On July 1, 1990, the two Germanys entered into a monetary, economic, and social union, an event that initiates the German Democratic Republic's (GDR) conversion to a market economy. In many respects the German experience will be unique, but as the process unfolds, many lessons will emerge for other countries in transition.

Monetary union

In early February 1990, the government of the Federal Republic of Germany (FRG) offered to replace the GDR's Mark with the DM as the common currency unit, on the condition that the GDR "simultaneously [create] the legal prerequisites for introducing a social market economy". This was a dramatic step in laying the foundation for German economic union. (All previous proposals envisaged a gradual transition of the GDR towards a market economy.)

Monetary and economic union is based on an immediate extension of the economic "space" of the Federal Republic to the GDR, thus removing all obstacles for labor and capital flows and private sector activity. After the introduction of an entirely new "environment" on July 1, the adjustments are taking place throughout the "real" economy.

The conversion from the Mark to the DM led to considerable controversy. In recent years, the average implicit exchange rate for convertible currency exports had been 4:1, and free market rates outside the GDR had even reached 15:1 (in 1989). However, there were good arguments for a 1:1 conversion, apart from political symbolism. Nominal (1:1) net wages in East Germany were about 45 percent of West German levels, and productivity has been estimated at about 50 percent of West German levels (with considerable sectoral variations). Therefore, although 1:1 conversion appeared feasible for wages, and other current payments, savings accounts (57 percent of GNP) represented a considerable liquidity overhang. Further, state enterprises had considerable debts (the counterpart of these household assets). Many would not have been able to survive if their liabilities had been converted at 1:1.

For these and social reasons, the adopted approach was similar to that for claims in a bankruptcy or restructuring proceeding. Wages, pensions,
stipends, rentals and other current payments were converted at 1:1. All other claims were converted at 2:1, except liquid assets of individuals, which are converted at 1:1, up to a ceiling of 2,000, 4,000, or 6,000 Marks, depending on age (children, adults, pensioners). The resulting conversion is thus 1:1 for current payments and an average of 1.86:1 for future claims. The conversion rate for current payments actually has only limited significance since prices and wages were de-controlled on July 1 (with some temporary exceptions, e.g. rents).

Conversion of Marks for DM is carried out exclusively through bank accounts. With the currency union, the FRG's Deutsche Bundesbank assumes all central bank functions for the territory of the GDR as well. It also takes over some of the personnel and facilities of the former State Bank of the GDR to implement the currency conversion and monetary and credit policies.

Currency reform has huge consequences for the balance sheets of financial institutions. A substantial part of their liabilities is converted at 1:1, while almost all assets (i.e., public enterprise debts) are converted at 2:1, leaving large negative net worth. For this purpose, an "equalization fund" is being created in the GDR. It will allocate claims on the fund (bonds) as assets to financial institutions to cover valuation losses arising from the currency conversion, plus shortfalls to meet the capital adequacy rules of West German banks. The equalization fund will pay market-related interest rates on equalization claims.

Economic union

The principal condition for the introduction of the monetary union was the simultaneous creation of a common regulatory environment. Its principal characteristics are set out in Article 1 of the German-German treaty as "private enterprise, competition, free market pricing and free movement of labor, capital, goods and services". This "does not exclude special forms of property or public participation in economic activities as long as there is no discrimination against private entities."

These broad principles are further elaborated with respect to the role of enterprises, intra-German trade, external trade, structural adjustment of enterprises, agriculture, and the environment. Enterprises are to have full independence over production, investment, labor relations, prices and the use of profits. External trade policies are to be based on free trade principles and GATT rules, with due regard for existing obligations with CMEA countries. The objectives and laws of the European Community are to be gradually implemented in the GDR, including the common agricultural policy. Rapid structural adjustment of enterprises in the GDR will be promoted with the objective of improving productivity, furthering private initiative, creating a diversified economic structure, and thus laying the basis for more growth and secure jobs. For new investments, the environmental and safety regulations of the FRG are to be applied, while existing GDR facilities will be adapted to FRG regulations as soon as possible.

With the economic union, the main elements of the West German tax and budget system will also apply in the GDR, although with some temporary adjustments and simplifications for the remainder of this year. Almost identical personal and corporate income taxes, value added tax, customs tariff and a number of excise taxes (alcohol, tobacco, petroleum products, etc.) became effective on July 1. Remaining taxes (e.g. property tax, inheritance tax, motor vehicle taxes, commercial tax) will be introduced on January 1, 1991, as well as fully equivalent laws and regulations for all tax and budgetary matters. The social security funds, state enterprises, public utilities and local governments will be separated from the central government budget, and borrowing limits are stipulated for the central and local government budgets for 1990 and 1991.

Annex II to the treaty indicates which legal provisions of the Federal Republic were to become laws of the Democratic Republic by the time of treaty implementation (July 1, 1990). These include: the relevant banking, financial sector and insurance laws, the economic sections of the civil code, the commercial code, the joint stock-and limited liability company laws, the merger and acquisition and the monopoly and fair trade law; and labor laws.

A number of transitional measures have been agreed upon to assist GDR enterprises to adjust. These include: (a) quantitative restrictions on imports of certain agricultural products into the GDR, to be phased out over two years; (b) a temporary import duty of 11 percent in the GDR on certain consumer durables; (c) an investment subsidy of 12 percent for the first year and 8 percent for the second year after the economic union, provided from the GDR budget; and a reduction of the value-added tax in the Federal Republic for imports from the GDR by 11 percentage points during 1990 and six percentage points until June 1991.

Social union

In accordance with the German concept of a "social" market economy, the social union is an integral part of the monetary and economic union. It covers, in particular, labor relations and a comprehensive system of social security. The principles of labor relations to be applied in the GDR are to be equivalent to those in the FRG. These include freedom of association, autonomous wage setting, the right to strike, worker participation and co-determination, and some protection against job termination. The GDR will introduce a system of social security equivalent to that of the Federal Republic, including retirement, medical, accident and unemployment insurance, with the same benefits and contribution rates as in the FRG. As contributions to unemployment and retirement insurance are expected to fall short of expenditures for some time, the Federal Republic will provide financial assistance to cover the difference during a transition period.

The existing public health care system will continue for the time being but will be adjusted gradually towards the structures prevailing in the FRG by permitting the establishment of private health care providers (doc-
Financing the transition

Introduction of the West German tax system will lead to a substantial reduction in size of government. The GDR government expenditures are projected to decline by 4 percent of GNP. Most of this is due to the removal of public enterprise financing from the budget. Even excluding this effect, government expenditures are projected to decline by 4 percent of GNP, due to personnel reductions and a cut in subsidies. These will offset increases in social expenditures (pensions, unemployment). Infrastructure investments are projected nearly to double to 8 percent of GNP.

The resulting deficit is estimated at about DM 52 billion, or 13 percent of GNP for the first full year (1991). Two-thirds of the projected deficit is to be financed by budgetary transfers from the Federal Republic (mostly financed through the “German Unity Fund” of DM 115 billion for 1990-94) and one-third through internal and external borrowing by the GDR government. In addition, a temporary financing facility will be created for the restructuing of state enterprises. The German-German treaty does not stipulate financing arrangements beyond 1991—it is assumed that a common budget will exist at that time.

Ownership

Ownership and privatization issues have been, with the exchange rate, among the most difficult issues in negotiating economic union.

The treaty guarantees the right of private investors to acquire, use and dispose of land and other productive assets, and stipulates that land will be made available to private investors in industrial zones and urban areas and that state enterprises will own their land after incorporation. In view of the absence of a well functioning land market, the treaty provides the option to agree at a later date on an adjustment of the purchase price.

A joint declaration on ownership issues has since been agreed to by both governments. It does not apply to property nationalized before 1949 but leaves open the option of compensation. Other property is to be returned to previous owners, except where property has been physically improved or legally transferred to new owners. Compensation has to be provided. Enterprises nationalized in 1972 are to be offered to their previous owners. For other enterprises, shares are to be offered to previous owners, taking into account the change in value in the interim.

With the economic union, there are to be no further restrictions on foreign ownership. The company laws and accounting rules of the FRG will become effective in the GDR. A law on privatization and reorganization of state property has been passed in the GDR, with the objective of rapidly privatizing state property. All state enterprises and combines were automatically converted into companies on July 1. They are to be fully restructured according to the (West German) joint stock or limited liability company laws by October.

The state property fund will carry out privatization through a half-dozen subsidiaries organized as joint stock corporations. These will offer the reorganized companies for sale. The proceeds will be used as follows:

* First, to reorganize or close non-viable enterprises (the fund also has a line of credit to speed this process). The Minister of Economics recently guessed that 30 percent of state enterprises would be competitive, another 40 percent could be restructured, and 30 percent would have to be reorganized or closed.

* Second, to improve GDR government finances, especially through amortizing the equalization fund and other government debt.

* Third, distribution of state property to the population at large. This will be carried out in proportion to savings, converted at 2:1. East Germany’s assets will be sold to fund losses of the banking system and to pay off debts, with the residue to be shared among the population, based on individual financial wealth.

The economic consequences of the monetary and economic union are difficult to predict, as this is an unprecedented change in economic policy and systems. A number of factors are particularly crucial and closely interrelated. Careful trade-offs had to be made, involving the exchange rate, the speed of structural changes, private capital inflows, and external labor mobility.

In setting the rate of exchange and, thus, initial wages, the trade-off was made between maintaining external competitiveness for GDR enterprises, on the one hand, and limiting migration, on the other. The 1:1 conversion can only be justified on the basis of the GDR’s shift to a totally different economic system and large inflows of capital, technology and management. The high initial wage rates will particularly affect the agricultural and food industry sectors, as these will not be competitive, even within the protected EC agricultural market. For this reason, temporary quantitative restrictions have been agreed upon, to give GDR enterprises time to meet EC sanitary and quality standards.

Labor mobility between the GDR and the Federal Republic introduces both constraints and opportunities. Average wages will be only half of West German wages, and wage differentials will be even greater for skilled workers. One can thus expect continued migration (relieving unemployment)
and substantial pressure for nominal wage increases. If collective bargaining leads to higher wages, this probably will result mostly in higher unemployment since monetary policy is unlikely to be accommodating. The success of economic union thus depends to a considerable extent on moderation on the part of labor unions. The East German transition to a market economy will, in any event, proceed with wage rates several times higher, in convertible currency terms, than in other East European countries.

Another unknown factor is the extent to which the private sector will respond to the opportunities arising from economic union. Again, the change in policies and expectations has been too rapid for current analysis to come up with definite conclusions. The unresolved issue ownership has been the main stumbling block, at least until the recent passage of the state property privatization and restructuring law.

Projections about the economic consequences of the union for the GDR have to rely on simple calculations and analogies with earlier periods, for example, the reconstruction years in the FRG after the currency reform of 1948. A simple approach is to make a projection of FRG growth rates and an assumption of the speed at which the GDR would catch up with the FRG. Such exercises generally project annual growth rates of 3.5 percent for the FRG for the next 10 years (compared to 2.5 percent without the union); and around 7.5 percent for the GDR, with the GDR reaching 72 percent of West German incomes by 1995 and 88 percent by 2000, compared to 55 percent in 1990. This compares to annual growth rates for 1950-59 of 7.5 percent for the FRG, 8.1 percent for Japan, and 5.7 percent for Italy. The investment requirements for such a trajectory are formidable.

Sectoral employment patterns in the GDR have been compared with FRG patterns at a similar stage of development. They imply that the largest absolute declines are likely to be in agriculture, mining and industry while commerce and construction will probably see the largest absolute increase in jobs. Employment in other services is expected to increase only slightly, overall, as large gains in some sectors (finance, business services, tourism, personal services) will be compensated for by job losses in education and public administration (defense, security, Party employment).

Inflation can be expected to remain moderate in the medium term, due to the Bundesbank's conservative monetary policies for both Germanys. But the removal of all price controls and barriers to trade (on July 1) will undoubtedly lead to considerable changes in relative prices in the GDR over the next 12 months. With the introduction of the FRG tax system, the heavy tax burden on industry will be considerably lightened, reducing gross value added in industry by an average of 50 percent. Consequently, industrial consumer goods prices are expected to decline by 25 percent or more, while food prices are likely to increase by 20 percent, due to the removal of most subsidies. The cost of many services is also expected to rise.

The principal effects on the Federal Republic will be (a) an increase in public sector expenditures, due to fiscal transfers of up to DM 50 billion to the GDR (including investments in telecommunications and railways); (b) an increase of exports to the GDR of DM 30-50 billion; and (c) FRG private sector investments in the GDR, estimated at DM 20 billion per year, combined with some reduction of planned capital expenditure in the FRG.

If these exogenous changes are incorporated into macro-economic models for the FRG, the results include: (a) an increase in employment and economic growth of 0.7-1.0 percent p.a.; (b) an increase in long-term interest rates of one percentage point (which has already happened); (c) increased tax revenues, due to buoyant growth, thus reducing net government borrowing by DM 40 billion by the third year and reducing net borrowing to about DM 10 billion; and (d) an increase in imports, combined with lower growth of exports to the rest of the world, thus reducing the DM 100 billion current account surplus (and capital exports) by a significant fraction. This produces a small, but significant stimulus for the world economy. But it makes fiscal adjustments elsewhere more urgent, as the availability of capital exports from the FRG declines.

Gerhard Pohl, The World Bank, Geneva Office

Note: Our Socialist Economies Unit (CECSE) in the Bank intends to draw on the results of a large research project funded by the Federal Republic of Germany to follow the unfolding of the transition process in the GDR. Alan Gelb, CECSE

"Well, I told you everything is available for DM!"

From the East German magazine Eulenspiegel
Milestones of Transition

* In May, the Czechoslovak government approved a comprehensive set of economic measures to effect a rapid transition from a command to a market economy. These include plans for the regulation of foreign investment; the privatization of state property; a commercial code; tax reform; and anti-monopoly regulations. The plans incorporate a schedule for the reform of retail prices and a proposal for the reform of wholesale prices. The target date for currency convertibility is set for January 1991.

In addition, the government has authorized the creation of a number of new institutions to facilitate the economic reform process. A Privatization Office will be formed, which will assist with the privatization of state property. Employment offices will start operating this August, a stock exchange will be in operation by January 1991, and a commercial court will be established by January 1991. An investment bank has already been created, and commercial banks will come into operation in 1991.

---

* At the June 6-7 high-level meeting of the 17-nation Coordinating Committee for Multilateral Export Controls (COCOM), all members agreed to take a comprehensive approach to adapt COCOM to the recent historic changes in the East-West strategic environment. Members agreed to overhaul the dual-use control list by December 1990 through the creation of a "core list." The result will be a restructured and further reduced control list encompassing only the most strategic goods and technologies. The core list will be formed primarily on the basis of "strategic criticality" but will also take into account controllability of an item and availability from non-COCOM member sources. Members also agreed to take immediate measures to facilitate formation of the core list. They are:

  - Substantial decontrol in the areas of computers, telecommunications, and machine tools, for which most export requests are made. Czechoslovakia, Hungary, and Poland will receive immediate preferential access to even more modern telecommunications systems.

  - Elimination of 30 of the 116 categories on the COCOM dual-use control list, effective July 1, 1990.

  - In areas not affected by the measures above, outright decontrol for all destinations, to approximately the level now exportable to China, with no prior COCOM review.

  - In recognition of the unique situation between East and West Germany, adoption of a greatly reduced list of export controls for East Germany, which, in turn, will adopt an export-control system.

Further, COCOM members agreed to grant wide-ranging special licensing privileges (beyond the area of telecommunications) to East European countries that COCOM agrees represent a lesser strategic threat and that have adopted adequate safeguard regimes to protect controlled technology from unauthorized use. These countries will receive a presumption of approval for all but a few controlled dual-use items. To ensure that COCOM's new control list results in the goal of "higher fences around fewer items," members agreed to take concrete steps by April 30, 1991, to ensure equal and effective enforcement of controls by all members.

---

* On July 13 in Poland, the Parliament's lower house approved the privatization bill that would give every citizen a share in any of several thousand companies now owned by the state. Under the bill, likely to be passed by the Senate, every Pole would receive coupons that could be exchanged for stock in any of the state-run companies that are slated for privatization. In addition, employees would be able to buy more shares in the companies where they work, at preferential prices — up to 20 percent of the shares in each company would be set aside for workers' purchase. Beyond the equity reserved for the coupon exchange and the reduced-rate offerings to workers, the plan envisions the sale of the remaining, and greater, portion of shares to the general public over a number of years.

---

* On June 19 the government of Sudan approved a plan to end state control of the major sectors of the economy and move toward a more market-based system. A gradual end of state monopoly in agriculture, textiles, leather, sea and air transport, hotels and telecommunications has been approved, along with a target of three years to balance the budget.

---

* In June and July a number of important laws were approved by the Supreme Soviet. The measures represent a significant step forward in the Soviet Union toward creation of the legislative framework for a market economy. The new laws include the Law on Enterprises, which is to become effective from January 1, 1991; amendments to the May 1988 Law on Cooperatives which will become effective on October 1, 1990; a government statute on joint stock companies, which was approved on June 19 and will have immediate effect; a law on the taxation of enterprises, which will take effect from January 1, 1991. The statute on joint stock companies is a lower-level executive measure, pending approval of a law in this area.

---

* Soviet Foreign Minister Eduard Shevardnadze reportedly told IMF Managing Director Michael Camdessus during their talks in Moscow on July 28 that the time is right for the Soviet Union to join the IMF. The country regards membership as a logical continuation of its policy of wider involvement in global economic cooperation, Shevardnadze said, adding that the International Monetary Fund had helped member countries overcome barriers to development and pay foreign debt, and that the absence of the Soviet Union undermines the global character of this institution. The Soviet news agency Tass said Camdessus responded positively to Shevardnadze's proposal for talks.

---

* The Romanian Parliament in July approved in principle a government plan described as the first step toward privatizing the economy of Romania. The plan envisages the free distribution of 20 percent of the estimated value of the country's state-owned industries to the public in the form of vouchers that would later be negotiated into shares.
Quotation of the Month: Milton Friedman’s View

"The transition to freedom (in Eastern Europe) cannot be accomplished overnight. The formerly totalitarian societies have developed institutions, public attitudes, and vested interests that are wholly antithetical to the rapid creation of the basic economic requisites for freedom and prosperity. These requisites are easy to state, but far from easy to achieve.

1. First and most important: The bulk of wealth (including means of production) must be privately owned in the fullest sense, so that the private owner has wide discretion in its use and can transfer it to other private individuals or groups of private individuals on mutually agreeable terms. This condition implicitly includes the right of any individual to exchange any services or products with others on any terms that are mutually agreeable: i.e., no control over wages or prices, including foreign-exchange rates; no restrictions on imports or exports.

2. Security of private property is implicit in the first condition. If governments can and frequently do expropriate property, property owners will have no incentive to take a long view — to preserve their property and enhance its economic value.

3. For private property to be secure, government must be narrowly limited to its essential functions of maintaining law and order, including enforcing private contracts; of providing a judicial system to adjudicate differences in the interpretation of contracts, and to assure that laws against theft, murder, and the like are applied justly; of establishing the rules of the game, including the definition of private property.

4. I list a relatively stable monetary system as a separate item rather than as part of item 3 for two reasons: a) As a theoretical matter, a stable money can exist without governmental involvement (other than to enforce private contracts). That was largely the case when gold or silver or some other commodity was the base of the monetary system.

b) As a practical matter, the major immediate threat to successful reform in most of the countries in question is inflation and the danger of hyperinflation. So monetary reform is a particularly urgent task.

... The countries seeking to imitate the success of the West will make a great mistake if they pattern their policies on the current situation in the West, rather than on what the situation was when the Western countries were at the stage the Eastern European countries are at now.

"None of these requisites is easy to achieve. The one thing that is common to all of them is a drastic reduction in the size and role of the government. Such a reduction threatens almost every powerful vested interest in the current society. Indeed, it will be attainable, I believe, only under conditions of extreme crisis and only if done rapidly.

A detailed blueprint specifying how to achieve these requisites is not possible. The specific details will depend on the circumstances of the separate countries, which differ widely with respect to economic arrangements, public attitudes, social structure, and political conditions. But a number of general remarks are possible.

With respect to the first requisite — widespread private property — some parts of the transfer of government-owned property to private individuals can be done readily: for example, the transfer by sale of current government-owned housing units to those existing tenants willing to buy them (for cash or credit) at a price that corresponds to a reasonable capitalization of a private market rental (the qualification is necessary because present rents are often nominal).

A similar process is possible for relatively small enterprises: government-owned retail and service shops, small manufacturing enterprises, and the like. The most difficult problem is raised by larger-scale enterprises — steel mills, automobile plants, shipyards, coal mines, railroads, and so on. One much-bruited solution must be avoided: selling the enterprises at bargain-basement prices to foreigners. That is equally true of another proposed solution: transferring plants to their employees. The property has been accumulated at the expense of all the citizens; no favored group should get something for nothing. Liabilities as well as assets should be transferred to private individuals — not transferring assets to individuals while leaving liabilities to the government.

Foreigners should be free to invest and engage in economic activities on the same terms as private citizens; no specially favorable conditions should be granted to them.

With respect to security of private property, it can only be attained over a long period, as a middle class grows up that is independent of the government and can provide a climate of respect for private property and ownership.

With respect to a stable monetary system and, indirectly, the free-price system required to make private property meaningful, two steps are essential: first, a sharp reduction in government spending so that the government is not forced to print money to finance its expenditures; second, prompt elimination of all controls over foreign-exchange transactions and the prices of foreign currencies.

Convert-
Soviet Union: "Market Economy is an Alternative"

The Soviet party (CPSU) congress in July approved a program statement, including an Action Program that calls for historic changes in the Soviet economy. The following excerpt is a verbatim translation of the most important part of the program's chapter on the economy.

"Toward a regulated market"

The market economy is an alternative to the outmoded administrative-command system of management of the national economy. Advocating a phased transition to the market, the CPSU deems it necessary to:

* accelerate the elaboration of legislative and legal norms and mechanisms ensuring a switch to a market economy;

* grant enterprises and all commodity producers, regardless of their forms of ownership, autonomy and free enterprise and to promote the development of healthy and honest competition among them; and to separate the functions of state management from direct economic activity;

* implement demonopolization of production, banking, insurance, trade, and scientific development; give support to the development of a network of small- and medium-size enterprises;

* gear the state regulation of market relations to the protection of citizens’ social rights, carry out major structural transformations in the national economy and the scientific-technical and ecological programs, and safeguard the country’s interests in the system of world economic links. Preserve state management of major transport networks, communications, the power industry, and defense complex enterprises within the framework of a single market on the basis of economic accountability principles and labor collectives’ self-management;

* switch, in the planning system, to the elaboration of strategic outlook plans for economic development and targeted state programs, to indirect regulation of the economy through state orders, pricing, depreciation, and customs policy, taxes, interest on credit, and so on;

* ensure the switch to a convertible ruble and to an economy that is open to the world market, the creation of favorable conditions for enterprises’ foreign economic activity, and the involvement of foreign capital to ensure the earliest possible introduction of progressive technologies and supplies to the market.

Market and protection mechanisms

In view of the fact that the switch to the market is not an end in itself but a means of solving social problems, and in view of the possible adverse consequences of this switch, the CPSU proposes:

* compensating the populace for losses due to the revision of retail prices of goods and services; introducing a flexible system for indexing the population’s monetary incomes and increasing them, depending on the growth of consumer prices;

* creating an effective mechanism for maintaining employment, for finding jobs, and for vocational retraining; compensation payments during the period of temporary unemployment, retraining, and acquisition of new skills;

* ensuring social and state monitoring of the observance of laws regulating market relation.

Agrarian policy

In it the party proceeds on the basis of the following principles:

* supporting the Soviets’ right to own land, and the state, collective, and individual farms’ right to use and manage land;

* ensuring equal economic relations between city and countryside;

* ruling out any kind of diktat and bureaucratic rule in all that pertains to land management and relying on the peasant’s free choice; ensuring equal opportunities for the development both of social farming (kolhas — collective farm) and soukhas (state farm) and of newly established individual, family, and lease farming;

* ensuring the priority development of the agro-industrial complex’s material-technical base in the light of the requirements of all forms of economic management;

* enabling every rural inhabitant and everyone wishing to live and work in the countryside to set up his own home and farm holding; improving the social infrastructure of the countryside and making work on the land socially attractive and economically effective.”

From Milton Friedman’s article in The National Review, May 14, 1990, pp. 33-34.
An Evolutionary Perspective for Eastern Europe

Drawing on insights gained from his recently published book *The Nature of Socialist Economies: Lessons from Eastern European Foreign Trade* (Princeton University Press, 1990), Prof. Peter Murrell examines some of the dilemmas facing reform economies. These are contained in a paper, "An Evolutionary Perspective on Reform of the Eastern European Economies", presented at a recent IMF seminar. Murrell, a Professor of Economics at the University of Maryland, argues that economic theories provide metaphors to guide reforms, rather than precise lessons.

Most current discussions of reform follow very closely from a "neoclassical" or "Walrasian" paradigm. However, there are other paradigms that could be used to provide a broad underpinning for reform ideas. Murrell's book claims that to understand truly the poor performance of the Eastern European economies vis-a-vis capitalist ones takes an evolutionary — or Schumpeterian — perspective on the nature of economic processes. What are the most important elements of evolutionary theory? There are three important facets:

- **The first** is a theory of organizational and individual behavior that sees economic agents as constrained, not only by financial and physical elements, but also by limits on information processing capabilities and difficulties of exercising control in complex organizations. Organizations use routines to discharge their functions, which are difficult to change and heavily constrained by past circumstances. Hence, change in organizational behavior is costly, and therefore, one should expect much persistence in organizational behavior.

- **Second** is the concept of the economic environment. Given a stable environment for a long enough period, the types of routines and behaviors that are present in any society will be conditioned by the environment in which the society's stock of organizations has survived, adapted, and prospered.

- **Third**, an evolutionary approach would emphasize the importance of selection processes in accomplishing change. Changes within organizations are deemphasized in favor of a focus on the shifts in control over economic resources between inefficient (or technologically obsolete) and efficient (technologically progressive) organizations, or to new organizations better suited to the new economic environment.

The importance of emphasizing these three features is that comprehensive economic reform means a radical change in the economic environment by countries that have very large organizational stocks conditioned by the old centrally-planned bureaucratic environment. Hence one should view the central problem of reform as a conflict between the "weight of the past" and the "requirements of the new."

**Weight of the past**

Murrell emphasizes two elements inherited from the past. The first postulates that enterprises will rely on procedures suited to an environment characterized by bureaucratic allocation and administrative supervision as well as consistent excess demand. Conversely, it is unlikely that such enterprises will function well in a dramatically different environment. Without a very long process of natural selection of economic units and reallocation of personnel, a dramatic change in the environment might reduce the efficiency of existing organizations drastically.

The second element posits that the existing organizational framework of socialist economies produces an excess demand environment and that central planning bodies have been able to develop bureaucratic procedures to contain this excess demand and thus avoid its worst consequences. These excess-demand pressures will not be eradicated by simply changing incentives and the locus of decision-making, as in traditional models of decentralizing reforms.

The two elements come together in the acknowledgement that the excess demand created within the system is a crucial characteristic of the environment. The enterprises were born and survived in this high-pressure excess-demand environment. Many observers have commented on how well enterprise arrangements are structured for such an environment. Therefore, an attempt to control the excess demand by radical new measures could necessitate a complete reorganization of enterprises. Such a process might take many years of reorganization by trial and error and natural selection. During that time of adversity and change, the efficiency of the existing organizations might be very low.

**Requirements of the new**

In the evolutionary view, appropriate organizational behavior for a particular environment does not come about because of conscious decision-making on organizational design. Rather there is much difference in opinion about what constitutes optimal organizational design and rational decision-rules. Therefore, selection processes have a vital role in producing an efficient society. Overstating matters somewhat, a society has efficient organizations for a given environment solely because its stock of organizations are the "winners in an efficiency race" in a given environment, not because people know how to produce efficient organizations. Assuming that effective selection processes are required to produce a
dynamic economy, three features of social arrangements are required:

• First, society must create conditions under which a variety of new economic organizations are formed. The new entrants will almost certainly come from the domestic private sector and from foreign direct investment. Therefore, an important question for reform is how the state could best foster the entry of domestic newcomers. The most successful newly-formed private companies will need loans to finance growth; this may conflict with macroeconomic austerity.

At the same time, these companies are unlikely to have the personal and political connections that state enterprises inherit from the old regime. Nor can such companies expect to match the security that the implicit backing of the treasury affords to state enterprises. Therefore, macroeconomic stringency in the private sector is inappropriate at the very earliest stages of reform.

• Second, the selection of units — for destruction or for survival, for expansion or contraction — must be based upon economic criteria. Survival and growth should depend upon revenues and costs calculated, using prices based on economic criteria. In the increasingly integrated world economy, those prices must be heavily influenced by world market valuations.

• Third, for the efficacy of a selection process, there must be continuity in the environment. Selection of units must yield the promise that these units will be the most efficient ones over time. Hence, a stable environment should be created, and this environment should be as similar as possible to the one that is envisaged as the goal of the reform process. There is not much disagreement on what that environment will look like. The economy will be one with a large private sector that is open to foreign trade. Hence, the environment that is envisaged at the end of reform is very different from any environment that would include the organizations presently existing in the Eastern European economies.

Five deep contradictions

Murrell summarizes his argument by pointing to five deep contradictions between the legacies of the past and the requirements of the new.

• A radical change in the environment (that is, reform) might diminish the productive efficiency of the state sector, while the private sector is not yet ready to take up the slack. Moreover, the efficacy of selection processes in the private sector requires a fairly stable environment for that sector. Again, this environment must be similar to the one at the end of the reform process. How can reforms provide continuity with the past for the state sector and continuity with the future for the private sector?

• Historical experience shows that only draconian macroeconomic measures will control excess demand in a marketized state sector. However, encouragement of the selective process requires a non-restrictive macroeconomic policy to provide a fertile environment in the short run for new private sector entrants. How can reform combine macroeconomic stringency in the state sector with non-restrictive macroeconomic policies in the private sector?

• Failing a draconian fiscal, monetary and exchange rate policy, bureaucratic intervention is needed to contain the excess-demand pressures of the state sector. However, such bureaucratic intervention is inconsistent with the selection of economic units on economic criteria. How can bureaucratic intervention in the state sector be combined with free markets in the private sector?

• Immediate exposure of the state sector to foreign trade is extremely risky for two reasons: the introduction of world prices and trading conditions might cause a large decline in state sector productivity; and openness without macroeconomic austerity will imply the accumulation of foreign debt by the state sector. However, because the long-term goal is openness to foreign trade, selection in the private sector must be in an environment that includes foreign competition. How can continuing insulation of the state sector be combined with openness of the private sector?

• In the short run, competition between the state and private sectors has little chance of identifying the entities most suited to the environment that is the desired end-state of reform. If economy-wide free mar-
kets were immediately instituted, the decisions of state firms would largely determine aggregate economic results. These decisions would not be those of competitive private firms, because of the effect of organizational structures inherited from the past. The effects of history ensure that the selective race can never be handicapped in a way that provides the appropriate test of the relative abilities of the two sectors. How can the state sector be prevented from ruining the selective process in the private sector?

Maintain a dual economy

How can a reform resolve the contradictions identified above? Murrell suggests that the only possibility is to maintain a dual economy during transition. The state sector must be subject to the traditional bureaucratic controls. In some cases, re-centralization might even be required during the early months or years of transition. At the same time, the private sector of the economy should be allowed to function freely without central help or hindrance.

Murrell emphasizes that the dual economy policy that he advocates is no less comprehensive than the typical plans for reform that are currently circulating. Nor is the dual economy strategy likely to be slower in terms of its effect on national economic performance. The typical reform plans emphasize a comprehensiveness across sectors, while the various functional elements of capitalist markets (e.g., macro-balance, decentralization, free prices, convertibility) are phased in.

In contrast, Murrell suggests a policy that is comprehensive, in that it immediately introduces all the functional elements of capitalism into a small and growing private sector. The transfer of the state productive sector into the private sector is handled in phases, enterprise-by-enterprise, or perhaps, sector-by-sector. Thus, in comparing Murrell's suggestions with other reform plans, the issue is not comprehensiveness versus a piece-meal approach. No reform will do everything at once, given the immensity of the reform task. Rather, the question is what components of comprehensiveness to choose. The usual schemes emphasize comprehensiveness across sectors; Murrell emphasizes comprehensiveness across the functional elements of capitalist institutions.

**Liberalizing the Ethiopian Economy**

It is a moot point whether the Ethiopian economy of the 1980s should be thought of as an African economy with socialist trappings or an economy organized along Marxist-Leninist lines set within an African context. Whatever the case, Ethiopia will be experiencing important transitional problems in pursuing the path of thoroughgoing liberalization, as announced by the government on 5 March 1990. The core of transitional problems lies in the state enterprises sector, where hitherto hidden inefficiencies are likely to be exposed as physical planning gives way to controls based on profitability and as private sector competition intensifies.

The background to Ethiopia's economic reform is a decade of very low growth and falling per capita income, a virtually flat trend in export growth, and a chronically overvalued exchange rate. On the institutional front, socialization had proceeded by degrees, with the nationalization of medium- and large-scale enterprises in all sectors and with the progressive, but less than complete, reduction of the role of the private sector in domestic and external trade. Peasant farmers were subject to bureaucratic controls that, inter alia, denied them security of tenure.

Prior to reform, the economy had dual characteristics. The public sector received allocations of foreign exchange at the official rate for imports of capital and for intermediate and consumer goods; it produced at costs that reflected wage and price controls; it handled the majority of official exports — which it was able to procure by dint of export subsidies or, as in the case of coffee, through restrictions on domestic marketing; and it distributed consumer goods domestically, at less than market-clearing prices, through public distribution channels. The public sector was subject to state planning, with annual budgets covering output, investment and financial flows for each enterprise. Although they were profitable in aggregate, the efficiency and competitiveness of most state enterprises were weakened by overmanning, wage fund determination procedures that rewarded production rather than productivity, and the absence of profitability and efficiency targets for management.

There was at the same time a parallel, private sector, economy, characterized by household enterprises in peasant agriculture, distributive services and small-scale industry that respectively accounted for approximately 35 percent, 10 percent and 5 percent of GDP. Official restrictions forbade private investment in commercial farming and strictly limited its scope in the production of non-farm goods and services. Despite inhibiting conditions attached to trade and transport licenses, distribution was the easiest avenue of development. In private trade, foreign exchange was at a substantial premium, and other prices, including those of exportables, were significantly higher than in the state sector. Coffee, livestock, and small quantities of gold were smuggled out and private imports, some also smuggled, were financed from the proceeds of unofficial exports and from the remittances of expatriate Ethiopians.
The reform of 1990

The economic reform of 1990 was inspired by a desire to break the cycle of stagnation and economic underperformance. The government's analysis was that growth had been held back by the absence of opportunities for the private sector and by the disappointing results achieved by the socialist sectors, including the state enterprises and producer cooperatives. Its prescription was to remove the limits on private sector activity, to give the private sector fiscal incentives, and to commence the task of reforming the public sector by exposing it to private sector competition and by resolving to judge its performance on the basis of profitability rather than output volume. So far, the government has acted by:

* Partially liberalizing own-exchange imports, particularly for commercial vehicles, which are badly needed in the private sector where there is very limited access to official foreign exchange.

To stimulate exports, the government is considering duty-free export processing and the creation of a revolving fund of foreign exchange for exporters.

It is too early to tell if these reforms will work. There are some profitable opportunities in commercial farming, especially in livestock products for sale in urban areas, and some peasant farmers, secure in their holdings and freed from the obligation to sell low-priced quotas of grain to the state, are likely to improve their farms and expand their output. In other sectors, the economy will be more sensitive to a macroeconomic context in which inflation is likely to mount from a historically modest level, as a consequence of a recent relaxation of control over the fiscal deficit. Reverses in the crippling expensive civil war may defer the revival of private sector confidence. The output response will also be muted and may in some sectors be negative until reform creates adequately functioning markets in labor, capital and foreign exchange. Even then the response will be distorted as long as the protection of foreign exchange rationing and high import duties persist. Export growth will be restrained as long as the exchange rate is overvalued and while the price structure is dualistic.

A key impediment to growth in the formal sectors are the labor laws which make it virtually impossible to dismiss staff and which for many years have dissuaded private sector employees from engaging personnel. The financial sector is monolithic and highly specialized. Its vocation is mainly, but not exclusively, to finance the public sector. In a country where all land remains government property, the reemergent public sector will have problems in establishing its creditworthiness and in putting up adequate collateral.

The most acute and binding restraint on a supply response, however, that of foreign exchange. Not only the long-starved private sector, but also the hitherto privileged public sector, is unable to operate to capacity because of foreign exchange shortages. Meanwhile, foreign investment is not likely to occur while there is no realistic prospect of remitting profits.

These problems of factor market operation and access can be overcome through legislative, administrative and exchange rate action, albeit not without some political difficulty. The government is open to the idea of some measure of factor market liberalization and to the lessening of distortions.

Adjustment problems in the state sector

It is in the state enterprise sector that some of the most acute and persistent problems of adjustment are likely to occur. The government has affirmed its readiness to restructure, privatize and, if necessary, liquidate loss-making enterprises, but it may experience serious practical difficulties in doing so. Two main problems arise.

First is the widespread overmanning; a speedy ending to this is ruled out by political considerations, even if amendments to the labor protection laws make it legally possible. The reform of state enterprises will probably have to proceed at the pace at which it is possible to retire redundant staff.

Second, competition from the private sector is increasingly likely to expose the inefficiencies of the state enterprises, taking market share away from them and causing financial losses for hitherto profitable enterprises. This is because state enterprises are unable to control their costs and cut their overheads to the level of business they are able to attract. State enterprise reform is envisaged that will give management autonomy and responsibility for making enterprises profitable, but this could well be ineffective so long as management has less than full control over costs. Conversely, where enterprise management continues to enjoy a high degree of monopoly power, the dismantling of physical planning is likely to exempt them to achieve profitability targets.
in the face of supply shortages, by reducing output and increasing prices. Delaying state enterprise reform in Ethiopia presents two dangers to the success of the adjustment process. First, and more obviously, increasing losses or falling taxable profits could upset the fiscal balance, which has hitherto been reliant on substantial transfers from state enterprises, so jeopardizing macroeconomic stability. Second, the longer the process of state enterprise reform, the longer will persist the misallocation of resources of labor, capital and foreign exchange in favor of relatively inefficient producers at the expense of more efficient ones in the private sector. As the rate of "de-manning" the state enterprises will be the determinant of the pace of state enterprise reform, preparing for and managing labor redeployment emerge as the most critical conditions of the long-term success of the economic reform program.

John Roberts, AP/ICO

On the World Bank/IMF Agenda

World Bank Supports Plan to Study Soviet Economy

World Bank President Barber Conable has offered his support for a proposal by the leaders of the world's seven leading industrial nations, the Group of Seven (G-7), to launch a study of the Soviet Union's economy. "The proposed evaluation of the Soviet economy is a very positive move by the G-7 summit leaders," the Bank's President said. "The experience that our staff can bring to such an evaluation of the Soviet economy would be very valuable," he added. In their communiqué, the G-7 leaders said they agreed to ask the IMF, the World Bank, the OECD and the designated president of the European Bank for Reconstruction and Development to undertake, "in close consultation with the Commission of the European Communities, a detailed study of the Soviet economy, to make recommendations for its reform and to establish the criteria under which Western economic assistance could effectively support these reforms."

Mongolia Applies for Membership

Mongolia has applied for membership in the World Bank, the International Development Association and the International Finance Corporation. Mongolia has also applied to become a member of the IMF.

Hungary Boosts Agricultural Exports

Hungary will increase its foreign-exchange earnings through a project aimed at boosting production of agricultural goods for export. The World Bank is supporting the project with a $100 million loan. Funds from the loan will be channeled to commercial banks through the National Bank of Hungary and re-lent to agricultural enterprises, including individual farmers, cooperatives and state farms, to finance improvements in agro-processing facilities, marketing operations, and equipment needed to increase and improve production of crops and livestock. Training and technical services will be provided to farmers and agricultural enterprises in market development, farm management, business planning and other services to improve efficiency and reorient their operations toward a market economy.

Yugoslavia Launches Major Highway Project

Yugoslavia is planning to invest $2.3 billion during the next two years to modernize and maintain its road network. The World Bank has approved six loans totaling $292 million to support the project, which is designed to strengthen highway planning and maintenance, upgrade roads to bolster economic activities and tourism, and improve links with neighboring countries. Other goals include raising the quality of freight transport, reducing travel costs, and promoting environmental protection through reduced automobile emissions. The project covers the republics of Bosnia-Herzegovina, Croatia, Macedonia, Serbia and Slovenia, and the province of Vojvodina. Other financing for the project will come from local road revenues, an earlier World Bank loan, and other foreign sources.

Project in China Will Benefit Poor Farm Families

Low-income farm families in China's Hebei Province will benefit from increased agricultural production and job opportunities under a project that is being supported by a credit of $150 million from the International Development Association (IDA). The incomes of about 540,000 farm families are expected to more than double as a result of the project, which inter alia, aims at strengthening the management of water resources in Hebei Province in the northeast; intensifying the productivity of existing low-yielding crops and diversifying cropping patterns; and improving research and extension programs.

Ethiopia Upgrades Living Conditions for the Poor

Residents in the poor neighborhoods of Addis Ababa, the capital of Ethiopia, will benefit from an urban development project designed to ease the city's chronic housing shortage and upgrade inadequate infrastructure. IDA is supporting the project with a credit of SDR $35 million. About 43,000 residents in the Kebeles neighborhoods — Addis Ababa's poorest and most congested section, covering 88 hectares — will benefit from upgraded houses, roads, drainage facilities, latrines, public water fountains, refuse containers, streetlighting and public showers.
Alan Peacock and Hans Willgerodt (editors)
GERMANY'S SOCIAL MARKET ECONOMY: ORIGINS AND EVOLUTION

These essays have been translated from the German to bring the views of a group of German liberal economic and legal thinkers to the notice of a wider public. This group of economists and lawyers came into prominence as a result of their influence on, and participation in, postwar economic policy in the Federal Republic of Germany when Ludwig Erhard was Minister for Economic Affairs and, later, Chancellor.

Seventeen essays have been selected to express the thoughts of the group who, because of their commitment to designing the appropriate economic and legal order or system, became known as Ordo-liberals. The essays deal with a wide range of contemporary problems such as the meaning of the social market economy, the problems of owner, employee and management interest, the role of the public sector, the control of monopolies, the problem of the welfare state and the need for self-help, and the role of the trade unions in industrial societies. The reader will find essays dealing with the more philosophical question of whether capitalist and communist systems are moving closer together in their approach to economic problems to such an extent that they will eventually converge.

William A. Byrd and Lin Qingsong (editors)
CHINA'S RURAL INDUSTRY: STRUCTURE, DEVELOPMENT AND REFORM
(A World Bank research publication)

A striking feature of recent economic development in China is the emergence of rural industrial enterprises, run in some cases by local governments, in others by private groups and individuals. The proliferation and growth of these firms -- many of which show great flexibility and energy -- have significantly increased personal incomes among rural Chinese and have begun to change the structure of the rural labor force. Rural industry has become the most dynamic part of the Chinese industrial sector.

This book, the product of a collaborative effort by Chinese and World Bank researchers, examines the genesis, institutional structure, operations, problems, and prospects of this grass-roots industrial activity. An unprecedented quantity and variety of data were gathered, mostly in four representative counties, where local government officials, factory managers, and employees were interviewed in depth. The results of the research provide insight into the economic picture at the local level: how firms are started and operated, the relationships between firms and governments at all levels, and the present and potential contributions of non-state firms to rural development, local finance, living standards, and employment. Both successes and problems are illuminated through a number of case studies. A final chapter compares Chinese rural industry with analogous enterprises in other countries.

At the time of writing, William A. Byrd was an economist in the China Program Division, Asia Region, The World Bank. Lin Qingsong was deputy director of the Institute of Economics, Chinese Academy of Social Sciences.

William Byrd and Alan Gelb
TOWNSHIP, VILLAGE, AND PRIVATE INDUSTRY IN CHINA'S ECONOMIC REFORM

Next to the decollectivization of agriculture, the most striking economic transformation in China since 1978 has been the rapid growth of rural non-state Industry. Firms in this sector (referred to here as TVPs) are owned by a hierarchy of local government units below the county level: towns (or townships), villages, and production teams (or, to a lesser extent, private individuals and groups). TVPs owned by township or village governments (that is, not privately owned) are termed TVCEs.

Important both to industry and the rural economy, TVPs have been at the forefront of economic reform. They are market-oriented in terms of output and input and, because of their tiny home markets, outward-oriented. There appears to be a close relationship between individual incomes and firm/community economic performance. Most individuals expect to stay in their firms for relatively long periods. In some ways, TVPs seem to resemble the so-called Z firms, rather than private or state enterprises.

Community incentives for promoting TVPs are strong. But their community orientation leads to certain problems, resulting from the fragmentation of markets for capital and labor and the mul-
multiple, sometimes conflicting, roles of community governments. Even if resources are used efficiently within rural communities, the immobility of factors of production can lead to increasingly serious misallocations and inequalities among communities. A gradual opening of capital and labor markets is a priority task in the next stage of reform. Weakening the involvement of community governments in management of rural industrialization is likely to be gradual and take a long time. A stronger legal framework in which TVCEs and private firms can operate will be needed. National government policy should be to minimize discrimination by government, legal, and regulatory apparatus against TVPs and, within the TVP sector, against private enterprise. The long-term goal should be elimination of differential treatment.

***

Kang Chen

CHINA'S ECONOMIC REFORM AND SOCIAL UNREST


In recent years, corruption, inflation and income redistribution have caused great social discontent in China. Although many believe the economic disorder was caused by the introduction of a two-tier pricing system, the author contends that it basically resulted from inconsistent reform guidelines. These include: (a) opening up the product market without establishing a factor market to ensure necessary adjustment of resource allocation, (b) altering the government's functions in economic management without transforming organizations that are still carrying out the old functions, and (c) establishing a market system without the necessary laws and regulations to guarantee proper functioning of the system. In addition to a two-tier pricing system, transfer of authority to the local governments was another direct result of these inconsistent reform guidelines. All of these provided more opportunities for corruption, contributed to economic disorder, and promoted social unrest.

***

Gottorm Schjelderup

REFORMING STATE ENTERPRISES IN SOCIALIST ECONOMIES: GUIDELINES FOR LEASING THEM TO ENTREPRENEURS


Schjelderup discusses the reform of state-owned enterprises in socialist economies by leasing them to entrepreneurs. He recommends lease payments to the state, based on fee schedules from the principal-agent literature. The aim of the principal (the state) is to get the agent (entrepreneur/lessee) to act in the state's interest. The state does so by rewarding the agents for observed actions and outcomes.

What is the process of evaluation, however, when the reform process is based on the fact that the state is unable to manage its own enterprise efficiently? Clearly, the state has to rely only on observed outcomes.

Despite the state's inability to evaluate actions, outcomes can be judged by a simple measure: the firm's profit level. Using the firm's profit level as a basis for sharing rules between the lessee and lessor, Schjelderup offers advice on how to structure and implement fee schedules and on the institutional framework they require.

***

David Burton and Jiming Ha

ECONOMIC REFORM AND THE DEMAND FOR MONEY IN CHINA


Error correction models of the demand for a range of monetary aggregates in China are estimated with quarterly data for the period 1983-88. The estimated models fit the data reasonably well and appear to be relatively stable. Money demand is found to be sensitive to changes in expected inflation. In the case of currency, demand increases in the short term in response to an increase in expected inflation even though there is a fall in demand in the long run. A "cash-in-advance" explanation for this response pattern is suggested. It is also argued that the estimation results taken as a whole provide indirect evidence against the existence of substantial repressed inflation in China during the sample period.

***

Bela Balassa

PERESTROYKA AND ITS IMPLICATIONS FOR EUROPEAN SOCIALIST COUNTRIES


Perestroika, introduced in the Soviet Union to reform the economy after the "period of stagnation" under Brezhnev, involves combining centralized planning with elements of a market economy. For it to succeed, certain micro and macro conditions need to be fulfilled.

As far as micro conditions are concerned, one should emphasize the interdependence of rational prices, decentralization, profit maximization, incentives, and competition. For commodities produced domestically, the establishment of ration price requires that prices equate demand and supply. This, in turn, necessitates the decentralization of decision-making and profit maximization by the firm. At the same time, managers would have to be provided with appropriate incentives to ensure that firms maximize profits. Finally, there is need for competition to guarantee that profit maximization does not lead to the exploitation of monopoly positions and inflation.

Various macroeconomic conditions also need to be fulfilled for perestroika to succeed. The government should aim at realistic growth rates, establish balance between investment and consumption, eliminate the overhang in the market for consumer goods and services, and drastically reduce the budget deficit.

At the same time, the success or failure of perestroika will have implications for the success of reforms in the European socialist countries. And the performance of the economies will be affected by the increased demand for quality in the Soviet Union. But successful reform by the socialist economies will help meet this demand to exploit the opportunities offered by the vast Soviet market.

New Books and Working Papers


Conference Diary

Housing Reforms

On June 12-13, 1990, the Infrastructure and Urban Development Department of the World Bank organized a policy and research seminar on housing reforms in socialist economies, attended by government officials and researchers from eight countries. The main objectives of the seminar were:

- to discuss recent experience in six socialist countries (China, Czechoslovakia, Hungary, Poland, Romania, Yugoslavia);
- to determine the extent of consensus on the sequencing of reforms;
- to identify the most critical areas for comparative research to support the housing reforms.

"We intend to give a more detailed report on the seminar in one of the next issues of this Newsletter."

SSRC Workshop on Soviet and Eastern European Economics

From July 8 to July 19, 1990, the Sixth Annual Social Science Research Council Workshop on Soviet and Eastern European Economics was held at the University of Pittsburgh. (The primary goal of the workshop is to promote research in the field of comparative economic systems.) This year's faculty included professors Herbert Levine (workshop director), University of Pennsylvania; Richard Ericson, Columbia University; Michael Marrese, Northwestern University; Andrei Polotayev, Institute for World Economy, Moscow; Jan Svejnar, University of Pittsburgh; and George Breilleur (political sciences), University of California, Berkeley. Junior participants were mostly from American universities, but there were also Soviets, Poles, and representatives from Czechoslovakia, and Yugoslavia.

The papers presented at the workshop covered the following topics:

- modeling of shortages in a general equilibrium framework (among others, Martin Weitzman from Harvard presented his paper entitled "Price distortion and shortage deformation: or what happened to the soup?");
- cycles in, and incentives for, investment and, in particular, modernization;
- the mechanism of soft budget constraint redistribution and its consequences, e.g., overmanning and delayed adoption of innovations;
- the augmented compensating variations model for the explanation of the interindustry wage differentials in the Soviet Union (stolen hours and materials augmenting the usual differentials in working conditions/requirements);
- repressed inflation and coordination failure;
- firm behavior in socialist countries (Poland);
- determinants of interregional migration in the Soviet Union; and
- Bayesian approach to modeling "market socialism."

Forthcoming Conferences

Agricultural Reforms

August 29 to September 1, 1990


The conference has three objectives: to synthesize experience to date with agrarian reform in socialist countries; to identify alternative strategies for reform; and to identify key areas of research to facilitate the design and implementation of reform programs. The conference will focus on the role of incentives, organizational structures, and policy, both at the farm level and in the larger agricultural economy. Participants will include leading Eastern European, Soviet and Western economists. Welcoming addresses will be delivered by the new President of the Hungarian National Bank and by a high official of the World Bank, the opening speech will be given by a senior member of the Hungarian government.

Contact person at The World Bank: Avi Shay Braverman, Division Chief, Agricultural Policy Division, 1818 H Street, N.W., Washington, D.C. 20433, USA. Tel.: (202) 473-0378; telefax: (202) 334 0568.

Adjustment Lending

October 4-5, 1990

"The World Bank's Experience with Adjustment Lending: Lessons for Eastern Europe." The conference is to be held in Poltusk, Poland. Organizers: The World Bank (CECEMG) and the World Economy Research Institute, Central School of Planning and Statistics, University of Warsaw.

Technology, Culture, and Development

October 26-27, 1990

Conference on "Technology, Culture and Development: The Experience of the Soviet Model." For information: James P. Scanlan, Director, Center for Slavic and East European Studies, 344 Dulles Hall, 230 W. 17th Ave., Ohio State University, Columbus, OH 43210/311; Tel: (614) 2928770.

Transition to a Market Economy

November 28-30, 1990

OECD-World Bank sponsored conference on "Transition to a Market Economy in Central and Eastern Europe."
Bibliography of Selected Articles

Socialist Economies


**Eastern Europe**


USSR


Asia


CMEA