two-tier foreign exchange market to develop in which exporters could swap their foreign exchange at market rates. Imports remain

controlled and tariff rates—although lowered—remain high for many products, providing a degree of protection to key state-owned domestic industries.

As a result, merchandise exports have grown at 12.5 percent and imports at 9.5 percent annually in real terms between 1980 and 1992. China's total two-way trade has grown from $38 billion in 1980 to $135 billion in 1992.

•*Macroeconomic stability.* Compared to most transition economies, China has enjoyed a high degree of growth and price stability. Nonetheless, China's macroeconomic management has had a "cyclical" character—that is, episodes of high growth and investments followed by rapid deceleration of credit creation and direct administrative controls to reduce aggregate demand and bring inflation under control. [This is happening right now: the Chinese government is trying to moderate inflation by cooling down an overheated economy that is growing at a 13 percent annual rate—The Editor.] The highest rates of inflation were experienced in 1987-88 when official price indices showed increases of 23 percent on average. Still, between 1980 and 1992 prices rose less than 8 percent annually.

•*Gradual, experimental and innovative reforms.* The ruling principles of China's reform program have been to work at the margin, trying a variety of reforms and ideas, experimenting to see what works in practice, and evaluating results before taking the next steps; to reinforce the changes that work, discarding those that fail; and then to slowly replace old institutions and ways of doing things with new ones. The Chinese leadership has placed great emphasis on avoiding "chaos" and large-scale unemployment, attempting wherever possible to minimize the social and economic costs of change and displacement.

•*Allowing the spontaneous emergence and rapid growth of rural nonstate enterprises in both industry and tertiary sectors.* The spectacular growth of the township and village enterprise sector has been perhaps the greatest achievement of China's reforms. At first resisted and later tolerated, the development of TVEs has occurred spontaneously at the local level and has been relatively unhindered. TVEs employ more than 90 million workers (60 percent in manufacturing and the rest in tertiary sectors including transport, distribution and construction) and account for a quarter of China's total industrial output and exports. Their growth rate has exceeded 20 percent a year in the past decade, easily surpasssing the growth rate of the state sector.

What is Different about TVEs?

TVEs are the most significant and rapidly growing component of the nonstate

Chinese Ownership Maze: Non State, Yet Not Private.

In China nonstate industrial enterprises are grouped into ownership categories described as "urban collectives," "township and village enterprises," "individual business," and "other types":

•*Urban collectives* are enterprises affiliated with municipalities or counties ("large" collectives) or with a district ("small" collectives) and include urban cooperatives. In 1991 about 190,000 such enterprises—including those jointly owned by cities and townships—accounted for about 5 percent of total industrial output. These collectives are essentially extensions of second-class state-owned enterprises with inferior access to capital and human resources. Many urban collectives are subsidiaries of state-owned enterprises from which they received start-up capital and hire surplus employees (or spouses and children). Most urban collectives suffer from bureaucratic inertia, interference, inefficiencies, and lack of clear autonomy (the same problems suffered by state-owned enterprises).

•*Township and village enterprises (TVEs)* are rural collectives affiliated with township or village governments and include rural cooperatives. In 1991, of nearly 1.6 million collectively owned enterprises, over 1.39 million were TVEs accounting for 24 percent of total industrial output. Thus, among all the nonstate forms of ownership, the largest share of industrial output is accounted by TVEs.

•*Individual Businesses,* owned by families or individuals, with a limit of seven employees, have been allowed to operate since 1978 and account for about 5 percent of industrial output. In 1991, 92 percent of the nearly 6.3 million individual businesses in China were in rural areas. (The number of individual businesses is closer to 17 million if one includes household and private ventures in agriculture and in the tertiary sectors.)

•The *"Other Types"* category includes private enterprises hiring more than seven employees, foreign enterprises, joint ventures with foreigners, other types of joint ventures (say, between state and nonstate and foreign partners), and joint stock companies. Some 10,800 enterprises in this category account for less than 5 percent of industrial output.

The "private" sector in China thus includes—at the most—the last two categories, although some rural enterprises classified as TVEs are dominated by a given group of individuals. Cooperatives are more in the nature of "partnerships" hiring many employees and should be considered private. Altogether, about 12.5 percent of total industrial output in 1991 was produced by "privately owned" enterprises using this classification, up from 5 percent in 1985.

The rest of China's nonstate enterprises are collectively and hence publicly owned and cannot be considered private by normal definitions of ownership. In China there is still a lack of legal protection for property rights and no clear commitment to private ownership.

sector in China (see box p.9). Compared with traditional state-owned enterprises, the operations of the TVEs have been characterized by :

•*Better governance.* TVEs are better able to overcome many of the principal owner-agent (manager) problems because they are locally owned, supervised and managed, instead of being supervised by far off central bureaus and ministries,

• *Greater autonomy.* Because TVEs are closer to the market, they are more market responsive. By changing resource and product mix, adapting to new technologies and market opportunities, and increasing investments (from own earnings) or disposing of fixed assets, they have demonstrated an impressive awareness of market realities. Compared to State Owned Enterprises, TVEs are more free to hire and fire labor, link wages to performance, rent and buy land locally, construct, and transact business with buyers and sellers, of their own choice.

•*Clear-cut incentives.* The major incentive for the local governments that own TVEs is to maximize post-tax returns to their capital investments, while taking care of their "own" labor force (as distinct from migrant casual labor). The state owned enterprises have no such clear and simple optimizing goals.

• *Hard budget constraint.* TVEs rely mostly on capital generated from their own earnings or on local and household resources. (Only 8 percent of all bank loans go to TVEs, while state-owned enterprises capture at least 80 percent.) TVEs receive neither the subsidized bank credits nor the centrally allocated materials commonly available to state-owned enterprises. They buy and sell inputs and outputs at market prices and generally operate under hard budget constraints.

•*Less regulations and social obligations.* Unlike state-owned enterprises, TVEs are not obligated to provide a plethora of social services including housing, health care, education, and lifetime employment and pensions to their employees and their dependents. They are thus free from the "iron rice bowl" that reduces factor mobility and compromises work incentives.

• *Greater competition.* TVEs number and smaller average size, coupled with the growth of domestic demand and reduction of barriers to internal trade, ensure growing and ever-fiercer domestic competition. Each year thousands of new TVEs enter the market, while thousands of old and failing ones exit from it. The greater concentration of TVEs in coastal provinces and the strong links to investors from Hong Kong and Taiwan—assiduously cultivated by Chinese local and provincial officials, even in inland provinces—have enhanced competitive factors by bringing in new technologies, and management methods, markets for exports, and a "kindred model" to emulate. Being very competitive, TVEs have actually increased the pressures on state owned enterprises for better performance.

In short, TVEs operate in a highly competitive environment in which managers, local workers, and local officials appear to behave as shareholders with consistent objectives.

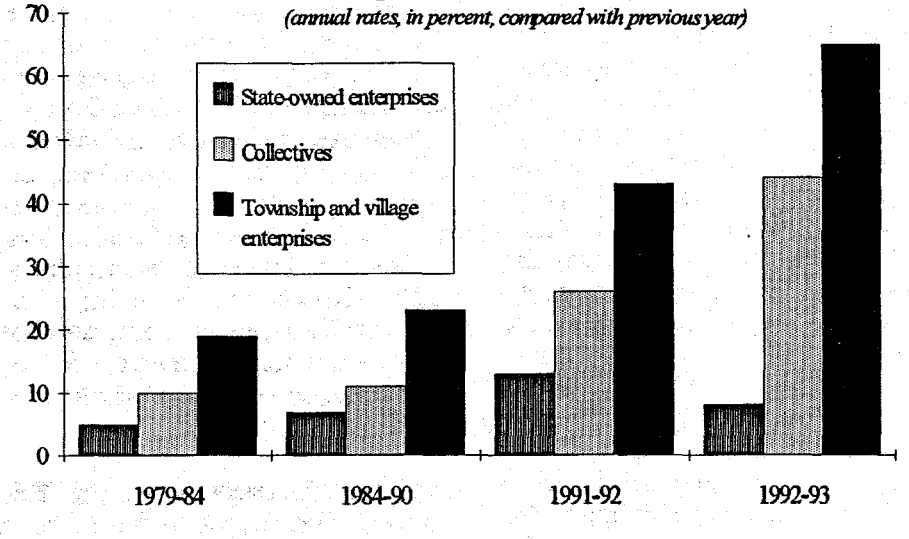
The nonstate sector's share in total industrial output has increased from 21 percent in 1978 to over 48 percent in 1991. Employment and exports have expanded much faster. TVE's share of industrial employment had increased from 22 to 39 percent in the same period, and their share of exports had grown from 4.8 percent in 1985 to 24 percent in 1990. State-owned enterprises that once dominated the commanding heights of the centrally planned economy and accounted for 90 percent of industrial output in 1966 have been slowly turned into islands in a sea of thriving and dynamic nonstate enterprises.

So far there has been no widespread change in formal ownership rights within China's state sector. State-owned enterprises continue to be publicly owned -by central, provincial, or county authorities. But "public ownership" is elastic enough to allow ownership diversification—including joint ventures with private foreign investors and ownership of shares by other publicly owned mutual and pension funds and insurance companies.

I. J. Singh, Transition Economics Division, Policy and Research Department, The World Bank, and
Gary Jefferson, Department of Economics, Brandeis University.

China's growth rates from 1979 to 1993

(annual rates, in percent, compared with previous year)



(Based on official statistics)

(preliminary, January-June only)

Should Eastern Europe Feel Privileged with Its Limited Market Access to the European Community?

Alan Winters Responds to Bartlomiej Kaminski on EC Trade Policy

Bartlomiej Kaminski's article in the September issue of *Transition* implies—although it does not state—that the Europe Agreements between the EC and the transitional economies of Central and Eastern Europe (CEE) represent good and fair policy on market access. He reasons that:

. CEE shares of the EC market have grown substantially since 1988.

. "There is no evidence of discrimination despite the economic slump in the EC."

. The Agreements offer the CEE countries more privileged market access than almost any other of the EC's trade partners. He supports this last claim with an account of most of the relevant components of the Europe Agreements and their implementation.

I disagree. Not with the facts that Mr. Kaminski presents but with his selection and interpretation of them. Mr. Kaminski frankly admits that he "prefers to look at [the CEE countries' market access] in the context of EC preferential trading arrangements," and from that viewpoint they are, indeed, not bad at all. But why consider the issue from this standpoint alone? Are the Alps small mountains because Everest is higher? Is having the flu fun because having pneumonia is worse? EC preferential trading arrangements generally offer trading partners relatively little market access in the goods they can produce efficiently and even less when the goods in question are sensitive in the EC. The EC thus curtails partners' ability to gain from comparative advantage and imposes costs on EC industry and consumers. The problem with the Europe Agreements is precisely that they come from the same mold as the earlier preference and Association Agreements and that one recognizes in them the influence of exactly the same set of EC producer interests, including coal, steel, agriculture, textiles, and clothing.

This is the EC View... "Do as we say, not as we do"

The EC does deserve some credit--it offers the CEE countries a more attractive trade regime than does, say, the United States or Japan and it has overcome some of the pressures from some of the interest groups in signing the Europe Agreements. But given the CEE countries' needs, the Agreements are hardly adequate. It is perverse to encourage the CEE countries to throw off the chains of economic planning in favor of free markets only to tie up some of their principal exports in the red tape of quantitative restrictions and managed prices. The advice "do as we say, not as we do" is not proving very constructive for Central and Eastern Europe's policymakers as they struggle with their own farmers' and steel workers' demands for support. To follow the lead of the EC Commissioner for Taxation, Mrs. Scrivener, and plead EC "economic crisis" as a reason for not liberalizing imports from the CEE countries does not help the case for adjustment in economies where output has fallen by 20 to 30 percent.

Mr. Kaminski is right to note that CEE-manufactured exports to the EC have grown strongly despite the identified nontariff barriers and that agricultural exports have grown slowly for domestic reasons. But one cannot conclude from these developments that the Europe Agreements are benign.

First, export growth per se is not a conclusive indicator of economic benefit—consider, for example, EC exports of cereals—and export growth from such a low base as that of the CEE countries in 1988 is not so spectacular. What matters is that the exports stimulate competition and efficiency in the exporting country, an aim that is seriously undermined if they are subject to quantitative management or implicit pressures from importing governments and industry associations.

Second, Hungary, Poland, Bulgaria, and Romania are all potentially strong exporters of some agricultural products, and the EC's restrictions in these areas will certainly constrain them eventually. Certainly, that is, unless these countries take the EC's implicit, and occasionally explicit, advice to manage output firmly. Current agricultural exports are small and have recently been disrupted, but rationalization and improved performance in this sector represents some of the more obvious and more easily achieved steps toward economic growth over the next decade. To be excluded from the rich neighboring EC market of more than 300 million people is a poor incentive for rational agricultural restructuring.

Manufacturing is subject to fewer restrictions under the Europe Agreements than is agriculture, even for most sensitive products. For example, although quantitative restrictions will remain in

force for at least five years on textiles and clothing imports, the quotas for the CEE countries have been significantly increased since 1988. The problem, however, is that continued access is not guaranteed. The Agreements abound with safeguard clauses that are easier to apply and offer more restrictive "solutions" than do safeguards under GATT rules. Moreover, even though the CEE countries have agreed to adopt the entire EC competition law within three years, they are still to be subject to antidumping actions. True, the EC will not use its draconian antidumping rules for nonmarket economies (a concession granted only after the signing of the first Europe Agreements), but the CEE countries will still be treated in the same delicate fashion as, say, Japan or Korea.

Steel is a good example. Steel quotas were relaxed for 1992, and CEE exports to the EC boomed. The result was antidumping action that was followed, despite the promise of unrestricted access under the Europe Agreements, by the imposition of quotas; those for the Czech Republic and Slovakia will reduce exports significantly in 1993 relative to 1992 (see p.20 on CEPR Discussion Papers, the Editor). Steel is not the only industry fingering the antidumping trigger, even if it is the worst. Moreover, it is far from obvious that a shift into more sophisticated goods will, as Mr. Kaminski suggests, avoid further problems. Central and Eastern Europe is worried that any serious expansion in their exports will encounter restrictions—consider, for example, color televisions, car radios, DRAMs, photocopiers, and outboard motors, all of which currently face EC antidumping duties on imports from some sources. The issue is not that all commercial successes will necessarily be thwarted, but that the threat that any of them might be so treated deters risk-taking, preventing success from emerging in the first place.

Finally, consider the complex and arcane rules of origin that constitute a large part of the text of the Europe Agreements. Broadly speaking, to qualify for free market access to the EC, Central and Eastern European exports must contain at least 60 percent local or EC content (and "local" does not even include all of the Central and Eastern European countries in every case). This is fine for EC firms setting up plants in the CEE countries, but what about non-EC firms? Many plants have to rely heavily on imports of parts in their early years, especially in host countries with weak industrial bases. Thus, these rules effectively preclude many non-EC firms from establishing viable plants in the Central and Eastern European countries.

Mr. Kaminski is right to remind us that the EC is not all villain in the matter of market access for Central and Eastern Europe. But given its historical and geographical role in the area, the CEE countries' needs, and the costs of restrictions to EC consumers, and considering that expanding CEE-EC exports would do so much for Central and Eastern Europe and impose so little adjustment on the EC (Central and Eastern Europe currently accounts for about 4 percent of EC imports), the Europe Agreements fall well short of what should have been offered.

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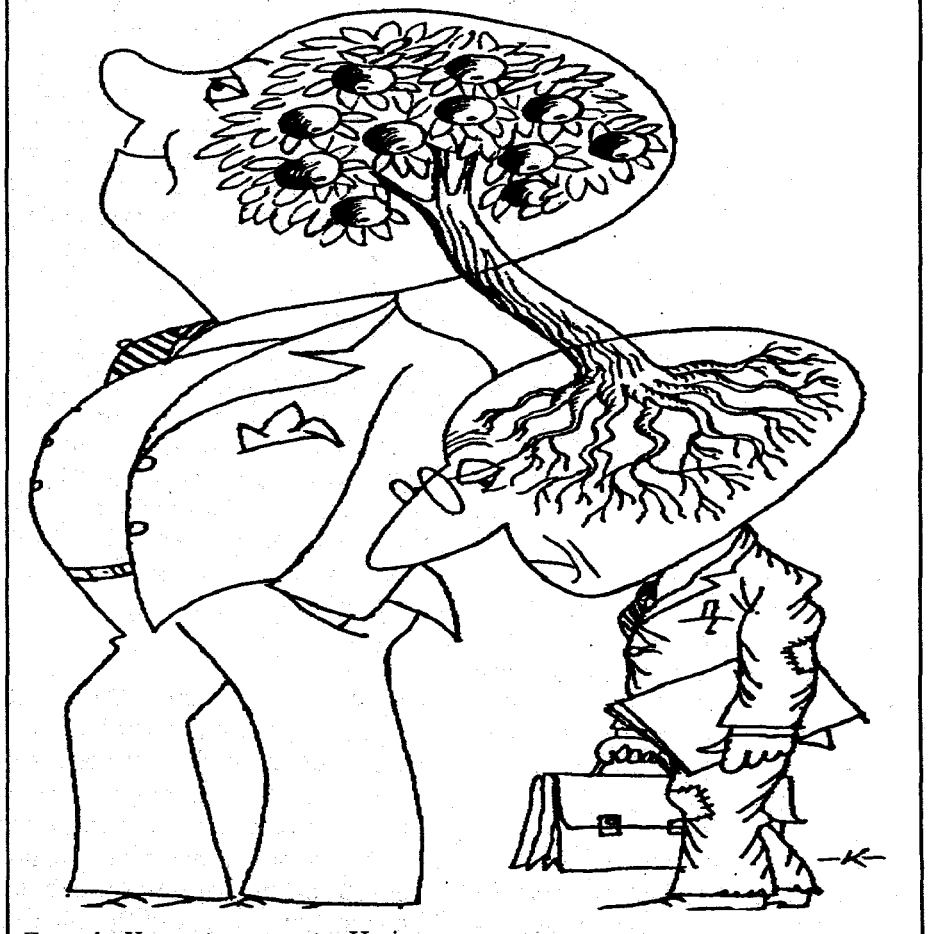
Fruitful ties: manager and advisor



From the Hungarian magazine Hocipo

Quotation of the Month: "The Goal is a Capital Market, Which Viet Nam Technically Never Had"
Global Investor Reports on the Preparation of Ho Chi Minh City's Stock Exchange

Viet Nam is growing up. As recently as eighteen months ago, a Western visitor could walk down the streets of Ho Chi Minh City accompanied by young children shouting "Lien Xo!" meaning Soviet. No longer. Economic reforms emanating from a government dedicated to *doi moi* (renovation), plus the collapse of the U.S.S.R, has led to a bustling economy pointing the Socialist Republic of Viet Nam on the road to the status of Asia's newest tiger.

One of the goals of the government and the newly emerging private sector is a capital market—something Viet Nam technically never had. Looking around at Shanghai, Shenzhen, and other seemingly brand new markets is seductive but misleading. Shanghai had thirty-five stock markets and informal trading centers all over China. Viet Nam has never had a stock market.

Meanwhile, the state bank appointed the Institute for Economic Research, an arm of the Ho Chi Minh People's Committee (the local government), to set up a task force to formulate a pilot stock exchange project. Chaired by Tran Du Lich, a member of the National Assembly and a lawyer by training, the task force presented its working paper in January of this year.

The paper recommended a two-phase approach where initially the exchange would include the trading of government bonds, plus the listing of five to seven firms drawn from state-owned companies that have gone through the process of equitization (the Viet Namese government's preferred word for privatization). Other firms that would qualify would be joint-stock or private shareholding companies. But according to Lich, "of the 487 joint-stock companies in Ho Chi Minh City, only two or three would qualify. We require the financial status of the companies to be good in that the company has to have two years of profits to become eligible. We also require a minimum of dong 10 billion ($1 million) in equity and good strong managers."

The second phase, not scheduled to take place until 1995, depends on the development of more joint-stock companies. Lich predicts that between 1995 and 2000 the listing process should attract about 100 qualified companies. His task force also leaves open the option of listing foreign or joint-venture companies.

While even the pilot plan seems small-scale, a number of issues remain. Only one company, Legamex, an aggressively managed diversified garment and footwear manufacturer, has gone through the process of equitization, with the flotation taking place the first week of August 1993.

The two-year-old Viet Nam Audit Company of the Ministry of Finance has been charged with valuing the potential equitized companies. Up to this point four companies—Legamex, Binh Minh Plastic, Hiep An Footwear, and the Union of Transportation Agents—have been officially assessed by the audit company.

The International Securities Consultancy [engaged by the World Bank's IFC to make recommendations on establishing a stock exchange] is more conservative, advising that the capital market establish first a money market to provide for trading of short-term debt and other instruments. Most Viet Namese keep their savings at home or in gold and have a deep distrust of banks. The take-it-slow approach has support in various circles, even from the governor of the South Viet Namese central bank, Nguyen Xuan Oanh. Oanh, who was also the deputy prime minister for economy and finance and was acting prime minister in the Saigon government, is now an adviser to the current government and a director of the Beta Viet Nam Fund.

"As for government debt," says Oanh, "setting up an open market operation is very much needed. I don't think the stock market is something we have to do immediately. We have to first institutionalize shares and make joint-stock companies work correctly. We need to set up a capital market system through money markets. The rest is three to five years off."

In fact, the whole concept of financial institutions in Viet Nam is still quite new. The Saigon Finance Company was established in late 1991 with capital of $1 million and a charter to perform financial services. Claiming to be Viet Nam's first financial company, the firm is only now getting off the ground. While the firm hopes to begin trading government securities soon, it is doing a brisk business in issuing and making a market in short-term promissory notes, says Ta Hong Gioi, finance director of the Saigon Finance Company.

Indeed, the tiny private sector, which was recognized by the Viet Namese government only in the last year, represents only about 5 percent of the country's enterprises. Compounding the problem, many of the state-owned enterprises are not profitable—some are even bankrupt. According to Le Trang, industrial

management director of the State Planning Committee's Central Institute for Economic Management, in 1989 there were 12,084 state-owned enterprises, but since the government's market reforms have taken hold, 5,000 have closed their doors. Many of these companies had their subsidies cut by provincial authorities, while others are too small or poorly managed to be competitive. "Only the big enterprises are positioned well. The small ones are difficult—nobody would buy them," says Trang.

Apart from the lack of cohesive corporate, commercial, property, and bankruptcy laws, Viet Nam's accounting system is still based on the socialist system of accounting for production rather than costs or profits. As with many other newly market-oriented economies, financial reports are not produced with an eye to presenting information to outsiders. With only this type of information to draw on, accountants agree it is difficult to determine the financial status of a company from an investor's point of view.

As a step toward dealing with the problem, the Ministry of Finance has just approved a short-list of accounting firms for a United Nations Development Program–funded plan to bring Viet Namese accounting standards up to internationally recognized standards.

A prime ministerial decree that would establish a National Securities Commission is being prepared. The draft decree includes a distinction between shares and bonds, preferred shares, and bearer and registered shares. The decree also covers securities companies, brokers, share trading, listing, issuing of shares to the public, management of the exchange, and the responsibilities of the National Securities Commission. [As agreed, it will be located at 17 Ben Chuong Duong, the former headquarter of Banque d'Indochine in the French colonial days. Fronting the Saigon River, the commanding building now proclaims itself as the State Bank of Viet Nam.]

From Betsy Massar's recent article "Taking Vietnam to Market," published in the Global Investor, *a Euromoney publication in the United Kingdom.*

Conference Diary

Forthcoming

Privatization in Central and Eastern Europe
December 3-4, 1993 Ljubljana, Slovenia

International conference organized by the Central and Eastern European Privatization Network (CEEPN). Sponsors include the Economic Development Institute (EDI) of the World Bank, Commission of the European Communities - PHARE, and United Nations Development Programme (UNDP). Attending will be senior officials, directors and experts from privatization ministries and agencies in Albania, Bosnia and Hercegovina, Belarus, Bulgaria, Croatia, the Czech Republic, Estonia, Germany, Hungary, Kazakhstan, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Slovakia, Slovenia, Ukraine, and Uzbekistan. Vaclav Klaus, prime minister of the Czech Republic, will attend the meeting. Discussions will include: privatization through restructuring; investment funds in privatization; foreign technical assistance for privatization; and new horizons of privatization in Central and Eastern Europe.
Information: CEEPN, Dunajska 104, 61109 Ljubljana, P.O. Box 18 Slovenia, tel. (386 61) 1683 396, fax (386 61) 346 660.

Labor Market Changes in Central Europe: Lessons for Social Policy
January 21-23, 1994, Vienna, Austria.
Information: Institute for Human Sciences (IWM), Vienna, Spittlauer Lande 3, A-1090 Vienna, tel. (431) 313-580, fax (431) 313-583.

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

Annual Bank Conference on Development Economics
April 28-29, 1994, Washington, D.C.

Organized by the World Bank, inaugurated by President Lewis T. Preston, with Vice President Michael Bruno's keynote address on aspects of adjustment, transition, and reform. Several sessions will focus on "Transition in Socialist Economies." Discussions will include: Macropolicy—Theory and Practice (Leszek Balcerowicz and Alan Gelb, Stanley Fischer, Janos Kornai); The Economy of the FSU—Retrospect and Prospect (Jeffrey Sachs, Anders Aslund, Maxim Boycko); Property Rights in Transition (Andrei Shleifer, Oliver Blanchard, Roman Frydman); Chinese Reform Experience with State and Nonstate Enterprises (Thomas Rawski, Gary H. Jefferson, Nicholas Stern, Shahid Burki).
Information: Boris Pleskovic, the World Bank, RAD, tel. (202) 473-1062, fax (202) 477-0955.

The Economy of Ukraine in Transition: Reforms, International Relations, Ecology
May 23-27, 1994, Odessa, Ukraine
Second Congress of the International Ukrainian Economic Association. Calls for papers (to be delivered in Ukrainian, English, or Russian).
Information: V. N. Bandera, Economics Deptartment, Temple University, Philadelphia, PA 19122, tel. (215) 204-5039, fax (215) 204-8173.

Economic Democracy after the Cold War and Self-managed Yugoslavia
June 16-18, 1994, Portoroz, Slovenia
The Seventh Conference of the International Association for the Economics of Self-Management (IAFESM).
Papers dealing with workers' participation, self-management, and economic and industrial democracy are welcome. More specifically: economic theory, empirical evidence, institutional and historical studies, and experiences in Central and Eastern Europe in both developed and developing economies.
Information: Vice President Milica Uvalic, IAFESM, Borgo Santa Croce 17, 50122 Florence, Italy, tel. and fax (39-55) 244-895.

The Twenty-sixth National Convention of the AAASS
November 17-20, 1994, Philadelphia, Pennsylvania
Information: The American Association for the Advancement of Slavic Studies, Jordan Quad-Acacia, 125 Panama Street, Stanford, CA 94305-4130, tel (415) 723-4438.

World Bank/IMF Agenda

Mongolia receives $30 million from IDA

A credit of $30 million from the International Development Association (IDA), approved October 29, will help Mongolia pay for imports and technical assistance needed to keep coal and copper output thriving during the next twelve to eighteen months. It will also improve Mongolia's railways, provide high-grade lubricants for tractors and trucks, and buy newer, more environmentally friendly gas pumps. Mongolia's large copper industry, which accounts for half of the country's export earnings, will also receive assistance from the credit. Prices for copper have dropped worldwide, so Mongolia needs to boost production to make up for lost income.

World Bank Loan to Master Shanghai's Traffic Congestion

A $150 million World Bank loan, approved end-October, will support the economic and social development of Shanghai, China's largest port and one of the world's densest cities. China aims to use the loan to improve the efficiency of the city's urban transport system and to improve the system's planning and management.

Donors Back Viet Nam

Sponsored by the World Bank and United Nations Development Programme, a donors' conference, held in Paris on November 9-10, pledged aid worth a total of $1.86 billion to Viet Nam to help it with economic reforms next year. Roughly 60 percent of the money will come from individual governments, led by Japan, while the rest will be provided by such international bodies as the World Bank and the Asian Development Bank. Do Quoc Sam, the chairman of Viet Nam's State Planning Commission, told aid donors that his country plans to double its GDP by the year 2000. Viet Nam adopted a policy of "doi moi," or renovation, in 1989. Doi moi measures include rural reforms; exchange rate, fiscal, and interest rate reforms; promotion of private sector growth; changes in foreign trade regulations; and programs to minimize the "social costs" of economic reforms. Real GDP has grown an average of 7.25 percent a year between 1991 and 1993, and inflation has decreased from more than 500 percent to the current rate of about 10 percent. Viet Nam's deputy Foreign Minister Vu Khoan told reporters the aid would be used to develop infrastructure and support social projects. The country needs to raise about $40 billion to meet its goal of doubling annual gross domestic product, currently $9.1 billion, by 2000, according to an official report.

IDA Credits to Viet Nam ...

On October 26, the IDA approved two credits to Viet Nam totaling about $228 million. A credit of $70 million will support primary education while another credit of $158.5 million will be spent on highway repair. The credits are the first Bank lending to Viet Nam since 1978. The primary education project will improve the quality of education and management in grades one through five nationwide, while more than 10,300 classrooms will be repaired or added to existing facilities and some 12,000 latrines and safe water supply systems will be provided. Recognizing that the transportation infrastructure urgently needs upgrading, highway 1-A, a two-lane highway that is the country's main north-south link, will be repaired and upgraded. (Only about 10 percent of the country's roads are paved, and a recent survey of that 10 percent found that almost 40 percent were in poor condition.) The Asian Development Bank (ADB) for its part approved a $76.5 million flood control project loan and predicted that two more loans would be approved in November, bringing this year's total lending to $261.5 million.

The World Bank and ADB have each estimated that they will lend $300 million to $350 million annually to Viet Nam during the next few years.

...and to Cambodia

The IDA on October 26 approved a credit of $63 million to help Cambodia rebuild crumbling essential services. The credit marks the first IDA lending to Cambodia since the country joined the institution in 1970. (IDA is a World Bank affiliate that lends on concessional terms to the poorest countries.) The $63 million will help pay for imports needed to keep Cambodia's badly deteriorated services moving—and critical economic production alive—during the next twelve to eighteen months. The bulk of the funds, some $38 million, will purchase a specific list of goods aimed at rehabilitating services in the agriculture, transport, health, education, power, and water supply sectors. The other $25 million will cover the cost of importing critical commodities, including fuel, spare parts, and machinery. Due to the partial economic reforms launched in 1991, economic output rose from 1.2 percent in 1990 to 7.6 percent in 1991, and to 7 percent in 1992. Barely half of Cambodia's 8.6 million people have access to health care, only 12 percent of the rural population has safe drinking water, and electricity is for many a thing of the past.

Donors Support Moldova and Belarus

The World Bank announced on October 22 a $60 million loan to Moldova to support the country's economic reform. The loan will help pay for imports such as medical supplies and heating fuel. In another development, Western donor nations and international financial institutions endorsed efforts by Moldova and Belarus to stabilize their economies and accelerate market-based reforms. The endorsements came at separate meetings end-October in Paris—the first World Bank-sponsored Consultative Group meetings for the two countries. World Bank Director Basil Kavalsky said after the meeting that Belarus would need external financing on the order of $600 million next year and Moldova, $150-$200 million. The Bank will seek over the next few weeks to firm up support at these levels from donor countries. Both the Bank and the IMF expect a further modest decline in output of the two economies next year, but according to Kavalsky, the recession triggered by the breakup of the Soviet Union appears to be bottoming out, with the beginnings of a turnaround expected in 1995. Kavalsky also remarked that it was of critical importance that producers in the former Soviet Union be given the opportunity to trade effectively and to penetrate western European markets; otherwise, those countries will need "enormous" aid for a long time. (In other developments, Belarus devalued the Belarus payment certificate by 27 percent to 4.1 rubles, while Moldova will introduce a national currency, the leu, by November 29.)

IMF, World Bank Bolster Baltic Economies

On October 28 the IMF approved $32 million to support economic reform in Estonia. The credit is split equally, with $16 million in stand-by credit to support the government's 1993/94 reform program (to be drawn until March 1995) and $16 million under the Systemic Transformation Facility (STF), which is available immediately. The IMF also approved $71.2 million in credits to Lithuania, divided equally between a seventeen-month stand-by and an STF. Valdis Freidenfelds of the Latvian Finance Ministry announced that the World Bank has agreed to help Latvia implement a complex program of banking and industry reform. The debts of state-owned industries to the Bank of Latvia will be transferred to one institution and restructured; once the indebted enterprises are able to resume production, they will have to repay their debts.

Aid Pledges to Africa

Emerging from a three-day meeting in Paris on October 19-21, 17 donors agreed on the program and the target of $8 billion in donors' adjustment assistance for the third phase of the Special Program of Assistance (SPA) covering the period 1994-96. Under the program, donors will continue to provide quick-disbursing balance of payments support for reform in 27 eligible countries in conjunction with assistance from IDA and the IMF. SPA donors pledged approximately $5.5 billion in adjustment assistance. Donors' ability to support African development efforts are constrained by the slow economic recovery in the industrialized countries and by many new competing demands for assistance elsewhere in the world. World Bank Vice President for Africa, Edward Jaycox, who chaired the meeting of donors, stressed that everybody has to make further efforts to close the remaining financing gap. "We will need to look to all sources of financing including an expanded ESAF (Enhanced Structural Adjustment Facility of the IMF) and for more concessional debt relief from the Paris Club, as well as greater selectivity in allocating assistance linked much more closely to the implementation of reform programs.

From the Russian daily, Izvestia

Milestones of Transition

Ukraine's central bank chairman Viktor Yushchenko said monthly inflation averaged 36 percent in the first three quarters of the year, an acceleration that he blamed in part on credits issued by the government. The entire financial system is in disarray, he told parliament. He proposed stern measures to control increases in money supply. He called for new taxes and lower government outlays to narrow the budget deficit and urged freeing prices and speeding privatization. He faulted the government for ordering the central bank to issue credits to failing industries, Yushchenko said inflation had been running at 50 percent a month since July. A presidential decree extended the state-ordering system into 1994. Under the system, both state-owned firms and quasi-private companies are obliged to sell part of their production to the government at set prices.

The **EBRD** executive board in early November approved a proposal by EBRD president Jacques de Larosire to reorganize the bank along regional lines by ending its distinction between merchant and development banking activities. De Larosire said the shift to a country focus was a way of reinforcing the EBRD's private sector mandate. Ron Freeman, current head of merchant banking, will be in charge of the new North Zone, and development banking head Mario Sarcinelli will head the South Zone. The number of specialist bankers assigned to a specific country is expected to rise to nearly 120 from around 40. In his first press briefing since taking over at the bank, de Larosire said he could not have gone on for another week with the problems the EBRD was facing. In a report to the board he described a confusing organizational structure that lacked operational focus. De Larosire praised the quality of the EBRD's staff.

Members of the **Coordinating Committee for Multilateral Export Control (Cocom)** decided at their November 3 meeting in Oslo to replace Cocom with a new body by the end of 1993. The new organization is expected to include Russia, with the possible proviso that it first establish an effective export control system. Cocom was established in 1951 to monitor and restrict exports of high-technology goods of potential military or strategic value to the former "Communist bloc" nations. The new organization is expected to focus on controlling exports to nations that sponsor or tolerate terrorism and to those countries that may be illicitly developing weapons of mass destruction.

The **European Union** agreed to wide-ranging trade concessions to Russia as part of a drive to secure a new trade and political pact with Moscow before December elections. The European Community agreed to seek a more liberal trade accord with Russia by year-end and offer Moscow the prospect of a free trade agreement as early as 1998.

Chinese economists, in a report prepared by the Academy of Social Sciences and the State Statistical Bureau, are predicting that inflation in China will moderate to about 10 percent next year compared with 14 percent in the first three quarters of this year. They are also forecasting that the country's growth will slow in 1994 to 10 percent from the 13.3 percent recorded in the nine months to September. (Growth of industrial output reached 19.1 percent in the first nine months of this year. Bank savings rose to $240 billion by the end of September, and infrastructure investment rose by 107.5 percent. However, the cost of living in the 35 biggest cities rose by 20.7 percent).

China expects pledged foreign investment in 1993 to hit a record $100 billion. Statistics from the Ministry of Foreign Trade and Economic Cooperation showed that pledged foreign investment in the first nine months of the year amounted to just over $83 billion for nearly 63,000 ventures, a 170 percent increase compared to the same period last year. Funds actually disbursed between January and September came to $15 billion.

The **Romanian** National Bank announced on October 26 that interest rates on overdrafts allowed to commercial banks will be raised from 150 percent annually to 250 percent. In another development, Radio Bucharest announced that in negotiations with the trade unions the government made new proposals, including an offer to raise minimum wages to 38,500 lei (about $38) and index salaries to the cost of living at a rate of 60 percent. The Romanian cabinet also approved a draft law providing money to help the poor pay their heating bills from November through April. The aid would amount to between 4,000 and 5,000 lei a month for people earning as little as 17,000 to 25,000 lei monthly. The money will be raised by a new levy on travel abroad whereby Romanians will have to pay 5,000 lei for each trip. The levy for local cross-border traffic will amount to 2,500 lei. The bill is expected to be passed in emergency procedures by Romania's parliament.

The **Hungarian** government is to launch a small investor shareholder program (SISP) in January 1994. About 100-120 billion forints worth of shares in 70 companies will be involved. Every Hungarian citizen over the age of 18 may open an investment account of 100,000 forints which would entitle them (for a registration fee of 2,000 forints) to obtain state-owned shares of equivalent value. Shares will be available for cash, compensation coupons, or five years' credit. A tender will be invited soon to lead the program. The initial wave of sales will

see shares worth 5 billion forints in eight profitable companies floated on the Budapest stock exchange in January.

A new **Hungarian** company, Investment and Trade Development, Ltd. (ITD Hungary), has been set up by the Ministry of International Trade to promote exports and attract more foreign investment to the country. Currently, some 15,000 Hungarian companies are involved in foreign trade as compared to 41 in the mid-1980s. The company sees good possibilities for foreign investors in areas such as manufacturing, food processing, and the tourist industry.

At end-October the **Slovak** cabinet approved a budget proposal that plans for a zero growth rate and a 5 percent budget deficit (16 billion koruny) in 1994. An earlier draft had set the unemployment rate at 20 percent, but the new one forecasts unemployment of no higher than 17 percent. The budget will now go to parliament for discussion.

Multilateral development institutions are claiming an increasing share of development countries' $1.4 trillion debt, according to a U.N. study. The study, "The International Debt Strategy as of Mid-1993," says that while official and private creditors have sought to restructure debt in collective forums, multilateral development institutions have maintained their preferred creditor status and remained exempt from debt restructuring. At the end of January 1993, 10 countries alone owed $4.6 billion in debt-service obligations to the IMF. However, since then, the report says, a considerable amount of arrears have been paid back also to the World Bank and the Inter-American Development Bank. By contrast, the amount of arrears owed to the African Development Bank nearly doubled in 1992 to $119 million, the study says.

The fall in **Bulgaria's** production in 1993 appears to be less dramatic than in previous years, Trade and Deputy Prime Minister Valentin Karabashev said in an interview with Frankfurter Allgemeine Zeitung on November 2. He was quoting recent economic statistics showing a 9.8 percent drop in output during the first eight months of 1993. In 1991 and 1992 the annual decline constituted around one-fifth of total production, causing the unemployment rate to rise above 16 percent. Karabashev warned that further jobs would be lost as privatization eventually gains momentum. He nevertheless disputed official figures indicating that more than 90 percent of the economy remains state-owned, referring to the fact that 40 percent of foreign trade and 60 percent of retail trade are currently run by private entrepreneurs. Speaking about Bulgaria's need to achieve a settlement with foreign banks on its $13 billion debt, Karabashev said his government has been showing a maximum amount of flexibility but that a deal must take "[economic] realities" in his country into account.

Preparations are under way for the start of a massive repatriation program to return refugees from **Mozambique** to their homeland. The three-year, $1 million program is part of the U.N. High Commissioner for Refugees' regional plan to repatriate 1.5 million people who fled Mozambique because of a sixteen year civil war and will also involve the 100,000 refugees in the country.

The **European Bank for Reconstruction and Development** (EBRD) in early November announced it will make a $59 million (5.7 billion forints) equity investment in MATAV, the Hungarian telephone company. The EBRD said it will purchase convertible preference shares in MATAV (a stake of about 1.8 percent) if a government decree links telephone tariffs with the producer price index, a key measure of inflation. (Currently, telephone rates are set by the Ministry of Transport, Telecommunications, and Water Management.) The EBRD intends to make MATAV's finances more attractive to bidders in the

"It's our parent company. We're not to drink too much, and we must be home early."

Williams/Squib/London

upcoming sale of a 30 percent stake in the telephone company. The preference shares will be converted into ordinary shares in 1994 at a rate that matches the rate paid by the eventual winner of the tender. MATAV will be able to offer telephone service to an estimated 400,000 new customers as a result of the EBRD investment. An earlier audit determined that the telephone company had a market value of about $3.3 billion. MATAV has assets totaling 122.7 billion forints ($1.3 billion) and registered capital of 59.3 billion forints.

Russia intends to restrict foreign banking up to three more years to protect the country's domestic banking industry from large Western competitors. Finance Minister Boris Fyodorov published a statement that his ministry would uphold current restrictions on granting licenses to foreign banks and disagreed with the central bank's policy of bolstering the number of licenses. Several senior government officials, including First Deputy Prime Minister Yegor Gaidar, agreed on the need to limit foreign banking operations in Russia, which could have "dangerous consequences if allowed to expand unchecked."

Over 60,000 **Belorussians** have become unemployed this year, Belarussian TV reported on November 1. Over 10,000 are seeking work through the official employment center, while the "invisible" unemployment is estimated at 5 percent of the work force, or close to 40,000 persons.

The final draft of **Russia's** new constitution, signed by President Boris Yeltsin, makes the central bank independent and says the bank's main task is to protect the ruble. The head of the central bank will be appointed or dismissed by the lower chamber of Russia's new parliament on the president's recommendation, the draft added. The draft has been described by Western experts as giving Russia a strong executive presidency and restricting the powers of its constituent regions.

New Books and Working Papers

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

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Monica S. Fong, **The Role of Women in Rebuilding the Russian Economy**, Studies of Economies in Transformation (SET), no. 10, Washington, D.C., 1993, p. 50.

Women make up the majority of Russia's population and labor force. They handle most domestic work and do most of the caretaking for the country's young, old, and disabled. By keeping women actively involved in the workplace, Russia's economy can only gain. Because women outnumber men among the unemployed and other groups facing poverty, aside from the economic benefits of women's contributions to the economy, assistance to women will have a great impact on reducing Russia's level of poverty.

Jane Holt, **Transport Strategies for the Russian Federation**, SET no. 9, Washington, D.C., 1993, 253 p.

Russia's transport system, built for a command economy, is "ill-suited" for a market system. The system has also been hurt by Russia's economic woes and the breakup of the FSU. Its financial performance has declined because of reduced demand and increases in fuel prices. So far, the government has covered the system's losses. The task of subsidizing the system and paying for unproductive investments could soon become unsustainable for the government.

Statistical Handbook 1993: States of the Former USSR, SET no. 8, Washington, D.C., 1993, 504 p.

Government officials in many FSU countries have made modest progress in changing their statistical systems to match internationally applied norms. This second annual edition, holding a wealth of economic information on the FSU, offers a snapshot of the 15 countries in their transition to market economies, presenting a wide range of macroeconomic data, drawn from national statistical offices, other government agencies and Bank staff estimates.

EBRD Working Papers from London

Leila Webster and Joshua Charap, **A Survey of Private Manufacturers in St. Petersburg**, WP no. 5, 1993, 82 p.

Phillippe Aghion and Olivier Blanchard, **On the Speed of Transition in Central Europe**, WP No. 6, 1993, 26 p.

Jan Winiecki, **"Heterodox" Stabilisation in Eastern Europe**, WP no. 8, 1993, 29 p.

Zhen Kun Wang and L. Alan Winters, **EC Imports from Eastern Europe: Iron and Steel**, WP no. 9, 1993, 41 p.

Larry Karp and Spiro Stefanou, **Domestic and Trade Policy for Central and Eastern European Agriculture**, WP no. 10, 1993, 37 p.

Leszek Balcerowicz, **Common Fallacies in the Debate on the Economic Transition in Central and Eastern Europe,** WP no. 11, 1993, 37 p.

Phillippe Aghion, Oliver Blanchard, and Robin Burgess, **The Behaviour of State Firms in Eastern Europe: Pre-privatization,** WP no. 12, 1993, 24 p.

To order: Publications Unit, European Bank for Reconstruction and Development, One Exchange Square, London EC2A 2EH, tel. (4471) 338-6541, fax (4471) 338-7544.

CEPR Discussion Papers from London

István P. Székely, **Economic Transformation and the Reform of the Financial System in Central and Eastern Europe,** DP no. 186, 1993, 45 p.

The lack of a properly designed and well-functioning financial system is one of the major obstacles to relatively fast economic transformation in the CEE region. The banking sector is expected to

- Deal with the bad loans inherited from the past and eventually find a relatively painless solution for writing off these debts.
- Take part actively in the process of enterprise restructuring and privatization and become important institutions exercising control over enterprise management.
- Increase the efficiency of credit allocation by realistic evaluation of credit applications.
- Create a modern retail sector and the necessary financial instruments to meet both investors' and borrowers' preferences.

The banking sector could eventually become a main booster supporting economic recovery and increase its share of GDP and employment in the region.

Zhen Kun Wang and L. Alan Winters, **EC Imports from Eastern Europe: Iron and Steel,** DP no. 825, 1993, 40 p.

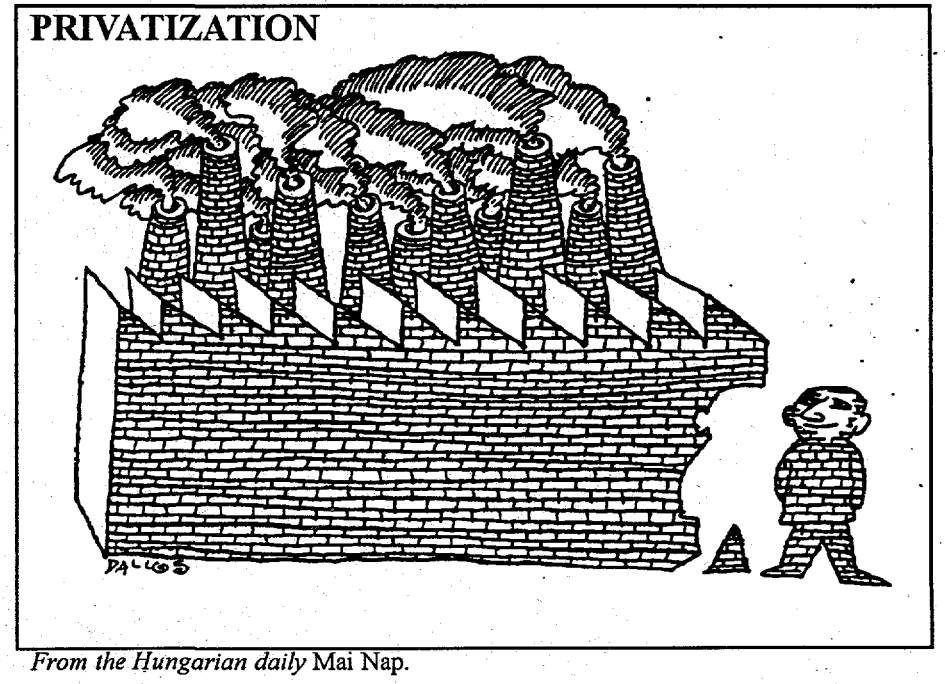
As Eastern Europe liberalized in 1989-91, the EC started to grant market access. Since March 1992 trade relations between the two groups have been governed by the interim components of the Europe Agreements between the EC and Czechoslovakia, Hungary, and Poland. Under the iron and steel protocol of these agreements, the EC eliminated its quantitative restrictions on imports of European Coal and Steel Community (ECSC) products from the three countries effective immediately, and tariffs will be completely abolished by the end of 1996.

EC steel imports from Eastern Europe have been rising fast since 1989, but EC trade in iron and steel will not be free for a long time. Falling internal demand in 1991 and 1992 led to complaints about the quotas offered to Eastern Europe, resistance to the steel clauses of the Europe Agreements, and increased lobbying by EC steel producers. As late as August 1992, after the Europe Agreements came in force, Germany and Italy requested that the Commission adopt safeguard measures to protect them from imports of steel pipes from (then) Czechoslovakia, and as a result import quotas were imposed on these specific flows. Even in the absence of formal agreements, East European suppliers could feel obliged to exercise self-restraint in their steel exports.

Preferential liberalization of EC imports of iron and steel from Eastern Europe would put mild pressure on EC producers' profits but generate great benefits for the EC consuming industries. Eastern Europe could gain substantially from EC trade liberalization, with potential increases in employment and output in the iron and steel industry.

Barry Eichengreen, **A Payments Mechanism for the Former Soviet Union: Is the EPU a Relevant Precedent?** DP no. 824, 1993, 54 p.

The European Payments Union (EPU) of the 1950s is frequently invoked as the model for payment unions. Intra-European trade, which had collapsed during the course of World War II, was restarted on the basis of unconvertible currencies and bilateral agreements, but the volume of trade remained depressed. Then came the EPU. It featured multi-



From the Hungarian daily Mai Nap.

lateral clearing and credits for countries in temporary deficit against the union. From its inception in mid-1950 to its dissolution and the restoration of current-account convertibility in late 1958, intra-EPU trade expanded vigorously, helping to fuel the recovery of the European economy.

The EPU is in fact an inappropriate model for organizing intra-FSU trade and payments. Credit-based settlements —a central feature of the EPU—will not be feasible prior to macroeconomic stabilization. The only multilateral clearing union that is currently feasible, therefore, is one based on continuous multilateral balance (current-account convertibility) among the participating countries. The effective choice for the FSU prior to stabilization is therefore between bilateralism and convertibility.

The newly designed Interstate Bank (ISB) is to provide clearing services for ten founding members (Azerbaijan, the Baltics, and Georgia have not yet agreed to join). ISB accounts should be denominated in hard currency, i.e. credits should be held in abeyance until stabilization occurs. This is tantamount to current-account convertibility. It would be preferable therefore for the FSU countries to move directly to this option.

To order: Center for Economic Policy Research, 25-28 Old Burlington Street, London W1X 1LB, tel. (4471) 734-9110, fax (4471) 734-8760.

Discussion Papers on Economic Transition (DPET), Cambridge University

Miroslav Hrncir, **Economic Recovery and Foreign Exchange Rate Regime: The Case of The Czech Republic,** no. 9301, 1993, 46 p.

Miroslav Hrncir, **Financial Intermediation in the Czech Republic: Lessons and Progress Evaluation**, no. 9302, 1993, 34 p.

Stephen Pudney and Wang Limin, **Housing and Housing Reform in Urban China: Efficiency, Distribution and the Implications for Social Security,** no. 9303, 1993, 29 p.

Christopher Doyle, **The Economics of Mobile Telephony in East and Central Europe: The Case of the Czech Republic,** no. 9304, 1993, 14 p.

To order DPET working papers: University of Cambridge, Department of Applied Economics, Austin Robinson Building, Sidgwick Avenue, Cambridge CB3 9DE, tel. (0223) 335-200, fax (0223) 335-241.

Other Working Papers

Guy Standing, Gyorgy Sziraczki, and James Windell, **Employment Dynamics in Bulgarian Industry,** International Labour Office, Geneva, WP no. 63, August 1993, 28 p.

Amid the economic revolution occurring in Central and Eastern Europe in the 1989-92 period, perhaps no country was as adversely impacted by the sudden changes in trading patterns and input prices as Bulgaria.

So far, industrial employment in Bulgaria has declined to a much greater extent than in most other central and eastern European economies prior to any substantial privatization. There has been downsizing—without restructuring. Indeed, it is notable that employment cuts were negatively related to the number of years establishments had been in operation. This is striking evidence of a relative absence of restructuring, especially as large-scale establishments had generally been operating for much longer than average.

In 1992 the International Labour Organization (ILO) undertook the Bulgarian Labour Flexibility Survey (BLFS) of industrial employers. The initial results of the BLFS were presented in a series of ten papers at a Conference on Labour Market Reforms in Bulgarian Industry held in Sophia May 18-20, 1993. The ten papers are:

- The Bulgarian Labour Flexibility Survery: Introduction
- Employment Dynamics in Bulgarian Industry
- External Labour Flexibility: The Drift to Casualisation?
- Occupational Restructuring in Bulgarian Industry
- Training and Human Resource Development
- Recruitment and the Employment Services
- Vulnerable Groups in Transition Labour Markets: Bulgaria and Hungary
- Industrial Wages, Payment Systems and Earnings
- Product Innovation, Technology and Work Reorganization Changes
- Patterns of Industrial Relations.

To order: Active Labour Market Policies Branch, Employment and Development Department, International Labour Office, 4, route des Morillons, CH-1211 Geneva 22.

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Peter van Ham, **The EC, Eastern Europe and European Unity: Discord, Collaboration and Integration Since 1947**, Printer Publishers, New York/London, 1993, 277 p.

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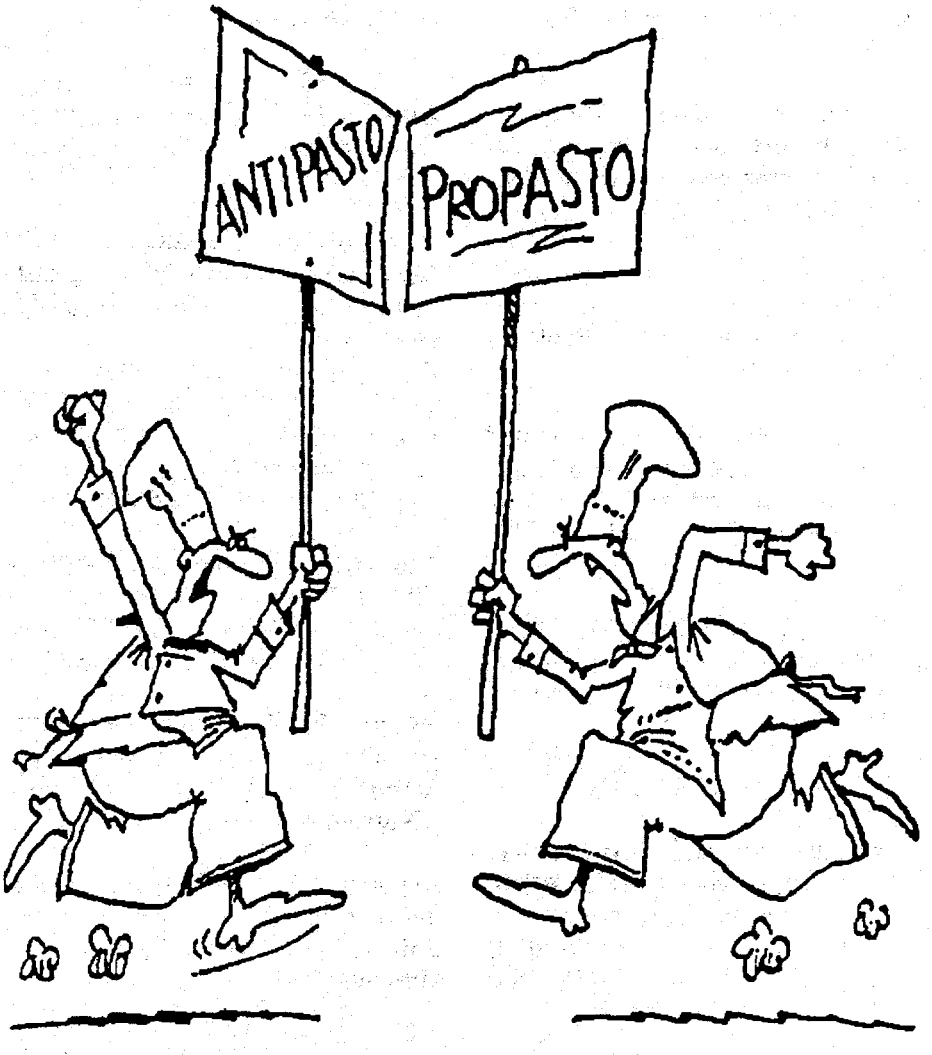
Insight East Europe, a newsletter that focuses on business, economic, and political developments in Eastern Europe.
Information: Asya Rep Ltd., 10/F Vogue Building, 67 Wyndham Street, Central, Hong Kong, tel. (852) 877-8011, fax (852) 877-8016.



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