Measuring Transition Is Tough
Observations of EBRD's First Transition Report Editor

Kasper Bartholdy, a senior economist from Denmark, headed the editorial group of the EBRD's inaugural Transition Report, which will henceforth be an annual publication of the Chief Economist's Office. The Report analyzes institutional changes as well as recent and future economic developments in Central and Eastern Europe and in countries of the former Soviet Union. In a London interview Bartholdy explained to Jennifer P. Walker from the World Bank's Transition newsletter the difficulties of measuring the progress in individual transition economies, the statistical methods the Transition Report uses and the accuracy of economic predictions.

Q. Since the EBRD's Transition Report was first published, in October 1994, what major new developments have occurred that could be included in the forthcoming report? Are there any spectacular changes in your "progress list" (table, page 3), which gave the best marks to the Czech Republic, closely followed by Estonia, Hungary, Poland, and Slovakia.

A. Some recent developments are already listed in our Transition Report Update. These developments may lead us to revise the assessments that are included in what you call the progress list.

Several countries took decisive steps in the direction of privatizing large companies, including Armenia, Slovenia, and Ukraine. Also, several countries—such as Belarus, Ukraine, and some Central Asian states—significantly liberalized their trade and domestic markets. The list attempts to measure how close the current economic structure in each country is to that of a "well functioning" market economy. One of the difficulties though is that different people have different views on what the ingredients of a well-functioning market economy are. Most would agree that ownership in such an economy should be primarily private; that most prices, interest rates, and foreign trade should be free from administrative control; and that banking should be competitive but subject to close supervision. This view is reflected in the choice of indicators for last year's table.

However, important aspects of the transition process, including the role of the state, legal changes, and the pace and sequencing of reform, were left out of the assessment. In these areas there is, of course, much less agreement in the professional, financial, and academic community.

Q. What's inside...

Future of Poland's Mass Privatization. Lucja Swiatkowski Cannon analyzes Poland's long-awaited mass privatization program. (page 7)

Quotation of the Month: "Eighty-five Percent of Committed Assistance Is Debt-Creating." PECAT, a Warsaw-based think tank, surveys Western aid to Central Europe. (page 9)

Aid Conference in Washington. Greater recipients involvement advised. (page 10)

Letters to the Editor. Electricity consumption as a substitute for GDP data? Email exchange on the politics of entitlement. (page 11)

German Blitz-Privatization. Treuhandanstalt has successfully privatized itself out of business, writes Hans-Peter Brunner. (page 13)

Gender in Transition—World Bank Conference in Bucharest. Mitigating the hardships of transition goes beyond specific women's issues. (page 15)

Deal of the Century? (page 17)

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community about what is desirable and what is not. We will be thinking long and hard about ways to address these aspects, but I will not guarantee that we will be able to deliver a solution.

Q. How would you explain why transition countries at similar development levels chose different routes to a market economy? Diverse economic policies of the Visegrad Four or differing economic strategies within the Central Asian states of the former Soviet Union are good examples.

A. Let me start off with the Visegrad countries. They all pursued relatively tight stabilization programs in the early phase of transition. They all moved quickly to liberalize prices, free up foreign trade, and privatize small-scale units of production. True, "quickly" may have slightly different meanings for the three countries. For instance, in Hungary liberalization of prices and trade began in earnest around 1988 and was phased in gradually over the next three years. In Poland and the former Czechoslovakia a more comprehensive liberalization was implemented during the early stage of transition, but it got started slightly later than liberalization in Hungary.

There is a more substantial difference, however, between these countries' privatization strategies for large enterprises. Early in the reform process the Hungarian authorities had a greater need to maximize revenues from privatization than their colleagues in Czechoslovakia. Meanwhile, because of risk factors, the Hungarians were better able to attract foreign investors than the Polish authorities. This factor and the wish to attract new owners who could lift the degree of corporate governance led the Hungarian authorities to focus their large-scale privatization efforts on sales to strategic investors.

In the former Czechoslovakia there was more emphasis on speed, possibly because at the start their economy was much more state-dominated than those of the other two countries. The Czechoslovak authorities opted for comprehensive voucher privatization to give the population at large a stake in the reform process. It was helpful that Czechoslovakia's external and fiscal debt problems were minuscule compared with those facing Hungary and Poland. Low debt levels allowed consideration of voucher privatization that would yield only small amounts of revenue for the state. It is more difficult to understand Poland's comparatively modest progress on large-scale privatization. The Polish authorities have, from a very difficult starting point, successfully implemented a radical stabilization program over a protracted period. But they have found it much more difficult and controversial to move forward with privatization. [See article on Poland's privatization, page 7. The Editor]

Governments in natural resource-rich Central Asian countries have been tempted initially to put off reform, considering financial pressures as being relatively weak. On the other hand, Kyrgyzstan—a country with a relatively modest natural resource base—became the region's earliest and most rapid implementer of market-oriented reforms. The scope among the more resource-rich countries for converting their oil, gas, gold, and cotton into hard currency looks somewhat less promising, at least in the very short run, than it did two years ago. But after initial hesitation, most Central Asian countries have come around to embracing market-oriented reform. We may see the rest of the region follow suit within the next few years.

Q. As you stated in your autumn report, most transition countries fall into the "middle income" category, having inherited more equal income distribution and better health and schooling indicators than the average in this group. In your view, what are the most efficient methods to dismantle the unsustainable welfare systems without losing the political support of the electorate?

A. It is never easy for politicians to cut benefits that people have come to regard as permanent entitlements. But welfare benefits must be reformed as the transition process increases strains on public finances, despite vigorous cutbacks in capital expenditures and in subsidies given to enterprises and consumers. Tax revenues become more difficult to collect as economic activity becomes increasingly concentrated in the private sector. Meanwhile, pressure for new expenditures arises, for example, as a consequence of open unemployment. In some countries this pressure has combined with unfavorable demographic trends that threaten, in the absence of reform, to substantially raise spending on pensions, health care, and family benefits.

It is crucial in reforming the benefit system that governments explain to the electorate the reason for the reforms. Reforms thus require a public relations effort. Furthermore, the move toward benefits systems that are based on means testing,
Progress in Transition in Eastern Europe and the Former Soviet Union

<table>
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<th>Country</th>
<th>Private sector share of GDP in mid-1994 (percent)</th>
<th>Enterprise privatisation</th>
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Performance has been measured on a scale of 4 to 1, based on rough estimated by EBRD staff.

* The overall score tallied by Transition, was not included in the original table.


rather than across-the-board cutbacks in universal benefits, may help contain the political fallout from the reforms. But means testing is not a problem-free solution. It is difficult to administer, and for some individuals it may raise the effective tax rate on marginal labor income to very high levels. In some cases extra labor income may even be more than offset by the sum of extra taxes and reductions in benefits. There are no simple solutions, but fiscal pressures make reform of these provisions inevitable.

Q. What will be your method for forecasting the 1995-96 development of transition economies?

A. Little has changed since last year's Transition Report to reduce forecasting difficulties. For many years we will not be able to rely with any confidence on econometric modeling methods, as most available data series are seriously flawed by measurement problems and structural breaks. The forecasts from the EBRD as well as from other agencies will remain rough. They will continue to be based on broad assumptions and considerations rather than sophisticated statistical analysis. In the absence of a better alternative we will, for the purpose of the Transition Report, use the approach commonly followed by other forecasters operating in the region: try to predict what the region's governments' estimates for growth and inflation will be. If we tried instead to forecast the "true" GDP growth and inflation, correcting errors on official estimates, then we would have no benchmark against which the accuracy of our forecasts could be measured.

Q. What do you think of the Doboz-Pohl proposal (Transition, January-February 1995) to measure GNP changes through changes in electric power consumption?

Electricity consumption as a measure of economic activity could be a useful indicator. The weaker the statistical system is in general, the more useful other indicators become, such as electricity use. But it is not without problems. It assumes constant ratios between electricity use and value added. These may have changed a lot, in either direction, during the transition. In Eastern Europe the efficiency of electricity use may have risen, but this is perhaps less intuitively clear in the case of the CIS countries, where the payment discipline for electricity is weak.

Q. World Development Report 1996 focuses on transition issues. Do you see any overlap between your publication and the World Bank's forthcoming undertaking?
A. We have been in close and constructive contact with the World Bank team to prevent excessive overlap in coverage between their publication and ours. We will aim to steer our forthcoming *Transition Report* toward topics that are close to the EBRD mandate, including factors that drive the investment process.

## EBRD Reviews Labor Cost Differences

The average wage expressed in U.S. dollars (the "dollar wage") rose in 1993-94 in the Czech Republic, Hungary, and Poland. However, this does not necessarily constitute evidence of an erosion of competitiveness, partly because the increase in the dollar wage may be offset by productivity growth. A better indicator of competitiveness is the dollar wage adjusted for labor productivity, that is a measure of the cost in common currency of labor inputs per unit produced ("unit labor cost"). In 1993 and 1994, labor productivity in manufacturing grew in Hungary and Poland at annual rates ranging from about 8 to 16 percent (see table). Thus, despite the rise in the dollar wage in Hungary and Poland, unit labor costs in dollar terms in manufacturing declined by about 9 percent in 1993 and by about 4.5 percent in 1994 in these countries.

By contrast, in the Czech Republic unit labor costs in manufacturing (in dollar terms) rose roughly by 26 percent in 1993 and 10 percent in 1994. The rise in the dollar wage far outpaced reported productivity growth, which in fact was negative until 1994. The increase in the dollar wage reflects the fact that wages in local currency increased rapidly while the nominal exchange rate remained fixed against a basket of hard currencies. Labor productivity movements were driven by the continued weakness of the index for manufacturing output, which fell precipitously in 1990-92, dropped further in 1993, and rose only marginally in 1994, long after the equivalent indexes in Hungary and Poland had begun to increase rapidly. The late and subdued turnaround in recorded industrial production in the Czech Republic may in part be the result of measurement difficulties, leading to an understatement of labor productivity growth and an overstatement of the rise in unit labor cost.

**Indicators of Competitiveness for the Czech Republic, Hungary, and Poland, 1991-94** (average percentage change)

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<td>in manufacturing¹²</td>
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a. Local consumer price index converted into U.S. dollars at the average exchange rate for the year.
b. Local wage in manufacturing converted into U.S. dollars at the average exchange rate for the year.
c. Manufacturing output per employee in the manufacturing sector.
d. Percentage shown for 1994 is the change between Q1-Q3 of 1993 and Q1-Q3 of 1994.
e. Cost in U.S. dollars of labor used in manufacturing per unit of gross output.

Source: EBRD staff calculations based on data from the "OECD Short-term Economic Indicators", no. 1, 1995.

From the *World Press Review/Liwanowski-Prawo*
The EBRD in Russia—Concentrating Limited Resources

In an interview conducted by Jennifer P. Walker, Istvan Ipper, head of the EBRD's Russia country team, highlighted some major features of the EBRD's operations in Russia, which is becoming the EBRD's most important partner.

Q. What changes have you experienced in Russian operations since Jacques de Larosière decided to reorganize the EBRD in November 1994?

A. The Bank was restructured and the merchant and development banking divisions merged. New country teams were created to give the Bank a stronger focus on individual member states. That is how the Russia team was born. Now it is able to respond more rapidly to Russia's particular needs. In another development, the EBRD's presence has increased remarkably in Russia. The Moscow Resident Office, which was opened in March 1993, now has a staff of 26. Regional representative offices now operate in Vladivostok, covering the far east regions, and in Volgograd, covering the southwestern area, including Krasnodar. There is a third regional representative in St. Petersburg and there will be a fourth in Ekaterinburg. All these offices are in cities in areas where we are particularly active—in order to be more efficient we decided to concentrate our limited resources in specific geographic areas. Also, we are now focusing more than before on supporting enterprises that are 100 percent Russian-owned. It is more difficult, and certainly riskier than helping joint ventures; but it is also more rewarding in terms of fulfilling our original objective: encouraging Russia's transition process and private sector growth.

Q. How would you summarize the Russian operations so far?

A. The Bank began its operations in Russia in September 1991. As of late March 1995 we had more than $1.3 billion worth of loan and equity financing commitments related to 43 different projects with a total project value of $3.8 billion. Of these, 28 have been signed, committing the Bank to providing $345.7 million, of which $228 million has been disbursed. Russia is also the single largest recipient of the Bank's technical cooperation funds, worth $107 million.

Russia's medium-size and large privatized enterprises badly need all kinds of banking services. To help develop the local banking and financial institutions, a joint EBRD-World Bank $100 million loan in the Financial Institution Development Program will support 15 Russian commercial banks (already selected). Another 25 banks are to be picked in the coming months. With this loan, the banks can enhance their financial soundness and modernize their information technology. Employing mainly twinning arrangements leading foreign banks will provide technical assistance to their Russian partner banks on business plans and implementation strategies.

As part of this program, a jointly financed EBRD-World Bank credit line called Enterprise Support Project (ESP) will make loans to the above-mentioned Russian commercial banks. The banks will then lend the funds to Russian enterprises that are large or medium-size, are at least 75 percent privately owned, and want to restructure.

Q. And how is the Russia Small Business Fund doing?

A. The Russia Small Business Fund is a very successful project. Pilot projects, including Business Training Centres, have already been set up in Nizhny Novgorod, Tula, and Tomsk. The Fund offers assistance in management and business planning, plus training, small loans up to $75,000, and micro-credits (of $100 to $30,000 ruble equivalent) to private businesses. Loans are for two years with a grace period of up to six months. Micro credits are generally for shorter terms. Half of the $300 million fund is financed...
from EBRD resources and the other half from donor countries.

Q. What progress has been made with the Regional Venture Funds?

A. Four such funds have already been established in selected regions of Russia. The first Regional Venture Fund was launched in the Smolensk district in January 1994, and has already disbursed its first investment. Another three followed later: in the Urals (Chelyabinsk, Perm, and Sverdlovsk regions), in St. Petersburg, (City of St. Petersburg, Leningrad District), and in the far east and eastern Siberia (Irkutsk and regions to East).

Each fund (apart from the first, which was set up with starting capital of $12 million) has capital of $30 million to invest as new equity capital in medium-size enterprises. The minimum investment is $300,000 and the maximum $3 million. At least 75 percent of the voting shares of the enterprise must be owned by private shareholders prior to the investment. The Bank's capital in each fund is complemented by $20 million, financed by donor governments. Each fund will be close-ended, with a ten-year life.

Another seven funds are under preparation and will be to set up gradually over the next eighteen months. The Bank also works through "normal" investment funds that are geared more toward joint ventures. Several of these are already up and running.

Cost-Cutting at the EBRD

One and a half years after its second president, Jacques de Larosière, took office, the EBRD has emerged from its early difficulties with a stronger sense of direction. Yet the Bank finds it increasingly difficult to track down projects that meet the necessary requirements—that are based on sound banking principles, support the transition process, and meet the "additionality" criterion, meaning that private lenders would not be interested in the project.

To step up investment in Central and Eastern Europe, the Bank developed a strategy known as "wholesale finance"—lending through financial intermediaries. These loans or capital now make up 35 percent of the EBRD's total portfolio. In 1994 almost 25 percent of the money committed by the Bank was channeled to other financial institutions.

Private sector lending accounted for 73 percent of the EBRD's total commitments in 1994. That is up sharply from 56 percent of total lending in 1993 and well ahead of the 60 percent minimum laid out in the Bank's articles of agreement. Last year the EBRD approved projects worth US $3.14 billion, up 17 percent from 1993. That brings total project approvals in the Bank's first four years to ECU 5.77 billion. Project disbursements in 1994 were 44 percent greater than in 1993. And the EBRD's focus is shifting east of Central Europe. By the end of 1994, it had committed funds to all 25 of its countries of operation, except Tajikistan.

Last year the Bank turned in a net profit, after provisions, of just 1 million ECUs. Most of the profit still comes from managing its liquid assets rather than from banking operations. For 1995 the Bank's outlook is "cautious," with no net profit expected. Hence the president's emphasis on cost-cutting. By all accounts, cost-cutting has been successful. If there's one exception, it's the board of directors. Their expenses, including salaries and benefits for each of the 23 board members and their staff—which consists of an alternate director, an assistant, and a secretary for the 23 countries represented—consume 12 percent (or $21 million) of the Bank's operating budget. Each board member receives a salary of more than US $124,000 a year, as well as a $35,000 annual housing allowance.

Polish Mass Privatization—The Debate Goes On
by Lucja Swiatkowski Cannon

Poland is experiencing its third year of rapid economic growth. Real GDP rose by 2.6 percent in 1992, 3.8 percent in 1993, and 5.0 percent in 1994. In November, industrial growth was 14.3 percent higher than for the same period in 1993. Most of this growth is because of the performance of the vigorous private sector, which produced 54 percent of GDP in 1994. This sector evolved mostly from small private businesses, which were created in the 1980s and early 1990s, rather than from privatized state enterprises. In 1993 privatized enterprises contributed only 3.1 percent of total sales, while the whole private sector’s share in total sales was 45.9 percent. Privatization of state assets may be the least successful aspect of Polish reform.

As of September 30, 1994 Poland still had about 4,800 state enterprises and 500 state joint-stock companies. Of the 4,800 state enterprises, 2,100 were profitable (before taxes), although 1,500 of those were small and medium-size. About 1,600 were bankrupt or in the process of liquidation, and about 1,100 were in shaky financial condition. About 400 of those are going through various restructuring programs.

A Short History

The social consensus of the late 1980s held that privatization was a means to transform the communist system into a democratic market economy. It was felt that depriving the state of its property would depoliticize the economy and give more autonomy to individual citizens. Forced savings, invested by central planners to modernize the economy, would be returned to citizens: individuals privatization vouchers or individual employee ownership through Employees Share Ownership Programs (ESOPs) were to be exchanged for state property. Allocating property rights would allow everyone to participate in the transformation and create of a new middle class that would sustain democracy.

The 1990 privatization law, however, contradicted this popular belief. The law’s primary goal was to increase the efficiency of the economy and raise funds for the state. It prescribed a top-down process to accomplish this and conflicted with the 1981 law, which declared state enterprises to be autonomous and self-financing. The new law "renationalized" enterprises and, through commercialization, reestablished state intervention. Initial public offerings (IPOs) on the stock exchange were supposed to become the major tool of privatization. These offerings would have preserved old management power, enabling only wealthy individuals to participate in the process.

After public protests a compromise was struck that allowed employees to lease enterprises and buy shares at a discounted price and established the voucher-based mass privatization (National Investment Fund) program. None of these measures changed the essentially centralized, state-controlled approach. Public support for privatization declined from 90 percent in November 1989 to 29 percent in November 1993, leading to political conflict and instability.

Program for 1995

The government privatization program for 1995 envisages the sale of 56 enterprises, compared with 35 in 1994. Breweries, chemical works, textile companies, tobacco firms, heavy construction, machine building, food-processing plants, shipyards, and the Bank Przemyslowo-Handlowy in Cracow are scheduled to be sold. The government should earn 16 billion zloty from cash privatization this year, twice the amount the treasury received last year. The government expects to receive a total of 29.5 billion zloty from privatization, including revenues from liquidation-privatization and sale of vouchers in the mass privatization program.

New privatization legislation claims to streamline and improve provisions of the 1990 law. This legislation would include a new mass commercialization program, turning 3,500 state enterprises (of 4,800) into state joint-stock companies, and exclude firms under liquidation or bankruptcy procedures. The government also plans to publish a list of enterprises that will remain under permanent state ownership. These enterprises may include coal extraction, electric power plants, oil refineries, highway construction, railways, and road transport.

The long-awaited mass privatization program, first proposed in the summer of 1990, finally took off. At the end of 1994 the Ministry of Ownership Changes approved the statutes and boards of directors of 15 investment funds. These boards began to negotiate with 15 potential management consortia. Once contracts between newly created boards and chosen management firms are signed, shares of participating enterprises will be allocated to the corresponding investment funds. Each fund will have a starting capital of about three billion zloty, to be registered according to the commercial code. The Ministry of Ownership Changes estimates that about half of
eligible Polish citizens—14 million people—will take part in the program.

In the summer of 1995 participation certificates are supposed to be sold to eligible citizens, and eventually individuals will be able to sell them on the secondary market. In 1996, investment funds will issue shares on the stock exchange and participation certificates will be exchanged for the investment fund shares.

**Hindering Factors**

A number of stumbling blocks threaten to slow the privatization process:

- The new privatization law was presented to the Cabinet in early April. However, it was withdrawn "for further study." The business community rejected it as a step backward that does nothing to provide easier credit terms for domestic investors.

- Former owners demand in-kind restitution for their former property—mostly land, real estate, and service companies. The governing coalition has proposed partial compensation awarded in shares of privatized enterprises and only for property nationalized in violation of post-war laws. This issue is still unresolved.

- Launching the National Investment Fund Program did not accelerate the privatization process, and its implementation is still endangered by delays. In April the negotiations with management companies were delayed because of a tax dispute with foreign consultants. Little progress has been made in printing and distributing shares or in installing computers and communications equipment for the over-the-counter market where these shares will be traded. Including management fees, additional costs sum to at least $200 million.

- Activity on the Warsaw Stock Exchange has drastically slowed. Low prices and investors' anxiety could jeopardize the National Investment Fund program. (IPOs and secondary offerings are already in trouble. An informal system of underwriting developed where the issuer seeks guarantees from Polish state banks and insurance companies, creating a maze of cross-ownership.)

- Domestic politics will also affect the privatization program. Privatization will be a major issue in the 1995 presidential campaign. President Walesa is expected to promote individual credit vouchers that can be exchanged for privatized state property. Center-right parties emphasize a limited role for the government, while demanding strong property rights and a strong private sector brought about by privatization through individual vouchers. Even the center-left parties that dominated the previous reformist governments are looking for more free market solutions, including individual vouchers.

- The government is ambivalent about foreign investors. Permits are still required to engage in business activities, and the government is withdrawing tax privileges that were given to joint ventures. On the other hand, the government abolished its permit requirements for investing in certain stocks.

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**Integration troubles**

From the Budapest magazine **Hungarian Economy**

April 1995
Quotation of the Month: "Eighty-five Percent of Committed Assistance Is Debt-creating"
Warsaw-based Think Tank Surveys Western Aid to Central Europe

The first phase of transition—the "top-down" transition—marked by impressive gains in macroeconomic stabilization and largely led by central governments with the support of Western assistance, has lost momentum. If the slowing down of reform cannot be overcome, Central and Eastern European (CEE) societies risk stagnating in their transition and retaining many structural features from the communist past. Since the start of transition, a number of "gap-filling" studies have claimed that bridging the gap between Eastern and Western Europe would require the yearly transfer of hundreds of billions of U.S. dollars. The past five years of transition have shown that such an approach is unrealistic:

- Although a total of $82.5 billion of assistance committed to 11 postcommunist European countries seems impressive, assistance commitments have not grown since a peak in 1991. This stagnation is expected to continue—the coming years will see few new commitments.
- By the end of 1994 some $62.5 billion of assistance had been committed to the six countries examined in this survey (Bulgaria, the Czech Republic, Hungary, Poland, Slovakia, and Romania). Only about $15 billion of these funds had been disbursed by the end of 1993 (most recent data available).
- Cumulative per capita disbursement figures suggest an uneven distribution of assistance. The highest per capita disbursement was given to Hungary in 1991 ($175). Total cumulative per capita disbursement for 1990-93 was $361 for Hungary, while Bulgaria received $155 and Romania just $94 per capita for the same period.
- As the average per capita disbursement of assistance to the six countries was only $30 in 1993, it is clear that transition is not assistance-driven.
- As much as 85 percent of committed Western assistance has been debt-creating, meaning that the six countries may face repayment difficulties in the medium to long term. This prospect has made recipient governments reluctant to accept additional loans despite their need.
- In terms of total commitments to the CEE countries over 1990-93, the European Union was the largest donor, with more than 40 percent of total committed assistance. The international financing institutions contributed an additional 35 percent.
- The lack of reliable, compatible, and current data, especially on the disbursement of assistance, causes confusion in formulating policies and planning assistance.
- Analysis shows the inflow of assistance resources is positively correlated with other financial flows, including foreign direct investment (FDI). It is important to make sure that the different resource inflows are appropriately targeted to avoid overlap.
- It should be noted, however, that FDI flows have also been less significant than expected, amounting to $10 billion for the six countries. This means the countries in transition face significant constraints to capital formation.
- In Central and Eastern Europe financial tensions will remain present for some time because of inherited foreign and domestic debt burdens. Therefore, balance of payments support will remain a necessary component of Western assistance for some transition countries.

Reflections from a Recent Aid Conference
by Janine R. Wedel

Since 1989 the West has allocated about $35 billion to help ease Central and Eastern Europe's transition to democracy and a market economy. With the end of the Cold War, tens of billions more were promised to Russia and other former Soviet republics. Yet assistance projects sometimes look different on paper than in the field: the view from Washington, Brussels, or Bonn can be very different than the view from Budapest or Bratislava.

Because discussion about aid to the region has been based more on armchair analysis than on empirical investigation, In April 1995 I initiated and helped organize a problem-focused working conference that brought Western policymakers and practitioners together with recipient aid coordination officials. (Participants included U.S. congressional staff, aid contractors, and social anthropologists; representatives of the U.S. State Department, USAID, and the U.S. General Accounting Office; participants in the European Union's PHARE program; German aid analysts; and aid coordination officials and analysts from Croatia, the Czech Republic, Hungary, Poland, and Slovakia.) The goals of the conference, which focused on grant aid provided by the major donors, were summarized in its title: "Western Aid to Central and Eastern Europe—What We Are Doing Right, What We Are Doing Wrong, How we can do it Better." It was hosted by John Lampe, Director of the East European Program of the Woodrow Wilson International Center for Scholars, and cosponsored by the Friedrich Ebert Foundation.

The conference brought about 40 people together at an opportune moment. Aid to Central and Eastern Europe and to the states of the former Soviet Union is under review in Washington. Arguments have been made for conditioning Russian aid on actions in Chechnya and Iran. Congressional staff representatives warned that U.S. aid to Russia would likely be cut and that the U.S. Congress is considering not whether or not to reduce foreign aid, but how much to reduce it.

The discussions focused primarily on privatization aid and aid to private and nongovernmental sectors, on structuring and implementation of aid projects, and on the degree to which these projects have been integrated into the local political and cultural environment. Nearly all participants agreed that present administrative and evaluation procedures tend to discourage risk-taking, although risk-taking and flexibility are important criteria of successful aid programs. Monitoring methods are often misguided, partly because they try to quantify the results (number of workshops held, number of participants) instead of assessing the quality of the workshops (whether the purpose makes sense, whether the purpose was fulfilled, whether the participants could make use of the material presented).

By discussing where to target limited resources, most participants agreed that training and educating the next generation of leaders in an entire range of skills, including vocational education, may have the highest long-term payoff. Local governments and institutions should receive a bigger share of the aid, as they are often overlooked in the assistance efforts. The final conclusion of the conference was that: for aid to be effective, recipients should be actively involved in designing, implementing, and evaluating the relevant projects, so as to meaningfully "own" them.

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Letters to the Editor

Flawed Conclusions

In their provocative piece on GDP and electricity consumption statistics, "Real Output Decline in Transition Economies—Forget GDP, Try Power Consumption Data!", Transition, vol. 6, no. 1-2, p. 17, Istvan Dobozi and Gerhard Pohl propose to dump the former and focus exclusively on the latter. They are correct that output generally declined less in the transition countries than indicated by the official national accounts data, but some of their arguments and conclusions are flawed.

Dobozi and Pohl claim that the likely downward bias plaguing official output statistics has only been supported by qualitative evidence. However, Berg and Sachs ("Structural Adjustment and International Trade in Eastern Europe: The Case of Poland," Economic Policy, April 1992) reestimated the output collapse in Poland and Gavrilenkov and Koen ("How Large Was the Output Collapse in Russia? Alternative Estimates and Welfare Implications," IMF Working Paper No. 94/154, December 1994) have reestimated the output collapse in Russia. Both showed that the official indicators overstated the actual decline by a large margin.

These studies look at the end-use side of GDP (consumption, investment, and net exports) rather than at the production side. More realistic estimates of real GDP can thus be derived. Gavrilenkov and Koen also discuss electricity consumption, suggesting that its resilience is one of several signs that actual output dropped less than officially measured activity. But they explain that because the relevant input/output coefficients and price elasticities are unknown, it would be hazardous to base an alternative real GDP series on electricity consumption alone.

Dobozi and Pohl argue instead that actual output cannot have diverged significantly from electricity consumption, and provide some dubious reasons. They write that in market economies output and electricity consumption move in lockstep. While this assumption may be broadly correct, it may not be that relevant for transition economies undergoing rapid and massive structural changes. Dobozi and Pohl further state that cross-country differences in the electricity consumption-GDP gap "cannot be explained rationally." But they fail, for example, to relate the increase in electricity consumption recorded in the Kyrgyz Republic to the policy of substituting electricity for other sources of energy.

The Dobozi-Pohl "methodology" thus leads to some very odd conclusions: actual output in Poland dropped more than indicated by the official statistics, "economic activity declined less in the former Soviet Union than in Central and Eastern Europe," and the Kyrgyz Republic actually enjoyed a cumulative increase in output rather than a deep fall. Such implausible inferences suggest that electricity consumption is not much more reliable as a summary measure of economic activity than official real GDP measures.

Vincent Koen,
Research Department, IMF

(The opinions expressed here are those of the author and should not be attributed to the IMF.)

E-mail Exchange on the Politics of Entitlement

Dear Professor Sachs,

A major message of your interesting article ("Postcommunist Parties and the Politics of Entitlement," Transition, March 1995) is that the recent large vote for "left-wing parties, descendents of the former communist parties of the region" arises from an entitlement mentality of the population. I do not believe that this analysis captures the major reasons for the described voting behavior. Let me give you three examples from my own recent experience in three different transition countries.

In country A, out of ten taxi drivers eight wanted to overcharge badly. Cheating and more serious crimes seem to flourish. While the old system engendered similar ills, no doubt a large proportion of the population was then, as now, honest. These people—including many who feel pressed to participate in the cheating in order to survive—must feel extreme discomfort about the continuing and ever-present dishonesty.

In country B, I learned that most top opera singers have left the country, and that many, who are left behind, are hoping for like opportunities. Just think about the loss of musical talent and experience. Do we suggest that the price of a market economy is to trash the fine and performing arts? And to rebuild them from scratch, when the people can "afford" culture again? Many educated people in these countries possibly feel anger and despair at the sellout and disappearance of their cultural achievements and symbols.

In country C, a Science Academy member's proposals for some technology improvements were rebuffed by the government: "Try to market your ideas as a private entrepreneur." But not everyone can be or wants to be an entrepreneur; nor does society need such an objective. However, in former communist countries any non-entrepreneurial
activity has been and still is disparaged. Don't you think that this attitude makes many people feel helpless and hopeless? What political parties should these individuals vote for?

Your article further recommends a move away from a solely pay-as-you-go pension system to one that is based on voluntary savings, enabling people to augment their future pension income. Considering the present inflation rates, why would it be practical to save for a supplementary old age pension (which for a new member of the workforce is perhaps 40 to 50 years away)? Frankly, for the time being, the pay-as-you-go pension approach might be the most sensible and viable for these countries.

_Fritz Königshofer, World Bank_

Dear Fritz Königshofer,

Thank you for your message. I found it very surprising. Your rather casual "empirical methods" have led you to believe that communism provided for honesty, culture, and technological improvement. This would surely be a shock to the people of Eastern Europe who lived through decades of degrading state-run corruption, suppression of freedom of thought and culture (other than socialist realism and a few accepted classics), and technology stuck in the 1930s except for armaments. The citizens of the Czech Republic, Hungary, Poland and elsewhere know better. The old system was a dead end in every dimension: economic, social, political, cultural, and moral. The transition to freedom is difficult, but freedom is overwhelmingly preferred to the prison of the earlier regime.

People are not voting for the left-wing parties to return to the old system, nor out of expectations that the left-wing parties will usher in more honest taxis, better culture or improved technologies. As in the United States and most of Western Europe, the public is seeking higher social spending, though combined with more freedom and lower taxes. This is normal politics, but it is contributing to fiscal stresses throughout the advanced industrial democracies. It is particularly dangerous in the countries of Eastern Europe, where per capita incomes are around one-fourth of the levels of Western Europe and the United States. The high taxation and inflation that pay for the ambitious social spending are important barriers to necessary economic growth.

As for pension fund privatization, I am thinking along the lines of the Chilean model of privatization (which is now spreading throughout Latin America). During the transition period, the current retirees and those who will soon retire would continue to operate on the existing pay-as-you-go arrangements, so that the changeover would take place over several years. In the meantime, inflation will fall if appropriate macroeconomic policies are pursued. Already inflation is near the levels that Chile had during its own successful transition to private pensions.

_Jeffrey Sachs_

Social Stability

I read the January-February 1995 issue of _Transition_ with trepidation and consequent dismay. The overwhelming impression it created was that if only Russia and Eastern Europe would run their economies as we in the West do, all would be well in this best of all possible deregulated global markets. Not a whisper of doubt was uttered about the encroachment of global markets on national sovereignty. Pursuing profit alone without considering social consequences is wrong: every Western nation is facing massive unemployment and social stress. Yet those same global markets cannot operate without stable societies any more than can the national markets.

_Cyril Appleton_

_Trustee, Cadet Development Center_

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From the Budapest magazine _Hungarian Economy_
German Blitz-Privatization: Lessons for Other Reforming Economies?

by Hans-Peter Brunner

Treuhandanstalt was born in May 1990 during the last days of the German Democratic Republic and amid the turmoil of German political and economic unification. The mandate of this institution, then the largest holding company in the world, was to restructure and privatize state property as fast as possible. Accordingly, privatization of the retail sector was completed by 1992, and the industrial sector was sold by 1994. Treuhand secured investments totaling about 200 billion deutsche marks (DM), and saved about 1 million jobs. By the end of 1994, only 350 of 13,781 former socialist enterprises remained on its books. The Treuhandanstalt has successfully privatized itself out of business.

The former GDR had a lopsided enterprise structure, resembling an upside-down pyramid, with most production concentrated in large conglomerates or "combines," few medium-size production units, and almost no small-scale businesses. Three years after German unification, the enterprise pyramid had assumed a normal position, as the Treuhand broke up large conglomerates and sold or liquidated the smaller units. While those dinosaurs were being extinguished, by mid-1994 an estimated 470,000 small and medium-size businesses began operating. Of these about 100,000 have gone out of business. This restructuring has significantly increased productivity, which has risen in eastern Germany's manufacturing sector by 5 to 10 percent annually since 1991.

Treuhand's success has come at a high price. By 1994 eastern Germany had lost about 80 percent of its industrial workforce, which numbered 3.2 million in 1989. Open and hidden unemployment has reached 30 percent. And, East Germans have not had enough investment capital to acquire any significant share in their former economy's assets.

Integrating eastern Germany into the western market economy has required enormous resource transfers. Since 1992, on average, the Bonn government has transferred more than DM 150 billion annually (financial gross transfer), and these transfers will continue in the years to come. Treuhand operations alone required DM 275 billion from the German taxpayers. Such a historically unprecedented drain of resources was not anticipated at the time of German unification. Was this costly road the only conceivable one to be taken?

Following unification Germany had three options:

- Maintain real wages at a level corresponding to eastern German productivity, which in 1990-93 was about a third of western Germany's productivity level. This option was not feasible given political circumstances arising from the unification and labor force mobility.

- Support uncompetitive eastern enterprises until they were able to increase productivity to western levels. Meanwhile, temporarily shield them from foreign competitors and investors. A 1991 proposal of U.S. economist George Akerlof pointed in this direction, but it was never considered in Germany.

- Bring wages rapidly up to western levels in a completely open economy, regardless of productivity increases. This wage shock would spare only the most innovative firms—those that are able to quickly overcome the high-wage, low-productivity disparity.

Germany chose the third option, and it has blighted the eastern industrial landscape.

In the first stage of Treuhand's activity in 1990 and 1991, many indigenous firms in eastern Germany were rooted out because of the sudden full exposure to international, mainly western German, competitors. Those newly privatized firms were not able to raise significant investment capital, and lacking Treuhand's guarantees, potential investors were not ready to risk their money. As a result, many areas in eastern Germany lost their traditional industrial base. Treuhand condoned not only the 80 percent downsizing of the labor force in manufacturing, but also an 80 percent cut of applied research capacity. Western high tech investments have been concentrated in a few selected regions in Saxony and around Berlin.

The weakness of the eastern German tradables sector is demonstrated by the pattern of intra-German trade flows. In 1994 eastern Germany purchased DM 255 billion from western Germany, while it sold the west a mere DM 45 billion of goods and services. (The trade gap was financed by the massive financial transfers to eastern Germany.) Closing the trade gap will require increasing the percentage of production devoted to intra-German exports by firms producing tradables to about 40 to 50 percent. At present, an average of around 10 percent of eastern industrial production is sold to the western half. Accordingly, companies in machine building and chemical,
optical, and electronic manufacturing must improve competitiveness to capture market niches from western rivals.

While the Treuhand has managed to dismantle the state sector and sell it off by the scheduled date (December 1994), it was only in the latest stage, from 1993 onward, that Treuhand developed strategies to counter the loss of competitiveness and was ready to provide money to support private owners' efforts. Treuhand supported management buyouts with technical advice, and it teamed up with some state governments to modernize enterprises considered essential to the maintenance of a regional industrial core. It also helped them gain market access in the west.

Private investors and companies, mainly from western Germany, swiftly integrated the acquired assets into a high-tech, high-wage economy. But the economies of Central and Eastern Europe cannot simply adopt the privatization model from Treuhand, which privatized the former East German economy in a stable macroeconomic environment, operated within a clearly defined institutional and legal framework, and was able to bring in investment capital and western management expertise on a massive scale. Even under these circumstances, large areas in eastern Germany lost their traditional industrial base, which is being only haltingly replaced by sustainable new industries.

If there is any lesson to learn, Central and Eastern Europe's transition pains cannot be alleviated by only large-scale liberalization, macroeconomic stabilization, and radical privatization. It is more advisable to support enterprises that initially are uncompetitive, but make serious efforts to gradually close the productivity gap with western rivals.

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Marks Replace Marx in Eastern Germany

Manufacturing as much as construction has contributed to the vigorous upturn of eastern German GDP, which grew by 9 percent in 1994. Manufacturing orders in the second half of 1994 were 20 percent higher than one year earlier. However, this output started from a low base and remains dependent on public transfers.

In 1995 gross official transfers to eastern Germany—including 7 billion deutsche marks (DM) from the European Union—are expected to reach DM 211 billion. By 1996 gross public transfers to the east will total DM 840 billion.

A breakdown of 1995 gross expenditure reveals that 20 percent of flows are directed toward pension and unemployment support and other labor market measures. The remainder is divided between public services, direct infrastructure investments, investment incentives, and public sector salaries. To cover their huge expenses, early this year Germany introduced a new Solidarity Surcharge, amounting to 7.5 percent of the income tax, and doubled the property transaction tax.

At present, more than 700 different incentive programs apply to the east. Regional aid could cover 45 percent of the cost of an individual project. A 50 percent depreciation allowance is allotted for investment in plants and buildings. Small and medium-size manufacturing and craft firms receive a 10 percent grant if they make new investments. Lucrative tax breaks are awarded to high-earning groups that invest in commercial and residential projects in the east.

Economics Minister Gunter Rexrodt has announced a 35 percent upper limit on assistance (calculated on investment cost in eastern Germany) until 1998, with a greater concentration on industrial projects. The investment grant, aid for medium-size firms, and depreciation allowances are to be continued to 1998, encouraging revitalization of the inner cities in eastern Germany. The tax breaks for investing in the east will be continued but at a lower level.

Western private manufacturers, however, are still hesitant to invest in the east. Government authorities, the railways, and telecommunications and electricity supply corporations have contributed a much larger share of productive investment. Investors have been deterred by uncertainty, such as the fate of property confiscated during the 1945-48 Soviet administration, the costs of redundancy and environmental cleanup, and the long-term future of enterprises in the hands of the Treuhand. (Larger loss-making firms—the industrial core)—which were left in the hands of the Treuhand's successor organizations, are now sustained by the state government.)

A key factor depressing profits and investment remains the high unit labor cost; eastern hourly wage rates are approaching the western level, and had reached 84 percent as of December 1994.

Unemployment remains at 14.7 percent (1.1 million) and a further 600,000 people are in job creation schemes or in training. Since 1991 about 60 percent of the eastern labor force has changed workplace, while the employed labor force has shrunk from 8.8 million to 6.3 million. Forecasts for the next ten years see an additional large cut in the labor force, with the migration of perhaps 1 million people out of eastern Germany.

Based on a report of Oxford Analytica, the Oxford (U.K.)-based research group.
Gender in Transition
World Bank Conference in Bucharest

Are all human resources—including those of women—being fully utilized during the transition? Are women being treated equally in the labor market and receiving a fair share of assets? Are vital services being provided, including care for children and the elderly (who are primarily women)? These issues, and others, were discussed at a World Bank-sponsored international seminar, "Gender in Transition," held in Bucharest in early February. The meeting—attended by participants from academia, nongovernmental organizations (NGOs), and the governments of ten countries from among the transition economies—revealed that gender issues must be addressed as a part of the broad-based transition process.

Yawning Wage Gap?

In Russia women still earn about 30 percent less than men on average (after controlling for age and education). This gap has changed little in the last thirty-five years, compared with the declining gap in other parts of the world. Andrew Newell and Barry Reilly's paper The Gender Wage Gap in Russia, based on a late-1992 survey of 6,000 employees, pointed out that women held only 30 percent of managerial jobs and 20 percent of skilled worker positions compared with 92 percent of clerical positions. However, women fill two-thirds of the professional occupations.

This "occupational segregation" has been responsible for much of the wage gap but might produce unexpected results—favorable to women and favorable to a successful transition. With dominant positions in the service sector (77 percent), especially in the financial sector, many women are particularly well positioned and well trained to contribute to the emerging market economies. In the next phase of the transition, women will be less vulnerable to widespread layoffs than those filling the overwhelmingly male-dominated blue-collar positions, especially in heavy industry.

However, Russian men still receive higher wages for performing the same job. Discrimination accounts for the greatest part of the wage gap. Also, because women continue to bear most of the burden of raising children, they follow different career paths than men, with greater interruptions.

Participants in the conference agreed that gender segregation should be replaced by unrestricted work choices. Also, protective legislation might deny women access to jobs that would preserve their earnings. Family costs should not be borne by firms. While public policy cannot influence the balancing of workload between men and women in the household, it can influence it indirectly by ensuring that family benefits result in gender-neutral outcomes in the household (i.e., parental benefits instead of maternity leave), so as to not hinder household participation.

What about Unemployed Women?

The paper of Sheila Marnie and Albert Motivans, Women in the Labor Market and Female Unemployment in the FSU, details the situation of women who are facing unemployment during the transition. The study is based on surveys carried out last year in three countries of the former Soviet Union (FSU). In 1993 women represented about 70 percent of the registered unemployed in Russia, 64 percent in Uzbekistan, and 52 percent in Latvia. The paper explores three different angles to determine why women have represented a larger share of the unemployed. The authors find:

- Initial efforts to cut wage costs were directed at clerical, auxiliary, and scientific-technical jobs—jobs filled mostly by women. This trend will be reversed in the next phase of enterprise restructuring, which will mainly affect jobs filled by men.
- The hidden unemployed—those listed on the payroll who neither work nor receive a salary—are estimated to be ten times the registered unemployed and to be concentrated among production workers.
- The higher labor costs associated with women's maternity and child-raising benefits pushes firms to discriminate against women. Although government policy can mitigate the costs to the firm, social attitudes are unlikely to change quickly.

Most women still want to work. When asked why they were working, 82 percent of Russian women answered, "because [my] family needed the additional income" (73 percent of Uzbek women and 81 percent of Latvian women gave similar answers).

Emancipation from the home was also an important factor, but only 37 percent of Russian women and 17 percent of Latvian women felt that children should be brought up in preschool facilities. Growing unemployment and declining social benefits—including childcare benefits—have probably increased the incentives for working mothers to give up their jobs and remain at home. Participants recognized that some reduced labor force participation by women was voluntary and, hence, not a cause for concern. Structural unemployment, however, will remain a serious concern for both men and women.
The unemployed have little confidence in the employment services' ability to help them find jobs. This attitude is not surprising given that the labor market is depressed. At the same time, participants urged that job placement programs be improved and made gender-sensitive, for example, by offering flexible hours.

**Sea Changes in Russian Agriculture**

Women in Russia's rural areas—which are undergoing sweeping agricultural changes—are more dependent on social services, particularly childcare, and are therefore more likely to remain on ex-Soviet state farms and cooperatives (the *kolchoz* and *sovhoz* systems) than men, who are more actively starting private farms. Sharon Holt reached this conclusion in her paper, *Gender and Agrarian Reform*, which was based on case studies in Moldova and Russia. She also found that, while not explicitly gender-biased, asset distribution favored men over women.

Holt reported that everyone on the farm, regardless of gender, was given a "land share," which entitled the owner to common stock in a joint-stock company or membership in a producers' cooperative. The nonland capital assets of the old farms were distributed as "property shares" according to wage levels and years of employment. But men received higher-valued property shares on average, because women tended to earn lower wages, retire earlier, and interrupt their employment more often.

Holt also found that farm members—men and women—were surprisingly uninformed about their rights, with farm managers exercising considerable personal control over farm management and assets. Conference participants agreed that providing ample information to both men and women was critical. Women should be encouraged to keep their tools and equipment. Also, social services should be detached from unstructured state and collective farms.

**Who Cares for the Children?**

Childcare is as essential for the well-being of children as it is for facilitating parents' participation in the labor market. In their *Review of Child Care Developments in Eastern Europe*, Judith Evans and her collaborators Ioana Herseni, Boyanka Komazheva, Marta Korintus, and M. Karwowska-Struczyk found that the share of children enrolled in kindergartens has declined, and increased unemployment and voluntary exit from the labor market have reduced demand.

At the same time, home-based and community-based alternatives to state facilities—many of which are deteriorating—are emerging. In reporting on central Asia, Jeni Klugman painted a picture of more rapid decline in childcare services, led by fiscal pressures.

Maria Frey warned that nurseries and kindergartens should not be seen primarily as services that enable parents to work; they have the potential to enhance the health and the educational and social development of children. They should therefore be saved even under dire financial circumstances. But how? The participants encouraged government and donor support to develop alternative options, including tax incentives for nonprofit, nongovernmental organizations and private sector partnerships with local governments.

Participants supported a mix of financing from both public and private resources, with a particularly important public financing role in the provision of childcare for poor families.

**The Plight of Elderly Women**

The most contentious session was stimulated by the work of Louise Fox and Monica Fong, *Gender Dimensions of Old Age Poverty and Pension Reform in the FSU*. Rather than discriminate against women, most pension systems discriminate in favor of women, with women retiring five years earlier than men—who are retiring relatively early compared with other countries—and living about ten years longer.

This group of pensioners have seen their real pension benefits erode the most. While there was consensus on the need to give a wider range of support certain groups of elderly poor—such as elderly women living alone or in rural areas—opinions differed on how to reform the pension systems. Participants suggested that reforms be analyzed in light of family support and labor market opportunities for the elderly.

**Summing Up**

Kathie Krumm, a principal economist from the World Bank, summarizing the lively discussion, emphasized that the gender issue should be perceived in a broader sense and embrace the man-women relationship both in the family and the workplace. The great resource that women represent should contribute to the success of the transition process. Unsolved issues in the transition economics, such as the fate of childcare centers run by local governments and enterprises or the vulnerability of elderly women in rural areas, should receive special attention.

The World Bank—which sponsored the studies prepared for this conference—is prepared to promote, in partnership with governments, NGOs, and other donors, policies and programs to mitigate the hardships of transition.

*Conference papers are available from Maria Estrella, World Bank, Room H-12-081, tel. (202) 473-2665, fax (202) 477-1942.*

April 1995
Deal of the Century?—The Elusive Russian Bank Proposal

The most damning criticism of Russia's halting move to a market economy is that reforms have failed to put effective new owners in charge of the country's factories, thereby allowing old directors to give full rein to the inefficient management practices of the Soviet era and to indulge in the newer pastime of widespread corruption. —Chrystia Freeland

On May 3 President Yeltsin's chief economic adviser, Aleksandr Livshits, endorsed a proposal for a consortium of banks to manage the government's stakes in industrial enterprises for several years in return for lending the government the money it hopes to raise from privatization proceeds this year. This "deal of the century" has been the subject of fierce debate, though the proposal itself remains shrouded in secrecy. The key question will be the extent of the banks' involvement in restructuring the enterprises whose stakes they hold? Or will the deal simply involve a loan to the government, with the enterprise stakes being used as collateral?

In any event, privatization has so far failed to ensure the efficient management of enterprises, one of its principal aims. When voucher privatization ended in July 1994, the management and workforce combined had a majority stake in over 64 percent of wholly or partly privatized enterprises. Although managers obtained only minority stakes, they have generally been able to pursue their own aims, appeasing employee-shareholders by minimizing redundancies through lack of restructuring and by maintaining real wages. Restrictions of shareholder rights—in particular the right to transfer ownership—often strengthen managerial control. Few strategic outside investors have emerged. Shares not owned by employees and managers are either widely held by small shareholders or remain with the state.

The current phase of privatization focuses on cash sales of government stakes, partly to finance the budget deficit, partly because the state is incapable of managing the enterprises it still owns. Russian State Property Committee Chairman Sergei Belyaev recently announced that 7,200 businesses not sold in a first privatization wave would be sold this year at public auction. He added that the companies were mid-size firms, ranging from port facilities to heavy-machinery producers. (The list excludes strategically important or more lucrative firms in industries such as defense, energy, and telecommunications.)

Although enterprises are to keep 51 percent of the proceeds from these sales, opposition to the second phase has been mounting. The state Duma's support of incumbent managers forced Yeltsin to enact the program by presidential decree. Moreover, economic and political developments in the second half of 1994, coupled with the inadequacy of the legal framework for investment, deterred many potential investors, both domestic and foreign. By late April the government had raised only 100 billion rubles ($19.7 million) through cash sell-offs this year, against an annual target of 9 trillion. This failure clearly adds to the attractiveness of the banks' proposal.

The banks' proposal comes at a time when Russia's commercial banks are increasing their already strong power base. (For example, a group of banks recently purchased Channel One, the only television station to broadcast to the whole of the former Soviet Union.) Now the banks appear to have focused their attention on enterprise ownership and management.

In late March nine banks (including Uneximbank, Stolichnyi Bank, Imperial Bank, Inkombank, Tokobank, and Menatep) proposed to establish a trust that would control a large portfolio of enterprise shares—including those of many of Russia's "blue chip" companies—to be managed by the banks for a period of three to five years. In return, the banking consortium would lend the government 9 trillion rubles (roughly $1.84 billion)—precisely the sum to be raised via privatization this year. On April 19 Citicorp Russia expressed an interest in joining the consortium. (A rival consortium called Nadyozhnoost [reliability] has submitted its own proposal in a letter to Prime Minister Viktor Chernomyrdin. Its members, Mosbusinessbank, Agroprombank, Promstroibank, Sberbank, Tokobank, Vozrozhdenny Bank, and Vneshtorgbank, have proposed to place large funds with contractors—not directly in the government—to carry out state investment programs.)

Many large industrial enterprises, including the major oil and gas giants—Lukoil and Gazprom (one of the principal owners of Imperial Bank)—are strongly opposed to the original proposal, as are most liberal economists. The proposal's leading opponents within the government include First Deputy Prime Minister Anatoly Chubais, most of the leadership of the State Property Committee, and Dmitry Vasilev, the de facto chief of the securities commission (which Chubais formally heads).

Critics fear that

• the proposal would concentrate ownership and hinder the formation of an open, transparent capital market.
• the banks, having secured a dominant position vis-à-vis industry, would simply milk it for profits and do little to restructure it effectively.
• the government is selling out in order to meet its budgetary requirements.

Arguments in favor of the banks' proposals:

• The finance ministry favors it, since the 9 trillion rubles slated to come from privatization revenues would be quickly secured.
• The ministry has also expressed (valid) concern that raising the funds through sales this year could simply flood the market with more shares than it can absorb, thus ensuring revenue shortfalls.
• Banks would have a real stake in ensuring efficient management of the companies. Bank control would allow more effective monitoring and permit effective countermeasures to prevent loans from becoming nonperforming. High salaries have attracted some of Russia's brightest minds into the banking sector. These banks have made significant progress in developing project appraisal skills. Their corporate governance would allow pooling of these scarce resources.

• Consequently, more bank credit, desperately needed for restructuring, might be forthcoming. Even with effective management, enterprises still face the obstacle of raising large amounts of finance due to the state of Russian capital markets, the lack of foreign strategic investors, and the inability of Russian banks to secure sufficient information to provide credit to enterprises on a significant scale.

(Based on recent reports of Oxford Analytica, the Oxford (U.K.)-based research group, and of news agencies.)
Russia's first quarter GDP fell by 5 percent compared with the same period in 1994. Industrial output and personal incomes fell respectively by 4.5 percent and 4 percent. Prices rose 42 percent in the quarter, though analysts say monthly inflation will fall to 6 percent in May from 8.9 percent in March.

First Deputy Prime Minister Anatoly Chubais said a 3 percent rise in first quarter M2 money supply had set the stage for low inflation in coming months. He said Russia's monthly inflation could fall to 1 to 2 percent by mid-year and that the ruble was showing more signs of stability. Russia's finance ministry said the federal budget deficit narrowed in the first quarter to 3.3 percent of GDP with revenues 3.3 percent above target.

In Russia the statutory monthly minimum wage and pension went up May 1 to 43,300 rubles ($8.50), double the earlier 20,500 rubles, under a new law signed by Russian President Boris Yeltsin. About 30 to 40 percent of Russians earn less than 249,000 rubles (equivalent to $50) a month, viewed as the average minimum subsistence level, said Vyacheslav Bobkov, head of the All-Russian Center for Living Standards attached to the labor ministry.

In Russia birth rates have plummeted and death rates risen owing to political chaos and economic decline, according to a study by Carl Haub, Demographer of the Population Defence Bureau. Life expectancy for men fell from 63.9 years in 1990 to 58.9 in 1993, the lowest among industrialized countries. Female life expectancy declined from 74.3 to 71.9 years. The birth rate dropped from 1.9 in 1990 to 1.4 in 1994, reflecting the gloomy outlook of the population. Infant mortality has more than doubled over the same period from 14 per 1,000 live births to 30 per 1,000. Haub estimated that if current trends continue, the Russian population could drop to 126.7 million by 2025, from 147.9 million in 1990.

Restrictions on Russian trade to the West remain as they were during the Cold War, Deputy Prime Minister Oleg Davydov said on April 18. He said Russia had already removed all barriers and that the European Union is using Chechnya as a pretext for not proceeding with an interim trade accord, thus allowing EU-Russian trade to be regulated by an agreement reached with the former Soviet Union. Russia is not recognized as a transition economy and all antidumping and protectionist measures remain intact. He cited Russian capabilities in aerospace industry and in the production of fissionable materials, aluminum, and nickel as areas in which Russia is more than competitive with the West.

In Slovakia macroeconomic goals for 1995 include GDP growth of 4 to 5 percent, inflation of only 8 percent, and a budget deficit of less than 3 percent of GDP. While limiting the state budget deficit to 3 percent of GDP, the government aims to raise investment spending on infrastructure without resort to income from the National Property Fund, which is to be used only for covering expenses related to privatization and financial restructuring of firms. According to released official data, in February the country's monthly inflation rate was 0.5 percent. In January and February industrial production grew by 7.4 percent over the first two months of the previous year.

The Hungarian Parliament on May 10 passed a new privatization law that should give the country's economic reforms new momentum. The law is aimed at speeding up the sale of state companies and will pave the way for the sale of utilities—for example, a majority stake in the state electricity monopoly and the sale of some of its subsidiaries. Under the new law, Hungary's two privatization bodies, AVU, the state property agency, and AV Rt, the state holding company, are to be merged into a single body, and cash sales and public offers will have priority. The government initially hoped to raise $1.27 billion in privatization revenues this year, but no sales have been completed so far.

Suzuki Motors has stopped exporting cars from Japan to Europe and will sell cars assembled in Hungary through the European dealer network. The change is prompted by high European import duties. To meet the demand of the European market, Magyar Suzuki will double its output in 1995 to 40,000 vehicles and increase its workforce from 840 to 1,000. The parent firm will invest 2-3 billion forint ($17-$25 million) this year to finance the expansion. Suzuki said his firm plans to raise the Hungarian content in its vehicles to around 80 percent from the current 52 percent and to increase the West European content, now about 11 percent.

Romania's first nuclear power plant is expected to begin generating power next month, Atomic Energy of Canada announced on April 12. The Canadian company is helping build the facility, which is located at Cernavoda. The project was started in 1979 by former communist leader Nicolae Ceausescu with Canadian government loans and technical assistance. It is years behind schedule and has been plagued by construction problems. Atomic Energy of Canada is to assist in the construction of a second reactor in Romania, estimated to cost about $710 million.

Strong growth in exports of garments, coal, and rice helped Viet Nam narrow its trade deficit to an estimated $85 mil-
lion during the first three months of 1995. But the inflation rate reached 20.5 percent in March despite the government's goal of keeping it in single digits this year.

**Poland**'s economy during the first quarter of 1995 has continued to grow strongly: industrial production was up 13.7 percent year-on-year, and construction activity was up 13 percent. Unemployment had fallen by the end of March to about 2.7 million, equivalent to 15.4 percent of the active labor force, down from 16.2 percent in January. Both exports and imports increased sharply; the cumulative trade deficit at the end of February amounted to $612 million. Between December and March, prices increased by 8 percent, against the government's 6.4 percent target. Real wages shot up in the first quarter, increasing by 8 percent in March alone.

A **United Nations** report said economic development giveaways to attract jobs were proliferating worldwide and often did more harm than good, *The Wall Street Journal* reported. The report, which analyzed the foreign direct investment incentives of more than 100 countries, said governments were overbidding in efforts to woo industries or companies.

Foreign direct investment in the **Czech Republic** increased by almost 52 percent in 1994 to $862.4 million, *Rude Pravo* reported on April 18. Germany accounted for the largest share of last year's investment, with 48.4 percent, followed by Austria (9.2 percent), France (8.9 percent), and the United States (4.6 percent). Since the demise of communism almost $3.1 billion have been invested in the Czech Republic.

Volkswagen's stake in the Skoda auto company, which became a majority holding in 1994, is the biggest factor in Germany's overall coverage 36.2 percent share of the total foreign investment since 1989. The United States comes next with 21.2 percent, followed by France (11.6 percent), Austria (7 percent), and Belgium (6 percent).

**Bulgaria**'s socialist parliamentary majority passed a controversial amendment to the land restitution law on April 14. The amendment states that owners wishing to sell their land have to offer it first to the state, which has two months to decide whether to buy it. It also restricts the right to sell small plots that are part of larger land blocks and to plant crops different from the ones in the rest of the block. The opposition will take the matter to the Constitutional Court.

Unemployment in **Bulgaria** is expected to rise to 750,000 in 1995, *Trud* reported. More than 300,000 unemployed receive no state compensation. The state paid out some 2.7 billion leva (about $180 million) in unemployment benefits in 1994. Inflation for 1994 reached 121 percent, the second-highest figure since 1989.

Newly contracted foreign investment in **China** dropped sharply in 1994 after the hectic pace of the two preceding boom years. China's State Statistical Bureau reported that new foreign investment pledged in 1994 amounted to $82.6 billion, down 25.8 percent from the year before. Numbers of new projects were down by 43 percent. However, actual utilized investment was up 30 percent from the previous year, reaching $33.8 billion. The Bureau reported a "noticeable shift" toward infrastructure projects in the 1994 investment figures.

**China's GDP** reached $116.8 billion in the first three months of 1995, an 11.2 percent rise over the same period last year. Economic growth was 12.7 percent in same period of 1994, prompting the government to declare the economy was heading for a soft landing. China's inflation rate continued to fall in March, dropping to 18.7 percent, but disparities between the developed coastal regions and inland agricultural provinces widened, *Beijing's People's Daily* reported. The People's Bank of China (central bank) forecasts 9 percent economic growth in 1995. Foreign debt repayment is forecast at $20 billion in 1995. China's inflation rate is expected to be 15 percent this year and 8 percent in 1996.

**Ukraine** will crack down on state enterprises that fail to pay for gas in an attempt to check rising external debt and alleviate a continuing energy crisis. Gas supplies to offending enterprises will be cut or suspended. Gas accounts for around 40 percent of total energy consumption, making Ukraine one of Europe's most gas-intensive countries. Acting Prime Minister Yevgheny Marchuk confirmed that the government will need up to $4 billion in Western financial assistance to cover the costs of closing the Chernobyl nuclear power plant.

**Tanzania's** founding father and first president Julius Nyerere called privatization plans antisocial and accused the government of being corrupt. Addressing a May Day rally, Nyerere claimed industrial powers were bent on killing industry in developing countries and "want us to keep selling raw cotton and coffee for the rest of our lives." Speaking out against government policies, Nyerere said he was told by other leaders that privatization is a condition for assistance from the IMF and the World Bank. "Who is this World Bank and IMF? Is the IMF pretending to be the International Ministry of Finance?" Nyerere is quoted as saying.
The New World Bank: Consultant, Adviser, Facilitator

Instead of financing dams and other big development projects in the Third World, the World Bank, at present only a minor source of capital, is expected in the future to focus far more on private investments and function more as a consultant or adviser. "We must create the conditions for private capital to flow into all these countries, insuring they develop a healthy, skilled work force, encouraging good governance and a favorable regulatory environment for business," James D. Wolfensohn, who will become president of the Bank June 1, has been quoted as saying in a recent article in the New York Times. "There is need for change in the Bank, and I intend to be an instrument of change," Wolfensohn said. According to the article, he is giving himself until January to decide on a plan of action. Lyn Squire, Director of the World Bank's Policy Research Department, in the same article also explained that the World Bank will become more a knowledge-based institution, advising countries, for instance, on developing their private sector. During the April meeting of the Development Committee, World Bank Managing Director Gautam Kaji underlined that the World Bank's goal is to help governments play the role more of facilitator than direct provider of infrastructure.

World Bank Loans for Russia

A $106.5 million World Bank loan, approved May 2, will help finance rehabilitation of the gas distribution network in the city of Volgograd, as well as the sale of energy-efficient equipment for commercial and residential customers in ten pilot cities. On April 25 Russia and the World Bank signed loan agreements totaling $555.8 million to fund economic reform and the cleanup of a massive oil spill near the Arctic Circle. The World Bank's commitments to Russia now amount to $3.6 billion. The new loans include $400 million to support the creation of private housing markets in a number of cities, $16.8 million to modernize the tax system, $40 million for training personnel in the financial sector, and $99 million to help clean up more than 100,000 tons of oil that leaked last year from a pipeline in the Komi Republic. Officials have described the last project as "a race against time" to contain the oil before the spring thaw. Russian First Deputy Prime Minister Anatoly Chubais who visited Washington for the IMF-World Bank spring meetings, said Russia wants to tap the World Bank more "aggressively" in the future, including seeking money to strengthen the social safety net to help Russians hurt by the country's economic reforms. He also revealed that Russia wants to talk with the IMF about a new three-year credit worth some $9 billion. According to Chubais, the two organizations' focus on one-year lending programs was "old fashioned." He said the Russian government had already mapped out a longer-term reform plan and would be discussing its 1996 budget in early May. He said that Russia had asked the G-7 to reschedule some of its debt and hoped for a response within three months.

Russia Repays Debt from IMF Loan

Russian Deputy Prime Minister Oleg Davydov said the government will use the first installment of a $6.5 billion IMF standby loan to service its $120 billion foreign debt. He said an initial understanding had been reached with the IMF to release $1.1 billion in May, adding that the money would be used to pay ongoing debts to the Paris and London Clubs of creditors and to selected countries and suppliers. He confirmed that Russia intended to sign commitments for the repayment of the former U.S.S.R.'s debt to all creditors before December 31, 1995.

IMF Ups Its Forecast for World GDP

The IMF has revised upward its October forecasts for world economic growth and said in its "World Economic Outlook" report that the world economy was expected to grow 3.8 percent this year and 4.2 percent in 1996. The Fund previously forecast 3.6 percent growth in 1995. The Fund warned that "recent changes in financial market sentiment toward some emerging market countries, together with turmoil in exchange markets more generally, have cast a shadow on the otherwise encouraging picture."

World Bank, IMF Approve Croatia Loans

Croatia and the World Bank have signed an agreement for an $80 million loan to support the Highway Sector Project. At a total cost of $570 million, Croatia is to speed up modernization and transformation of the transport sector. The IMF has approved an additional $103 million systemic transformation facility (STF) loan (second drawing) to support the Croatian government's 1995 economic stabilization and reform program. An IMF statement said that in spite of significant progress—GDP increased by 1.8 percent in 1994, inflation has been halted—the situation remained fragile because of the slow implementation of planned structural reforms and uncertainties connected to the security situation in the region. The government's economic program for 1995 is based on 4.5 percent economic growth and an annual inflation target of 2.6 percent.
Lodz Receives Loan

The World Bank has granted a $3.7 million investment loan to the Lodz Province Management of Telekomunikacja Polska S. A. Jan Wasilewski, deputy director of the firm, said the funds would be spent on the development of local international telephone exchanges and the laying of cables in Lodz and other towns in the province.

MIGA Surges Ahead

In the first three months of 1995, the World Bank's Multilateral Investment Guarantee Agency (MIGA) issued 12 political risk investment insurance contracts to investors for projects in seven member countries. The guarantees totaled $92.9 million in new coverage. MIGA is the World Bank Group agency that promotes private investment in member countries by providing insurance to protect investors from noncommercial risks. MIGA guarantees this financial year, which started in July 1, 1994, have to date facilitated more than $650 million in direct investment to 16 member countries. Projects have ranged from a state-of-the-art paperboard printing factory in the Czech Republic to gold mining in Uzbekistan. Seven countries have joined MIGA this fiscal year, including Mozambique, Ukraine, and Viet Nam, bringing membership to 128 countries.

Viet Nam's First Power Loan

The World Bank has concluded negotiations over two loans worth $265 million for Viet Nam; the Bank's first power sector loan to the country will expand a power station in southern Viet Nam, while another loan will upgrade the electricity network in Ho Chi Minh City. In another development, IDA credits of $100 million to rehabilitate and develop Viet Nam's irrigation system, including the completion of seven irrigation schemes covering a gross area of about 130,000 hectares, will enhance the income of about 300,000 rural families.

IMF Standby for Estonia

The IMF has approved a fifteen-month, $22 million standby credit for Estonia to support the government's 1995 economic program. The government aims to achieve real economic growth of 6 percent, reduce inflation to 26 percent, and improve the country's balance of payments. Estonia's new coalition government, headed by Prime Minister Tiit Vaehi, was confirmed by President Lennart Meri. Lina Tonisson is economy minister, Mart Opmann is finance minister.

Ukraine's Hydro Empowering

A $114 million World Bank loan approved April 11 will help improve the efficiency, reliability, safety, and environmental performance of Ukraine's hydropower plants, the country's lowest-cost power source. The loan will also foster more efficient power dispatch from all power plants, with improved communication, command, and control systems throughout the grid. The project will extend the life of the nine major hydropower plants by about twenty years. Improved environmental performance of these plants will reduce river pollution; better monitoring of dams and reservoirs will reduce the risk of dam breaks. "This project is a positive step that should help eliminate or reduce the rotating blackouts several cities experienced last winter," says Laszlo Lovei, an infrastructure specialist in the Bank's Europe and Central Asia Region and task manager for the project.

World Bank Reaches Out to Russian Cities

World Bank loans totaling $400 million are slated to improve infrastructure in a number of Russian cities. A $36.95 million loan will help the Rostov-on-Don administration to develop municipal transport. Another $35.9 million will speed up five construction projects in St. Petersburg. The money will be used to provide an engineering network for cottage building in the Kamenka and Kolomiagi districts. It will also repair and modernize the downtown sewage collector, build another collector along Primorsky Avenue, and finish the construction of a pumping station in the Pamas industrial zone. Kostroma, one of 14 Russian cities whose public transportation systems are slated for upgrading, will receive a $14.5 million loan to acquire 91 buses. A $42.6 million credit line for Tomsk will finance revamping of the city's transportation system.

Lithuania Develops Private Banking...

A $25 million World Bank loan to Lithuania, approved April 13, will boost private sector development by helping enterprises get better access to medium-term credit from private rather than government banks. The loan will also provide post-privatization technical assistance for enterprises and help for state-owned enterprises that failed in their initial privatization attempts. (In Lithuania the number of registered private enterprises has almost doubled to 88,446, and more than half of all workers are now employed in the private sector.) Sweden has agreed to provide another $10 million to increase the capital funds of commercial banks. Lithuania can expect loans worth $250 to $300 million from the World Bank by 1998, to support the further development of the Lithuanian economy, according to Europe and Central Asia Regional Office Director Basil Kavalsky.

FYR Macedonia Mitigates Transport Woes...

A $38.7 million World Bank loan approved April 18 will help FYR Macedonia address transport problems caused by the closing of its Serbian and Greek borders. The project will improve port access with renewed east-west roads,
fund a new customs system, and provide planning advice for transport agencies. On May 5 the IMF approved a thirteen-month $35 million standby credit, and a second systemic transformation facility (STF) drawing of about $20 million. The government is aiming to achieve real growth of about 0.8 percent this year, compared with a 7.2 percent decline in 1994. Inflation is targeted at 17.8 percent, against 55 percent in 1994.

...and Kazakhstan Accelerates Privatization

A $62 million World Bank loan approved April 18 will back Kazakhstan's plans to privatize, restructure, or liquidate large enterprises and to provide market training for managers. It will also help develop two private banks, strengthen bank supervision, and ease the processing of large transactions.

IMF and IDA Injections for Azerbaijan

The IMF has approved a $46 million economic support program for Azerbaijan. The support comes after Azerbaijan set the stage for lower inflation by tightening government credit and money supply. The government wants to slow the 21 percent decline in output registered in 1994 to 6 percent this year. Efforts to check the runaway 1,664 percent inflation in 1994 are expected to result in 520 percent inflation in 1995. The 1994 fiscal deficit of 13 percent is to be cut to one-third, and the current account deficit should be almost halved. The IDA's first loan to Azerbaijan, $20.8 million approved on April 20, will help the country's oil industry and encourage private foreign investment.

Dam on the Yellow River

A $100 million World Bank loan and a $110 million IDA credit, approved April 25, will help finance an ambitious plan to improve irrigation and reduce daily flood damage in China's Yellow River Basin. The funds will help build a multipurpose dam for both power generation and flood control and resettle the reservoir population. Another development, $25 million each from the World Bank and the IDA will help establish a national administration capable of implementing tax reform countrywide. The IFC and some Hong Kong and Singapore conglomerates will be the main investors in a $250 million cement plant in China. The plant, in the eastern Chinese province of Jiangsu, will have an annual production capacity of 1.5 million tons.

Latvia: IMF Standby, IFC Stake

The IMF has approved a thirteen-month, $44 million standby credit for Latvia to support the government's 1995 economic program. The government aims to increase GDP growth from 2 percent in 1994 to 5 percent this year, and to reduce inflation from 26 percent in 1994 to 15 percent by the end of 1995. The overall fiscal deficit is expected to narrow this year to 2.2 percent of GDP from 4.1 percent in 1994. The IMF said in a statement that Latvia had been successful in coupling the process of transition to a market economy with the implementation of stabilization policies, but it warned that continued progress in developing a full market economy would depend on a firm commitment to the overall aims of the current economic program. Meanwhile, the International Finance Corporation has signed an agreement to acquire a $16.4 million stake in Tilts Communications, a company created in partnership with the Latvian government to subsidize the modernization and privatization of the Latvian state-owned company Lattlekom.

IDA Supports Georgia

The IDA has approved a credit of $75 million to boost the Georgian government's efforts to implement its reform program, continue price and trade liberalization, reduce and redefine the role of the public sector, and improve targeting of social benefits.

Confidential

From the Budapest magazine Hungarian Economy
IMF-World Bank Spring Meetings in Washington

Faced with a decline in aid from the richer countries, the world’s poorer nations should look more to the private sector to finance their development, particularly costly infrastructure, the IMF and World Bank advised at their recent Spring Meetings. "Adequate, efficient, and carefully designed infrastructure with full regard to the environment is crucial to sustainable development," the Development Committee of the Bank and IMF said in a statement. The Committee said developing countries should pass on the commercial risks of infrastructure projects to the private sector and rely less on public funding and guarantees. The Committee urged the richer nations to continue funding the IDA.

The IMF’s policymaking Interim Committee reached agreement on strengthening the surveillance capacities of the Fund, to improve early warning systems to prevent Mexico-style financial crises. The Committee encouraged the IMF to improve its dialogue with member countries and to be frank in its recommendations about the risks attached to policies followed by members. It also urged members to publish comprehensive data on their economies and asked the IMF to develop standards for the provision of this information to the public.

The Committee asked the IMF to continue to review the adequacy of its resources and ways they can be bolstered, warning that the Fund’s liquidity is projected to decline sharply over the next two years. It also requested that the IMF conduct a study of the role and functions of the special drawing right (SDR). The Committee praised the “courageous policies” followed by Russia and Ukraine. It will meet again on October 8, 1995.

Earlier at the meeting of the G-7 countries, a plan was discussed to bolster the IMF’s general arrangement to borrow (GAB) and to use it for bailouts similar to that of Mexico. (Established in 1962, expanded in 1983, and renewed in 1992, the GAB permits the Fund to borrow, under prescribed conditions, currencies from 11 industrialized countries and, through an associated agreement, from Saudi Arabia.) Under the plan the GAB would be turned into an emergency fund; new members would be invited to join; and current members to increase their contributions. The plan was not endorsed in Washington. United States Treasury Secretary Robert Rubin noted that the US supported expanding the number of countries contributing to the GAB and said this expansion was a possible approach to the IMF’s financing needs.

On the other hand, British Chancellor of the Exchequer Kenneth Clarke warned the Interim Committee that creating a special facility to help countries facing Mexico-style financial crises risked sending an undesirable signal that the international community stood ready to bail them out. He said that G-7 officials had agreed to review the future of the IMF and the World Bank at the G-7’s June meeting in Halifax (Canada). “We think the IMF and World Bank are somewhat large and bureaucratic, with some overlap between them,” said Clarke.

IMF Managing Director Michel Camdessus at a press conference after the G-7 meeting said that the IMF may sell some of its gold reserves [worth about $40 billion] to finance assistance to poor countries. He noted that approval for such a measure would require the support of 85 percent of the membership. Camdessus said that if the IMF does sell some gold, it will need various safeguards, and he suggested that it sell gold in parallel with receipt of contributions from bilateral donors. He said, moreover, that the proceeds from the sale should remain within the IMF and be used to help turn the enhanced structural adjustment facility (ESAF) into a permanent source of financing for the poorest countries. Camdessus said there was opposition to a proposal that the IMF consider borrowing on the capital markets for emergency financing. He said the IMF’s resources should be doubled to $440 billion to help maintain a stable, growing world economy. The Managing Director also pressed for an SDR issue in excess of the SDR 36 billion he initially proposed in 1994. (Camdessus has suggested resurrecting a Japanese proposal made a few years ago to use SDRs to set up a new IMF loan facility of up to $30 billion to help countries facing liquidity crises.)

On April 26, 1995, the eve of the IMF-World Bank Spring meetings, an article in the Financial Times addressed "the dogma that debt owed to the IMF and IBRD must never be written off." This is now being called into question because multilateral debt is rapidly emerging as one of the most pressing burdens for the very poorest of indebted developing countries, claimed the paper.

A revised joint IMF-World Bank study has concluded that—assuming zero real export growth, 23 countries would face multilateral debt service exceeding 10 percent of their exports, and 7 have multilateral debt service ratios above 20 percent. Objections to the principle of rescheduling debts to the IMF and the Bank remain fierce. IMF officials tend to dismiss the suggestion that debt be written off as out of the question, however, while Bank staff talk ominously of the damage this would do to the Bank’s AAA credit rating. Attention now focuses on ways of making the IMF lending to the poorest countries under ESAF even more concessional by extending repayment terms.
Conference Diary

The Case for Russia's Far East: Investing, Trading, Partnering
May 9-10, 1995, New York, N.Y., USA

A Business Development Forum presented by the Geonomics Institute, the Russian Far East Update, and the Pacific Law Center (Vladivostok). Conference aims to bring together Russian entrepreneurs, the international investment community, and specific company experience to discuss—in an interactive and varied format—the Case for Russia's Pacific Far East. Panel topics include: The Russian entrepreneur today; Financing project development and the new entrepreneur; Infrastructure development in the Russian Far East; Distribution and the retail market in the Russian Far East; Natural resource extraction: the key sector for Western investment.

For information: Geonomics Institute, tel. (802) 388-9619; fax (802) 388-9627, (Email: FYoung@Middlebury.edu).

Industrial and Enterprise Restructuring in Transition Economies
May 17-19, 1995, Leuven, Belgium

Industrial and enterprise restructuring, the most urgent problem facing the transition economies in Central and Eastern Europe, will be the subject of a major conference in Leuven. LICOS will bring together researchers from its COST network to review their work on investigating the dimensions of restructuring challenges and solutions. This program, which is sponsored by DG XII of the European Commission, is completing the first of three years' operations. The public plenary session on Thursday evening will feature a report on major research work of the World Bank by Professor Mark Schaffer of the London School of Economics and will continue Friday morning with discussions of other major specialists on restructuring.

Information: LICOS secretariat, tel. 32 (016) 32 53 40, fax 32 (016) 32 53 44.

Economic Reforms in Cooperation Partner Countries: Opportunities, Constraints, Security Implications
May 28-30, 1995, Brussels, Belgium

The 24th NATO Economics Colloquium, organized by NATO Economics Office of Information and Press.

Information: Daniel George, NATO Economics Directorate, Brussels, tel. (322) 728-4780, fax (322) 728-5228.

Restructuring of Agrobusiness in Eastern and Central Europe
June 10-14, 1995, Sofia/Vitosha, Bulgaria

Organized by the Institute of Agrarian Economics, Prognostication, Planning and World Agriculture (IAEPPWA) and the PHARE-ACE.

Information: R. Trendafilov, Sofia, tel. (3592) 552-808, fax (3592) 552-805.

Competitive Banking in East European Countries
July 10-11, 1995, Krakow, Poland

Organized by the Jagiellonian University/PHARE-ACE

Information: E. Miklaszewska, Department of Economics, Jagiellonian University, Krakow, tel. (4812) 216-484, fax (4812) 226-306.

Restructuring in the Transition Newsletter
June 12-13, 1995, St. Petersburg, Russia

This international conference, sponsored by the World Bank with participation from the Russian government, will examine the extent and problems of enterprise restructuring in the Russian industrial sector since 1992 and their policy implications. Most papers for the conference are based on a large, randomly selected survey of Russian industrial enterprises conducted in the second half of 1994. Participants will include senior officials from Russia and the World Bank as well as well-known researchers from around the world.

Information: Qimiao Fan or Unee Lee, the World Bank, 1818 H Street, N.W., Washington, D.C. USA, tel. (202) 473-7373/0991, fax (202) 477-3288. For registration, please contact Elena Belova, the Leontief Centre, 16 Voznesensky Pr., St. Petersburg, 190000, Russia, tel. (7-812) 314-4119, fax (7-812) 319-9814, (Email: sln@leontief.spb.su).

Emerging Capital Markets in Russia: Mid-Year Update
July 26-27, 1995, New York, N.Y., USA

The Summer 1995 Business Development Forum, sponsored by Geonomics Institute of Middlebury, Vermont, will provide information and tools for those who want to assess and reduce investment risk in Russia and identify available opportunities. Money managers, private and institutional investors, and hedge-fund managers can gain direct access to the architects of Russia's emerging market infrastructure, to independent research providers, and to major market-makers from both Russia and the West.

Information: Michael P. Claudon, Geonomics Institute, 14 Hillcrest Avenue, Middlebury, Vermont 05753, USA, tel. (802) 388-9619, fax (802) 388-9627.

Implications of CEE Business Development to Economic Integration in Europe
September 11-13 (new date!), 1995, Brno, Czech Republic

Information: M. Kerkovsky, Technical University of Brno, Faculty of Business and Management, Brno, Czech Republic, tel. (425) 4114-2685, fax (425) 4121-1410.
New Political, Military, Economic, and Environmental Security for Europe
September 22-24, 1995, Krakow, Poland

Third European Peace Research Conference, organized by the European Peace Research Association (EuPRA). Topics include: Post-Communist states and European integration; Southeastern Europe and its security surroundings; Economic perspectives in Europe. (Papers should be sent no later than September 1, 1995.) Information: Karl-Heinz Koppe, c/o Arbeitsstelle Friedensforschung Bonn (AFB), Beethovenallee 4, D-53175 Bonn, Germany, tel. (49228) 356-032, fax (49228) 356-050 or 353-603, (E-mail: afb@iz-bonn.gesis.d400.de).

Nordic Baltic Workshop on Environmental Economics

New Books and Working Papers
The PRDTE unit of the World Bank regrets that it is unable to supply the publications listed.

World Bank Publications


Economies of early reforming countries in Eastern and Central Europe achieved positive growth in 1994, but output continued to plunge in the former Soviet Republics. Over the next decade, in 1995-2004, the Bank forecasts average annual growth of 3.4 percent for transition economies of Europe and the FSU. Their exports are projected to grow at an annual 5.5 percent. East Asia, including Cambodia, China, Laos, and Viet Nam, could achieve 7.7 percent growth, while its exports could increase by 9 percent over the next decade. Income growth per capita between 1995 and 2004 is expected to reach 6.6 percent in East Asia. Global capital is likely to be tight in the years ahead, although it is unlikely there will be a shortage, provided industrialized countries continue to make progress on fiscal consolidation. "The sea change in policies in developing countries, and their increasing integration into world trade and finance, are underpinning the prospects for economic growth in these countries and for growth in trade," World Bank Vice President and Chief Economist Michael Bruno stressed during a press conference introducing the Report.


The 1995 edition of the statistical report monitors socioeconomic development for individual countries and presents a framework to compare key country indicators. Some highlights form the book: While living standards in low-income countries have been continuously improving, disparities between regions are widening. In particular, a gap has become noticeable between the South Asia region and sub-Saharan Africa. The number of poor people living on $1 or less per day will reach as many as 1.3 billion worldwide by 2000,


Christiaan Grootaert, Poverty and Social Transfers in Poland, PRWP no. 1440, March 1995, 79 p.

In 1993 social transfers accounted for 18.7 percent of Poland’s GDP, including pensions (14.9 percent), unemployment benefits (1.9 percent), family allowance and other social insurance (1.4 percent), and social assistance (0.5 percent). The social minimum, the conventional benchmark for measuring poverty in Poland, has lost much of its relevance; in 1993, 55 percent of Poles spent less than the minimum. At present, minimum pension and minimum wage are the yardsticks for measuring poverty. In 1993, 26.3 percent of the population had spent less than the minimum wage, and 14.4 percent less than the minimum pension.

April 18-21, 1996, Svanke, Bornholm, Denmark

Organized by Roskilde University and the Nordic Economic Research Council. Information: Prof. Dr. Hans Aage, Roskilde University Department of Social Science, tel. (4546) 757-781/2458, fax (4546) 756-618, (E-mail: hansaa@fosv.ruc.dk).
Poverty is highest among social income recipients, followed by pensioners and workers, of whom about 11 percent live below the minimum pension. In large cities (with more than 200,000 people), 5.5 percent live below the minimum pension. The smaller the settlement, the greater the percentage of the poor. Their rate is as high as 22 percent in villages.

Minimum wage occurrences indicate a similar pattern. Only 3.4 percent of childless couples are below the minimum pension (many of these households are pensioners). The poverty incidence rises steadily with the number of children. Among households with four or more children, 42.6 percent spend (per equivalent adult) less than the minimum pension, and 60.8 percent less than the minimum wage.

The social safety net in Poland represents 44.9 percent of the expenditure of an average household. The safety net is mildly progressive, providing 55.1 percent of expenditure for average households below the minimum pension, and 42.7 percent of expenditure for households above the minimum wage. This suggests that there is ample room in the system for better targeting. Proposed reform options include:

- Conducting income testing for the family allowance, with double the amount paid out to large households. (A freeze of the family allowance since mid-1992 has hurt the poor the most.)
- Reducing eligibility for the family allowance to 18 years and taxing the allowance; providing income-tested day-care vouchers for young children.
- Improving income testing for social assistance. (At present, 55 percent of beneficiaries are nonpoor and nonpoor households and are actually are paid more—in absolute numbers—than the poor.)
- Extending unemployment benefits eligibility for the low-skill jobless in large households. (Current eligibility is limited to twelve months, and this hurts low-skill workers the most.)


To order: Jennifer Prochnow-Walker, Rm. N11-023, tel. (202) 473-7466.

*Extendingunemploymentbenefitseligibilityfortheundeskilljoblessinhugehouseholds.(Currenteligibilityislimitedtotwelvemonths,andthishurtsundeskillworkersthemost.)Toorder:Nona

Sachdeva, Rm. S5-029, tel. (202) 458-2717.

Peter Orazem, Milan Vodopivec, and Ruth Wu, Worker Displacement during the Transition, PRWP no. 1449, April 1995, 28 p.

The paper describes displacement trends and the characteristics of displaced workers, comparing them with those in North America during a major recession. Among their findings:

- A comparison of displacement in Slovenia in 1990-93 and in North America during the recession of the early 1980s shows striking similarities in the incidence of displacement by gender and industry, as well as in reemployment paths.

- Women are no more likely to be displaced than men, and face smaller postdisplacement wage losses.

- About half the displaced workers who find new jobs change occupations and about a third change industry.

To order: Jennifer Prochnow-Walker, Rm. N11-023, tel. (202) 473-7466.


Reform of state-owned enterprises (SOEs) has been proceeding since the Chinese government announced sweeping reforms in November 1993, which included the stated goal of creating a "socialist market economy" by 2000. Despite China's impressive growth, inefficiencies still burden many of the SOEs that are at the core of the country's industrial sector. Competition from non-state sector firms has eroded the market share of SOEs. For China to capitalize on its past successes, it must restructure the overall SOE sector and intensify enterprise reform. SOEs face challenges on three levels: poor corporate incentive and governance systems; distortions in the policy and regulatory environment; lack of well-developed markets for labor, capital, and technology.


April 1995

**IMF Publications**


In most countries the national treasury is in charge of optimizing the financial management of government operations. Reflecting historical and cultural factors, the economic situation of the country, and the balance of powers among government agencies responsible for economic management, the treasury’s role can extend to the following areas:

- Planning and control of the central government’s budget and the monitoring of operations of the extra-budgetary funds and subnational governments.
- Day-to-day cash management, including control of inflows and outflows into the government account(s) with the banking system; and securing the smooth financing of government expenditures.
- Management of government debt and debt guarantees.
- Management of government financial assets, including equity holdings in public enterprises.
- Accounting of government operations and development and maintenance of government financial information systems.

The treasury can play a passive role in executing the budget (if the treasury merely makes resources available to spending agencies) or an active role (if it is authorized to limit expenditures, or even approve certain payments). The treasury can also share the management of public debt with the central bank. It may or may not be responsible for the accounting in the central administration.

The paper argues that, in countries facing substantial economic and financial adjustment problems and/or rapid institutional change, such as the economies in transition, it is desirable to give the treasury a broader (rather than narrower) range of responsibilities in government financial management. The paper also highlights the importance of an appropriate information system for the effective financial management of government operations, and the relationship of the treasury with other public sector entities, in particular the central bank.


**CASE Publications, Warsaw**


*Foreign Privatization in Poland*, CASE no. 30, October 1994, 74 p.


Marek Dabrowski, Western Aid Conditionality and the Post-Communist Transition, CASE no. 37, April 1995, 28 p.

To order: Center for Social and Economic Research, 00-585 Warszawa, ul. Bagatela 14, Warsaw, Poland, tel./fax (48-2) 628-6581.

Center for Agricultural and Rural Development (CARD) Publications, Ames, Iowa.


To order: Betty Hempe, publications secretary, Information Services Division, Iowa State University, Center for Agricultural and Rural Development, 578 Heady Hall, Ames, Iowa 50011-1070, USA, tel. (515) 294-1183, fax (515) 294-6336.

CEPR Papers, London


John Micklewright and Gyula Nagy, Unemployment Insurance and Incen-

The honeymoon is over for trade liberalization in Central and Eastern Europe. Neither GATT membership nor the Europe Agreements alone are strong enough to withstand the recent growth in protectionist pressure. CEE trade policy must begin a new and stronger institutional basis. Trade policy must above all be designed to emphasize accountability, independence, and transparency. The book also states: *Despite the Europe Agreements and the GATT, Hungary (for example) needs a strong institutional framework to support liberal trade policies.*

*Legislatures in the CEECs should decide the principles of underlying trade policies, but the details should be delegated to the executive, under the responsibility of a separate and senior ministry for trade.*

*The CEECs should also establish independent review bodies (possibly with World Bank or EU assistance) to analyze instances of protection and offer a public forum for consumer and user interests and for exporters.*

*The CEECs should adopt the contingent protection provisions of the Treaty of Rome, which are preferable to those in the Europe Agreements.*

SIGMA Publications, Paris

Bureaucratic Barriers to Entry: Foreign Investment in Central and Eastern Europe, OCDE/GD no. (94)124, 1994, 22 p.


To order: Support for Improvement in Governance and Management in Central and Eastern European Countries [SIGMA], 2 rue Andre-Pascal, 75775 Paris Cedex 16, France, tel. (33-1) 4524 8200, fax (33-1) 4524-1300.

WIIW Publications, Vienna

Helen Boxx and Peter Havlik, Slavic (dis)Union: Consequences for Russia, Belarus, and Ukraine, WIIW no. 157, January 1995, pp. 234-51.


Peter Havlik and others, Growth in Central and Eastern Europe: Contrasts with Recession in the CIS, WIIW no. 213, February 1995, 85 p.


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

Other Publications


Enterprise Insolvency in Russia, Institute for EastWest Studies, Prague/Budapest/Warsaw/New York/Atlanta, March 1995. To order: Institute for EastWest Studies, 360 Lexington Avenue, New York, New York 10017, USA, tel. (212)557-2570, fax (212)949-8043.


The first phase of transition to a market economy in Central and Eastern Europe was characterized by a sharp decline in output. The fall in real GDP exceeded 20 percent while real industrial production decreased by 40 percent. This study deals with various hypotheses trying to explain what has happened: Did the governments overshoot the credit and fiscal restrictions? Was the collapse of the
CMEA and the U.S.S.R. too much to swallow? Were domestic producers too unexperienced, too rigid, to adjust the output to new patterns of demand? The authors provide a combination of data based on national studies. Understanding the causes of recent output decline helps to assess further prospects for Eastern Europe.

To order: Kluwer Academic Publishing Group, Order Department, P.O. Box 358, Accord Station, Hingham, Massachusetts 02016-0358, USA, tel. (617) 871-6600, fax (617) 871-6328.


Will China be able to preserve the momentum of its economic reform in the post-Deng Xiaoping era? Will China’s rising regionalism lead to internal chaos and warlordism? Is China’s central government capable of acquiring the much-needed policy instruments to maintain macroeconomic stability? This book seeks to answer these questions by adopting the Public Choice approach to analyze the complex ways in which China’s political processes affect economic outcomes during its transition toward the market.

China’s economic transition is characterized by changing state-society relationships resulting from unorganized collective actions and the diffusion of power under the decentralization reform. The author describes how macro-level policy initiatives affect the behavior of micro-level actors such as households, enterprises, and localities, and how micro-level behavior changes multiply by "large numbers" and converge into unorganized yet powerful collective actions, which in turn send strong signals to macro-level policymakers and thus change the state’s policy inclinations and result in new state-society relationships. The author argues that as Chinese society becomes more heterogenous and bureaucratic hierarchies become further "flattened," new incentives are created and new interest groups are generated to sustain those changes and demand further reform. These changes reinforce one another, making the market transition an irreversible process.

To order: Singapore University Press, Yusof Ishak House, Kent Ridge Crescent, Singapore 0511, tel. (65) 776-1148, fax (65) 774-0652.


Instead of "leaping to the market," China’s reform in the 1970s introduced markets at the margin, parallel to planning. State enterprises and peasants were still required to fulfill planned output quotas and deliver them to the state at planned prices, but were allowed to sell their above-the-plan outputs at market prices and to retain part of the earned profits as an incentive. Planning was thus maintained initially in virtually all industries. These controlled institutional changes were followed by rapid economic expansion in China and a relatively stable macroeconomy.

The switch to complete decentralization from centralized or integrated decisionmaking under central planning will lead to output contraction. In the presence of interindustry dependence and imperfect competition, the big bang reform reduces state industries’ aggregate profits relative to the wage rate, while China’s reform raises state industries’ aggregate profits. Since governments in the reforming economies still collect most of their revenues from state industries, this model offers a structural explanation for the severe budget crises in the big bang economies and hence the macroeconomic instability.

To order: Fuqua School of Business, Duke University, Box 90120, Durham, North Carolina 27708-0120, USA, tel. (919) 660-7820, fax (919) 681-6244.


The author puts the Central and East European transformation process in a broader historical context extending to the precommunist era, analyzing the domestic factors that contributed to the demise of the communist systems. In detailed case studies on Czechoslovakia and Poland, the author demonstrates why the different initial conditions, despite many similarities, resulted in differing political agendas and economic policies in the two countries. Political and
social opinion polls demonstrate the interaction of economic and political developments.

Carmelo Mesa-Lago, Are Economic Reforms Propelling Cuba to the Market? North-South Center, University of Miami, 1994, 85 p. To order: North-South Center, University of Miami, P.O. Box 248205, Coral Gables, Florida 33124-3027, USA.


Petra Opitz and Wolfgang Paffenberger, Adjustment Processes in Russian Defence Enterprises within the framework of Conversion and Transition, Beiträge zur Konversionsforschung, Germany, 1994, 119 p. To order: Beiträge zur Konversionsforschung, Die Deutsche Bibliothek-CIP-Einheitsaufnahme, Dieckstr 73, 48145 Munster, Germany; tel. 0251 235-091, or Hallerplatz 5, 20146 Hamburg, Germany, tel. 040 446-446.


Newsletters


Economic Trends in Eastern Europe, publication providing subscribers with a comprehensive picture of Eastern European countries. To order: Kopint-Datorg, Research Department, Dorottya u. 6, H-1051 Budapest V., Hungary, tel. (361) 266-6640, fax (361) 266-8858.
Bibliography of Selected Articles

Postsocialist Economies—Interregional Issues


Central and Eastern Europe


Defending the EBRD. Central European (U.K.), April 1995, pp. 16-17.


CIS and the Baltics


