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Bolshevik Biscuit in Private Hands

Successful Transformation of a Russian Company

Among the many ironies in present-day Russia is that one of the very first large enterprises to be fully privatized is a firm called the Bolshevik Biscuit Company. As a state enterprise, this company produced the best-known, highest-quality cakes and confectioneries in the Moscow region, and its new owners see no reason to jettison a recognized brand name. Thus, the word that was used to denote the most militant, uncompromising wing of the Communist revolutionaries of 1917 now refers to a privatized joint stock company in the Russian capital. To date, only about 100 other large enterprises across Russia have matched Bolshevik's achievement. But several hundred others have launched a similar process, and hundreds more—soon perhaps thousands—have taken the first steps toward becoming fully private. The details of the privatization process vary considerably in Russia's heavily decentralized program, but all companies must go through the essential steps followed in the Bolshevik transaction.

Bolshevik's management had expressed interest in "corporatization"—transformation into a joint stock company—in the late 1980s, during the Perestroika reform period. When the Russian government, in December 1991, announced the general outline of its 1992 privatization program, Bolshevik's management responded by drawing up a specific divestiture proposal aimed at the retention of most shares by the enterprise's workers and managers. This home-grown scheme was never implemented, but was put on hold as the government elaborated a complex set of privatization regulations through the spring of 1992. In June the final detailed program was published, and a large number of enterprises, including Bolshevik, were required to corporatize and then to choose from among three alternative routes to the first phase of divestiture.

Bolshevik's workers and managers opted for the approach that let them purchase—in a "closed subscription"—51 percent of the company's equity, at a price set by the government at 1.7 times the book, or historical accounting, value as of early 1992. The government applied the 1.7 multiplier in an effort to make those opting for employee and management buyout pay a "reasonable" price. The government added to the difficulty of this option by requiring that purchasers pay in full within 90 days of the sale but without providing any special credit arrangements. Nonetheless, Bolshevik's workers and managers chose the buyout option—indeed, about half of all Russian enterprises slated for divestiture are attempting

What's inside...

to use this method. The other main closed subscription method gives workers, free of charge, 25 percent of a company's shares—but they are nonvoting. This option also allows workers to purchase an additional 10 percent of voting shares, and managers 5 percent, all at a price based on book value.

In October 1992 Bolshevik's 2,300 workers (up from 1,600 five years ago) and managers paid 39.2 million rubles to the state to become the majority owners of the firm. High inflation reduced the severity of the 1.7 multiplier; moreover, Bolshevik's workers and managers were able to use a previously established "privatization fund" in the company's accounts to make their payment. Little cash came from the purchasers, and there appeared to be relatively little personal capital at risk in this (or any other) closed subscription transaction.

What about the remaining 49 percent of equity? The regulations state that each firm undergoing the closed subscription process of corporatization must put forward a proposal specifying how the remainder of its equity would be disposed of. Bolshevik's proposal called for a public offering of the remaining shares, with an additional portion reserved for workers and managers. The proposal did not set a specific timetable for the sale of the remaining equity. But it was generally assumed that sales would begin in the spring of 1993, and that 35 percent of total shares would be reserved for voucher auctions (this had been set in the

Highlights of Anatoly Chubais's Privatization Update

Russia's Deputy Prime Minister Anatoly Chubais made a short presentation in Washington on March 19. The presentation, hosted by the Professional Bankers' Association (PBA), was titled "Russian Program of Privatization." Chubais, as Chairman of the State Committee for the Management of State Property, is in charge of that program. While in Washington, Chubais also signed a $90 million privatization loan from the World Bank, on behalf of the Russian government. The loan will finance expert advice for carrying out privatization transactions and an information campaign to educate Russians and potential investors about the switch to a market economy. Managing Director Ernest Stern signed the agreement on behalf of the World Bank. Some highlights of the Russian guest's address follow [with Editor's notes in brackets].

Small-Scale Privatization: Almost 50 percent of all small businesses—including retail outlets, restaurants, and catering businesses—are already privately owned. It is a considerable achievement as the small-scale privatization [of entities employing less than 200 people] started only last year in earnest.

Vouchers: The mass privatization program got under way in the second half of 1992, as there was little chance to create investment demand otherwise. Russia's 150 million citizens were able to obtain vouchers for the nominal value of 10,000 rubles [representing an equal share of Russia's fixed capital stock of 1.4 trillion rubles, calculated as of January 1992]. By the end of January 1993 the procedure had been completed; millions of citizens have obtained freely tradable vouchers. [In January about 35,000 vouchers a day were changing hands on the country's largest trading floor at the Moscow Commodity Exchange.] The price dropped to 5,000 rubles last October, then hit 3,900 rubles in February; in mid-March it was 4,500 to 4,600 rubles. As soon as voucher auctions become part of everyday life, the market price should rise.

Enterprise Transformation: The wide-range program started last October. In the first stage, 5,600 of the largest state companies were selected for corporatization, that is, to be transformed into joint stock companies. [It is expected that by the end of May about 2,000 of the largest enterprises will be corporatized.] Workers and managers can use their vouchers to purchase shares in their own company. [Most of the joint stock companies have chosen a privatization option that gives workers and managers a 51 percent controlling share in the enterprise. See *Transition,* vol 3, no. 10, November 1992, p.6.] Closed subscriptions thus preceded auctions open to all voucher holders.

Voucher Auctions: We must accelerate the pace of voucher auctions, selling the remaining shares in corporatized firms for vouchers. In December 20 enterprises were privatized this way, 90 more in January, 190 more in February, and about 300 in March; starting in May, 500 monthly auctions are expected all over the country. In the next stage of voucher auctions, shares of huge, "GM-sized" companies will be offered for sale, and they require a nationwide sales center network. Just a few days ago one of the biggest Russian industrial enterprises, the ZIL company, was put on the block. [The largest company yet to be privatized in Russia, the ZIL company in early March began selling off 35 percent of its assets for vouchers, about one million shares. The company, which produces limousines, trucks, buses, and refrigerators, has some 15 plants and employs more than 100,000 workers across the country. About 60 offices have been opened throughout Russia to accept bids from voucher holders. In the next step, interregional auctions require institutional decentralization, and a decision will be made on the location of the voucher auctions.]

Voucher Investment Funds: With the aim of aggregating shares—and diversifying risks—several hundred investment funds, with 700 local branches, have registered in Russia, and their number is growing rapidly. As more assets appear on the auction market, we expect that the funds will play a more active role. [When they are fully functioning, funds will accumulate the vouchers of citizens, giving them in return shares in the fund itself. Funds will trade their accumulated vouchers for shares in enterprise auctions. No fund can hold more than 10 percent of the shares of any company, nor can it invest more than 5 percent of its total assets in any one firm.]

regulations as the maximum percentage of a firm that could be sold for vouchers).

In late October 1992, in an effort to drive up the market value of vouchers, the government increased the percentage of shares that could be traded for vouchers to 80 percent. And it advanced the timing of the voucher auction process to show a concerned population that the privatization program was moving forward.

At the end of October the federal privatization agency (GKI) sent telegrams to all *oblasts* asking regional authorities to produce lists of enterprises that had been corporatized and had completed the closed subscription process, and were ready and willing to take part in an advance, or pilot, voucher auction program. The response was highly positive; a large number of *oblasts* put forward the names of dozens of firms—far more, indeed, than local authorities can yet handle. At Bolshevik the process was even more direct: the company's senior managers were well known to high officials in the GKI, who simply phoned them and asked whether they were ready to take part in the scheme. The answer was yes.

The GKI then furnished the enterprise with a technical assistance team composed of a senior GKI staff member, an investment banker, and a management consultant (the last two were foreigners, funded by a variety of external grants). This team of outsiders worked in close consultation with Bolshevik management. They explained the process to the work force. They produced information for potential purchasers on the firm's assets and liabilities, finances, clients, suppliers, and prospects (no formal prospectus was prepared; instead, information was printed on posters hung on the walls of the auction center). They undertook a public relations campaign in the press and on television. And they handled the myriad legal and administrative steps to obtain all necessary approvals for the auction, and set up the mechanisms by which it would be carried out.

This entailed intense and exhausting work by both the Bolshevik staff and their external advisors, since nothing they were doing had any precedent in Russia. The preparatory work was rapidly completed, numerous bureaucratic and legal obstacles were overcome, and the Bolshevik auction began on December 9, 1992. Transactions were allowed for two weeks, and by December 24 the entire share offering—44 percent of total equity—was divided among the voucher bids received in the trading period.

The Russian government uses a simple voucher bidding system compared with that in Czechoslovakia. The number of shares put up for sale is calculated according to the historic book value of the enterprise. During a two-week bidding period investors can make an "unrestricted" bid, stating how many vouchers they wish to invest in a company but without specifying a price. Or they can make a "stop-price" bid specifying a ceiling price for their investment. All investors end up paying the same price (in vouchers) per share at the end of the bidding period, when the supply of shares is equated to total demand. Those making an unrestricted bid always get a share (or shares, or percentage of a share); those making a stop-price bid get shares if supply equals demand at any price lower than their ceiling.

In future auctions, 5 percent of will be reserved to be sold for cover the costs incurred by local cies in the sale and to induce th lead the process. In Bolshevik's this was not done. Bolshevik's agement claims that "a specia rangement" was struck allowing w ers and managers eventually purchase an additional 5 percent, that this amount is presently be held by the Federal Property Fund. any event, 5 percent was not sold; a no revenues accrued to any of the se ers.

If one totals the vouchers traded a their face value of 10,000 rubles each, one could say that 44 percent of Bolshevik equity was "sold" in the auctions for 197 million rubles. But in December vouchers were trading at between 5,000 and 6,000 rubles on the Moscow secondary market. Taking an average voucher value of 5,500 rubles for the period, 44 percent of equity went for 108.35 million rubles. Details on how many individuals traded these 19,700 vouchers for shares are not yet available. Bolshevik management hazarded a guess that between 50 and 80 percent of the purchasers were insiders—workers, managers, or pensioners of the company, and their families. Most transactions were small; observers could not recall seeing bundles of vouchers being traded for large blocks of shares.

Shareholders of Russia, Unite!

"By the end of 1993 Russia will have taken an irreversible step towards the creation of a market economy if the present privatization program proceeds as planned. Up to 1,000 medium and large state-owned enterprises will have been privatized. Shares in these companies will have been issued to workers, managers, and widely to the Russian population. Investment funds have collected vouchers from the population and issued shares in their closed-end mutual funds. Emerging stock exchanges in various regions throughout the country will be linked and an off-line share trading system will be in place. Depositories and systems for clearance and settlement of share trading will have been established and in operation. All of this will be very basic or rudimentary, but it will form the basis for an emerging capital market, a market of immense proportions and potential."

From a presentation titled "Russia as an Emerging Capital Market" given at a recent London conference by Ira W. Lieberman, Senior Manager (PSD) at the World Bank.

What is clear is that the workers and managers obtained their closed subscription shares at a very large discount compared with the voucher auction prices. If workers and managers had paid the December secondary market price per share, the subscription would have generated 155.65 million rubles rather than 39.2 million. The government recognized that fixing and transferring property rights took precedence over maximizing sale revenue.

Price is not the question; the real issue is, what happens next? Bolshevik is now a private joint stock company. Its first annual general meeting will convene soon, and a board of directors representing the interests of the shareholders will be elected. Well and good. But where will it obtain its working and investment capital in the future? How ruthless can its commercial policy be when the vast majority of its shares are held by workers and other insiders? How will secondary trading evolve to bring in foreign or strategic investors? Will managers buy up a significant number of shares from workers interested in quick profits? What steps should and can Bolshevik take to maintain its market position in the face of growing entry?

None of these questions can at the moment be answered with assurance. What must be stressed, however, is that in one short year, and mostly in the period from August to December, Bolshevik Biscuit moved from being a state-owned enterprise to being a fully private firm. If that can be accomplished, so can much else.

John Nellis
PSD, The World Bank

Private Firms in St. Petersburg—Small Businesses with Great Ambitions

Findings of a Survey

In late January, experts from the World Bank, with the help of staff from the European Bank of Reconstruction and Development (EBRD) and from two Russian think tanks, the Leontief Center for Social and Economic Studies and the Institute of Economic Forecasting, surveyed 86 private service firms in the St. Petersburg area. These firms, which offered services ranging from hairdressing to trading in raw materials, each had to satisfy three criteria: that more than 50 percent of their revenues are derived from services; that a majority of their stock is privately owned; and that their foreign ownership is less than 50 percent. The first impressions from the survey results are given below, and a report will be available in June.

Boom and Bust

About half of the enterprises surveyed were registered as joint stock (limited liability) companies. The average age of entrepreneurs was 42, and about 90 percent were men. Many of the owners—especially at the small privatized firms—had either worked in the same enterprise before privatization, usually as directors, or had been in a similar line of business. The firms' average number of employees ranged from 5 to 50.

Eighty-five percent of the firms claimed to have an operating profit, with only 5 percent indicating losses and 10 percent a break-even situation. Using a mix of indicators, the

Real Income and Real Estate

St. Petersburg has a population of 5 million, and another 1.7 million people live in the surrounding Leningrad Region. The Leontief Center estimates that in October 1992 the state sector employed 79 percent of the work force, and that in December 1992 about 100,000 people were unemployed. St. Petersburg's production of goods and services is estimated to have declined by 20 percent during the first nine months of 1992, and households' real income to have fallen by 44 percent, compared with the first nine months of 1991. St. Petersburg has been hit harder than the surrounding Leningrad Region, where production dropped 12 percent and household income 32 percent.

In this historic city, real estate is a complicated matter. In principle, nonhistoric buildings may be purchased, and anyone purchasing both the building and the equipment it contains can also buy the land beneath it. Historic buildings can be leased for a maximum of 49 years, and the land beneath them must also be leased. Space inside a building can be leased for a maximum of only 15 years. Lease payments are set by a detailed regulation that distinguishes both among categories of property and among categories of lessees. For example, a trading firm would have to pay more than a manufacturing firm, and a foreigner more than a Russian citizen. Budgetary agencies—schools, hospitals, research institutes—pay the lowest rent, and many of them try to acquire as much space as possible so that they can earn income by subletting.

interviewers classified three-quarters of the firms as moderately or highly successful and one-quarter as weak or muddling through. Those judged as weak were mostly in consumer services (such as hairdressing, tailoring, and watch repair), for which demand has fallen sharply as a result of the decline in real personal income. Many firms with a domestic business or a conventional export business, such as tourism, are exploring untested export markets—for example, for alternative medical practices.

Some Concerns

The private firms surveyed reported a few worries, including:

- Uncertainties about the future course of reform.
- Rampant inflation accompanied by frequent and unexpected changes in relative prices.
- Sluggish demand for many services, especially private health care, hairdressing, transport of goods, advertising, catering, tourism, and research, the last due to the drop in government contracts. (At the same time, there is strong demand for some business services, such as consulting and legal assistance.)
- The absence of a stable and transparent body of laws and regulations, including tax laws. Existing laws are subject to frequent and unexpected changes. Property law and contract law are unclear, and there is little legal recourse in the face of injustice. There is only limited use of the courts to settle disputes or collect debts. Meanwhile, "Mafia" groups extort payments for protection and also provide some "legal services," such as debt collection and contract enforcement.
- The absence of citywide programs of training, technical assistance, or credit for private businesses. (There are several training programs supported by Finland, Germany, and the United Kingdom, however.)
- Deficiencies in banking services, such as delays in payment, excessive fees, lack of medium- or long-term finance, and lack of confidentiality.
- The absence of affordable work space and the insecurity of lease arrangements.
- High tax rates. The main taxes are the value added tax (20 percent on most products), the profits tax (32 percent), several payroll taxes (totaling 38 percent), the personal income tax (with a basic rate of 12 percent), and various local taxes, including taxes on transport and advertisement, that have recently been imposed. Tax authorities sometimes request taxpayers to prepay certain taxes, and increase taxpayers' liabilities retroactively.

Business Center—A Suggestion

Some seed money could be offered to set up one or more business centers in St. Petersburg to provide:

- Information on domestic laws.
- Updated standard forms required for obtaining permits, concluding leases, and filing taxes.
- International information and communication facilities.
- Services facilitating contacts with foreign businesspersons.
- Technical advice in financial management and project development.
- Business incubators.
- Training and foreign study.

Questions that need to be explored—and that are undoubtedly being explored elsewhere in Russia—are whether such services should be provided together or through competing centers, how such activities should be financed (whether such an operation could obtain its own financing, either from user charges or external grant assistance), and whether such centers could provide loans for projects. The city government could perhaps be persuaded to provide space for such pilot projects.

Martha de Melo, Gur Ofer, and Olga Sandler
PRDTM, The World Bank

Hurdles in Business Finance

Real interest rates in Russia—with a monthly inflation rate of 40 percent—are highly negative. Nominal rates range from 80 to 200 percent annually, and loan maturities from several weeks to a year and a half. Banks can charge these interest rates because they pay low rates on savings deposits and virtually nothing on demand deposits. Penalty rates for loans not repaid on time are substantially higher (up to 5 percent a day) than the contractual interest rate.

To obtain a loan, a client must have collateral, a guarantee from another company, or loan insurance. (Apparently, collateral is not registered anywhere, and there are no procedures for sales when the borrower defaults. Thus, banks may end up owning firms that owe them money.)

Relatively few private firms have outstanding loans. The reason for this, besides the lack of medium-term credit, is that many firms were unable to obtain loans to cover their commercial transactions, which are subject to delays in delivery and in payment.

To overcome the financing shortage, most businesses in St. Petersburg either plough back their profits or try to find a "silent partner" to provide office space or cash for an in-kind return. Many firms are looking for a foreign investor who could provide hard currency and help promote exports. And several firms are making equity investments in banks with a view to assuring adequate credit in the future.

China's Surge toward a Socialist Market Economy

Spring Session of the Parliament

China's parliament, the National People's Congress, approved a new government lineup and a series of economic, legal, and administrative reforms during its session in the second half of March. It did not conceal its intention "to translate the outcome of the Communist Party's last Congress in October into an action program for the government" (see *Transition*, vol. 3, no. 9, October 1992). Going beyond just rubber-stamping the Party's decisions, the parliament has approved several amendments to the Chinese constitution. (The former version, adopted in 1982, had been amended only once, in 1988, to permit private ownership and the transfer of land.)

The latest amendments to the constitution include the following:

- The theory of developing "socialism with Chinese characteristics"—the formal description of Deng Xiaoping's philosophy—is incorporated into the preamble with the same status as Marxism-Leninism and Mao Zedong's thought.
- The description of the economy is to be formally changed to a "socialist market economy," with references to "planned economy" excised.
- All references to "state-run industry" are being amended to read "state-owned industry," paving the way for rapid corporatization of public enterprises.

Prime Minister Li Peng, later appointed to a second five-year term, introduced the government's Work Report (the Chinese version of the State of the Union address) calling for continued rapid economic growth and more free-market reforms. The report announced the formal adoption of the revised target of 8 to 9 percent annual economic growth for the next five years, allowing individual regions to pursue faster growth if conditions permit. The official target for 1993 is an 8 percent increase in GNP.

On the expansion of economic reform, the prime minister mentioned four relatively new areas:

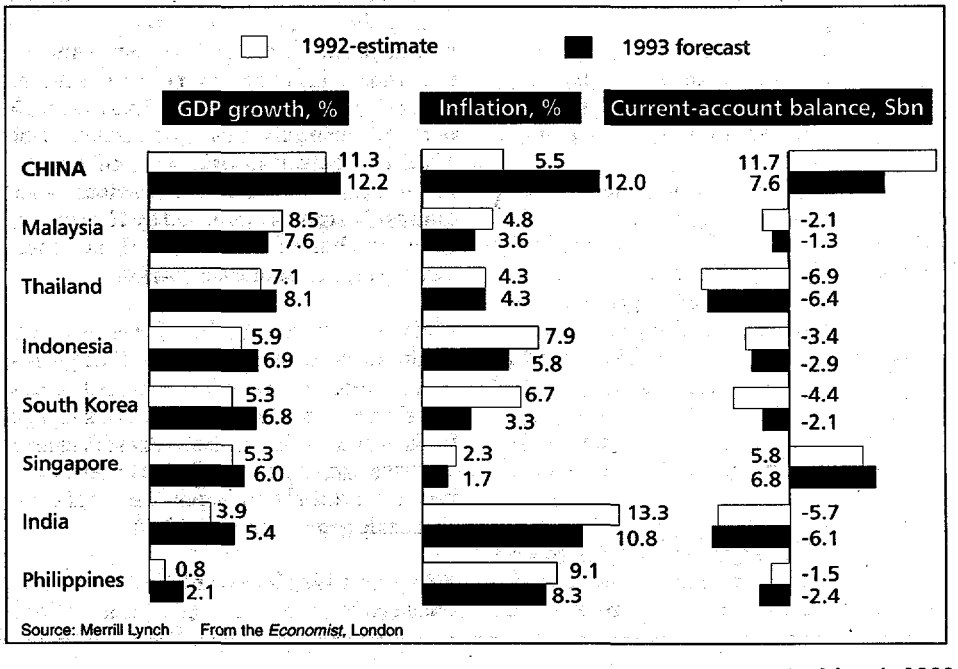
- He referred to "some state enterprises which may be leased or sold to collectives or individuals through public bidding," an indication of a change of heart on the issue of privatization.
- He voiced the government's determination to "rectify the excessively low prices of coal, electricity, oil and railway services."
- The banking system is to see an important, though risky, innovation with the establishment of "banks whose sole function is to make low-interest loans for state projects," while the commercial banks would "gradually relinquish" their present responsibility for this.
- Labor market reform has increased in importance, as reflected by a set of policies to eradicate permanent employment, such that "enterprises will be able to hire employees independently and individuals to choose their own jobs." This is the strongest such statement on labor reform ever seen.

At the same time, the net result of the reorganization of the government—

The National People's Congress is China's parliament, the highest official state body. It is elected—or selected—every five years and has one annual meeting. A standing committee carries on its business for the rest of the year. Its method of selection, which assures that the delegates will support the Communist Party proposals, is peculiarly Chinese. Once elected, the People's Congress performs three main functions:

- *It passes laws, and amends the constitution.*
- *It appoints senior government and state officials, including the prime minister and the president.*
- *It approves the annual budget and the government's economic and development program.*

China and Other Asian Economies—Some Economic Indicators



Source: Merrill Lynch From the *Economist*, London

Economic Prospects for China in 1993—Predictions of Oxford Analytica

China is poised to enter its third consecutive year of rapid growth. GDP growth will continue in the 8 to 10 percent range, and foreign trade could increase by about 20 percent. For the past two years, the economy has been emerging from recession, with slack capacity and abundant supplies preventing overheating. This period is now over. Growth-induced strains are likely to become more evident in 1993, providing new challenges to policymakers as they debate the pace of reform. Inflationary pressures have already begun to mount. Markets for consumer goods have remained stable, but danger signs have emerged in the markets for producer goods that will make macroeconomic management more difficult in 1993.

The consumer markets show little sign of impending inflation:

- The urban wage bill increased only 16 percent in the first three quarters of 1992 while the price level increased 9 percent (12 percent in the larger cities). By contrast, industrial output, measured in constant prices, was up 20 percent over the same period.
- Another good harvest is being reaped. Total grain output is expected to exceed last year's record, and the steady growth of subsidiary farm products has continued. The prices on farmers' markets are stable.
- Sales of big-ticket durables have grown slowly, and the savings rate remains high.

As for the producer markets, fixed investment has jumped 37 percent, putting pressure on the industrial economy:

- Market prices for producer goods have been increasing since mid-1992. Structural steel and cement saw the biggest rises.
- Bottlenecks are emerging in the transport sector. Total freight traffic increased only 4.6 percent, and transport delays have increased markedly.
- Energy shortages are reemerging. The primary energy supply grew only 2.8 percent during the first 10 months of 1992.

Problems in energy supply have so far been averted by improved sector performance, however. Crude petroleum output increased only 1.8 percent, although production of refinery products was up 8.5 percent. Coal production increased 3.1 percent, and electric power generation was up 10.8 percent. The changes reflect the inefficiency of traditional industry and the impact of large stockpiles built up during the 1989-90 recession.

These trends will continue in 1993. Nominal investment growth will continue at about 30 percent, although price increases for investment goods will, to some extent, offset this. Delays and occasional shortages will increase.

Foreign trade will continue to be dynamic. Imports are accelerating from last year's 23 percent growth rate, and exports will maintain their 1992 growth rate, averaging about 17 percent. By increasing the availability of essential inputs, rapid import growth has eased strains on the economy.

Foreign investment is likely to accelerate further. Contracts for new investment, which typically lead actual investment by a year or two, doubled in value in both 1991 and 1992:

- In Guangdong province, rapid export growth based on foreign investment is expected to be maintained. The province's exports to the United States are growing at about 40 percent a year. (The United States' deficit with China was approaching $20 billion by the end of 1992.) With investment in export-oriented factories rising, this trend will continue.
- The performance of the Lower Yangtze provinces is even more impressive. Jiangsu's industrial output increased 35 percent during the first three quarters of 1992, and output in October 1992 was 47 percent higher than in the previous year. Jiangsu's exports increased by 19 percent, showing that its rapid growth is based largely on the domestic market.

While export growth has preserved the trade surplus and foreign exchange reserves, most of the slack within the domestic economy has now been used up. With sound foreign exchange reserves and a stable consumer market, the authorities are unlikely to apply the brakes to economic growth during 1993.

Although China's current leadership has accepted the market, it retains a distinct preference for control whenever possible. With market prices stable over the past two years, policymakers have been able to concentrate price reforms in state-controlled sectors. State prices were adjusted upward toward market prices, with the bulk of adjustments in 1991 concentrated in energy and ferrous and nonferrous metals. Because these commodities are produced in large state firms, the price hikes increased state revenues.

With this period over, reformers face greater fluctuations in market prices and a period of rising prices. With reform policies likely to return to a pattern of decentralization and the opening up of markets, future trends are likely to include the following:

- Local market experiments will be given more leeway.
- Shanghai's stock exchange will expand significantly, and local land markets will be formalized in a number of regions (in addition to Guangdong).
- Moves to tackle the inefficient state industrial sector will commence in 1993. A plan to lay off 30,000 coal miners and close 30 pits was announced in the official media in December 1992. Nevertheless, changes will be cautiously introduced.
- The Lower Yangtze region will match, and in some respects surpass, the degree of market orientation that Guangdong already displays.
- Because of its size, population, and energy and raw material resources, China will continue to expand as a center for manufacturing operations, particularly for those relocating from more expensive sites in East Asia.
- Foreign trade liberalization will become increasingly central to economic reform. The most important provisions of the October 1992 U.S.-China trade agreement will take effect in December 1993.
- These changes will be controversial. Differences about specific policy initiatives will intensify, but with economic fundamentals remaining positive, potential instability is unlikely to undermine rapid growth in 1993.

From reports of Oxford Analytica, the London-based economic research group.

announced at the October Party Congress—is to reduce the number of ministries from 41 to 40 and to add one new state commission. In one interesting development, however, the Ministry of Materials is being combined with the Ministry of Commerce to form a Ministry of Internal Trade responsible for regulatory issues.

The widespread reform of industrial ministries did not occur; all that took place was the conversion of the Ministries of Light Industry and Textiles into industry associations. Nevertheless, the prime minister did announce an intention to reduce the number of government employees by 25 percent over the next three years. About 2 million people will be affected. The government will shed employees by enforcing regulations concerning retirement and encouraging staff to work in service industries or to start their own businesses.

The annual development plan, which usually adds little to the prime minister's speech, signaled important changes in the role of the Planning Commission (SPC), changes that the World Bank has been encouraging for some time.

- The plan contained many more macroeconomic projections than ever before, including external trade forecasts and, for the first time, the target for credit growth.
- The SPC stated clearly that the focus of public investment would be on the provision of economic and social infrastructure, which would receive 70 percent of such funds.
- There would be continued reductions in mandatory planning, falling from 12 percent of transactions by value to only 7 percent in 1993. This is the first occasion that can be recalled in which a public statement on the scale of planning was given in terms of value.

Two other aspects of Li Peng's speech merit a mention:

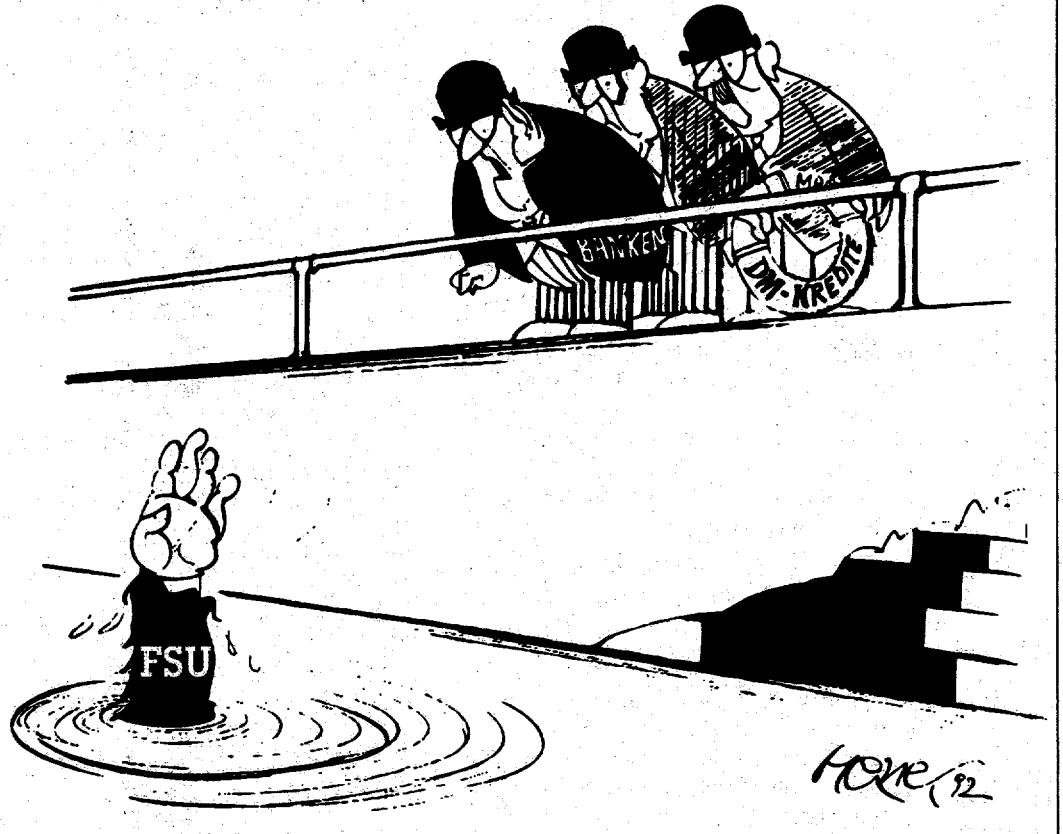
- The frequent and strong statements on the need to eradicate corruption indicate that the problem must be reaching very serious proportions and that is an issue of real concern to the government, not least because of its importance to the events of 1989.
- The speech contained a vitriolic attack on the proposals by the governor of Hong Kong for greater democracy; this signaled continued wrangling on the issue, which could complicate China's international relations.

A number of important personnel decisions were announced before the 1993 session was wrapped up, including the promotion of Communist Party General Secretary Jiang Xemin to President, the appointment of Prime Minister Li Peng to a second five-year term, and the appointments of Qiao Shi as chairman of parliament and Li Ruihuan as chairman of the Chinese People's Political Consultative Conference, the top advisory body.

To sum up, the Chinese parliament had a busy session this year, one that will further cement the position of reform at the center of China's strategy, and secure Deng Xiaoping's philosophy and approach to development.

Peter C. Harrold, EA2CO, The World Bank

The Banks and the States of the Former Soviet Union



"—But are you creditworthy?"

From the German daily *Kölner Stadt-Anzeiger*

Quotation of the Month: "The success of Russian democracy cannot be gauged only by high politics in Moscow"

History Professor from Berkeley Cautions in *The New Republic* against Premature Panicking

The real question is not whether the Yeltsin-Gaidar reforms have "succeeded"—of course Russia does not yet have an effective market democracy—but how good are the results thus far. And this can be answered only if we take sober account of the universal "rubble," in Solzhenitsyn's metaphor, that was Russia's inheritance from Sovietism. For the Soviet Union was not Franco's Spain or Pinochet's Chile, where a market, private property, and civil society existed beneath a despotism whose end sufficed for democracy to emerge. The Soviet Union was totalitarian: everything—from politics to the economy to culture—was absorbed into the Party-state. Gorbachev's perestroika showed that such a total system cannot be reformed piecemeal: it ends in total collapse, leaving behind a total problem. And to climb out from under the wreckage, everything has to be done at once, thus creating an impossible situation where everything, logically, has to be done first.

Yeltsin did not have the choice of carrying out separately and seriatim a democratic political reform, a liberal economic reform, and building a Russia distinct from the Soviet Union. He had to take the gamble of attempting all at once. This took him beyond reform to revolution—but revolution of an unprecedented sort. Earlier Western revolutions were by breakthrough, as when an already formed English Parliament or the dynamic French Third Estate cracked the outworn shell of royal power. But the anti-Communist revolutions of 1989-91 were by implosion, with the shell of the Party-state simply disintegrating, leaving no viable institutions for the successor democracy to build on.

So the old Parliament was left in place, and Russian democracy began its career without a constitution; or, what amounted to the same thing, with its only legal basis the Brezhnev Constitution of 1977, as amended more than 200 times and written for a Union that was now disappearing.

Thus the internal political problem fused with the issue of what to do about the Union. As a matter of both principle and practical politics, it was impossible to demand democracy in Russia and yet refuse self-determination to the Union republics. And after the shock of the coup, these all voted to secede, leaving some 25 million Russians stranded in what was now the "near abroad." This result was unsettling to most Russians, who, though they had always lived badly under communism, still derived consolation from being citizens of a great state. Thus, the end of the now detested old regime was nonetheless felt as a national humiliation, a sentiment aggravated by Russia's new dependence on the West.

All the same, it is an exaggeration to say that these circumstances have engendered rabid nationalism. In fact, for the magnitude of the loss in power and prestige, and the very real problem posed by the Russians "abroad," the reaction has been mild—as comparison with the backlash in France after the loss of Algeria or America's trauma after the "loss" of China readily reveals.

For those who would read the Russian future through the prism of Croatia and Bosnia, it should be pointed out that the Commonwealth of Independent States has already passed the flash point that produced that tragedy. This point was the Yugoslav secession movement in late 1991 and 1992, a process the Soviet Union went through nonviolently in the fall of 1991. And the reason for the difference in the two outcomes was that a Yugoslav Communist Party still in power, and in possession of an army, exploited Serbian nationalism to combat secession and so maintained its position, whereas the Russian democrats aimed to destroy the Party and to shrink the armed forces, and therefore sponsored secession in the Baltic states and Central Asia and accepted it in Ukraine and Belarus. This, of course, does not mean that the Russian diaspora no longer presents a potential for conflict, as the current tension in Moldova shows. But it does mean that post-Soviet ethnic problems can be resolved nonviolently if they are channeled through democracy. And this brings up the matter on which democracy's success depends above all: the economy and the fortunes of shock therapy.

To be sure, Yeltsin's first year has been the worst one yet in Russia's long-running economic crisis; the gross national product dropped around 20 percent, and industrial production 50 percent; prices rose 2,000 percent while inflation was running at a monthly rate of 25 percent to 30 percent; and the ruble was down to 450 (now 550) to the dollar from 135 in June. Only 40 percent of taxes were being collected, and the government lost control of the money supply, with a deficit of 1.5 trillion rubles.

Yet it is absurd to impute these problems primarily to the mistakes of the Yeltsin-Gaidar government, real though these at times have been. The economic decline began under Brezhnev; it had assumed crisis proportions by 1989 under Gorbachev; and it had become a freefall by 1991. If this process accelerated in 1992, this was, partly, because of the collapse of both the external and internal Soviet empires and the disruption of trade. But, above all, the decline was due to the salutary reduction of military procurements by around 80 percent from the

previous year, which accounts for most of the production fall bemoaned by the Civic Union. Far from being the cause of the deepening debacle, shock therapy was the first serious attempt to do something about it.

In theory, there are two economic options for the exit from communism: the revolutionary way of shock therapy and the evolutionary way of gradual transition. Gorbachev's perestroika was an approximation of the second way. He never intended to go over to the market and private property, as his rejection of the Five Hundred Day Plan in 1990 attests. But the result of his half measures, such as enterprise autonomy, was to disrupt the Plan, which at least kept production going, without creating a market. So the democrats concluded that a clean break with the old order alone could salvage the economy.

And this was the pattern in all post-Communist countries. Poland, after the failure of the Jaruzelski-Rakowski perestroika, was the first to try a "big bang" of liberalization, in January 1990; but all Eastern European countries (with the partial exception of Hungary) attempted one or another variant of a cold turkey cure. In East Germany this took the bruising form of unification with the West; in the Czech republic, of Vaclav Klaus's carefully calibrated liberalization plus privatization.

Everywhere, too, the pain of the result led to outcries that a more "gradual" course should have been followed. Yet it is a curious fact that nowhere has a concrete program of gradual transition been advanced. When one looks at the various candidates for this "centrist" role—from last year's backtracking Olszewski government in Poland, to that of Meciar presently in Slovakia, to the Civic Union in Russia—one finds only such ad hoc measures as subsidies and price controls to preserve the existing industrial plant and worker security, but nothing to promote a transition. This is what the Gaidar team of Young Turks realized. They, like Yeltsin, are not reformers, but revolutionaries. Their chief aim has not been the short-run revival of the economy, but the destruction of the old command-administrative system; for this is the indispensable prelude to real economic revival, stable democracy, and national reconstruction alike. In public they talked only about the market and private property; in private they called their program "capitalism." Gaidar also said he was a "kamikaze" who expected to last only a few months after price liberalization; in fact he lasted a year. They were as much interested in shock itself as in its immediate therapeutic results, for their goal was to create an "irreversible situation" that would make return to the old order impossible.

The success of Russian democracy cannot be gauged only by high politics in Moscow. Perhaps more important are spontaneous changes at the grass roots and in the provinces, changes we hear little about because they escape the net of Russia's deficient statistics. And in those areas, centrifugence has unleashed the entrepreneurial spirit among the population, especially the young. To be sure, some of this has fed mafias and criminal activities, facilitated by the lack of a new administrative and judicial system appropriate to the market. But activity from below has also produced a surge of marketization in services and light consumer production. Both sectors have doubled in the last year. They now employ around 40 percent of the labor force outside agriculture. If we add to this the privatization of old enterprises, some 25 percent of GNP is now nonstate. Moreover, regions such as Nizhnii Novgorod, the Urals, and the Far East are introducing their own market reforms. The main failure of reform thus far has been in collective agriculture. The government claims 150,000 new private farms, but this is probably an exaggeration. Still, in November the term "private property" was at last introduced into the constitution by presidential decree; and 15 percent of agricultural production is now marketed privately.

But will Russia's bleak political culture permit it to achieve any constitutionalism? Well, that heritage is not monolithic or immutable. Though its government was always autocratic, after 1855 the autocracy was constantly under challenge by such "Westernizers" as Alexander Herzen, even from the progressive bureaucrats who devised the Great Reforms of Alexander II, and then the Kadet Party in the Legislative Duma after 1905. Old regime Russia was thus going through the same transition from royal absolutism to constitutional democracy as the rest of pre-1914 Europe, but some 50 years later. This tradition, of course, lost out in 1917. We should not forget that the more advanced liberal traditions of most of Europe also lost out between 1918 and 1945. Yet this did not prevent all of Europe from turning to democracy between 1945 and 1989. Nations do change. Russia has already done so mightily since 1985, again 50 years after the other interwar dictatorships. And never has this change been more rapid than in Yeltsin's first year.

So what does that year add up to? The first aim of stabilization was not realized, but a great advance was made toward the objective of irreversible structural change. Society has become monetarized; real prices—not administrative directives—are now the norm for economic activity. Although the bulk of the country's capital stock is still state-controlled, privatization of this sector is gaining momentum and a new, nonstate sector is developing even more rapidly alongside it. All these trends can no longer be stopped, only slowed.

Still, in a society as radically dysfunctional as Russia amid the rubble of Sovietism, things have to get worse before they get better. So we should brace ourselves for the long haul, and not panic every time there is a crisis in Moscow. Crisis is the stuff that exits from communism are made of.

Excerpts from Martin Malia's article "Yeltsin's Plan for Survival—Apocalypse Not" in The New Republic, *a U.S. weekly. The author is a history professor at the University of California, Berkeley.*

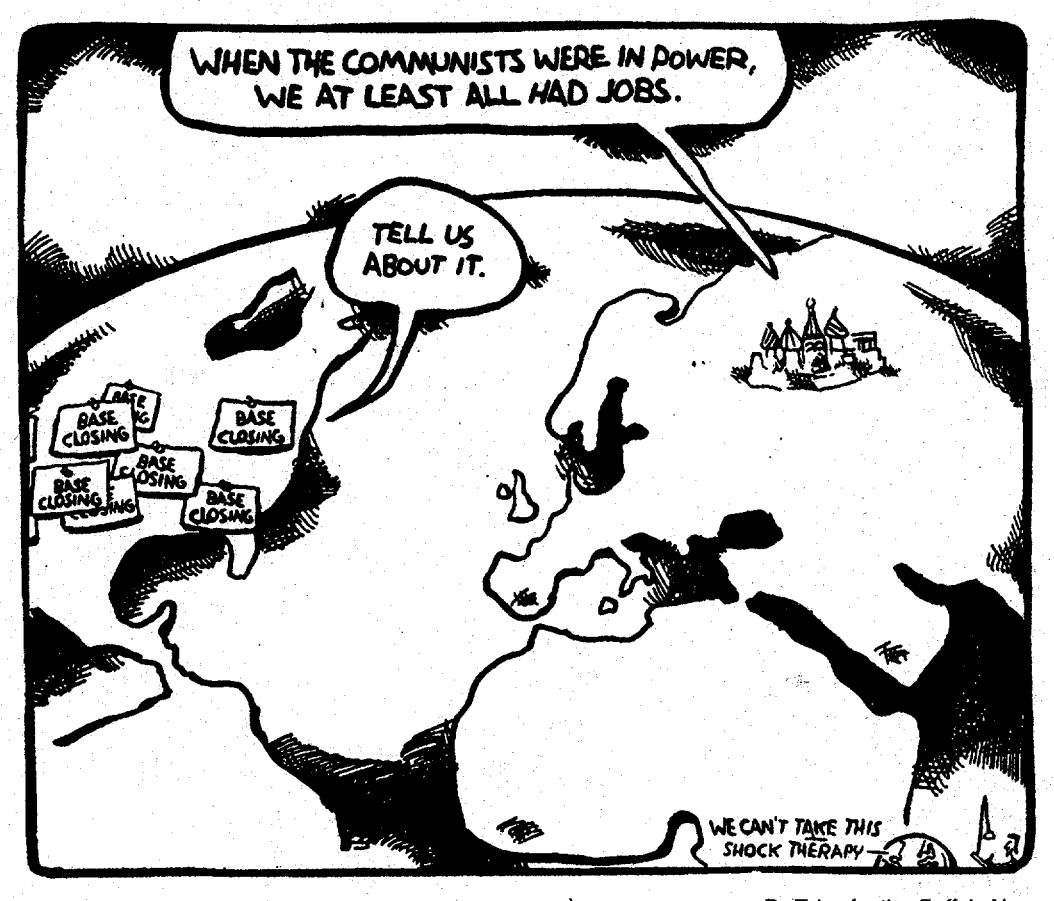
Milestones of Transition

Bulgaria reached an association agreement with the European Community in early March that provides for a gradual opening of markets in both directions, financial and technical assistance to the Bulgarian economy, and regular political consultations. The EC's agreement with Bulgaria is similar to those it struck earlier with Poland, Hungary, then-Czechoslovakia, and Romania. An interim trade accord will be in force until the association agreement is ratified by the EC and the Bulgarian legislature. In separate news, the new minimum monthly wage in Bulgaria rose from 850 leva ($33) to 1,200 leva ($46).

Poland's parliament defeated a government bill that would have converted 600 state companies into private enterprises by creating 20 mutual investment funds to oversee the companies and hold controlling shares in them. Shares in the mutual funds would have been offered to all adult citizens in Poland for a nominal fee. Employees of privatized firms would have received 10 percent of the shares in their firms free of charge. The program was designed both to improve the management of the privatized firms and to give the broader public a chance at ownership. The funds would have been run initially by Western experts, whose fees, paid in cash, would depend on the performance of the companies under their management. Prime Minister Hanna Suchocka announced that the government would reintroduce the plan in parliament.

Viet Nam approved foreign investment projects in the first two months of 1993 worth $510 million, equal to the amount approved for all of 1989, according to the Viet Nam news agency. That brought to $5.2 billion the total foreign investment capital registered since the country's foreign investment law was promulgated in December 1987. According to the account, 44 projects were licensed in the first two months of this year. More than 600 projects in total have been licensed.

The German government, the opposition, and Germany's 16 regional states have agreed on long-term measures to finance **east German** reconstruction. East Germany will receive about DM55.8 billion in 1995—DM51 billion from the federal government and the rest from western regional states. A housing program for east Germany financed by the Reconstruction Loan Corporation will be doubled to DM60 billion. The Treuhand privatization agency's borrowing limit will be doubled to DM60 billion to enable it to preserve core industries and clean up pollution. There will be no cuts in social benefits. In February the unadjusted unemployment rate stood at 15 percent in east Germany, and at 8.4 percent in the western half of the country.



By Toles for the *Buffalo News*

Hungary's commercial banks had by mid-March traded bad loans amounting to Ft102.6 billion (about $1.2 billion) for government bonds maturing in 20 years with interest rates adjusted to the 90-day Hungarian treasury bills. (These bills carry an annual interest rate of 15.9 percent in the first half of 1993.) The bad loans were transferred to the state-owned Hungarian Investment and Development Bank Ltd (MBFB), which is working out restructuring programs tailor-made for 115 major loss-makers. The MBFB is expected to forgive a significant part of the debts, according to HVG, the Hungarian economic weekly.

Direct foreign investments are flowing into **Hungary.** PepsiCo, the U.S. food and drink group, has acquired a 79 percent interest in FAU, a leading Hungarian soft drink company, and has

said that it will invest $115 million in the Budapest area in the next five years. FAU had produced Pepsi products under license for the Budapest area. In addition, the Marriott Hotel Group has acquired Hotel Duna Intercontinental for $52 million.

No agreement was reached on prices for **Ukrainian** imports of Russian natural gas in the mid-March negotiations in Moscow. Under a Russian proposal Ukraine would pay 26,700 rubles per 1,000 cubic meters (about 60 percent of the world price) for the next half year and guarantee transit deliveries to the West. Another Russian proposal would have had Ukraine paying 15,600 rubles per 1,000 cubic meters (about 35 percent of the world price) until April 30, with firmer commitments on deliveries and future prices to be worked out later. According to the Russian daily *Izvestiya*, Russia sells its natural gas for 15,000 rubles per 1,000 cubic meters, or about 33 percent of the world price, to other signatory states of the CIS customs union treaty.

Kyrgyzstan, Uzbekistan, Azerbaijan, and Turkmenistan will adopt a Latin-based 34-character alphabet after making the necessary internal changes, according to a mid-March statement by the four Central Asian countries.

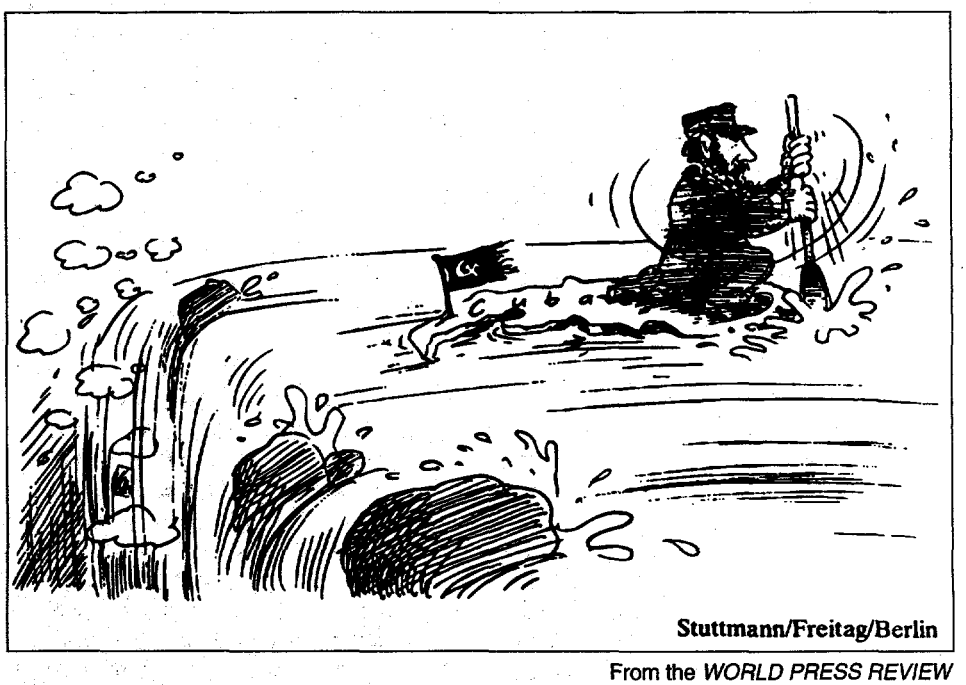
In February consumer prices in the **Czech Republic** were on average 8.5 percent higher than in the previous month, says the Czech Statistics Office. Food prices had increased by 8.2 percent, nonfood prices by 6 percent, and prices for services by 12.7 percent. And compared with January 1992, consumer prices were 21.2 percent higher. The price hikes were caused by the introduction of a new tax system in January.

The social character of **Slovak** economic reform will differentiate it from the Czech model of reform, Prime Minister Vladimir Meciar disclosed in a March interview with Slovak television. All citizens, institutions, and enterprises must cooperate to halt the country's economic decline, as the government cannot reverse the situation by itself, he added. (According to official statistics, Slovakia had more than 300,000 jobless workers at the end of February, making the unemployment rate almost 12 percent. Of the 301,244 jobless, 35.4 percent were receiving unemployment benefits.) Later, in London the prime minister also disclosed that Slovakia will not hold a second round of privatization based on the voucher method, but will sell enterprises directly to foreign firms in competitive public bidding.

Romania's privatization authorities recently published a list of the first 162 candidates for a privatization scheme designed to sell off 2,000 small companies over the next two years. Voicing concern over plans for the new administrative board of the State Ownership Fund to privatize larger companies, SOF President Emil Dima said that some are too important to be closed. "The state should increase its interventions in the economy to boost production and efficiency," he added. (Unemployment in Romania grew from 8.5 to 9.2 percent in February, and the number of jobless reached 1,025,000, according to the Ministry of Labor and Social Protection.)

Croatia's Prime Minister Hrvoje Sarinic resigned, and Nikica Valentic, the former head of the Croatian INA oil company, is to form a new government. The country's economy has been badly disrupted since the outbreak of hostilities in the Balkan. Last year Croat production and employment fell by 30 percent, and the inflation rate for the year hit 1,000 percent. Prices for textiles rose by more than 4,000 percent, and production in high-tech industries dropped by 70 percent. Iron and steel production came to a virtual halt.

Beginning April 1, **Serbia's** commercial banks may offer a monthly interest rate no higher than 2 percent on short-term deposits. Earlier, private banks offered 15 percent monthly interest rates for deutsche mark deposits, according to a report by Oxford Analytica. The German currency's unofficial exchange rate shot up from 2,000 dinar to 20,000 dinar during the first quarter of 1993. The monthly inflation rate reached 600 percent during the same period. Last year GDP fell by 25 percent and industrial output by 22 percent, with the vehicle manufacturing and nonferrous metallurgy sectors registering declines of 50 percent over 1991.



Stuttmann/Freitag/Berlin

From the *WORLD PRESS REVIEW*

World Bank/IMF Agenda

The IMF Stands by Prague

The IMF approved a $243 million stand-by credit for the Czech Republic on March 17 to support the country's 1993 economic program and to boost official reserves. Those reserves fell sharply, reaching the equivalent of about two and a half weeks of imports early this year, because of capital flight and a sharp acceleration in imports at the end of last year. The Fund expects the reserves to be rebuilt quickly. (The Czech Republic's outstanding financial obligations to the IMF, about $1 billion, are the result of transactions of the ex-Czechoslovakia.) For this year the Czech government envisages economic growth of 1 to 3 percent, inflation of 15 percent, a balanced state budget, and moderate wage increases.

A second wave of large-scale privatization now under preparation will involve about 900 companies, with about a third to be privatized through the distribution of vouchers to the adult population at a nominal fee. Under the first wave, 1,500 enterprises were privatized, of which 990 were in the Czech Republic. Of the shares in these enterprises, 65 percent (by book value) were sold through the voucher method, 3 percent were sold to foreigners, 15 percent went to the National Property Fund, and 12 percent went to state participation in financial institutions. The remaining 5 percent were set aside to satisfy restitution claims and for possible further sale. With 22,000 units sold, the privatization of small enterprises was almost completed by the end of 1992.

Debt Reduction from Poland's Stand-by?

The IMF approved a $655 million one-year stand-by credit for Poland on March 8. Polish authorities have asked that 25 percent of the credit be set aside for debt reduction operations. The IMF would consider an increase of the stand-by credit if Poland and its commercial bank creditors conclude financing arrangements that reduce Poland's debt service and that are consistent with its economic program. (Poland is negotiating with the London Club to reschedule its $12 billion in commercial debt.) The agreement notes that Poland wants to reduce its budget deficit from 7.2 percent of GDP in 1992 to 5 percent in 1993, bring inflation down from 45 percent to 32 percent, hold social security payments constant relative to GDP, and introduce the value added tax.

IBRD: $150 Million to Pave Poland's Roads

The World Bank approved a $150 million loan for the Poland Road Project (total cost, almost $300 million). The loan is for 17 years, including five years of grace, with a variable interest rate, currently 7.43 percent, linked to the cost of the Bank's borrowing. The project, expected to be completed in 1999, includes improvement of the road network, further development of a private construction industry, and introduction of competitive bidding for road works.

Lewis Preston on the World Bank's policy in Russia

World Bank President Lewis Preston addressed the Foreign Policy Association in New York on March 25 on the Bank's new challenges in the post–Cold War period. He voiced concern that the new nations of the former Soviet Union are confronting an economic crisis much worse than the Great Depression. Their exports have fallen by half over the past two years. Their average GDP declined by about a fifth last year. And prices are rising 25 to 30 percent a month. In Russia, the drive to establish a market-oriented economy is faltering in the face of hyperinflation and political opposition. The major obstacle to progress is the constitutional crisis and the lack of political consensus on the direction of reform; thus, to that extent, the fate of Russia lies in Russia's hands. Preston urged macroeconomic stabilization and sound monetary policy in Russia, a drastic reduction of subsidies to large-scale enterprises, and an acceleration of the privatization process.

Oil and gas resources have the potential to finance the restructuring of the economy through increased export earnings. Major investment, both public and private, is needed to rehabilitate these industries. Russia's oil production is declining rapidly—it has lost a million barrels a day in each of the past three years. To stabilize production at the 1993 level (about 350 million tons) will require investing about $50 billion between now and the year 2000. Without this, Russia faces the prospect of becoming an oil importer by the end of the decade. The World Bank is trying to help shape an investment climate that can attract the badly needed foreign capital. The Bank is also working with the European Bank for Reconstruction and Development on a $1 billion oil sector project in Western Siberia. If successful, this project could quickly generate additional revenues—about $750 million a year by 1994.

Fifty million people, a third of the Russian population, are now living below the poverty line. More than half of the households headed by women have fallen into poverty. Buffering the impact of the transition is important to reduce social and political tensions. Existing arrangements for pensions, unemployment compensation, and the protection of vulnerable groups need to be strengthened. The Bank's Board has already approved an employment services project and is looking at other ways in which to help the poor.

World Bank Loans to China

China has designed a teacher development program for lower middle schools in 15 provinces and autonomous regions in an effort to introduce universal nine-year basic education. The World Bank is supporting the initiative with an IDA credit of $100 million. (More than 95 percent of Chinese children enroll in elementary schools, the drop-out rate is low, and the literacy rate for those age 15 and above is about 77 percent.) The project will focus on institutional, management, and quality improvements in lower middle school teaching services. It will target 124 teacher training institutions and provincial and county education bureaus. The $100 million loan brings World Bank lending to China's education sector to about $1.29 billion.

Five key industrial sectors in the Municipality of Tianjin, located around China's third largest city, will be restructured with help from another World Bank loan, this one for $150 million. Targeted sectors include machine tools, construction machinery, automotive parts, electronic components, and electric motors.

Support to Moldova's Drought-Stricken Farms

Under Moldova's Emergency Drought Recovery Project, $26 million of a World Bank loan approved on March 15 will go to help the country's farmers, hit last year by the most severe drought in more than four decades. The loan will help farmers plant for the coming season, and acquire seeds, pesticides, poultry feed, and spare parts for agricultural machinery. In February the IMF approved a credit equivalent of about $19 million for Moldova to help defray the excess cost of cereal imports for the 12 months ending June 1993. (The credit was made under the cereal component of the IMF's compensatory and contingency financing facility. This component provides resources to member countries experiencing balance of payments problems caused by an excess in the cost of cereal imports that is both temporary and beyond the control of the authorities.)

New Address in Moscow

The World Bank's resident mission in Moscow has moved to a new location. The new address: World Bank, Moscow Resident Mission, Sadovo-Kudrinskaya No. 3, Moscow 123242, Russian Federation. The telephone number is 7-095 (254-8685), and the fax number 7-095 (254-8765) or 7-095 (254-8368).

Algeria to Receive Loans of $240 Million

Algeria's housing supply is estimated to fall 2 million units short of demand, with the average occupancy rate hitting 8.5 persons per unit. The country plans to bring more housing to its overcrowded cities with the help of a $200 million World Bank loan approved in early March. The loan will enable Algeria to complete the construction of 51,000 public housing units for sale. The loan will also support Algeria's reform plan for the housing market, aimed at reducing the government's dominance in the housing market and allowing private entrepreneurs to play a bigger role, liberalizing real estate development, and freeing the rental housing market. A $40 million World Bank loan to Algeria will support improvements to basic and secondary education. The project will affect about 14,000 basic and secondary schools and improve learning for about 5 million pupils.

Electricity Loan to Bulgaria

A project financed in part by a $93 million World Bank loan may soon enable Bulgaria to meet its demand for electricity and cut back on expensive electricity imports. The project includes the completion of a 432-megawatt power plant at Chaira, southeast of Sofia. It also includes technical assistance to Bulgaria's national electric company to help the organization become more commercially oriented and streamline its operations. Prices for coal and other forms of energy had been artificially low until the government launched reforms in 1990 giving a greater role to market forces in setting energy prices. The reforms also discouraged waste and promoted energy efficiency.

New World Bank Members—Croatia and Slovenia

Following their admission to the IMF, Croatia and Slovenia have also become members of the IBRD, succeeding in the membership of the ex-Yugoslavia on February 25, 1993. Croatia and Slovenia have also become members of the IDA and the IFC. The IBRD now has 174 member countries, the IDA 150, and the IFC 153.

Madagascar Nutrition Project

To support the Masdagascan government in carrying out a food security and nutrition project, the World Bank approved an IDA credit of $21.3 million. (The credit is for 40 years, including 10 years of grace; it carries no interest but has an annual charge of 0.75 percent on the disbursed balance and a variable charge—currently zero percent—on the undisbursed balance.) The proposed project will help alleviate poverty and reduce malnutrition by providing the poor with access to income-earning opportunities.

Conference Diary

For the Record

Reforming the Hungarian Economy: Stony Path or Road to Prosperity?
March 1, 1993, London

István Székely, an economist at the U.N. Department of Economics and Social Development who is participating in the Research Program on Transformation in Eastern Europe of the Centre for Economic Policy Research (CEPR), discussed the current state of the Hungarian reform process at a lunchtime meeting organized by the CEPR. In Székely's view, Hungary's economy could produce a further increase of exports in 1993. Also on the positive side, investment revived to a certain degree, the current account of the balance of payments improved, international reserves were replenished, net foreign debts were reduced, and foreign direct investment has stabilized at a relatively high level.

Persistent budget deficits are endangering Hungary's economic recovery, however. [Editor's note: A senior official at the Ministry of Finance disclosed in early April that the budget deficit might exceed Ft185 billion (about $2 billion) by year-end.] High real interest rates and an increase in bankruptcy and liquidation procedures foreshadow another wave of layoffs. Major new reform steps should include financial, budgetary, social security, and pension reforms, and relatively rapid completion of the privatization process.
Information: David Guthrie, Centre for Economic Policy Research (CEPR), London, 25-28 Old Burlington St., London W1X 1LB, tel: (4471) 734 9110. See also the recent CEPR book "Hungary: An Economy in Transition," edited by István Székely and David Newbery and published by Cambridge University Press. To order: Cambridge University Press, Customer Service Dept., The Edinburgh Building, Cambridge, CB2 2RU, tel: (44-223) 32-5970.

Forthcoming

European Bank for Reconstruction and Development (EBRD)—Second Annual Meeting
April 26-27, London

The two-day meeting of the Board of Governors will be preceded by roundtables and seminars for all participants starting on April 23. Topics include accounting systems and practices in the Central and Eastern European countries, the EBRD's procurement policies, introducing institutional investors in Eastern Europe, cofinancing with export credit agencies, regional environmental programs, Asian models of transition, and unemployment and migration issues in Central and Eastern Europe.

Black Sea Oil and Gas: Emerging Opportunities
April 28-29, Istanbul

Conference hosted by Europe Energy Environment Ltd. and the Marmara Bank.
Information: Europe Energy Environment Ltd., London, tel: (4471) 493-4918, fax: (4471) 355-1415.

World Bank-IMF, Meetings of the Interim Committee and the Development Committee
April 30-May 1, Washington, D.C.

Fifth Annual Bank Conference on Development Economics
May 3-4, 1993, Washington, D.C.

This conference sponsored by the World Bank traditionally brings together international researchers, Bank staff, policymakers, and development practitioners to focus on major issues in development policy. This year's topics include financial policy (R. McKinnon will present a study on financial control of state enterprises in the Russian transition: lessons of the Chinese experience); principles, capacity, and constraints of regulation; the energy sector and the environment; and the economics of regress.
Information: The World Bank, Research Administration, Boris Pleskovic, tel: (202) 473-1062.

Guaranteeing, Collateralizing, and Financing Foreign Investment and Regional Economic Development
May 6-9, Middlebury, Vermont

Geonomics Gateway Seminar sponsored jointly by the Geonomics Institute, the Russian State Investment Corporation (RSIC), and the Fund for the Complex Development of the Volgograd Region. Topics include:

- Relationships between regional and national governments in addressing economic development issues.
- Defense conversion as a priority for national and regional economic development funds.
- Specific opportunities for western investment in Volgograd and the South Russia region.

Information: Nancy Ward, Vice President, or Robert Waltemyer, Geonomics Institute, 14 Hillcrest Avenue, Middlebury, VT 05753, tel: (802) 388-9619, fax: (802) 388-9627.

MoneyMarket '93—Rebuilding Finance and Trade in the Central and Eastern European Region
May 6-7, Budapest

International conference organized by CMC Ltd., Budapest, and sponsored by Hungarian Foreign Trade Bank Ltd. Topics include the role of finance in rebuilding trade relations in Central and Eastern Europe; financing foreign trade and the development of commercial banking; government export credit guarantees in support of foreign trade; money markets and economic growth in the region; and setting up direct sales networks.
Information: Dora Hadhazy, CMC Ltd., 1145 Budapest, 3 Szabo Lorinc u., tel: (361) 251-1647, fax: (361) 184-3982.

How to Fund Exports and Investments to Eastern Europe and the Newly Independent States
May 13-14, New York

A joint conference of the World Bank and the EBRD. Participants will explore possibilities for tapping into the $24 billion in World Bank, IFC, and EBRD contracts in Central and Eastern Europe and the former Soviet Union. Speakers from those international finance institutes and from U.S. federal agencies and U.S. companies will speak on the procurement procedures and upcoming projects and provide lessons of experience.
Information: Bill Collins, Conference Coordinator, ITC Consultants Inc., tel: (813) 572-8035, fax: (813) 965-2630.

Doing Business with Hungary: Banking, Currency, and Taxation
May 20, Washington, D.C.

A Hungarian-U.S. Business Council Conference. Topics include an overview of Hungary's financial sector; accessing Eximbank financing; foreign exchange transactions in Hungary; sources of offshore and domestic investment capital; risks and opportunities for U.S. financial firms; the present and future of investment tax credits; coping with tax regulatory requirements; VAT, social security, and reinvestment credits; maximizing deductions and utilizing training and R&D incentives; and opportunities in the Budapest Expo '96. (On May 6 Hungarian Minister of Finance Ivan Szabo will meet with the Hungarian-U.S. Business Council.)
Information: M. Kay Lercom, Executive Director, U.S. Chamber of Commerce, 1615 H Street, N.W., Washington, D.C. 20062, tel: (202) 463-5488, fax: (202) 463-3114.

Sources of Privatization Financing in Eastern Europe
May 21-22, Budapest

International workshop sponsored by UNCTAD and the Kopint-Datorg Research Foundation, Budapest. Discussions will focus on privatization experiences in the Czech Republic, Hungary, Poland, and Slovakia, and on financing privatization through foreign investments and domestic savings. Participants include Wlodzimierz Brus, Marek Dabrowski, Karel Kouba, Michal Mejstrik, Bruno Dallago, Wladimir Andreff, Eva Voszka, and David Stark.
Information: Laszlo Szamuely, Kopint-Datorg Inc., Budapest, tel: (361) 266-6640, fax: (361) 266-6483.

Privatization and Socioeconomic Policy in Central and Eastern Europe
June 7-10, 1993, Krakow, Poland

International conference organized by Boston College Graduate School of Social Work, The Carroll School of Management, International Marketing Institute and the Department of Economics, and hosted by the Jagiellonian University, the Krakow Academy of Economics, and the Krakow International Cultural Center. It will address such questions as: How can a society best transform its socioeconomic structure? Who benefits from and who bears the burden of economic and social change? What social, political, and economic decisions seem to lead to a successful transition? What determines the willingness of firms to locate and invest in the transitional economies? How can society balance economic efficiency and social justice?

The conference program will include country reports on Bulgaria, the Czech Republic, Germany, Hungary, Poland, Russia, and Slovakia.
Information: Prof. Demetrius Iatridis, International Conference Planning Committee, Boston College Graduate School of Social Work, Chestnut Hill, Massachusetts 02166, tel: (617) 552-4041, fax: (617) 552-3199.

New Books and Working Papers

PRDTM regrets that it is unable to supply the publications listed.

Recent World Bank Publications

Tanzania: AIDS Assessment and Planning Study
A World Bank Country Study, Washington, D.C., 1993, 161 p.

Tanzania has been one of the nations hardest hit by AIDS. Among its 25 million people, 800,000, or 3.2 percent, are believed to be infected with the human immunodeficiency virus (HIV). About one-eighth of those infected have developed AIDS, and every year, 20,000 to 30,000 Tanzanians die from the disease. AIDS has overtaken malaria as the nation's leading cause of death among adults, and in the next few years it is expected to become the leading killer among children as well. By 2010, up to one of every six Tanzanians could be infected with HIV.

The epidemic will change Tanzania's economy, its demographic composition, and the makeup of its workforce. The country will lose many skilled workers, often in their prime years of productivity. The labor force will become younger, less educated, and less experienced. That loss could make Tanzania's gross domestic product fall 14 to 24 percent below normal levels by 2010. New demands from victims will strain the health system and the budget in a country in which the average per capita income is about $100. To cushion the impact of AIDS, Tanzania should continue to pursue economic reform that will allow the country to grow, and seek help from donors and investors. And health care should be stepped up and made more efficient. A successful prevention program could save up to 4.5 million lives during the next 20 years.

This study calls for a broad government program focusing on the prevention and control of all sexually transmitted diseases (STDs), and low-cost measures for coping with the consequences of AIDS. By treating and counseling people with curable STDs, the program would reach those most at risk of getting and transmitting AIDS. The study also calls for improving the supply, distribution, and promotion of preventives and reducing the need for blood transfusions. Better information, education, and communication programs aimed at changing behavior are also important.

Jean-Louis Lamboray and A. Edward Elmendorf, **Combatting AIDS and Other Sexually Transmitted Diseases in Africa: A Review of the World Bank's Agenda for Action**, World Bank Discussion Paper 181, Washington, D.C., 1992, 34 p.

Both of the above publications are available at the World Bank bookstore, or to order: World Bank Publications, tel: (908) 225-2165, or P.O. Box 7247-8619, Philadelphia, PA 19170-8619.

Policy Research Working Papers

Brian Pinto, Marek Belka, and Stefan Krajewski, **Transforming State Enterprises in Poland: Microeconomic Evidence on Adjustment**, WPS 1101, 1993, 43 p.

The authors present new evidence—drawn from visits in late 1992 to 75 large state-owned manufacturing enterprises first surveyed in mid-1991—about the successful transformation of several state-owned enterprises in Poland. The largely autonomous business operations of those enterprises indicate that decentralized transformation could be efficient—if bolstered by appropriate managerial incentives.

The authors analyzed various adjustment indicators (labor shedding, material and energy costs, bank borrowing, and export performance) and correlated those indicators with the firms' 1992 financial performance. This revealed significant differences in business strategy between successful and unsuccessful firms. (By 1992, presumably, the transitional measurement distortions of 1990 and 1991 had disappeared.) Successful managers have tended to stress a change in product mix, have generally become more efficient in the use of materials and energy, have maintained labor productivity, and have shown restraint in setting wages and in borrowing from banks. The authors conclude that, over the past three years, managers have learned a good deal about operating in a market economy.
To order: Marylou Kam Cheong, The World Bank, Room K6-115, tel: (202) 473-9618.

Richard Bird and Christine Wallich, **Fiscal Decentralization and Intergovernmental Relations in Transition Economies: Toward a Systemic Framework of Analysis**, WPS 1122, 1993, 85 p.
To order: Bonnie Pacheco, The World Bank, Room H11-065, tel: (202) 473-7033.
[Editor's note: See also Research Update in *Transition*, vol. 3, no. 11, p. 10.]

Recent IMF Publications

Joshua Aizenman and Peter Isard, **Resource Allocation during the Transition to a Market Economy: Policy Implications of Supply Bottlenecks and Adjustment Costs**, IMF Working Paper 93/6, Washington, D.C., 1993.

While much of the concern with bottlenecks has centered on impediments to international trade, bottlenecks can also arise whenever the requirements for certain inputs to production are stochastic (such as needs for energy sources or spare parts) and the opportunity cost of holding inventories is high. Once budget constraints are hardened and credit markets begin to function effectively, these conditions are likely to prevail in the state industrial sector—whose creditworthiness is currently limited by its outdated production technologies.

Although many other factors need to be considered in designing policies to influence resource allocation, the paper's analysis suggests that:

- Once budget constraints are hardened and credit markets begin to function appropriately, the externalities associated with production bottlenecks and adjustment costs provide a case for subsidizing the costs of critical inputs for the state industrial sector but not for the new private sector.
- The appropriate policy has an important time dimension, with the optimal "finance" through taxing the wage income generated in the state sector, which will strengthen incentives for workers to move out of that sector.
- The eligibility requirements for such subsidies should be made conditional on maintaining wage restraint and meeting prespecified benchmarks in restructuring and in other enterprise reforms.

Although financing requirements constrain the size of the subsidies that can be provided to the state sector without undermining macroeconomic stability, countries should view the amount of financing to raise as a fundamental policy choice in designing their reform strategy. Their willingness and ability to finance a gradual or moderately paced contraction of the state industrial sector may be crucial in maintaining popular support for the transformation effort and making the sustainability of the reform program credible. This in turn may be crucial for obtaining the financial support of domestic savers and foreign private investors.

Ehtisham Ahmad and Jean-Luc Schneider, **Alternative Social Security Systems in CIS Countries**, IMF Working Paper 93/8, Washington, D.C., 1993.

This paper presents a simple demographic model to compare pay-as-you-go (PAYG) and funded options for providing benefits. It concentrates on pensions and standardized family allowances, although the argument could be extended to provisions for the unemployed. The empirical investigations, for Belarus, Russia,

Turkmenistan, Ukraine, and Uzbekistan, illustrate the effects of different demographic characteristics in the European and Central Asian republics in 1991. They show that if interest rates are negative in the medium term, a move away from a PAYG system would be undesirable and, specifically, that a move toward a funded system would greatly increase contribution rates. Even if rates of return are positive, they would need to exceed population growth rates for a funded system to be desirable. Thus, the funded option would be less attractive in the Central Asian countries than in, say, Belarus or Ukraine.

Alternative methods of lowering net overall outlays are also discussed, including the basic benefits-in-kind system providing basic food items through food stamps or the cash equivalent. The paper concludes that a combination of PAYG benefits and basic benefits in kind would be most effective in minimizing overall cost while providing adequate benefits during the transition period.

Ehtisham Ahmad, **Poverty, Demographic Characteristics, and Public Policy in CIS Countries**, IMF Working Paper 93/9, Washington, D.C., 1993.

The states of the former Soviet Union represent two broad demographic archetypes. The first group of countries—which includes Belarus, Russia, and Ukraine—is characterized by relatively low birthrates and a mature and aging population. Because of the extremely high loss of life among males in the European republics during the Second World War, many of the current retirees are single women.

Countries in the second group, including Turkmenistan and Uzbekistan, typically have lower per capita incomes, relatively high population growth rates, high youth-dependency ratios, and relatively few retirees. Although countries will base their policy choices on these key characteristics when adopting permanent social security instruments, they are likely to need similar policy interventions during the transition period, involving major changes in relative prices.

The concentration of people at relatively low income levels is a feature common to all of the states of the former Soviet Union, and in some the reforms have increased the concentration of "vulnerable" groups. As a result, their options for reforming the social security instruments—in particular, pensions and allowances—are limited. The differences in demographic characteristics will govern the emphasis that is given to each instrument.

Although means testing may be useful for restricting outlays, the distribution of incomes suggests that savings are likely to be small; moreover, administrative outlays may be substantial. It will take time to develop adequate local social assistance mechanisms. A combination of measures that includes targeted subsidies for essential goods could be an option.

Financial Sector Reforms and Exchange Arrangements in Eastern Europe, two papers by Guillermo A. Calvo and Manmohan S. Kumar, and Eduardo Borensztein and Paul R. Masson, IMF Occasional Paper 102, Washington, D.C., 1993, 59 p.

To order IMF Publications: IMF Publication Services, 700 19th Street, NW, Washington, D.C. 20431, tel: (202) 623-7430, fax: (202) 623-7201.

National Economic Resource Association (NERA) Working Papers

J. Stern, K. Bunt, and N. Thomas, **Foreign Direct Investment to the Countries of Central and Eastern Europe**, NERA Working Paper 2, 104 p.

D. Barrowclough, J. Rhys, and J. Stern, eds., **Case Studies of the Effects of Economic Reform in Central and Eastern Europe on Greece, the Republic of Ireland, Northern Ireland, Southern Italy, Portugal and Spain**, NERA Working Paper 3, 183 p.

To order NERA Working Papers: 15 Stratford Place, London, W1N 9AF, tel: (071) 629-6787, fax: (071) 493-5937.

Other New Publications

George Soros, **Nationalist Dictatorships versus Open Society**, The Soros Foundations, New York, 1993, 20 p.

Mr. Soros, in this expanded version of a November 1992 lecture he delivered at the Harvard Club in New York, compares the success of the Soros Foundations in the postcommunist economies with his personal failure to influence policy in those regions. He concludes that while the foundations proved to be the appropriate institutional framework for persons eager to act, his policy initiatives indirectly tried to influence governments that were not that eager to act.

Defining "open society," he points out that it is more than just democracy in the popular meaning of the term. If democracy is taken simply as the rule of the majority, it can lead to intimidation and even ethnic cleansing. A market economy, the protection of minorities, and freedom of thought and expression are vital ingredients of an open society. So is the existence of a civil society that is not dominated by the state.

In the United States and the United Kingdom, in particular, the dominant view was that freedom is best served by allowing people to pursue their self-interest. But the most important lesson to learn from recent history is that the pursuit of self-interest is not sufficient to produce a free and open society. And the collapse of a closed society does not automatically lead to the emergence of an open society. People must also be willing to subordinate their self-interest to the pursuit of this goal. Advancing from a closed to an open society requires active assistance from the outside. The closed society of communism has disintegrated, and the process is likely to continue indefinitely until and unless sufficient forces are mobilized to es-

tablish a different principle of social organization.
To order: The Soros Foundations, 888 Seventh Avenue, New York, NY 10106, tel: (212) 757-2323, fax (212) 974-0367.

Stephen G. Deets, ed., **The Economics of Sustainable Agriculture: American and Bulgarian Perspectives**, National Academy Press, Washington, D.C., 1993.
Summary of a Bilateral Workshop, October 21-30, 1991, cosponsored by the National Academy of Sciences and the Bulgarian Academy of Sciences.
To order: Office of Central Europe and Eurasia, National Research Council, 2101 Constitution Avenue, N.W., Washington, D.C. 20418, tel: (202) 334-2644, fax: (202) 334-2614.

The Uncertain State of the Russian Economy, Institute for EastWest Studies, New York/Prague/Budapest, 1992, 109 p.
To order: Institute for EastWest Studies, 360 Lexington Avenue, New York, NY 10017, tel: (212) 557-2570, fax: (212) 949-8043.

Michael P. Claudon and Kathryn Wittneben, eds., **After the Cold War: Russian-American Defense Conversion for Economic Renewal**, Geonomics Institute for International Economic Advancement Series, 1993.
The 14 papers in this volume argue that Russia's fledgling free-market economic reforms cannot succeed without the conversion and privatization of much of the country's military-industrial complex.
To order: Michael P. Claudon, Editor, Geonomics Institute, 14 Hillcrest Avenue, Middlebury, Vermont 05753, tel: (802) 388-9619, fax: (802) 388-9627.

Privatization: A Bibliography—References, University of Maine, Eastern European Enterprise Institute, 1993.
To order: Dr. Dennis McConnel, Eastern European Enterprise Institute, College of Business Administration, University of Maine, Orono, Maine 04469, tel: (207) 581-1988, fax: (207) 581-1930.

Val Samonis, **Foreign Investment in the East: An Interpretative Modelling of Soviet and Post-Soviet Experience**, Nova Science Publishers, Inc., University of Toronto, February 1993.
Information: Nova Science Publishers, Inc., 6080 Jericho Turnpike, Suite 207, Commack, NY 11725, tel: (516) 499-3013/6, fax (516) 499-3146.

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Quarterly analysis of economic and political issues in Eastern Europe and the former USSR.
Information: NovEcon Consulting Group, 1217 Olivia Avenue, Ann Arbor, Michigan 48104.

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A bimonthly magazine on Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan.
Information: Central Asia Monitor, RR 2, Box 6880, Fair Haven, Vermont 05743, fax: (802) 537-4362.

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