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THE NEWSLETTER ABOUT REFORMING ECONOMIES TRANSITION

Volume 8, Number 6

December 1997

Interview with Joseph Stiglitz

Transition Economy Is Still A Well-Defined Category

*Joseph Stiglitz, senior vice president, Development Economics, and chief economist joined the Bank on February 1, 1997. Before that, he spent four years at the U.S. Council of Economic Advisers (1993-97) where he became chairman of the council in 1995. He is following the transition process closely, well proven by his pathbreaking book, *Whither Socialism?* How can the Bank contribute to accelerating and making this process as painless as possible? Is there an alternative to global capitalism? These were some of the questions Mr. Stiglitz reflected on during the following interview with Transition editor, Richard Hirschler.*

Q. The “stock market is not an unmitigated blessing,” as you put it, in your book *Whither Socialism?*, warning stock exchange fetishists. Don’t you think that transition economies, especially in light of the present upheavals in Southeast Asia, are expecting too much from share trading?

A. Let me put it in a broader context. On one hand, stock markets and securities markets are valuable mechanisms for companies to use to raise capital and share the risks of business operations with the stockholders. This is critical for development and for the transition to a market economy. On the other hand, it is extremely difficult to ensure that capital markets function well. There are numerous examples of fraud and abuse, especially in countries where strict regulations are not in place and where the oversight of trading and the protection of minority shareholders are not assured. For example, in the Czech Republic it has been revealed that investment fund

managers were able to sell controlling blocks of shares of smaller firms through shady “bypass enterprises” to investors who were ready to pay—not over the counter but under the table—fat premiums above the shares’ market price [ed.: see “Market Failure and Corruption in the Czech Republic” on page 4]. This “tunneling” of assets clearly undermines trust and makes a mockery of fair business practices. It is also true that a lot of stock market activity is based on speculation, and price fluctuations are more the result of psychological factors and have less to do with economic fundamentals.

Q. According to many experts, one reason for the current realignment in Southeast Asia is that other emerging markets, including those in Central and Eastern Europe and the former Soviet Union, became more competitive and, to some extent, East Asia is losing the competitive edge...

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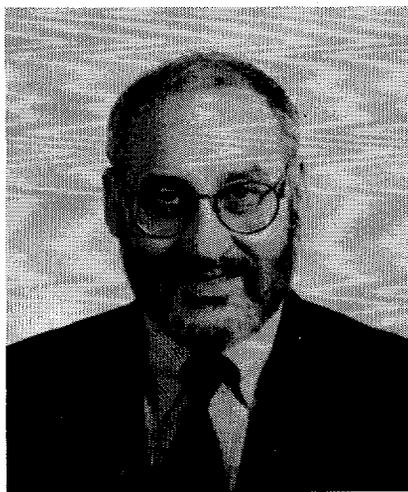
A. It may be one element, but a more important factor is that the financial systems of many Asian economies are much weaker than had been thought. Suddenly everybody is focusing on the weaknesses of Asia's financial sector, including mismatches between bank liabilities and assets. There is a maturity mismatch, as many banks borrowed for the short term but lent imprudently for the long term; there is also a foreign exchange mismatch, with assets denominated in local currency and liabilities in foreign currency. Once disillusioned foreign investors started pulling out of these countries, local currencies lost value, the huge and partly hidden debt of the banking and enterprise sector suddenly surfaced, and the economies—the Republic of Korea is the latest in a row—face a severe liquidity crunch.

Q. The consolidation of financial sectors will certainly have huge social costs, in terms of enterprise downsizing and shrinking real wages—just as happened in many transition economies. In your book *Whither Socialism?*—which is as much a critique of socialism as of the neoclassical model of Hayek—you speculate on whether it would be possible “to bring closer together insights of modern economic theory and the utopian ideas of the nineteenth century.”

A. The book was written in the early 1990s, at the onset of transition, when many of us thought that these countries were moving toward capitalism from a more egalitarian base than had been the case for economies that had evolved into capitalism out of feudalism, without the intervening stage of socialism. So the question in our minds was whether this would wind up with a form of people's capitalism—the reign of market forces, but with a more egalitarian distribution of income? Experiences over the past few years have not

been particularly sanguine with respect to fulfilling that dream. There are three hypotheses that explain this turn of events:

- First, the move to a market economy and privatization in Russia and a number of other countries occurred rapidly—to solidify transition and eliminate the possibility of a reversal and to avoid the asset stripping of state enterprises. The consequence was the creation of a system in which managers garnered a disproportionate share of wealth. Voucher privatization in the Czech Republic was more in accord with egalitarian distribution, but as I mentioned



before, the country failed to put in place laws to protect the securities market. So the Czech Republic wound up with another set of problems.

- Second, in order for capitalism to work there needs to be a concentration of wealth to solve the public good problem of management. The Czech Republic's idea was based on the notion that you could have good management without concentrated wealth. It didn't happen. So the question is whether inequality is an inherent property of capitalism.

- Third, these countries simply did not have the option of moving slowly; “you can't jump over a chasm in two steps.” That is a debatable proposition. In fact, privatizing before introducing the conditions for com-

petition creates vested interest groups such as those that are now in play, that try to stave off any competition and impede the development of a competitive market economy. It may have been a mistake to put all the weight on private property and neglect competition. China has given priority to competition and has put less weight on private property (that is, settling property rights), and it seems to have been quite successful in the past decade and a half.

Q. With respect to the transition process, do you believe that there is such a category as “transition country?”

A. Definitely. If you believe, as I do, that history matters, then the legacy of the experience that these countries have had over a half a century or more is obviously going to affect them. The impact of common history diminishes over time, but we have not moved far enough down that road. On the other hand, some transition economies, such as the Central Asian countries, happened to be embedded in the Soviet Union, but in some ways have more in common with the “planned economies” of other developing countries. The legacy of the past is very much influencing development in Russia, Belarus, and Ukraine, although they all have different characteristics. A number of Central European countries, like Hungary and the Czech Republic, clearly are moving fairly rapidly into integration with the more industrialized countries, and they will become less and less differentiated as a category.

Q. How can the World Bank, as a knowledge bank, help the transition process?

A. The Bank has seen its role as capacity building and learning center. For the transition economies, it has a unique potential; most of these countries have highly educated labor forces and highly educated populations, but they were not

educated in the principles of a market economy. They had the learning capacity, but did not have the knowledge about market economies. We have learned in eight years of the transition process that making market economies work is extremely difficult. Therefore, it is extremely important to draw on a knowledge base that is even broader than the Bank's knowledge base. We are developing a particular expertise in trying to translate and transmit that information.

Q. So what should be the major thrust of the Bank's research and education in the next two years?

A. Right now there is a certain focus on financial markets, and we will use this focus as an opportunity to transmit what is an enormous amount of received wisdom on that. The restructuring of enterprises is another important topic both for research and education. We need to know more about the conditions, the vehicles, and the mechanisms that will lead to more effective restructuring. For example, we know from empirical evidence that after privatization foreign investors tend to carry out far more restructuring than do domestic entrepreneurs. We should look into this more deeply.

Another area of research and education is how to make government more efficient and how to provide the preconditions for effective private sector development. So we are seeing government and the private sector in much more complementary roles. Government should provide the legal structure and make sure that markets are competitive and that antitrust and regulatory laws are in place. Our investigation also includes the fight against corruption: what are the main causes, and what can we do about it?

Q. How can you reconcile a sense of social responsibility—which is noticeable all along in your book *Whither Socialism?*—with the

scholar's economic rationalism? To put it differently, what serves people better, to confront imperfect markets or imperfect governments?

A. My sense is that the engine of the economy has to be the market, that government is not generally a good vehicle for production. We are increasingly recognizing that government has a very important but limited role to play in providing the conditions—the legal framework that enables the market system to function. At the same time, the government has assumed market-like characteristics in many of its activities. We are also recognizing a very big role for institutions in our society that are neither private nor government, I'm talking about voluntary, nonprofit institutions. We do not know why and how they work in the same sense that we understand profit motives and the political process.

These institutions are made up of voluntary groups of citizens who come together to pursue a common good that goes beyond the members of those groups.

Q. And these nongovernmental organizations can be the seed of a better society in the future?

A. Yes, maybe we are evolving into a society whose members will pursue collective action without using government that has the power of taxation and the power of compulsion. That says something about an element of human behavior that is not quite as selfish as some of the economic maxims have led us to believe. Or, to put it more broadly, people get personal satisfaction and private utility out of doing public good. So economists can always reconcile something seemingly contradictory with their paradigm.



From the *World Press Review*

Market Failure and Corruption in the Czech Republic

by Andrew Schwartz

The circumstances behind the resignation of Czech Prime Minister Vaclav Klaus illustrate the perils of unbridled markets to attaining economic freedom and political democracy. Klaus's troubles are a variant of the ills that are buffeting the East Asian economies. What provoked Klaus's resignation were the allegations that linked a \$5 million Swiss bank account to officials in Klaus's party, and the discovery of suspicious payments to the same party from a successful bidder in a privatization case.

The deeper causes for Klaus's resignation lie in a free market system in which nearly everyone in government is assumed to be on the take, the stock market is rigged, and bribery is considered legitimate business. The communist-era motto: "He who doesn't steal, steals from his family," seems applicable under Czech capitalism.

The Western press has attributed Klaus's troubles to the inevitable misfortunes of an economic slump. At first glance, this sounds like a good explanation for Klaus's political misfortunes. The Czech Republic has seen its currency collapse by more than 20 percent against the dollar, its trade deficit and government budget deficit balloon, and its economic growth slow to a crawl just this year. Even the remarkably low Czech unemployment rate is up by more than 25 percent, though to a still-mild 4.9 percent.

Nonetheless, the economic slump is not the fundamental reason behind the political upheaval in the Czech Republic. Rather, it is the excuse behind the upheaval. The real culprit is the unregulated

free market. The unregulated free market came to the Czech Republic and the other former communist countries under the guise of rapid privatization, the main market reform strategy of the early 1990s. The idea was to privatize before threatened former communist enterprise managers, bureaucrats, and trade unions could set up defenses against the development of free markets. Rapid privatization is behind Klaus's political vulnerability.

Led by Klaus, the Czech reformers religiously pursued rapid privatization. Prior to 1989, the Czech state owned 97 percent of total economic assets. From 1992 to 1994 the Czech Republic transferred more than 70 percent of national assets from state to nonstate owners. Today, the state share is less than 20 percent; and by the turn of the century that share may well be less than 10 percent.

Rapid privatization, especially the Czech voucher program—which offered citizens chances to purchase shares in large companies at nominal prices—met with popular enthusiasm. Within two years nearly every Czech was a shareholder; indeed, the Czechs were the largest per capita shareholders of any country in the world, including the United States.

Rapid privatization seemed to underpin the country's dramatic economic recovery from communism. Entry into the European Union seemed a matter only of when, not if. Klaus was overheard to say "the question is not, whether the Czech Republic is ready to join the European Union, but whether the European Union is ready to join the Czech Republic."

Illusions began to crumble almost two years ago. Then, the Czech public first learned that several managers of the funds designed to invest the public vouchers were instead systematically stealing from their own investors. The Czech Ministry of Finance recently enumerated 15 techniques for stealing in a widely distributed report. A common one: The investment fund managers sell company shares in the portfolio to dummy companies at absurdly cheap prices. The dummy companies sell the shares on the market. The dummy companies deposit the ensuing profits into overseas bank accounts. The fund investors (the trusting public) are left with nothing.

But that's the least of it. The Czech public is now learning that dishonest operators have systematically squeezed the assets from many of the country's best companies, its municipalities, and its banks (private- and state-owned). The locals have coined a charming euphemism for the criminals—tunnelers. The tunnelers have achieved their wealth primarily through the corrupt collusion or, at the very best, the benign neglect of the state.

These developments seemed to confirm the belief that rapid privatization was not the mass distribution of national wealth but the private appropriation of national wealth. Is it any wonder that decent Czechs felt betrayed, even humiliated? They were reminded of the proverb "the fish stinks from the head."

The political and economic turmoil in the Czech Republic illustrates that private property does not make a market any more than elections define a democracy.

A fair and efficient state is necessary to regulate the market reform process. Unbridled markets lead irresistibly to unimaginable thievery. Elsewhere, the lack of attention to building a functional state administration has distorted markets and democracies throughout the former communist world, including Russia.

Where will the Czech Republic go from here? Certainly, the country is at a cross-

roads. A new generation of leaders is talking seriously about capital market regulation, bank regulation, and modern accounting and auditing standards. Behind the surface gloom of deficits, currency crises, and capital flight, long-term venture capital is seeping into the economy. One fine day the large banks will be fully privatized to honest and experienced foreigners, who will pass on skills to the locals. Most im-

portant, the easy money already has been stolen, and the first generation of market reformers is fading from the scene. In their absence, I am hopeful that the next generation of Czech leaders will develop a capitalist state, the sine qua non of the modern world.

The author is a researcher and is associated with the Berkeley Roundtable on the International Economy.

Czech Capital Market Control—To Be Announced Later

It is generally expected that caretaker Prime Minister Josef Tosovsky will seek to maintain the momentum of the capital market reform effort and support a major legislative initiative aimed at improved regulation and increased transparency in the capital markets, stricter control of the investment funds, and acceleration of bank privatization. But these measures—already far behind the original schedule—are likely to be delayed by the political vacuum in the next six months, and only a new post-poll government—securing its mandate through the next parliamentary elections—will be able to go ahead with these reforms. The following is a summary of recent legislative initiatives:

- The Senate demanded amendments to the legislation that would have established a capital markets securities commission as of January 1. The law was already passed by the Chamber of Deputies (or lower house of parliament). The commissioners would have had the power to impose fines of up to 100 million korunas (\$3 million), revoke licenses, block suspicious trades and capital transfers, and approve or reject share issues. That would have gone a long way in stemming those scams that have stripped companies of their assets, leaving behind worthless shares and “tunneled” investment funds into offshore bank accounts. As a result, great volumes of securities were traded at undisclosed prices outside of financial markets. On December 22, Czech Finance Minister Ivan Pilip warned that if the creation of a commission is delayed into 1998, he will not hesitate to introduce tougher regulations on the capital markets.
- Another postponed legislation on investment funds would limit fund holdings in any company to just 11 percent, prohibit transactions between the fund and its man-

agers, and ban advance payments on the purchase of securities—practice that has been used by unscrupulous managers to drain cash from funds. The bill would force closed-end funds, through which some of the murkiest deals have taken place, to become open-ended funds if they traded at a discount of more than 40 percent to their net asset value.

- A banking law amendment, already passed in the lower House, would limit banks’ holdings to 50 percent of industrial companies and prohibit bank officials from sitting on boards of industrial companies. It calls for a clearer separation of each bank’s commercial and investment banking activities. Combined with the plan to privatize the country’s four largest banks during the next 18 months, the amended law could lead to substantial reforms in the banking sector. Bank privatization could be crucial to industrial restructuring and greater capital markets transparency. The Klaus government agreed in July to sell its 36 percent stake in the country’s third-largest financial institution, Investicni a Postovni Banka (IPB), to Nomura. However, only the post-poll government will be able to make the final decisions on the sale of the three remaining banks—Ceska Sportelna, Komerčni Banka, and Ceskoslovenska Obchodni Banka. The total assets of the “big four” account for around 60 percent of total banking assets. More than 30 percent of those assets are nonperforming, largely as a result of tougher central bank regulation, which is making it increasingly difficult to write off bad debts. The banks desperately need a capital injection to increase reserves and improve provisioning levels.

Based on AP, Dow Jones, and Oxford Analytica reports.

EBRD Report Predicts Accelerated Growth in Most Transition Countries

Old *Nomenklatura* Benefited Privatization

The European Bank for Reconstruction and Development's (EBRD) *1997 Transition Report* (its fourth) "Enterprise Performance and Growth," assesses the reform process across Central and Eastern Europe, the Baltics, and the Commonwealth of Independent States (CIS).

Corporate Governance Requires Changes

A new phase of economic transition is necessary in Eastern Europe and the former Soviet republics to counteract a legacy of communist-era managers who still retain control over many former state firms. This next stage of transition requires new forms of corporate governance that allow shareholders to sack managers who are incompetent or corrupt. The EBRD, in its *1997 Transition Report*, urges governments across the formerly communist world to create new laws and market institutions that boost competition and crack down on corruption. Characterizing old state managers as "insiders," the EBRD report says that outside investors—including small shareholders and strategic investors—must have more control over the managers of newly privatized firms in order to improve corporate performance.

Privatization in most of the CIS countries, as well as in Poland and the former Yugoslavia, have benefited primarily the old state managers and other insiders, who remain largely in control. Russia has sold off the entire spectrum of companies' operations to incumbent managers and employees. The managers quite often seek to control workers' shares as

well. Incompetent or corrupt managers are becoming entrenched in what would otherwise be good firms. The desire of these managers to retain control is causing many potentially profitable companies to miss out on investment from external sources. That also hurts the overall macroeconomic performance of these countries. Privatization programs thus fall short of their primary goal—to bring about economic growth and stability by strengthening the performance of former state firms.

Competitive market pressures are considered as one strong influence on the performance of insider-controlled companies. This raises the need for laws and institutions that foster a competitive marketplace. But the continued government subsidies to firms with incompetent managers is preventing the emergence of new private firms that could prove to be more efficient. Also, the benefits of competition are being squandered by arbitrary bureaucratic hurdles on the part of government—another legacy of the communist era that is making it difficult for new firms to enter the marketplace.

The rise of financial-industrial groups in countries like Russia and Ukraine could be a challenge to the insider domination of industry. Such groups could eventually evolve into effective agents of corporate governance and restructuring. But if not properly regulated, they could also recreate the kind of industrial or regional monopolies that prevailed under communism. Effective competition policies could keep the powers of the financial-industrial groups in check.

Corporate governance is lax in the Czech Republic, where private investment funds played a vital role in the success of voucher coupon privatization. The system of cross-ownership among state-owned banks and the investment funds has insulated Czech fund managers from external control. A lack of transparency is depriving minority shareholders of rights that would be considered part of the fair value of share ownership in the West.

Independent agencies are needed that monitor and control emerging capital markets. The ultimate goal should be a stock market system that allows both the ownership and control rights of companies to change hands. Another way to break up insider control is to gradually increase outside ownership through outside financing. This process appears to be taking hold slowly in Russia. A last-resort approach to corporate governance is the threat of bankruptcy. The threat is important in countries like Bulgaria, where insider privatization has drained most state firms and where banks and capital markets are weak.

Corruption in the CIS

Corruption is higher in the Commonwealth of Independent States (CIS) than in any other region in the world. The EBRD ranks Azerbaijan, Kazakhstan, Russia, Ukraine, and Uzbekistan highest for corruption of public officials, based on estimates by the London-based Economist Intelligence Unit and the DRI/McGraw Hill Global Risk Service. Both organizations are consultants who evaluate investment risks for po-

tential foreign investors. The Economist Intelligence Unit asked country experts to assess the "degree to which public officials are involved in corrupt practices" on a scale of 0 to 4 (0 being very low and 4 being very high). Among the 97 countries surveyed, 18 were former communist states that are making the transition to market economics. The average corruption score of these transition economies was 3.35—"higher than any other region in the world." All five CIS countries included in the survey (Azerbaijan, Kazakhstan, Russia, Ukraine, and Uzbekistan) received the highest rating—a score of 4—for corruption among public officials.

DRI/McGraw Hill studied 21 transition economies in its analysis of 33 risk factors across 106 countries. For the 12 CIS countries included in that survey, the average corruption score was 64 percent, "a level only slightly exceeded by the countries of Sub-Saharan Africa." However, DRI/McGraw Hill's corruption scores for the East European and Baltic countries were substantially lower.

A recent country-by-country survey asked more than 3,600 entrepreneurs in 69 countries to respond to the following statement: "It is common for firms in my line of business to have to pay some irregular 'additional payments' to get things done." Within the 10 CIS countries studied, 65 percent of respondents said that this was, frequently, usually or always true.

In this study the regional average for the CIS was 15 percentage points higher than for the next highest region—Sub-Saharan Africa—and 24 percentage points higher than for Latin America. The entrepreneurs were also asked if they could predict how much they would have to pay in bribes if they wanted "to get things done." The respondents in the CIS countries reported "a level of predictabil-

ity of corruption nearly twice as high as any other region, with the exception of Eastern Europe." The entrepreneurs were asked to respond to a second statement: "If a firm pays the required additional payment, the service is usually delivered as agreed." More than 80 percent of the respondents in the CIS and Eastern European nations tended to agree that this was the case.

The remarkably high levels of corruption in transition economies reflects a high degree of uncertainty about government policies toward the market. Managers, especially in the CIS, appear to rely on corruption—transactions they regard as relatively predictable and credible—as a means of hedging against the risks associated with the instability of government policy, much as they did under central planning. Governments in transition countries need to improve the predictability of their policy decisions if they want to reduce the underlying causes of widespread corruption.

Capital Flow Picks Up

Net private capital flows into the region have surged in the past two years and could exceed \$55 billion in 1997, reflecting growing confidence. The inflows could bring their own problems. "There is a danger of overheating, of excessive real exchange rate appreciation and of volatility." A Czech currency crisis in 1997 indicated the risks. Foreign direct investment has continued to flow into the region at a rapid pace, with Poland the main recipient in 1996, replacing Hungary, which had led the field since 1989. The pace of investment has accelerated again in 1997, with Poland and Russia each set to attract a quarter of the estimated total foreign direct investment of \$18 billion for the region. In 1998 regional foreign direct investment is forecast to rise to more than \$20 billion.

International competitiveness in manufacturing declined in several transition economies in 1996 and 1997, driven by a combination of real-wage increases outstripping gains in productivity and continuing appreciation in real exchange rates. The average increase in unit labor costs in deutsche mark terms in the advanced countries of Central and Eastern Europe in 1996 came to 9 percent. Wages, however, remain substantially lower than in Western Europe, and there is little evidence that the increase in labor costs has damaged exports in general.

Forecast 1998: Regional Growth Returns

The collective gross domestic product (GDP) of the Eastern European region is expected to grow in 1997 for the first time since market reforms were launched after the collapse of communism, despite anticipated declines in Albania, Bulgaria, Moldova, Romania, Tajikistan, Turkmenistan, and Ukraine. The general trend remains one of robust growth in Eastern Europe and the Baltic states and a gradual return to growth in the CIS, most importantly in Russia. Most transition economies are now expanding in contrast with the situation of a few years ago, when many were experiencing extreme economic dislocation and rapid falls in output. Average GDP in the former communist world is expected to increase by 1.7 percent in 1997. This follows seven years of continuous decline in the overall output of goods and services.

In 1998 real growth has been forecast for all Eastern European countries, with overall GDP expected to increase 4.3 percent in Eastern Europe and the Baltics and 4 percent in the CIS. Contraction of the Russian economy—by far the region's largest—has finally come to an end. Expansion of the Rus-

sian economy is expected to drive growth in the other regional economies.

Growth in Central and Eastern Europe and the Baltic states in 1997 will be below the earlier expectations of many forecasters, due largely to the sharp contractions in output in Albania and Bulgaria and slower growth in the Czech Republic—a little more than 3 percent is projected (see table). In 1998 four percent growth is expected. (This compares favorably with the 2.7 percent growth predicted for Western Europe next year.)

In the CIS economies growth is projected at 0.8 percent in 1997. That also is lower than the earlier forecast, due to the slower-than-expected pace of enterprise restructuring in Russia, which accounts for 75 percent of GDP in the CIS. Russia (as well as several other countries in the CIS in which output has fallen since reforms began) might record positive growth in 1998.

However, the growth performance is highly uneven across the 25 transition countries. In some countries, such as Poland, growth has been sustained for six years, whereas in others, such as Azerbaijan, it is just beginning. In the East European and Baltic states the star performer is expected to be Poland, with GDP growth projected at 5.5 percent in 1997. At the other end of the scale, Albania's output is expected to contract by 15 percent, and Bulgaria's by 7 percent.

In the CIS countries the top performer was Georgia, with growth in 1997 projected at 10.5 percent. At the bottom of the list is Turkmenistan, whose GDP is expected to shrink by 15 percent. Armenia, Azerbaijan, Croatia, Estonia, Georgia, Kyrgyzstan, Lithuania, Poland, Slovakia, and Slovenia are now growing at annual rates of 4 percent or more.

Growth in the more advanced economies is being driven by domestic demand, especially by private consumption, whereas exports were the driving force when growth first resumed. But countries such as Belarus, Moldova, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan are lagging. They have recorded low or

negative growth, reflecting the slow pace of reform and, in some cases, high rates of inflation. Their economic prospects are uncertain.

Inflation has continued to fall in most transition countries. Inflation is expected to be less than 10 percent in

Growth, Inflation, and Foreign Direct Investment in 25 Transition Economies

	GDP			Projected level of real GDP		FDI per capita		
	1996 ^a	1997 ^b	1998 ^b	in 1997 (1989=100)	Inflation 1996 ^a 1997 ^b	in 1998 ^b 1996		
Eastern Europe and the Baltics								
Albania	8.2	-15.0	10.0	73	13	33	17.0	28
Bulgaria	-10.9	-7.0	2.5	63	311	592	37.0	12
Croatia	4.2	5.0	5.0	74	9	9	4.0	73
Czech Republic	4.1	1.0	2.5	90	9	9	8.5	123
Estonia	4.0	7.0	5.0	76	15	12	10.0	71
FYR Macedonia	1.1	2.0	5.0	56	0	8	6.5	20
Hungary	1.0	3.0	4.0	89	20	17	14.0	195
Latvia	2.8	3.4	5.0	54	13	8	7.0	92
Lithuania	3.6	4.5	5.5	44	13	10	9.0	41
Poland	6.0	5.5	5.0	110	19	15	14.0	71
Romania	4.1	-1.5	1.5	87	57	116	40.0	9
Slovakia	6.9	4.5	3.0	94	5	7	6.5	33
Slovenia	3.1	4.0	4.5	99	9	9	8.0	90
Average^c	4.1	3.1	4.0	95	38	65	14.0	66
CIS countries								
Armenia	5.8	5.8	5.0	39	6	19	14.0	6
Azerbaijan	1.3	5.2	8.5	41	7	7	6.5	87
Belarus	2.6	3.0	2.5	66	40	99	105.0	7
Georgia	10.5	10.5	10.0	34	14	9	7.5	5
Kazakhstan	1.1	2.0	3.5	58	29	12	11.0	67
Kyrgyzstan	5.6	6.0	5.0	60	35	24	25.0	7
Moldova	-8.0	-2.0	3.0	34	15	11	9.5	13
Russia	-5.0	1.0	3.0	57	22	14	13.0	14
Tajikistan	-7.0	-3.0	0.0	36	41	105	36.0	14
Turkmenistan	-3.0	-15.0	8.0	51	446	44	58.0	2
Ukraine	-10.1	-3.0	2.0	37	40	15	18.0	10
Uzbekistan	1.6	1.0	2.5	86	64	40	32.0	2
Average^c	-4.6	0.8	3.1	56	63	33	28	17
Total Average^c	-1.1	1.7	—	72	—	—	—	31

a. estimate.

b. projection.

c. Estimates for real GDP represent weighted averages. The weights used were EBRD estimates of nominal dollar-GDP for 1996.

— Not available.

Source: *Transition Report 1997*, EBRD.

eight countries in 1997. The EBRD says that prices will have climbed less than 20 percent in 16 countries. But five economies have seen a marked acceleration in inflation—Bulgaria, Romania, Belarus, Albania, and Tajikistan.

Income disparities have increased across Central and Eastern Europe, the Baltic states, and the CIS countries in the 1990s. Social policies in Central Europe have mitigated these disparities to some extent, but, in the CIS, inequality and poverty have risen sharply. Related social indicators, particularly life expectancy, have also deteriorated in many countries.

The life expectancy at birth of male Russians in 1995 was 58, the lowest in any transition economy. Dramatic increases in deaths from heart disease, higher suicide rates, and the spread of infectious diseases seem to be related to higher stress and a deterioration in public health services.

A new phase of the transition has begun in the countries across the region. Governments should strengthen the institutions that support competition, investment, and innovation. The potential for growth is large, but so is the possibility of reform being trapped by vested interests, monopolies, and bureaucracy. With a combined GDP of \$1 trillion (about 3 percent of the world economy), the region is rapidly establishing itself as a major emerging market.

Contribution of RFE/RFL correspondents Stuart Parrott and Ron Synovitz are appreciated. To order EBRD Transition Report: Publications Desk, One Exchange Square, London EC2A 2EH, U.K., tel.44171-338-7553, Email: pubsdesk@ebrd.com, website: <http://www.ebrd.com>.

Why the Strict Trade Regime in Uzbekistan?

David G. Tarr

As of the fall of 1997 Uzbekistan's trade regime remains excessively controlled and is far from what is needed to integrate it into the world trading environment, even by the standards of the Commonwealth of Independent States (CIS). It has led to significant inefficiencies and rent-seeking and has not prepared the country for growth or poverty reduction. What are the reasons for this strategy?

Import Controls. The primary means of regulating imports is through the rationing of foreign exchange at the official exchange rate. This means that only a limited range of applicants receive foreign exchange to buy foreign products and services not on the prohibited list. Imports tariffs vary from 5 to 50 percent. The government claims that these tariffs help to increase budget revenues. But, unless they are uniform, inefficiencies and rent seeking develop.

Ban on Exports. Export taxes range from 20 to 40 percent, and many items cannot be sold abroad. The Ministry of Foreign Economic Relations imposes licensing and export quotas for the most important export products, such as cotton, fuel, ferrous and nonferrous metals, and ores, which together constitute about 80 percent of total exports. Cotton is the major export item. Under a system of state orders, the state buys cotton at a low price, strictly limits its exports, and restricts quantities that can be sold freely on the domestic market.

Foreign Exchange. Probably the principal problem with Uzbekistan's trade regime is the foreign exchange regime. It remains highly controlled, and the result is a considerable excess demand for foreign currency. It is rationed at the over-

valued exchange rate. Exporters have to surrender 30 percent of their foreign exchange earnings to the state. Uzbekistan's strict foreign exchange regime has the following consequences:

- It is an added tax on exporters.
- Most exports have become uncompetitive in world markets, because exporters demand higher prices to cover the tax and the surrender of foreign exchange. Although other factors also play a role in the steady decline in exports (especially of manufactured products) the exchange regime further aggravates this trend.
- Since the price of imports is determined at the unofficial exchange rate, importers who obtain foreign exchange at the official rate reap large profits (economic rents). This induces corruption in the allocation of foreign exchange.
- The majority of commodity markets are monopolized due to the limited access to foreign exchange.
- Prices to consumers remain high due to economic rents and monopoly profits.
- Capital is fleeing the country either through the underinvoicing of exports or through the overinvoicing of imports, banking the difference abroad. Thus less foreign exchange is repatriated and less is available to purchase critical imports.

State control of the trade regime means that there is limited control over what is imported—through preferred foreign exchange rationing and nonuniform tariffs—strong controls on exports and low prices to domestic producers of key commodities. The results are lower production of key products (especially cotton), reduced exports and imports, and misallocated imports.

The country gives the impression that it is resisting the allocation of resources

through market forces and integration into the world market economy. A market economy allocates resources based on price signals in the market, and in a small economy without world market integration those signals will be very distorted. Therefore, for a small economy like Uzbekistan, it is crucial to have an open trade regime if it is to convert to a market economy. Although it has not had a sharp decline in output thanks to its mineral wealth, the failure to make more progress toward a market economy and integrate into the world trading system means that Uzbekistan has not yet established the conditions for sustained growth.

What Explains This Strategy?

The fear of adjustment costs, the desire to preserve the industrial base or prevent frivolous imports have been offered as explanations for the restrictive trade regime. But are these concerns a valid basis for the Uzbek trade regime?

The fear of adjustment costs. Most transition countries that have adjusted the fastest have arrested the output decline the fastest. Estonia, Armenia, and Latvia—whose experience is the most relevant for Uzbekistan—led the other countries in arresting their output decline, and they also were the leading reformers in trade policy. On the other hand, slow adjustment in other CIS countries, such as Ukraine, has led to a continuing decline in output. In these countries much of the adjustment costs still lie ahead and will have to be borne if they want to move forward. Thus fear of adjustment costs does not appear to be a valid explanation for a trade regime such as Uzbekistan's. There are three other more legitimate reasons:

• **The desire to preserve the industrial base of the country.** It is true that, if left to the market, the productive structure of many countries in the Baltics and the CIS will change markedly. For example,

services were underproduced during the Soviet past and under market conditions all economies will allocate more resources to services. Attempts to preserve the inherited industrial structure are the same as trying to preserve central planning on a smaller scale than in the former Soviet Union. This is a failed strategy. Sustained growth will come only through the transformation to a market economy, and an open trade regime is a fundamental element of a market economy, especially in a small economy.

• **The desire to prevent frivolous imports.** Some authorities argue that free markets allow frivolous imports like Coca-Cola and chewing gum, and that they must control imports in order to allocate foreign exchange to essential imports. Central planners, however, are notoriously incompetent in making decisions that involve millions of people and thousands of firms, when compared to a functioning market system that reflects the demands of millions of people. It is impossible for a central planner to know whether imports to one industry are worth more to the whole economy than imports to another, or more than consumer imports. And there is nothing wrong with consumer goods. In a well-functioning market economy, the demands for consumer goods are balanced by firms' demand for intermediate and capital goods, so the value to society of each class of goods is approximately equalized. The high demand for imported consumer goods in Uzbekistan reflects the underproduction of consumer goods in the domestic economy, which was typical of the traditional industrial structure of the former Soviet Union. The control system (through the tax on exports in various ways) makes fewer exports and, therefore, less foreign exchange available for buyers of consumer goods and intermediate goods from abroad.

• **The desire of government officials to either wield power or get rich through**

extracting rents (bribes). Under the planned economy, pervasive price controls and shortages provided ample opportunity for the *nomenklatura* to collect rents through the preferred allocation of rationed goods. As the controls of the state wither away under the transformation to the market economy, the opportunities for collecting rents drastically diminish. In a number of countries policymakers realized that the trade regime was one of the most effective remaining means of collecting rents. Licenses that convey enormous economic rents (profits) to the recipients provide great incentive for payments to the officials providing the licenses. When there is excess license to control the trade regime (for example, foreign exchange rationing plus quotas and licenses on imports and exports) it is difficult not to conclude that numerous official actors are trying to get into the act of collecting payments for granting licenses.

Rent Seeking = Economic Dislocation

Rent seeking exists to some extent in all societies. If rent seeking were simply a transfer of wealth among individuals, without growth consequences, it would be a less severe problem. But if rent seeking is extensive and pervasive in a small developing economy, economic growth and poverty reduction are endangered. Entrepreneurs who develop new or make better products, introduce new technologies into the economy, or cut costs, are scarce talents that must be cultivated in developing economies. But if it becomes more profitable to solicit a government official for a license than it is to compete on the market by cost cutting or making a better product, the economy will fail to grow because scarce entrepreneurial talent is diverted into rent seeking and others are prevented from competing.

David Tarr is lead economist of the World Bank's Development Research Group.

Som Like It Appreciated.....

By presidential decree, Uzbekistan abolished customs duties and export licensing for manufactured goods as of November 1, 1997. President Karimov's decree also:

- Halved the corporation tax on firms exporting more than 30 percent of their output
- Abolished advance payments by exporters (including cotton exporters), subject to bank guarantees of convertible currency proceeds
- Exempted from excise duty and value-added tax (VAT) enterprises selling their own products to firms within the CIS, (effective January 1, 1998). This should revive direct Uzbek sales primarily to Russia.

But restrictions were not lifted for primary products that constitute (or will constitute) the bulk of its export earnings—cotton, gold, other precious and nonferrous metals, rolled steel, and oil and gas. In terms of world production, Uzbekistan ranks fourth in uranium, fifth in cotton, seventh in gold, and tenth in natural gas. It possesses other minerals as well.

The government decided to keep the official exchange rate of the som and the strict foreign exchange control intact. Imports rose in 1996 to \$4.5 billion, from \$2.7 billion in 1995. Despite the tight currency controls and import licensing, the trade balance deteriorated further in the first half of 1997. The trade surplus shrank from \$136 million in the first three months of 1996 to \$75 million in the first quarter of 1997. In November the som's black market rate dropped to 160-180 som to the dollar, while the official rate is 76 som to the dollar. The market value of the currency is estimated at 90 som to the dollar, closest to the commercial exchange rate used by banks. The central bank spent \$3.3 billion dollars in 1996 intervening to protect the currency. (The som was introduced in November 1993.)

In 1997 the government was due to implement its commitment to the IMF's Article VIII provisions for full current account convertibility and the nondiscriminatory availability of foreign currency to residents. However, Tashkent reneged. The import and foreign exchange restrictions caused the IMF to suspend its \$185 million Systemic Transformation Facility in December 1996, after \$92 million had been disbursed. Shortly afterwards, the World Bank deferred release of a \$250 million Enterprise Reform Loan. The IMF's First Deputy Managing Director Stanley Fischer warned the government that it would have to prepare a new economic program by the end of 1997 and meet all its earlier commitments—including a 3 percent budget deficit to GDP

ratio—before the IMF would resume payments. Fischer emphasized the need for the unification of the exchange rate at a market-determined point between the official and unofficial rates. However, there is little indication that President Karimov intends to endorse a som devaluation at this time.

In late October Minister of Macroeconomics and Statistics Bakhtiyor Hamidov predicted that industrial output would increase by 6.5 percent and investment by 26 percent in 1997 over 1996. This would represent the first upturn from post-communist recession: industrial output in 1996 was 7 percent less than in 1995. Agricultural output is estimated to be up 7 percent year-on-year, and GDP growth for 1997 is forecast officially at 5.2 percent. Monthly inflation in 1997 is likely to average 2.2-2.3 percent. (Annual inflation was brought down from 1,200 percent in 1994 to 64 percent in 1996).

In 1996 the cotton crop fell from a 1993-95 average of 4 million tons to 3.1 million tons, while the grain harvest dropped from 3.2 million tons in 1995 to 2.7 million tons in 1996. In 1997 the crop suitable for human consumption is forecast at only 2.5 million tons, compared with a requirement of 4.5 million. There will, therefore, be a substantial demand for foreign exchange for importing grain. No official statistics are yet available on the full cotton crop. Early indications are that the government's target of 4 million tons might be reached.

Uzbekistan received \$342 million in foreign direct investment in 1989-96. There was a net outflow of investment in 1995, and so little foreign investment arrived in 1996 that, in per capita terms, Uzbekistan ranked as the least attractive transition economy. Uzbekistan has the least per capita foreign direct investment in all of Central Asia. In the longer term, the government wants to reverse this trend, although it did not promise an easing of the administrative procedures for the time being. However, in December 1997 the country was successful in signing a \$1 billion agreement with a United States-Japanese consortium (ABB Lummus Global Nissho Iwai and Mitsui & Cothat) to build a \$1 billion chemical complex in Shurtan, 350 kilometers southwest of Tashkent, to be completed by the end of 2000. The facility will have an annual capacity of 125,000 tons of polyethylene, 137,000 tons of liquid gas, and 37,000 tons of gas condensate.

Based on reports of news agencies and the international research group, Oxford Analytica, Oxford, U.K.

1998 Index of Economic Freedom

Being loyal to Transition's tradition, we summarize the latest Economic Freedom Index, a joint venture of the Heritage Foundation and the Wall Street Journal. The ranking is based on measures of 10 broad economic factors in 156 economies. (The higher the score on a factor, the greater the level of government interference in the economy and the less economic freedom.) Again, we have to express some reservations about the objectivity and comparability of these calculations. Quoting from the executive summary: "...Estonia and the Czech Republic, both of which score well in the 1998 Index... are following the models of Hong Kong and Singapore..." The latest upheavals in the Czech Republic confirm the validity of this statement, but alas, from a completely different perspective. And there are some strange results in the rankings: an example, Mongolia precedes Slovenia, and Cambodia leads Croatia. We can agree, however, with the final conclusion of the authors: countries with more economic freedom also have higher rates of economic growth and are more prosperous than those with less economic freedom.

Index of Economic Freedom Rankings

Rank	Economy	Score				Trade	Tax- ation	Government intervention	Monetary policy	Foreign investment	Bank- ing	Wage/ prices	Property rights	Regu- lation	Black market
		1998	1997	1996	1995										
1	Hong Kong	1.25	1.25	1.25	1.25	1	1.5	1	2	1	1	2	1	1	1
2	Singapore	1.3	1.3	1.3	1.25	1	1	1	1	1	2	1	1	1	1
3	Bahrain	1.70-	1.6	1.7	1.6	2	1	3	1	2	2	2	1	2-	1
17	Estonia	2.15+	2.35	2.35	2.25	1+	3.5	2	4	1	2	2	2	2	2+
20	Czech Rep.	2.20-	2.05	2	2.1	2-	4-	2	2	2	1	2	2	2-	3+
62	Latvia	2.85+	2.95	3.05	-	2+	2.5	3	5	2	2	2	3-	3	4
66	Hungary	2.9	2.9	2.9	2.8	4	4	3	4	2	2	2	2	3	3
69	Poland	2.95+	3.15	3.05	3.25	2+	3.5	3	5	2	3	3	2	3	3
74	Lithuania	3.00+	3.1	3.5	-	1+	3	3	5	2	3	3	3	3	4
77	Slovakia	3.05	3.05	2.95	2.75	3-	4.5	3	2+	3	3	3	3	3	3
80	Mongolia	3.01+	3.3	3.5	3.33	1+	4	3	5	3	3	3	3	3	3
80	Slovenia	3.1	3.1	3.35	-	4	4	3	5-	2+	2	3	2+	3	3
94	Romania	3.30+	3.4	3.7	3.55	2	5	3	5	2	3	2	4	4	3+
96	Cambodia	3.35+	3.55	-	-	3+	2.5	3+	5-	3	3	3	4	4	3
96	Moldova	3.35	3.35	3.45	4.1	3	3.5	3	5	3	3	3	3	3	4
104	Armenia	3.45	3.45	3.75	-	2	3.5	3	5	4	3	3	3	4	4
104	Russia	3.45+	3.65	3.5	3.5	4+	3.5	3+	5	3	2	3	3	4	4
114	Bulgaria	3.65-	3.6	3.5	3.5	4-	4.5+	3	5	3	3	3	3	4	4
120	Albania	3.75-	3.65	3.45	3.55	3	3.5	5	5	2	4	3	4-	3	5
120	China	3.75+	3.8	3.8	3.8	5	3.5+	5	3	3	3	3	4	4	4
120	Croatia	3.75-	3.7	3.7	-	3	3.5-	5	5	3	3	4	4	4	3
125	Ukraine	3.80-	3.75	4	3.9	4	4+	3	5	3	4	3	4-	4	4
132	Kyrgyzstan	4	-	-	-	4	4	3	5	3	4	4	4	4	5
135	Belarus	4.05-	3.85	3.55	3.65	4+	4.5	3	5	4	3	4-	4-	4-	5
136	Kazakhstan	4.1	-	-	-	4	4	3	5	4	4	4	4	4	5
143	Azerbaijan	4.40+	4.6	4.7	-	5	4	5	5	4+	4	5	4	4	4+
143	Tajikistan	4.4	-	-	-	5	5	4	5	4	4	4	4	4	5
145	Turkmenistan	4.5	-	-	-	5	5	4	5	4	5	4	4	4	5
146	Uzbekistan	4.55	-	-	-	5	4.5	4	5	4	5	4	4	5	5
147	Vietnam	4.7	4.7	4.7	4.7	5	5	5	5	4	4	4	5	5	5
154	Cuba	5	5	5	5	5	5	5	5	5	5	5	5	5	5
154	Korea, D.R.	5	5	5	5	5	5	5	5	5	5	5	5	5	5

Source: Bryan T. Johnson, Kim R. Holmes, and Melanie Kirkpatrick, "1998 Index of Economic Freedom." (New York: The Wall Street Journal.

--Not available.

Calculating the Scores

Fifty independent economic variables were analyzed and grouped into the following 10 economic factors: trade policy, taxation, government intervention in the economy, monetary policy, capital flows and foreign investment, banking, wage and price controls, property rights, regulation, and the black market. Each factor was scored according to a grading scale unique for that factor:

Trade policy

- Average tariff rate
- Nontariff barriers
- Corruption in the customs service.

Taxation

- Top income tax rate
- Tax rate that applies to the average income level
- Top corporate tax rate
- Other taxes.

Government intervention in the economy

- Government consumption as a percentage of the economy
- Government ownership of businesses and industries
- Economic output produced by the government.

Monetary policy

- Average inflation rate from 1985 to 1995
- Average inflation rate for 1996 (for informational purposes only).

Capital flows and foreign investment

- Foreign investment code
- Restrictions on foreign ownership of businesses
- Restrictions on the industries and companies open to foreign investors
- Restrictions and performance requirements on foreign companies
- Foreign ownership of land
- Equal treatment under the law for both foreign and domestic companies
- Restrictions on the repatriation of earnings
- Availability of local financing for foreign companies.

Banking

- Government ownership of banks
- Restrictions on the ability of foreign banks to open branches and subsidiaries
- Government influence over the allocation of credit
- Government regulations, such as deposit insurance
- Freedom to offer all types of financial services, such as buying and selling real estate, securities, and insurance policies.

Wage and price controls

- Minimum wage laws
- Freedom to set prices privately without government influence
- Government price controls
- The extent to which government price controls are used
- Government subsidies to businesses that affect prices.

Property rights

- Commercial code defining contracts
- Sanctioning of the foreign arbitration of contract disputes
- Government expropriation of property
- Corruption within the judiciary
- Delays in receiving judicial decisions.
- Legally granted and protected private property.

Regulation

- Licensing requirements to operate a business
- Ease of obtaining a business license
- Corruption within the bureaucracy
- Labor regulations, such as established work weeks, paid vacations, maternity leave, and selected labor

regulations

- Environmental, consumer safety, and worker health regulations.
- Regulations that impose a burden on businesses.

The black market

- Smuggling
- Piracy of intellectual property
- Agricultural production supplied
- Manufacturing supplied
- Services supplied
- Transportation supplied
- Labor supplied.

Ratings of 1 are indicative of a mostly free economy, and ratings of 5 are indicative of extensive economic interference by government. Each economy in the index has been given an overall economic freedom score, based on the average of the 10 individual factor scores. A plus sign (+) indicates an improvement and a minus sign (-) a worsening of the score on a particular factor compared with the economy's score in 1996.

The four broad rankings of economic freedom are:

- **Free:** 1.99 or lower
- **Mostly free:** 2.00 to 2.99
- **Mostly unfree:** 3.00 to 3.99
- **Repressed:** 4.00 or higher.

1998 Index of Economic Freedom, by Bryan T. Johnson, Kim R. Holmes, and Melanie Kirkpatrick, 1998, 408 p. To order, call The Wall Street Journal Fulfillment Center at 1-800-975-8625.

Eastern Europe behind a Red-Tape Curtain

DHL Customs Report Rebukes Bureaucratic Regulations

The Iron Curtain dividing Europe might have come down, but a "red tape" curtain still shields the Eastern half of Europe, according to Western European multinationals. DHL's recent customs report for Central and Eastern Europe shows that shipments have been turned back at border posts because forms were not filled out in the right color ink. Customs held back a British shipment of cider because they didn't have a product code for it and wouldn't label it as an apple drink. As the leading air express operator, DHL conducted the survey to find out to what extent customs difficulties prevent Western companies from doing more business with countries in the region.

One hundred multinationals from 13 European countries—Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Norway, Spain, Sweden, Switzerland, and the United Kingdom—took part in the survey, conducted in August 1997. Most respondents were export managers. Half of the companies that participated have an annual group turnover of more than \$2 billion, and all have experience in trading with at least two Central and Eastern European countries.

Problems with customs rules and regulations is by far the biggest challenge that Western European multinationals face when doing business with Central and Eastern European countries. Almost 9 out of 10 multinationals (89 percent) experienced customs clearance problems. By comparison, 30 percent of respondents said that currency fluctuations had caused difficulties for their company, 27 percent cited political instability, and 25 percent mentioned the problem of corruption.

Only 10 percent of Western multinationals in the survey felt that customs authorities in Central and Eastern Europe operated as facilitators (6 percent) or partners (4 percent). Thirty-nine percent felt that customs authorities operated as barriers, 37 percent felt that they were duty collectors, and 25 percent felt that customs authorities in the region operated like policemen. Over half of multinationals that took part in the DHL survey reported that the customs delays had resulted in lost revenue to their businesses. Estimates ranged from "hundreds of thousands of pounds" to "several million."

According to respondents, the most straightforward customs procedures can be found in the five countries that are first in line for European Union (EU) membership. Forty-one percent said that, out of all the countries in Central and Eastern Europe, they had encountered the least difficulties with customs in the Czech Republic. Thirty-four percent felt that Hungary offered the smoothest customs clearances, followed by Poland (12 percent), Slovenia (12 percent), and Estonia (12 percent). Eleven percent said that they had encountered the least number of difficulties in Lithuania, while 7 percent cited Latvia and Slovakia. Less than half (49 percent) of the companies that took part in the DHL survey believed that customs procedures in the region had improved over the past two years. Countries in which improvements had been noted included Hungary (23 percent), the Czech Republic (18 percent), Poland (15 percent), and Slovenia (12 percent). Those respondents who had noticed better customs procedures also noted an easing of documentation requirements (50 percent), faster processing of

shipments (35 percent), and closer cooperation with the EU (21 percent).

The report concludes that customs authorities, who often see themselves as police rather than as facilitators of the economy, should be educated about what businesses need. Peter Davies, DHL regional director for Central and Eastern Europe, noted that in some countries customs officers lack motivation, resources, and pay.

Stefan Korshak of Radio Free Europe's Kyiv office, supplemented this with the following report:

In the DHL office in Kyiv, Ukraine, three resident customs officers are enforcing Ukraine's import rules. A DHL customs broker, a former customs officer himself, estimates that his former colleagues delay from a quarter to a third of the firm's incoming packages. In the recent DHL survey, Ukraine was put in the same group as Romania, Bosnia, and Yugoslavia, offering the "least straightforward" customs rules. No nation was deemed to have improved them as little as Ukraine. Some examples of customs roadblocks in Ukraine:

- Videotapes, CD-ROMs, and floppy disks entering the country require individual export licenses under legislation enacted in July to protect international copyrights. One DHL shipment ran into trouble recently because it included a corporation's annual report stored on computer floppy disk. The same material easily could be transmitted electronically via Internet.
- A Customs Committee rule blocks courier shipments of financial instruments such as credit cards, travelers' checks and even blank checkbooks.
- Foodstuffs require certification from the

State Quarantine Commission and quality approval from a State Food Committee.

- Medicines need the blessing of the health ministry.
- Electronic equipment must be vetted for radiation hazards by the Ukrainian Standardization Center for radiation and electric hazards. Communications equipment like mobile phones, satellite antennae, and pagers, if deemed to pose no threat of radiation, fall under the purview of the Communications Ministry.
- Christmas presents—sent through a courier company—often fall under regulations that control wholesale manufacturers, and therefore are subject to taxes and licensing approvals. The same thing sent by mail invokes different rules allowing goods valued at up to \$200 to pass into Ukraine unimpeded. Recently, managers of express delivery offices in Kyiv met with customs agents in an attempt to rescue Christmas fruitcakes that might otherwise be held hostage until July.

To order DHL report call Dirk Singer or Richard Kanareck, DHL London, 44-171-465-7700, or email: Dirk-Singer@classic.msn.com.



From the *World Press Review*

Letter to the Editor

How to Speed Up Growth and Keep Debts at Bay?

by Bruno S. Sergi

Recently, Stanislav Menshikov and David Gisselquist wrote about fiscal policy in Russia (*Transition*, Vol. 8, No. 2 pp. 13-16). Menshikov argued that Russian fiscal and monetary policies are restrictive, real money supply is inadequate, and there is no need to fight against “the nonexistent demand-pull inflation.” By restricting aggregate demand: “the government helped prolong depression in the real sector while failing to restrain supply-side inflation.” Increasing government spending would not risk a new inflationary surge, he concluded. David Gisselquist—while not sharing some recommendations of Menshikov—supports the view that “fiscal austerity has gone too far and is not the way to promote economic growth. To turn the corner in Russia is to prioritize growth rather than reform,” he pointed out. But apart from the quoted opinions, most authors of your newsletter strongly believe that restrictive monetary and fiscal policies are the precondition for successful economic reforms.

Postsocialist economies have entered a new stage of transition. In terms of GDP growth, many perform better now than a few years ago (table 1). However, there is a plausible risk that, in many of these economies, recovery may lose steam, and their GDP will level off somewhere around the level that prevailed before transition (see the cumulative real GDP growth in table 1). No question, investments are absolutely necessary to keep these economies growing.

While I do agree with Menshikov that Russian inflation is not a demand-pull

phenomenon, therefore restrictive fiscal policies are unwise, I do not agree with him when he advocates a new program to expand aggregate demand in Keynesian terms. I am for “directed” public expenditures and “directed” tax incentives.

Table 1. Basic macroeconomic indicators
(percent)

	GDP Growth 1997*	Inflation 1997*	Cumulative Real GDP growth 1990-97
Bulgaria	-4.8	769	-37.5
Czech Rep.	4.5	8	-5.8
Hungary	2.0	18	-12.4
Poland	5.5	16	+11.6
Romania	-1.5	109	-13.0
Russia	1.0	14	-49.6
Slovakia	6.0	6	-2.5

* forecast.

Source: *World Economic Outlook* (1997), the World Bank MultiQuery. Database (1997), and *Russian Economic Trends* (1997.1).

Deficit in transition countries can be considered as a transition deficit, being the outcome of a transition recession: the GDP falls and tax collection breaks down, as has been the case in Russia and other CIS countries. In Russia tax collection is not even 20 percent of GDP, and only 10 percent of overall revenues originated from personal income tax.

Since the current rate of inflation easily outperforms that of real GDP growth, governments can reduce their relative amount of debt by means of inflation. Thus

the budget deficit is compatible with the stability of government debt, and it is not only the outcome of increased budget spending but also of a tax-cutting policy (see table 2). What I call "active deficit," encourages the rapid accumulation of savings, along with human and physical capital investments, and is compatible with an open policy toward foreign investment, technologies and telecommunications.

Governments, however, should not merely expand aggregate demand in order to boost economic growth "a la Keynes." They can put their economies to a rapid growth track if they are able to induce positive supply response, stimulating the economy through public sector investment (infrastructure) and introducing tax incentives (for example, to promote foreign direct investment). That implies "directed" public expenditures and "directed" loss of tax revenues. This "active" deficit is compatible with a policy that is oriented toward stabilizing indebtedness.

Thus I contest the current wisdom that only rigid fiscal policies assure stability and the prospect of income growth. In this second stage of transition, policymakers, by boosting expenditures and applying tax exemptions, can speed up economic

growth and, at the same time, cut down their external and domestic debt.

The author is professor at the University of Messina, Italy, tel. 39-330-907 841, fax 39-965-279-74.

Table 2. Basic fiscal indicators in 1996
(percent of 1996 GDP)

Country	Government deficit	Government revenue	Domestic public debt	External public debt	Total public debt to government revenue (%)
Bulgaria	13.3	32.0	24.1	96.9	378
Czech Rep.	0.6	46.5	8.7 ^a	16.5	54
Hungary	1.1	51.2	33.0	40.5	143
Poland	2.8	45.9	16.8	30.2	102
Romania	5.7	31.4	3.6 ^b	18.2 ^c	69
Russia	6.5 ^a	12.4	16.0	30.2 ^d	364
Slovakia	1.3	44.9	10.2 ^b	9.5	44

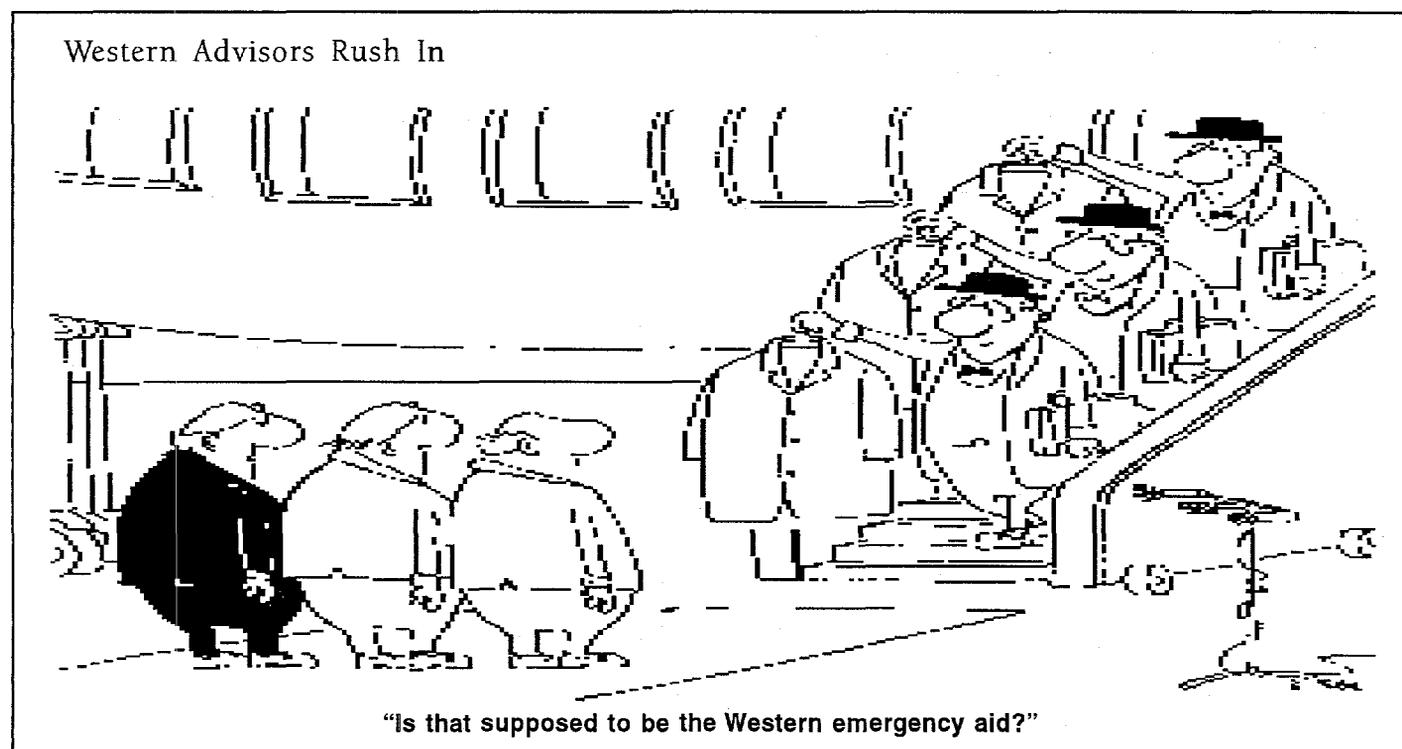
a. International Financial Statistics 1997, IMF.

b. Taken from "Aspects of Fiscal Performance, in Some Transition Economies Under Fund-Supported Programs," IMF Working Paper 97/31, W. H. Buiter 1994..

c. 1995, calculated as total external debt minus private nonguaranteed long-term external debt.

d. 1995, calculated as total external debt minus short-term private external debt.

Sources: The World Bank MultiQuery Database, (1997).



From the Hungarian daily *Nepszabadsag*

Russian Grassroots Fight for True Federalism

by Adam Korengold and Leonid Polishchuk

The past few years in Russia have seen a massive transfer of economic and political power from the national government to the regions. In theory such a major decentralization could vastly increase the efficiency of public decisionmaking. These gains, however, are contingent upon:

- Unhampered economic links between regions within a national market
- A constitutional structure that imposes checks and balances between different branches of the government
- A culture that respects and insists on the rule of law and compliance with constitutional norms and provisions.

Since none of these conditions are being met in Russia, the country's political and economic decentralization has, to this point, been more a source of contention than a path of prosperity. Violations of federal constitutional norms by regional authorities norms abound. Local bureaucrats frequently exploit their region's distrust of Moscow to delay market reform and preserve their economic and political control. In turn, the federal government threatens to overstep its limits of authority and curtail regional powers.

Inconsistent and inadequate legal systems (both federal and regional) further aggravate the problem. Legal and constitutional reforms are implemented separately at the federal and regional levels. Such separation is helpful, considering the diverse regional needs and preferences, but it also jeopardizes the unity of the Russian state. Legal reform has become part of the

overall tug of war between the political elites of the center (Moscow) and the regions. Lack of constitutional consensus and stability undermines the authority of law; renders legal, fiscal, and regulatory arrangements unpredictable; and stifles economic growth.

In 1995, with the support of the Council of Federation (the upper house of the Russian parliament), a group of Russian legal scholars and experts, along with politicians and other practitioners of constitutionalism, formed the Russian Con-

IRIS + CU = U.S.-Russia Regional Programs

Since the spring of 1995 the Constitutional Union and the Center for Institutional Reform and the Informal Sector (IRIS) affiliated with the University of Maryland's Department of Economics, have collaborated on several legal issues, including establishing constitutional charters for Russian regions, working out bilateral treaties between regions and the federal government, and dealing with the legal and constitutional aspects of fiscal federalism. Since 1993 IRIS has worked in Russia on many programs funded by USAID and other donors. The prospective agenda of the two partners includes such topics as the legal foundations of local self-government; development of an independent regional judiciary; regional legislative autonomy and economic integration; and political, social, and economic rights in federal and regional legislation. With financial support from the Mott Foundation, the CU and IRIS will jointly undertake a series of seminars for Russia's regional policymakers. The two organizations will also promote direct links between Russia's regions and U.S. states, cities, and municipalities.

stitutional Union (CU), an independent grassroots organization. As its charter points out, the CU strives for uniform application and enforcement throughout the country of principles based on the

"supremacy of human rights and rule of law, democracy, and federalism." The CU undertakes networking in all 89 constituent regions of the Federation, provides expertise on a broad range of legal, fiscal, and regulatory issues; drafts key constitutional legislation, including model charters for regional governments; and functions as advocate and information clearinghouse.

In the two years since its inception the CU has established local chapters in 52 constituent regions of the Federation. Its

legal experts are drafting and discussing key legislative acts and constitutional documents which deal with the following issues (among others): the principles governing division of power between the federal and regional governments and between the regional legislative and executive branches, the legal foundations of local self-government, and the reform of public law at the subnational level.

Constitutional reform at the regional level heads the CU agenda. The recent regional gubernatorial votes have vested subnational governments with greater authority, but at the same time have increased their accountability. The regional governments, however, still depend heavily on transfers from the federal budget. This serious mismatch between increased responsibilities and inadequate fiscal resources is squeezing regional politicians who, rather than turning to the mistrusted center, are asking independent experts of the CU for help working out a broad range of

Russian Asymmetric Federation—Regional Economics 101

Efforts to negotiate and regulate relations of economic policymaking and economic resource control between the center and the regions have been ongoing since the Soviet collapse. The March 1992 Federation Treaty and the 1993 Constitution enshrined a system of asymmetric federalism:

The 21 ethnic republics were granted autonomous status within the federation; but the 57 regular territories—*oblasti* (regions), *kraya* (territories), and the cities of Moscow and St. Petersburg—and 11 autonomous districts (*okrugi*) located within these republics became administrative units of a unitary state.

Under this legal framework, the republics enjoyed key rights to control local economic development including:

- Control over natural resources, strategic enterprises, and infrastructure—federal property was limited mainly to defence-related enterprises
- Independent privatization policies
- Unilateral tax retention and locally applied federal tax rates subject to bargaining with the center
- Independent foreign economic relations.

In practice, the ability of the ethnic republics to pursue independent economic policies depended more on their economic assets, bargaining skills, and political influence than on their *de jure* rights. (The Constitution deliberately includes some ambiguous formulations, which gives the federal authorities leverage to intervene.) The republics' legal economic rights were further enhanced by a series of bilateral power-sharing agreements signed with the center beginning in February 1994, when Tatarstan negotiated the first such deal. The regular regions resented the preferential treatment given to the ethnic republics and lobbied for the legal enhancement of their economic rights.

The center has in many cases conceded and has signed power-sharing agreements with the regions. To complicate matters, some resource-rich *okrugi* also want to separate from their regions. For example, Yamalo-Nenetsk and Khanty-Mansi in Tyumen oblast have claimed exclusive rights to resource extraction on their territory.

The republics and the regular regions tend to pass different types of regional economic legislation. In the republics, economic legislation has aimed mainly to assert more economic autonomy. For example, Bashkortostan, Sakha-Yakutia, and

Tatarstan have made claims to:

- Full responsibility over issues defined in the legal documents as joint federal-republic functions (such as federal taxes, customs duties, and defense)
- Exclusive right of resource extraction (Tatarstan passed a law in May regulating oil and gas exploration and production-sharing agreements)
- Revaluation of federal property and federal privatization.

In regular territories, legislation has differed:

- Reform-oriented leadership (such as those in Nizhni Novgorod, St. Petersburg, and Samara) approved regional legislation on land privatization, real estate markets, and bankruptcy in 1995-96
- Conservative leaders (Tula, Ulyanovsk, and Voronezh) created local trade barriers, price controls, and taxes that impede the free flow of capital and labor
- In regions where local corporatism predominates and there is a close entanglement of local political and economic power (Sverdlovsk and Irkutsk), attempts were made to raise additional revenues from exports through local customs duties and rent seeking.

Overall, the system of asymmetric federalism, combined with the nontransparent nature of much center-regional bargaining, has greatly complicated foreign direct investment (FDI) in Russia. The center has largely been unable to impose standard regulations for the drafting of regional legislation. There is no central registry of subnational legislation. However, differences between regional economic legislation seem to marginally influence FDI into the regions. Regions benefiting from major urban agglomerations; relatively well-developed transport, distribution, and financial infrastructure (Moscow Oblast and city, Yekaterinburg and Novosibirsk) and a favorable gateway location (St. Petersburg, Arkhangelsk) receive most of the FDI.

Market-friendly institutions and legislation have helped to create a generally favorable environment in Nizhni Novgorod and Samara. But some western investors seem to prefer local leadership with authoritarian tendencies and less diversified economic and political interests, such as that in Tatarstan, since in some respects this makes foreign investment dealings easier and cheaper.

Based on the report of Oxford Analytica, the Oxford (U.K.)-based international research group.

legal, fiscal, and regulatory issues, and resolving conflicts that arise from conflicting interpretations of the constitutional law.

Some 200 legal experts from across the country convened at the CU's annual congress, held last summer in Moscow. The congress's message was clear: "Treaties between the federal government and the regions are often based on political expediency, rather than on sound principles of fiscal and administrative federalism. That erodes the Russian constitutional system and puts bargaining ahead of constitutional norms. The Russian federal constitution itself requires fundamental amendment. The notorious vagueness in the division of power between the federal government and the regions should be eliminated. Regional jurisdictions need protection from federal incursions. Constitutional oversight must be more vigorous; and legal responsibility for violation of constitutional provisions and norms should be strengthened."

The CU recognizes that unless legal reform is accompanied by efforts to improve the legal culture of Russian society—that is, public acceptance of constitutional authority as well as appreciation and respect for the rule of law—it will have limited results. Thus the organization initiates debate over public law and public policy, with the goal of educating government officials, politicians, and the public. Fostering a greater public acceptance of improving the Russian legal system and the rule of law, is the mission of the Constitutional Union.

Adam Korengold and Leonid Polishchuk are, respectively, Project Coordinator and Research Associate at IRIS. Inquiries may be directed to IRIS, 2105 Morrill Hall, College Park, MD 20742, tel. 301-405-3110, fax 301-405-3020, Email: lpol@iris.econ.umd.edu, IRIS website: <http://www.inform.umd.edu/IRIS>.

Hungary's "In Vivo" Pension Reform Experience

by Antal Deutsch

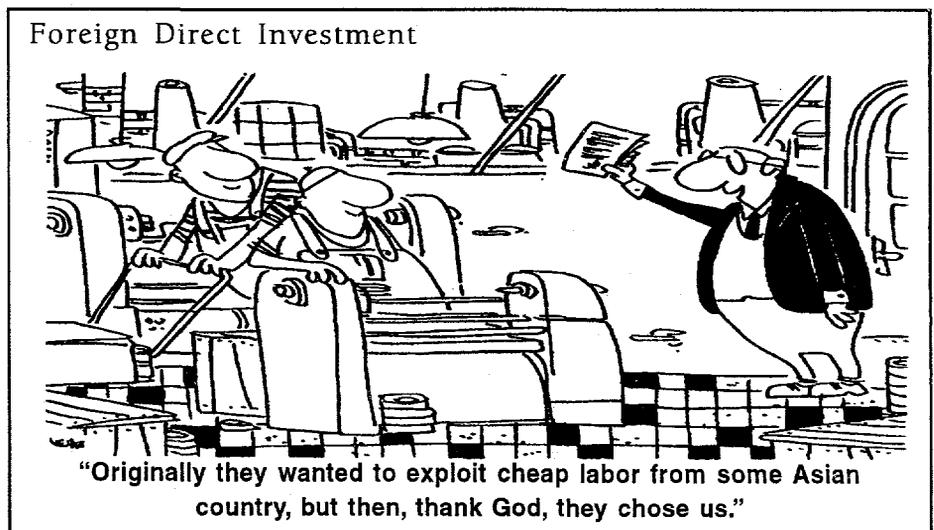
Hungary's population is 10 million and is slowly declining. The birth rate is low, and the death rate of middle-aged men is spectacularly high. The causes of death are smoking, alcoholism, generally bad diet, and a high level of stress. The retired population is overwhelmingly female, aging, and in need of ever-increasing medical expenses. The labor force is 4.5 million, of which about 16 percent are officially unemployed. There are 2.9 million pensioners, including those on early retirement and disability benefits. The retirement age was low: 55 for women, 60 for men. The pension system itself aimed for a replacement rate of about 40 percent of the average wage.

The ratio of old and young population to the working-age population is high and will continue to rise in the foreseeable future; current estimates predict that the dependency ratio will be 79 percent in 2001 and will increase to 87 percent by 2020. According to the traditional view, change to a funded system means that the present generation will have to bear

not only the ongoing costs of pay-as-you-go (PAYGO) plans, but also the burden of the investment required to establish the new system. Another view takes the promises of the present system as given sunk cost or unrecorded national debt. In other words, any government "deficit" specifically arising from paying these claims is only turning implicit debt into explicit debt.

The specific reform arrangements in Hungary are:

- The retirement age is to advance in stages, from 55 and 60 for women and men, respectively, to 62 years for both, by 2008.
- The annual inflation indexation of ongoing pensions will follow the Swiss indexing formula, taking half the change in the consumer price index and combining it with half the change in the average industrial wage.
- The payroll tax used to finance pensions will extend its base to capture all wage-like incomes.
- In the reform's initial year of 1998, 6



From the Hungarian magazine *Hócipő*.

Russia Is Getting Ready for Private Pension Funds

Russia's government in mid-December gave the go-ahead to an ambitious reform program for the country's pension system, which has been a heavy burden on the government's already-strapped finances. The plan calls for shifting the current system of broad but low state benefits—inherited from the Soviet era—to a combination of state pension and private pension-savings accounts, funded from worker and employer contributions. The plan doesn't involve raising the retirement age, (women are able to retire at 55 and men at 60) but will create incentives for people to work longer by tying pensions more closely to time served on the job.

The plan will go to the president for final approval in January. "The program won't affect current pensioners except to ensure better financing of benefits and automatic indexing in line with wage levels", Deputy Prime Minister Boris Nemtsov said. New hires would presumably fall under a new, privately funded system.

There are 37 million pensioners out of a total population of 150 million. About 12 million of the 37 million pensioners are

early retirees. The workforce numbers about 80 million. There are too few workers supporting the population. This has produced great strain on the system. Although life expectancy for men is just 57, once they reach that threshold, they can expect much longer life.

About ten million pensioners live under the poverty line. The minimum pension received in the country is about 70 (new) rubles per month, the equivalent of \$12. End-December, the average pension was 370 rubles a month, up from 322,5 rubles at the beginning of 1997. The level of taxation that should be collected for pensions is around 28 percent of wages. The number of pensioners being supported are being supported from the formal economy. The government struggled in 1997 to pay off huge pension debts built up because the State Pension Fund failed to collect necessary payroll taxes. The size of the informal economy is such that there are many people generating GDP that is not being accounted for. One can work as little as five years in the formal system and still receive a pension.

Based on news agency reports.

percent of wages will be diverted to individual retirement accounts for those participating in the new system. In 1999 the diversion will be 7 percent; and in 2000, and thereafter, it will rise to 8 percent of wages. These contributions will be deductible from the income and social security tax bases. [Employers' contributions—currently 24 percent of gross salary, but due to fall to 22 percent by 2000—will continue to fund the state pensions, together with the contributions (now 6 percent, to be increased to 8 percent by 2000) of those employees who do not join the new system.]

- Participants in the new plan will include all those entering the labor force after January 1998 and anyone wishing to switch to the new system.
- There will be a floor-guarantee for individuals who have spent at least 15 years in the new system. At the same time, there is no ceiling on the new publicly provided annuity.

As a result:

- These reforms will reduce the scope

of the PAYGO program and hence the government's deficit in the long run.

- Reforms will substantially increase the stock of domestically owned savings.
- The level of pension benefits will be more closely related to the level of earnings on which they are based.
- The private defined contribution pension will more than offset the cut in the government-defined benefit pension, thus leaving future pensioners better off.

The major unknown now is the proportion of persons who will actually opt to transfer to the new system. That number can only be guessed at. The government hopes that the proportion will be low enough to accommodate the resulting annual shortfall in the cash flow of the PAYGO system. (Experts reckon that the shortfall—to be funded from the central budget—can be kept within 1 percent of GDP, or about 70 billion forint at today's prices).

In 1993 Hungary was the first transitional economy to legislate the opera-

tion of private pension funds. A period of rapid growth in terms of both membership and assets followed. By the end of 1997 membership was expected to be 847,000, and assets at 51 billion forints (\$275 million). In the summer of 1997 Hungary was also the first transitional economy to have legislated thorough-going reform of its social-security system. It remains to be proved that individual pension accounts produce a suitable real rate of return, or that the book-keeping costs of the reform are not underestimated. Decisionmakers of other transforming economies will watch and evaluate the early Hungarian experience closely. So the story is about much more than local significance.

Excerpted from fall 1997 issue of World Economic Affairs, vol. 2, no. 1.

The author is Professor of Economics, McGill University, Montreal, Canada, and an advisor to the Hungarian Ministry of Finance. E-mail address is indu@musicb.mcgill.ca.

The World of Pensions

Pensions are replacement income for those too old to work. "Funded" pension plans have a pool of assets large enough to meet their future liabilities. Pay-as-you-go (PAYGO) plans have little or no assets and rely on future payments into the plan to finance benefit payouts. There are two kinds of pension benefits.

- Defined-Benefit (DB) plans promise a monthly income calculated on the basis of previous earnings and years of service. In order to run a DB scheme the plan need not be funded, but there must be a solvent guarantor.
- By contrast, Defined-Contribution (DC) plans simply accumulate a savings account that will buy whatever annuity is available on the market at the time of retirement. DC plans require assets and safeguards but no guarantor of a promised level of benefits, because there is no such promise.

Government-sponsored plans in most major industrial countries are based on PAYGO arrangements. This means that everyone's pension is paid by some other people down the road. Successful PAYGO plans presume that the working population as a proportion of the total, will grow (or at least not decline!) and labor productivity in the economy will also grow. Such public pensions include elements of income redistribution: from rich to poor, also from later generations of contributors to the initial generations of recipients, and from men with short life expectancies at retirement to women with long ones. Governments often earmark a payroll tax to cover the ongoing expenditures of the PAYGO system.

Pension reform consists of designing a new system while maintaining the liabilities of the old system. The twin goals of reform are usually to reduce budgetary cost to the government, along with the burden of taxes to citizens, as well as to increase benefits to future retirees. Pension reform in the late 1990s involves:

- The redesign of the public pillar (PAYGO) by reducing benefits
- The redirection of funds from the PAYGO system to privately owned and managed contribution accounts that are fully funded. These are attractive because they confer a sense of ownership on the pension saver and, if competently managed, promise much better returns to the typical participant than can be obtained by putting the same funds into the PAYGO arrangement.

Milestones of Transition

Stress, often related to poverty or the fear of unemployment, is playing a significant part in shortened life expectancy in transition economies. On December 9 the World Health Organization (WHO) reported that the average life expectancy at birth is now 67.3 years for men and 75.3 for women in the CEE countries, and 60.6 years and 71.9 years in the countries of the former Soviet Union (to compare: 73.8 years and 80.6 years in the European Union). The extremely high smoking rates, particularly in Russia, the Baltic states, Albania, Bulgaria, and Croatia suggest that 21st century health services will face an enormous burden from this disease. The report's message is stop smoking, cut down on alcohol, and eat more fruit and vegetables and less animal fat.

Trade among the former East Bloc countries is roaring back to life, according to a recent article in the *Wall Street Journal*. U.S. companies are fueling much of the cross-border activity. Under communism, 70 percent of East Bloc countries' trade was among themselves, particularly with the Soviet Union. In the early 1990s the backlash caused a shift west: companies were hungry for hard currencies, and consumers were hungry for products with Western labels. The drift back to the East is a strong sign of the region's long-term fitness and stability, economists claim. Western Europe will always be the region's main market and supplier, but the return of neighborly trade is giving a strong boost to several companies.

OECD ministers signed a new international convention outlawing bribery by companies to win foreign contracts. Bulgaria and Slovakia also signed the convention. The agreement will also end the practice whereby companies have been allowed a tax deduction against foreign bribes. The convention includes a sweeping definition of those covered by the offense by defining a "foreign public agent" as anyone who holds a legislative, administrative, or judicial post in a foreign country as well as anyone with a job in a public sector company or an international organization. The convention will go to member countries' parliaments for approval before being ratified a year from now.

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“There is need for socialist care for the poorest, conservative defense of tradition, and liberal reflection on efficiency and growth.”

Adam Michnik Explains the Central European Syndrome

People from Central Europe like to tell jokes. For years jokes offered them asylum. In the world of jokes they not only felt free and sovereign, within captivity and Soviet domination, but they also laughed. Two people, with the experience that comes with age, were playing tennis. The tennis ball ended up in the bushes. While looking for the ball, one of the players saw a frog. The frog spoke to him in a human voice, “I’m a beautiful princess, turned into a frog by a mischievous wizard. If you kiss me, I will become a princess once again. I will marry you, you will be a prince, and we will live happily ever after.” The player put the frog into his pocket, found the ball, and continued the game. After a while, the frog again spoke to him, this time from his pocket, “Sir, did you forget about me? I am this beautiful princess, turned into a frog. If you kiss me, I will become a princess again. We will get married and live happily ever after!” And then she heard his answer: “Dear lady frog, I will be completely honest with you. I have reached the age at which I would rather have a talking frog than a new wife...”

This frog is Central Europe, knocking at the gates of NATO and the European Union. NATO and the European Union have not yet made up their minds to kiss. They don’t yet know whether they prefer to have a talking frog or a new wife. [Since the publication of this essay, both NATO and the EU decided to “kiss the frog.”] Let us skip the controversies over defining the borders of Central Europe. Let’s remind ourselves, however, of the statement by the Hun-

garian writer Gyorgy Konrad: “It is we, who live in Central Europe, who began the two great World Wars.” Put differently, this multinational mosaic, conquered by German, Austro-Hungarian, Russian, and Ottoman empires, was, and still is, a source of conflict and destabilization. Today, seven years after the collapse of the Berlin Wall, the nations of Central Europe are facing new opportunities and new challenges.

Decades and centuries of existence in an environment of oppression and repression produced a specific culture, characterized by honor and self-irony, the stubbornness to stand by values, and the courage to believe in romantic ideals. Here, national and civic consciousness developed as a result of human bonds—and not by the order of state institutions; here it was easier to devise the idea of civil society, precisely because the sovereign national state remained largely in the realm of dreams.

The system of parliamentary democracy and the market economy have had fierce adversaries since their inception. Let’s give them the symbolic names of “conservative” and “socialist.” For the conservative, the democratic order was a negation of tradition—the defeat of the Christian spirit by a rapacious nihilism; the total victory of relativism over the world of tested and absolute values. For the socialist, it was a system that generated, disguised, and perpetuated inequality and injustice.

The conservative saw in man a wild being, that cannot be domesticated by calls

to reason. Only strong institutions can achieve this. The socialist, on the other hand, saw in man a good being, forced by inhuman social conditions into animal behavior. Both conservative and socialist rejected the order of a freedom based on the free play of political and economic forces and on the specific domination of property and money. The conservative held that this order liberates an animal rapaciousness in man, while the socialist was of the opinion that this order virtually requires an animal aggression.

Why did we rebel against communism? Why did we prefer to become a small, repressed minority, rather than to join the majority who lived and made careers in the world of totalitarian dictatorship? Well, we rejected communism for several reasons: it was a lie, and we were searching for truth. Communism meant conformity, and we desired authenticity; communism was enslavement, fear, and censorship, and we desired freedom; it was an ongoing attack on tradition and national identity, which we held to be ours; it was social inequality and injustice, and we believed in equality and justice; communism meant a grotesquely deficient economy, and we sought rationality, efficiency, and affluence; communism meant the suppression of religion, and we held freedom of conscience to be a fundamental human right. So, we rejected communism for reasons equally dear to a conservative, socialist, and liberal. In this way, a peculiar coalition of ideas emerged, which Leszek Kolakowski noted in his well-known essay, “How to be a Conservative-Liberal Socialist?” This coalition collapsed along

with communism. Egalitarianism found itself in conflict with the principles of a liberal economy; conservatism challenged the spirit of liberal tolerance.

Dilemmas arose and were resolved in different ways by the socialist, the conservative, and the liberal. For the socialist the central issue was to give a human face to a rapacious market economy, to defend the poorest sectors in society, to pressure the secular character of the state, and to show tolerance toward people of different faiths and nationalities. The conservative, for his part, wanted to bring back the continuity of national symbols and would fight for a Christian reshaping of the constitution and institutions; he would warn against the dangers of liberalism and relativism; and he would demand harsh treatment for members of the old regime. The liberal would say, "the economy first," economic growth, clear market rules, a stable system of taxation, privatization, and exchangeable currency. He would be a careful defender of the idea of a tolerant state with regard to the Church, to national minorities, and to neighboring countries—and with regard to the past.

At the same time, a nostalgia appeared, surprising—the socialist, the liberal, and the conservative. It was nostalgia for the security of the "good old communist days," when, it was said, "the state pretended to pay the people, and the people pretended to work."

The dispute over the shape of the market economy took on the form of a social conflict in which the arguments of the socialist and the conservative came together in a criticism of the policies of liberal transformation. Unemployment, social contrasts, the frustration of employees—all contributed to a slowdown in the reform process. The dispute over the shape of the state turned out to be fundamental, especially in multinational

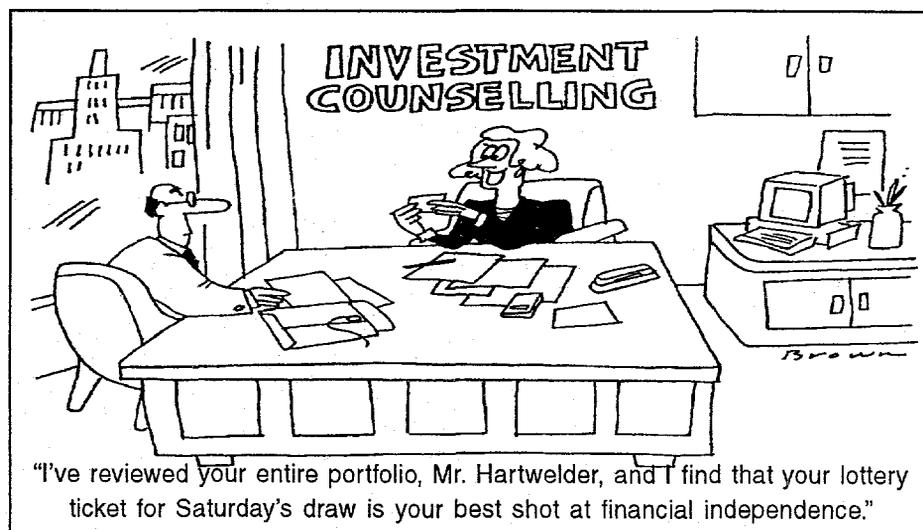
countries that had just regained independence after a long enslavement. Conservative partisans of the national principle emphasized the need to reconstruct the ethnic fabric destroyed through years of official denationalization; partisans of the civil principle defended the fundamental tenets of democracy against an "invasion of intolerant chauvinism."

Democracy is gray, established only with difficulty; its quality and flavor are best recognized when lost under the pressure of advancing "red" or "black" radical ideas. Democracy is not infallible, because in its debates all are equal. This is why it lends itself to manipulation and may be helpless against corruption. This is why, it frequently chooses banality over excellence, shrewdness over nobility, and empty promise over true competence. Democracy is a continuous articulation of particular interests; a diligent search for compromise among them; a marketplace of passions, emotions, hatreds, and hopes; eternal imperfection; and a mixture of sinfulness, saintliness, and monkey business. Yet only democracy—with its capacity to question itself—also has the capacity to correct its own mistakes. Only gray democracy, with its human rights and its institutions of civil society, can replace weapons with arguments. The

subject of democracy is people, not ideas.

Today, the classic ideological positions—like liberalism, conservatism, or socialism—do not dominate public debate about taxes, health reform, or insurance. Yet, in each of those debates, there is a need for the presence of a socialist care for the poorest, a conservative defense of tradition, and a liberal reflection on efficiency and growth. Each of those values is needed in democratic politics. It is these that give color and diversity to our life; it is these that equip us with the capacity to choose; it is thanks to their contradictions that we can afford inconsistency, experimentation, changes of opinion, and changes of government. Fundamentalists of different stripes condemn the moral relativism of democracy as though it were the state that should be the guardian of moral virtue. We, however, the defenders of gray democracy, do not grant the state this right. We want human virtues to be guarded by the human conscience. That is why we say, "gray is beautiful." And all of this has been told to you by a frog from Central Europe.

Adam Michnik is Editor-In-Chief of the Polish Gazeta Wyborcza. This is excerpted from his essay "Gray is Beautiful; A Letter to Ira Katznelson."



From the *World Press Review*

Continued from page 21

Central and Eastern Europe

The latest OECD survey expects higher growth rates in most Central and Eastern European countries

	GDP		
	1996	1997	1998
Bulgaria	-9.0	-6.0	2.0
Czech Republic	4.4	0.9	1.7
Estonia	4.0	9.0	--
Hungary	1.0	3.0	3.9
Latvia	2.8	4.0	--
Lithuania	3.6	4.0	--
Poland	6.1	5.6	5.4
Romania	4.1	-4.0	1.0
Russia	-4.9	0.5	3.0
Slovakia	7.0	5.0	4.5
Slovenia	3.5	3.5	4.0
Ukraine	-10.0	-4.0	--

-- Not available.

Source: OECD.

The European Union (EU) is to begin enlargement negotiations on March 31, 1998, under the United Kingdom's presidency. Full membership talks with Cyprus, Czech Republic, Estonia, Hungary, Poland, and Slovenia will be accompanied by preliminary talks with Bulgaria, Latvia, Lithuania, Romania, and Slovakia. All 11 nations will be part of the newly formed European Conference. All will be eligible for \$83 billion in EU economic aid grants and soft loans in 2000-06 to help the aspirants attain EU standards. Expanding the club will oblige EU members to make major structural changes, including a change in costly farm subsidies, reallocation of aid for poor regions, and simplification of convoluted decisionmaking rules. Addressing these issues could take years.

CEE countries are facing a major restructuring of their power industry, which has become obsolete and requires costly modernization, energy

experts attending a regional forum of the World Energy Council in Warsaw said. Poland, for example, needs to spend \$3 billion annually to upgrade its power sector. Some 112 million people living in the region's 11 countries are facing a gradual but substantial growth of energy prices in the next 20 years that will match prices in the West. Participants agreed that privatization of the energy sector is vital for the region.

Albania

Major macroeconomic targets for 1998: 10 percent GDP growth, 20 percent inflation, and a \$170 million budget deficit (down from \$333 million in 1997). The government wants to raise public sector wages by 20 percent, but also cut 15,000 jobs in that sector in 1998, Prime Minister Fatos Nano announced in mid-December. Of the 267,000 people currently employed by the government, some 150,000 work in government administration. The government hopes to help create 73,000 new jobs in the private sector. Albania has 162,000 registered unemployed, while another 155,000 families receive welfare payments. The average monthly salary in the state sector is \$55.

Bosnia

According to the Muslim-Croat Federation's Privatization Law, adopted last October, small-scale privatization should involve firms with up to 50 employees and up to 280,000 dollars in assets, to be followed by the sale of strategic enterprises, (electricity, water supply, transportation, mining, forestry, telecommunications and public service, and media). The government will settle its obligations to citizens groups by issuing vouchers that can be used to buy assets offered for sale through auctions and public tenders. The World Bank suggested that small-scale sell-offs

start in the spring of 1998, followed by strategic sectors in the summer, and banks in 1999. In the Serb Republic some 400 firms will be sold, 55 percent of shares are to go to state-run privatization funds, 30 percent will be offered to citizens through a voucher scheme, and 15 percent to strategic investors for cash.

Bulgaria

Bulgaria will accelerate privatization and the liquidation of money-losing state enterprises in order to attract foreign investment, according to Prime Minister Ivan Kostov. Prime Minister Kostov also announced that the government plans to eliminate 30 percent of loss-suffering enterprises by the end of 1998 and will have closed 90 percent of such companies by the year 2001. The introduction of an IMF-backed currency board on July 1 marked the beginning of an increasingly confident economic and financial recovery after a 9.7 percent fall in GDP over the first half of 1997, according to the *Financial Times*. The currency board has played an important role by stabilizing the currency and permitting the re-monetization of an economy that had largely reverted to barter and black market trading. December-December inflation in 1998 is anticipated at 16-17 percent and GDP growth at 4 percent.

Czech Republic

Czech GDP for the first nine months of 1997 slowed to just 1.1 percent above the same period in 1996. The Czech economy is now expanding at its slowest rate since it returned to growth in 1994 and is slower than any other Central European economy. Consumer spending and corporate investment have declined, and government spending dropped. The 11-month trade deficit totaled 123.9 billion koruny (\$3.6 billion), compared with 140.1 billion koruny 1996, the Statistical Office reported. Imports

increased 12.8 percent year-on-year, while exports were up 19.1 percent. However, export growth was boosted by the weakened koruna and will be sustained in the longer term only if greater progress is made in industrial restructuring. London-based IBCA lowered the country's sovereign rating to BBB+ from A-, citing a slowdown in the restructuring of the Czech economy. Josef Tosovsky, the new caretaker prime minister, was head of the national bank before his appointment. He is expected to call for new elections in mid-1998. He promised to adhere to tight fiscal and monetary policies, similar to his deputy and close associate Pavel Kysilka, who has taken over temporarily at the central bank.

Hungary

The Hungarian economic boom is expected to accelerate until the turn of the century, but the country may have difficulty in achieving its inflation targets, according to the latest OECD study of Hungary. OECD analysts put GDP growth at 3 percent in 1997, 3.9 percent in 1998, and 4.2 percent in 1999. (The nine-month 1997 GDP was up 3.9 percent year-on-year, reflecting growth in investment and consumer spending.) The export increase is predicted to compensate for the expected boom in imports. Also, the country will continue to attract large amounts of foreign capital, because the return on investment ratio and market competition are improving. In 1997 the OECD expected the central budget deficit to account for 5 percent of GDP, and for 5.4 percent of GDP in 1998. The government may not be able to hit its inflation targets as they largely depend on wage outflows. The OECD forecasts inflation of 14.4 percent in 1998, in light of an agreement with employer organizations on a 13.5-16 percent wage increase.

Wage increases slowed the decline in inflation in 1997 and may jeopardize the 1998 inflation and exchange

rate targets, warned National Bank of Hungary Governor Gyorgy Suranyi. He called for self-restraint in Hungary's wage increases. The main monetary policy target for 1998 was to ensure that the decline in inflation was sustained in the next few years as Hungary prepares for EU and Monetary Union membership.

Hungary has leaped from fifth to first place on the list of Central European countries ranked by their investment worthiness, published annually in the Central European Economic Review. Poland ranks second, followed by Slovenia, the Czech Republic, and Estonia. Hungary received high grades for international integration, legal system, accessibility to investment, productivity, political stability, and fighting corruption, and lower grades in economic growth, price stability, and current account balance. The list is based on assessments by economic analysts from PlanEcon, Deutsche Morgan Grenfell, CSFB, HSBC, the Daiwa Research Institute, and WIW.

Poland

The revised 1998 budget draft sets the deficit target at 1.5 percent of GDP, down from the 1.6 percent set by the previous government. The revised draft also foresees subsidy cuts for state companies and indirect tax increases. The deficit is in line with the preferences of Finance Minister Leszek Balcerowicz and National Bank President Hanna Gronkiewicz-Waltz, who has said that a 1.5 percent deficit will allow a reduction in the zloty's devaluation rate to maintain anti-inflationary pressure while seeking to curb trade deficit growth. Poland's 1997 January-October trade deficit reached \$12.4 billion from \$9.7 billion in the same period in 1996, with imports surging by 12.6 percent against exports growth of 5.3 percent.

Romania

The government's failure to accelerate the privatization of enterprises and banks, implement the foreign investment law, start the land reform, and go ahead with the closing of loss-suffering industries provided criticism from a majority of domestic and foreign observers, who nevertheless agree that Victor Corbea's year-old government is much more reform-oriented than its predecessors. By the end of 1997 the government issued an emergency decree on the sale of state-owned companies in a bid to accelerate reforms and simplify the process. The new rules will become effective January 1, Privatization Minister Valentin Ionescu announced. The government still wants to maintain control of strategic enterprises, such as those in the aviation, energy, and telecommunications sectors. Out of the nation's 6,500 state-owned enterprises, those to be sold will most likely be the smaller ones—4,000 have assets of less than \$100,000. Romania's inflation rate forecast for 1997 is 120 percent. In recent months industrial output dropped, the trade deficit increased, and the leu's exchange rate declined 10 percent against the dollar.

Slovakia

Slovakia's state budget for 1998 anticipates real GDP growth of 5 percent and 12-month inflation of 6 percent. Expenditures are set at 184.8 billion crowns (\$5.4 billion) against revenues of 179.8 billion crowns. Parliament approved the budget on December 12. The resulting deficit is equivalent to just 0.4 percent of GDP, but excludes repayment of state debt principal, totaling 46 billion crowns. (The finance ministry has abandoned the accounting deficit method of calculating the deficit, which it used for the 1997 budget.) The January-November trade deficit increased to 43.9 billion

crowns (about \$1 billion), the Statistical Office reported on December 21. Eleven-month exports were up 9.9 percent year-on-year, while import growth was just 4.5 percent.

The country's third-largest bank, Investicna a Rozvojova Banka (IRB), is being placed under forced government administration because of severe liquidity problems. The bank suffered a 1.2-1.3 billion crown (\$35-38 million) loss in 1996. IRB argues that it did not receive compensation for losses that it incurred because the government forced it to provide a low-interest loan program to housing cooperatives and to provide housing for young couples. IRB's ownership structure is another factor behind the bank's difficulties: the steel producer VSZ is both a major shareholder and a significant debtor. The national bank will guarantee all deposits and draft a rehabilitation program.

Baltics and the Commonwealth of Independent States

Estonia, Latvia, and Lithuania agreed to abolish nontariff customs barriers and establish a joint economic area that would allow free movement of labor and services among the three countries and the creation of a joint border regime. During their end of November meeting in Riga the three prime ministers also signed a resolution that stresses the need to continue to cooperate in combating illegal immigration and to tighten control over the countries' eastern frontiers.

Baltic trade deficits deteriorated in 1997. Estonia's trade deficit for the first nine months increased to \$960 million, up from \$660 million in the first three quarters of 1996. Latvia showed an eight-month trade gap of \$600 million, up from \$480 million for the same period in 1996. In Lithuania the trade deficit grew to \$1.1 billion for the first eight months, up from \$640 million in the same period of 1996.

For 1997 Estonia's growth was expected to reach almost 10 percent. In the second quarter of 1997 Latvia's GDP increased by 6.5 percent and Lithuania's growth was a mere 2 percent, compared to the same period in 1996. Estonia's 1998 budget (passed by the parliament on December 17), targets a surplus of up to 54 million kroons (\$3.8 million). The budget surplus is intended to slow economic growth. The rapid GDP growth has been underpinned by a strong influx of foreign capital, mostly "hot money" as foreign direct investments fell as a proportion of the total from 80.3 percent in 1996 to 17.3 percent in 1997. Foreign capital inflow fueled a credit boom (credit volumes doubled in 1997), while the current account deficit reached 9.8 percent of GDP.

Azerbaijan

In Azerbaijan about 70 percent of enterprises are to be privatized by the end of 1998. Under a three-year privatization program, 15,000 small enterprises have been sold by auction. Under a mass privatization program, launched last March, 7.1 million voucher books—each containing four vouchers—were distributed among the citizens. In larger enterprises that have been converted into joint-stock companies 15 percent of shares are sold to the employees for vouchers, another 55 percent at open voucher auctions, and the remaining 30 percent in cash auctions in which foreigners may also participate. By the end of 1997 shares in 400 larger enterprises are expected to be sold (out of a total of some 2,000). Railroads, water facilities, historical and cultural monuments, pension funds, and the national bank are excluded from privatization. The President or the Council of Ministers can authorize the sale of fuel and energy production, petrochemicals, telecommunications, and bread- and wine-making (a nonvoting "golden share" is reserved for the state). The stock exchange and investment funds have yet to be established.

Experts estimate that private consortia will account for 75 percent of oil production by 2010.

Kazakhstan

Annual inflation in 1997 will not exceed 12 percent, according to the government. The National Statistics Agency reported that consumer prices increased by 9.8 percent from January to November 1997, compared with 24.8 percent in the same period in 1996.

About 73 percent of Kazaks live below the government-defined poverty line of \$50 per person a month, representatives of the International Federation of the Red Cross reported during a recent press conference in Almaty. The Red Cross's vulnerability study was conducted last February and March among households of seven representative regions. More than half of the respondents said that they were malnourished, while 11 percent of children in the republic were not attending school because they lacked adequate shoes and winter clothes.

Russia

President Boris Yeltsin launched a veiled attack against the radical reform wing of his government on December 26. "Today it is obvious to the majority of people that there are few noticeable successes in the economy," Mr. Yeltsin admitted. He said that the country's economic failures stemmed in part from the reformers' Marxist style of governance. "We haven't lost the habit of thinking in accordance with [communist] clichés and rules," Yeltsin noted. "Only party slogans have been replaced with economic ones. Instead of exhortations to build the Dnieper Power Dam or the Magnitka plant we called for 'privatization at any price.'"

The revised 1998 budget, which is headed for a third reading in the Duma

in January, outlines revenues of 367.5 billion rubles (\$57 billion) and expenditures of 499.9 billion rubles (\$78 billion). These amounts are in redenominated rubles—as of 1998 one new ruble equals one thousand current rubles. The projected budget deficit still remains at about 4.8 percent of GDP, and inflation for 1998 is estimated at 5.7 percent. The government has proposed that the new tax code be approved in stages so that changes in personal income tax policy could be implemented at the turn of the year, followed by the new value-added tax (VAT) and profit tax in July 1998. (In the first nine months of 1997 Russia's tax service collected 172.1 trillion rubles (\$29 billion) in taxes, which meant that revenues were running at only 52 percent of budget. Around 30 percent of enterprises are in arrears to the federal budget.

The credit ratings agency Standard & Poor's downgraded its outlook for Russian sovereign debt from "stable" to "negative" on December 19. Gross government debt as of November was 56 percent of GDP. Based on official Russian data, this comprised a gross external debt of \$143.8 billion; domestic debt of just over \$60 billion, mostly in treasury bills; and payments due to state employees and suppliers totaling around \$44 billion (converted according to the market exchange rate, not purchasing power parity). GDP in 1997 is likely to be around \$445 billion at the prevailing exchange rate.

In November foreign investors moved to repatriate some \$4 billion in ruble-denominated debt, forcing the central bank to spend more than \$1 billion of reserves to offset the heavy demand for dollars, according to central bank estimates. Foreigners own around \$20 billion of government securities, compared with reserves of \$21 billion at the bank's disposal, and the stock market has declined about 40

percent since early October. The government was forced to raise interest rates on treasury bills to 28 percent in order to attract and keep investors. The bills are key because they help to cover growing budget deficits. But rising interest rates have put even more debt-service pressure on a government that has already borrowed heavily and collects only about half the taxes it is owed.

Russian workers are experiencing the worst conditions since the 1920s, Bill Jordan, the secretary-general of the International Confederation of Free Trade Unions, told a news conference in Moscow at the end of November. He noted that 40 percent of workers (32 million) did not receive their October wages and that only 25 percent of workers (20 million) are paid on time and in full. Twenty million Russian workers are owed 54,000 billion rubles (\$9.1 billion) in back wages. Jordan said that people have not been paid for a year in parts of Russia, and about 10 million workers are now paid with items ranging from canned pineapples, to manure, to meat grinders, to coffins. The bulk of back wages is owed by private companies, many of which are loss-suffering and mired in interenterprise debt.

The number of Russians with incomes lower than the subsistence level rose during September from 31.9 million to 33 million, and their share in the population rose from 21.6 percent to 22.4 percent, according to data from the Russian State Statistics Committee. The average monthly subsistence level in Russia dropped to 407 thousand rubles in September 1997, as against 413 thousand rubles (\$71). Sergei Kalashnikov, a former sociologist who heads the Duma's Labor Committee, argues that the real income of those living below the poverty line continued to shrink from January to August 1997. There are six million ric—defined as those with annual incomes in excess of

55 million rubles (\$10,000). The status of the 110 million middle-income Russians is also precarious. Kalashnikov suggests that 20 million of them could fall below the poverty line if the government's planned increases in rent and utility charges are implemented.

Russia's population shrunk by nearly 300,000 in eight months. There were 147.2 million as of September 1, 1997, compared with 147.5 million at the beginning of the year, the State Statistics Committee reported. Since the beginning of the year the natural decrease in the population (the difference between the number of deaths and births) reached half a million, while the population increased by 200,000 through migration.

Early in November George Soros, the Hungarian-born investor-philanthropist, pledged to donate \$500 million to needy Russian health and education programs over the next three years. Soros, who has already poured \$260 million into Russia since 1994, will now be sending more foreign aid to the country than the U.S. government. Soros has amassed a \$5 billion personal fortune trading currencies, and he has significant business investments in Russia. He has given \$1.5 billion to humanitarian projects worldwide, and wants to put more Western publications in Russian libraries and hook up more schools and hospitals to the Internet. He plans to set up training programs for business managers, lawyers, and local government officials. In addition, Soros has begun consulting with U.S. health officials on funding tuberculosis treatment and the decrepit prison system in Russia's provinces.

Russia is expected to increase net grain output to 76-82 million metric tons, around 15 percent more than in 1996. While still below the 1991-95 average, it is a welcome sign considering that grain production has contracted 40

percent in this decade. Earlier, the Duma criticized the government's agricultural policies, claiming that the rise in the costs of industrial inputs needed in agriculture had outstripped the rise in agricultural producer prices many times. Because of this about 70 percent of farms were forced into bankruptcy, about 18 million hectares of farmland were fallow, crop yields were 50 percent of their previous level, and around half of the country's food needs were now being met by imports.

President Yeltsin proposes compromise for privatizing rural land. Yeltsin, in a meeting with parliamentary leaders on December 26, proposed a free market for land in urban areas and a tightly controlled system for selling land in rural areas, including a ban on selling agricultural land to foreigners and a provision mandating the buyer to use the land for farming for an unspecified period. Lawmakers agreed to form a working committee to revise the recently adopted land code that aims at preventing investors from buying up large chunks of land, but also thwarts the owner to sell or mortgage land. Many farmers are also wary of privatizing rural lands.

Turkmenistan

The gas-rich Central Asian country, Turkmenistan, has become the second state in the region after oil-rich Kazakhstan to win sovereign rating (B-2) by Moody's Investors Service. Turkmenistan's reserves of natural gas are estimated at 21 trillion cubic meters. In March Turkmenistan expects to announce the results of tenders issued in September for eight of its 30 oil and gas fields in the Caspian Sea. Results in Turkmenistan's economically important agricultural sector have been disappointing: grain harvests amounted to 639,000 tons and cotton harvests, 620,000 tons, compared with projected figures of 1.2 million tons of grain and

1.4 million tons of cotton. In the 1998 state budget revenues are set at 6.4 trillion manat (\$1.5 billion) and expenditures at 6.6 billion manat (\$1.58 billion). The budget deficit is not expected to exceed 1.4 percent of GDP.

Ukraine

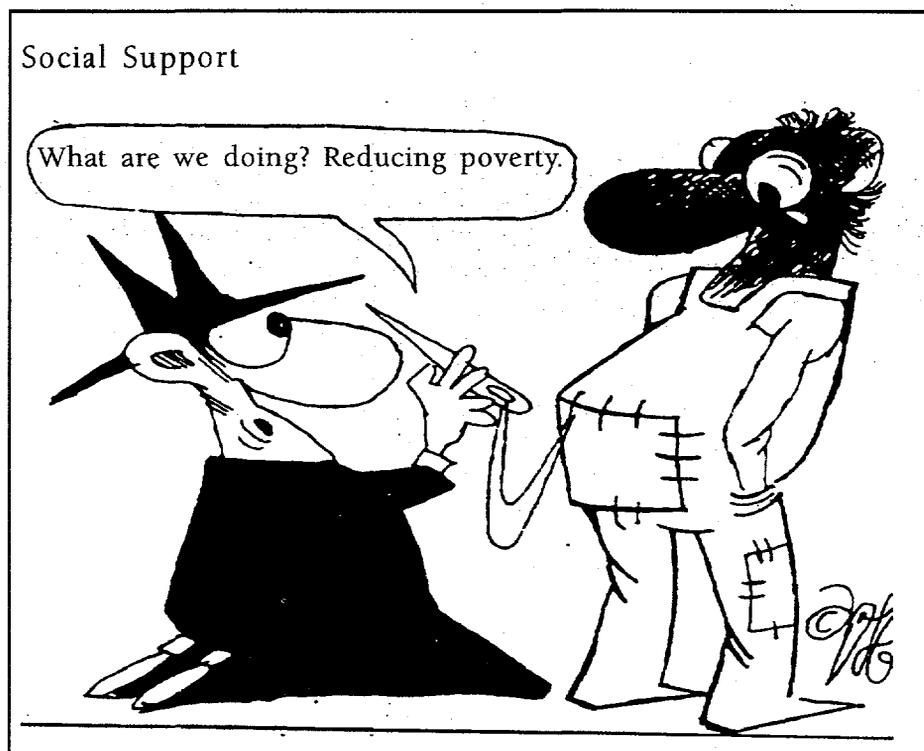
The government has received only 60 percent of annual budget revenues through October, while GDP declined by more than 4 percent. At the same time, the State Property Fund has collected only 198 million hryvnya of the 500 million it was required to channel to the state budget by the end of 1997. On December 17 the government confirmed that it will sell treasury debt worth 750 million hryvnya (\$395 million) to help finance the 1997 budget deficit (targeted at 5.5 percent of the GNP). The debt will be issued in two tranches, with foreign sales handled by Merrill Lynch International and domestic sales handled through the First Investment Bank. The Central Bank raised its discount rate to

35 percent to avoid currency devaluation and prevent a run on the treasury bills. Foreign companies hold half of Ukraine's 6 billion T-bills. *Vlodymir Lanovyi*, the acting head of the Ukrainian State Property Fund, said that Kyiv will sell major state-owned industrial firms for cash rather than use vouchers. At the end of November the IMF released an additional \$103 million to help support Ukraine's currency.

China

China is willing to slice the average tariff imposed on imported goods by more than half by 2005. Chinese officials said that the tariff reductions, from a current average rate of between 23 percent and 26 percent to 10 percent, would be done in the context of negotiations over China's terms of entry to the World Trade Organization. During his 1997 trip to the United States, Chinese President Jiang Zemin noted that total foreign capital invested in the country so far exceeds \$200 billion.

Social Support



From the Kazakh weekly *Asia: Economy and Life*

China's financial regulators are considering broad liberalization of the domestic foreign exchange market in 1998. The package would increase the number of financial products traded and give domestic companies greater responsibility for risk management. Under a proposal now before the central bank, forward contracts on the yuan would be introduced and regulations eased governing the amount of foreign currency that state-owned commercial banks and foreign trade companies are allowed to hold.

Vietnam

Vietnam's government is expected to introduce new incentives for foreign investors in the new year. The following measures are expected: tax breaks for investment in machinery or equipment manufacturing and in the transport sector; lower import taxes; land rents to be slashed by 25 percent; and foreign companies will be able to sell shares and issue bonds, thus raising capital domestically.

However, in oil and gas exploration and in the telecoms sector, western businesses will still be required to sign cooperation contracts, and foreign manufacturers of consumer electronics, detergents, garments, footwear, and some building materials will still be required to export at least 80 percent of their production in order to protect Vietnamese producers. According to the latest official statistics, the planning and investment ministry licensed 288 new projects in the January-November period, with total investment capital of \$5 billion, compared with \$8.8 billion worth of foreign investment approved in 1996.

We appreciate the contributions from the RFE/RFL Service, in particular from Viktor Luhovyk, Stuart Parrott, Stefan Korshak, Stephanie Baker, Michael Wyzan, and Floriana Fossato.

World Bank/IMF Agenda

World Bank Support to Russia: \$800 Million Structural Adjustment Loan...

On December 18 the World Bank approved two loans totaling \$1.6 billion for reforms in Russia. Since Russia joined the World Bank in June 1992, Bank commitments have amounted to almost \$10 billion for 39 projects. The \$800 million structural adjustment loan will focus on restructuring electricity, gas, and railway services (the natural monopolies); developing urban land and real estate markets; improving tax collection; enabling banks to efficiently mediate savings into investments; improving bank regulation and supervision as well as reforming money markets and payment systems; and further liberalizing Russia's foreign trade and investment trade regime.

...and Another Coal Loan Worth \$800 Million

The World Bank's \$800 million coal sector adjustment loan will help the government to liquidate Rosugol, the national coal company, privatize viable coal companies (accounting for 45 percent of coal production), continue to reduce coal subsidies, close mines, and provide a social safety net for affected workers and their families. Economics Minister Yakov Urinson announced that 86 out of some 200 coal mines in Russia will be shut down in 1998 and he promised social support to employees of those mines.

Officials in Moscow vowed that the money will reach its intended recipients this time around, according to the *Moscow Times*. The *Times* reminded readers that some funds transferred from the World Bank's first \$500 million coal loan, approved in 1996, never reached the intended beneficiaries. (As

Transition wrote in February 1997, "the Bank's verification missions, sent to three major coal basins—Kuzbass, Rostov, and Tula—reported that not all the funds trickled down through the bureaucracy to reach the intended recipients, housing and public utilities of the coal communities.") Deputy Minister for Fuel and Energy Igor Kozhukhovskii acknowledged that some 30 percent of government funds earmarked for the coal industry have been misappropriated. He also said in mid-December that wage arrears to coal miners totaled 3.5 trillion rubles (\$590 million) as of December 1 and overall debts to coal mines reached 9 trillion rubles. Energy producers owe the most debt as 90 percent of the coal is consumed by power plants. Line Minister Sergei Kiriyenko promised to introduce a system of tough controls, including the use of payment certificates to miners, to prevent the diversion of funds. But he also hinted that the distribution of state funds to the coal sector will continue to be carried out by Rosugol.

IMF Traffic Light Turns Green

Under an agreement with Russia, reached on December 12, the International Monetary Fund will proceed with the next \$700 million installment of a three-year \$10.1 billion loan in January, a month ahead of schedule. The Fund suspended further disbursements last October after Russia had drawn down about \$5 billion of the loan. The Fund said that Russia had failed to meet key conditions, chiefly the collection of taxes. But now Russia is making new efforts to improve its tax collection, cut government payroll, and establish a new Treasury system that will give the finance ministry authority over the budgets of powerful ministries, such as the interior and defense.

Donor Pledges to Georgia, Armenia, Moldova

In mid-December 1997, the World Bank hosted a series of Consultative Group Meetings in Paris with officials from Georgia, Armenia, and Moldova. Representatives of donor countries and international organizations met separately with high ranking government officials of the three countries. Assistance commitments were made at the meetings to meet the external financing requirements of the three countries in 1998.

- In Armenia 1997 was the fourth consecutive year of GDP growth. Real GDP growth is expected to reach 5.2 percent in 1998. Inflation is targeted at 9 percent for 1998 as well. The current account deficit is estimated to slightly increase to about \$420 million, despite projected export growth of more than 10 percent. The World Bank on December 11 approved a \$20 million social investment fund to Georgia that will help mobilize resources for microprojects related to water supply, irrigation, roads, and schools in approximately 400 communities. (Since it joined the World Bank in 1992 and IDA in 1993, commitments to Georgia reached \$366 million for 14 projects).

- The current account deficit of Armenia (excluding official transfers) is expected to decrease from 27 percent of GDP in 1997 to 22 percent of GDP in 1998. External financing requirements for 1998 are likely to be around \$400 million, down from about \$500 million in 1997. In mid-December the Bank approved a \$15 million credit that will improve the financing and management of Armenia's school system. (Since Armenia joined the Bank in 1992 and IDA in 1993, commitments totaled \$355 million for 15 projects.)

- The Consultative Group for Moldova confirmed their continued support for that country's financial stabilization and

structural reform program. The Government has embarked on an ambitious extension of the reform program, anchored by the privatization of the agriculture and energy sectors, and reform of the social sector, notably the pension system. The Government expected the decline in GDP to stop in 1997 and experienced a modest growth of 3 percent in 1998, increasing to about 5 percent over the medium term. The World Bank indicated plans to commit up to \$300 million over the next three years, of which over half would be IDA credits.

\$2.4 Billion Aid to Vietnam

Vietnam's international donors, during their December 11-12, 1997 meeting in Tokyo, chaired by World Bank Vietnam Country Director Andrew Steer, pledged a total of \$2.4 billion in aid for 1998. The expected 1998 reform of trade, state enterprises, and the financial sector justify high levels of assistance, the participants pointed out. In order to achieve an annual growth rate of 9-10 percent, Vietnam needs to effectively utilize its labor force, private sector, and stable macroeconomic environment, and adhere to an outward-oriented, competitive, and labor-absorbing growth strategy, the donors suggested.

Supporting Romania's Land Market

On December 9, 1997 the World Bank approved a \$25.5 million loan to Romania to finance the General Cadastre and Land Registration. The project seeks to provide secure land ownership rights, facilitating land transactions, and helping to consolidate economically inefficient farms. Since Romania joined the World Bank in 1972, Bank commitments have totaled more than \$4.8 billion for 52 projects.

Post-Conflict Aid to Tajikistan

On December 16 the World Bank approved a \$10 million Post-Conflict Rehabilitation

Credit for Tajikistan. The government will use the loan to reduce the arrears for the social safety net and to finance the resettlement of refugees, internally displaced persons, and demobilized soldiers. (In June the government signed a peace deal with the United Islamist Opposition to end more than four years of civil war.) Tajikistan received \$56 million in pledges at the Vienna, Austria international donor conference, which was attended by representatives from 40 countries. This money will also be used for post-conflict rehabilitation of the economy.

IMF Supplemental Reserve Facility

On December 22 the IMF approved the Supplemental Reserve Facility (SRF) as a new mechanism to disburse assistance to countries undergoing acute financial crises. The facility would provide financial assistance to members experiencing exceptional balance of payments difficulties due to massive short-term financing as a result of a major loss of market confidence. Financing under the SRF will be available immediately, but repayment will also be faster—within one to one and a half years of the date of each disbursement and costlier—3 percent above the average IMF rate on loans of 4.7 percent. The IMF has the authority to extend the repayment period by up to one year.

IMF Releases Tranche for Bulgaria

On December 16, 1997 the IMF released the fourth \$80 million installment of a stand-by loan to Bulgaria, approved in April. Some \$160 million remains to be released. The loan agreement is valid until June 1998. On December 17 IMF Resident Representative Peter Stella praised the Bulgarian government for the successful implementation of its currency board, saying that it was now important to sustain the momentum of stabilization and persevere with structural reform. He told a news conference

that the IMF would like to see the country's privatization program move forward, and he believed it was natural to link it to a timetable. On October 30 the World Bank approved a \$100 million loan to help cover Sofia's balance of payments shortfall.

International Finance Corporation Invests in Sofia Hilton

The World Bank's International Finance Corporation (IFC), together with a group of international investors, will finance a new hotel in Bulgaria's capital, Sofia. The financing consists of up to \$12.8 million in IFC loans and a syndicated loan of up to \$9.5 million.

Joint Efforts to Help Albania Recover

On December 9 the World Bank approved two IDA credits, one for \$25 million and the other for \$5 million, to help Albania dismantle the pyramid schemes, reform banks, and increase and improve unemployment benefits and other social services. Since Albania joined IDA in 1993, IDA commitments to that country totaled \$273 million for 20 projects. Earlier, the IMF approved emergency post-conflict aid of around \$12 million.

The government's 1998 economic program aims at 12 percent real growth and 15-20 percent inflation. Privatization will be the main focus of a three-year agreement with the IMF that is to be signed in the spring, Prime Minister Fatos Nano said during his visit to London. In the first half of 1998 the legal framework for large-scale privatization would be completed, while some state enterprises would be restructured in preparation for sale. In another development, Albania signed a \$250 million deal with the IFC and a consortium of western firms to boost production at the Patos Merinze oilfield.

Donors' Enlarged Aid Package to Mongolia

Donor countries and international organizations pledged \$250 million in a new aid package for Mongolia in a strong message of support for its market economy reforms. The World Bank and Japan cochaired the meeting of the Mongolia Assistance Group. The aid package for 1997 was \$212 million.

World Bank Continues Loans to China

To ensure healthy, long-term growth of the economy, China should improve its fiscal and pension systems, reform its state-owned enterprises, and commercialize its state-owned banks, World Bank Country Director Yukon Huang pointed out. He confirmed that the Bank will continue to lend China between \$2.5 and \$3 billion each year to support economic reforms.

Croatia Does Not Need IMF Money

As of 1998 Croatia will undergo IMF monitoring, take technical assistance, but refrain from drawing further loans from the Fund, National Bank Governor Marko Skreb announced. The Croat government didn't draw the second and third tranches (totaling \$78 million) of its \$486 million, three-year IMF Extended Fund Facility (EFF).

The EFF, designed to support structural reform (especially in the financial sector), was awarded in March 1997, suspended for months, and made available again after 10 Bosnian Croats voluntarily surrendered to the Hague war crimes tribunal. Croatia claims that it will not need the IMF loans because it has ample foreign reserves (\$4.4 billion). According to an IMF delegation recently returned from Croatia, the country's real GDP can grow as much as 5.5 percent in 1997.

World Bank Credit to Bosnia and Herzegovina

On December 23, 1997, the World Bank approved two credits for Bosnia and Herzegovina. The first credit of \$10 million will support the reconstruction of the Natural Gas System of Sarajevo; the second credit of \$17 million will support basic reconstruction investments in Republika Srpska in the agriculture, housing, water and sanitation, and electric power sectors. In other news, the Moslem-Croat federation government is to liquidate the biggest prewar state bank after legislation on banking reform has been adopted by parliament. Privredna Banka Sarajevo is burdened with a prewar debt amounting to \$1.6 million and is considered insolvent by international standards.

IMF 1998 Growth Forecast Has Shrunk a Bit

Asia's financial crisis threatens to put a damper on global growth, the IMF said in its interim *World Economic Outlook*, published last December. Overall world output however would still grow by 3.5 percent in 1998, 0.8 percent below the IMF's previous forecast last October.

Transition countries (Central and Eastern Europe (CEE), Russia, the Transcaucasus, and Central Asia) will grow by an average 3.3 percent in 1998, 0.8 percent less than projected last October. (The CEE, without Ukraine and Belarus, can achieve an average 4.3 percent growth rate, 0.4 percent more than projected in October. That was the only country group that merited a "growth-upgrade" from the IMF, despite the South Asian crisis.) China's growth in 1998 will reach 8.8 percent, 0.7 percent less than projected last October, according to the IMF forecast.

Conference Diary

For the Record

Meeting of the ECPD Permanent Study Group on Privatization

October 24-25, 1997, Sveti Stefan, Federal Republic of Yugoslavia

Organized and sponsored by the European Center for Peace and Development (ECPD) of the University for Peace, established by the United Nations. The meeting, attended by some 20 participants, aimed to take stock of what privatization achieved in the Eastern European countries, including the Federal Republic of Yugoslavia. Minimizing the social costs of privatization is a primary concern in assessing the advantages and disadvantages of different methods of privatization. More research is needed in order to arrive at reliable comparative indicators of the relative efficiency of privatized firms.

The short-term results of privatization could differ significantly from longer-term results, partly depending on the rate of progress of institution building. The functioning of both the capital market and of monitoring and regulatory institutions is decisive. Participants agreed that strengthening corporate governance was an indispensable adjunct to and prerequisite of successful privatization.

Information: Ms. Gordana Hofmann, ECPD, Terazije 41, 11000 Belgrade, tel. 38-11-324-6041, fax 3811-324-0673, Email: ecpol@afrodita.rcub.bg.ac.yu

Serbs and Albanians—The Struggle over Kosovo

November 19, 1997, Washington, D.C., United States

Information: Marvin Center, Room 405, 800 21st Street, NW, Washington, D.C. 20052, or Elliott School of International Affairs, George Washington University, 2013 G Street NW, Suite 402F, Washing-

ton, D.C. 20052, tel. 202-994-7099, fax 202-994-5436.

Forthcoming

Russia-China-Central Asia: From Geopolitics to Geo-Economics in Eurasia

January 23, 1998, Reading, United Kingdom

Organizers: Centre for Euro-Asian Studies, University of Reading.

Language: English.

Topics: Geopolitical trends; international security and regional conflicts; economic trends, trade patterns, and business interests; dynamics of relations between Russia, China, Central Asia, and the West.

Information: Nicholas Tucker, Administrator, The Centre for Euro-Asian Studies, GSEIS, The University of Reading, Whiteknights, P.O. Box 218, Reading, RG6 6AA United Kingdom, tel. 44-118-9316637-20, fax 44-118-9755442, Email: cpss@reading.ac.uk

The Widening of the EU toward Central, Southeastern, and Eastern Europe

February 20-22, 1998, Lubeck-Travemunde, Germany

Organizer: Ostsee Akademie.

Language: German.

Information: Dr. Jorg Hackman, Ostsee-

Akademie Travemunde, Europaweg 3, D-23570 Lubeck, Germany, tel. 49-4502-803206, fax 49-4502-803200, Email: ostseeakademie@tonline.de

City Marketing as a Way to Investments and Common Projects

February 26-28, 1998, St. Petersburg, Russia

Organizer: Institute Eurograd.

Information: Boris Grintchel, Institute Eurograd, Izmailovsky, 14, St. Petersburg, Russia, tel. 7-812-112-6478, fax 7-812-112-6506, Email: root@eimi.spb.ru

Active Towns: Strategy and Marketing to Increase Competitiveness

April 20-22, 1998, St. Petersburg, Russia

Organizer: Institute Eurograd.

Information: Boris Grintchel, Institute Eurograd, Izmailovsky, 14, St. Petersburg, Russia, tel. 7-812-112-6478, fax 7-812-112-6506, Email: root@eimi.spb.ru

International Conference on Privatization, Corporate Governance, and the Emergence of Markets in Central and Eastern Europe

May 22-23, 1998, Berlin, Germany

Information: Eckehard F. Rosenbaum, Frankfurt Institute for Transformation



"I want plastic surgery. I look too honest for anyone to bribe me."

From the Hungarian daily *Nepszabadsag*

Studies, European University Viadrina, P.O. Box 776, D-15207 Frankfurt (Oder), Germany, fax 0335-5534-807, Email: erosen@euv-frankfurt-o.de

Investment Climate of Towns and Regions

May 28-30, 1998, St. Petersburg, Russia

Organizer: Institute Eurograd.

Information: Boris Grintchel, Institute Eurograd, Izmailovsky, 14, St. Petersburg, Russia, tel. 7-812-112-6478, fax 7-812-112-6506, Email: root@eimi.spb.ru

International Conference: Finance of Ukraine

May 1998, Dnipropetrovsk, Ukraine

Organizer: International Program Committee.

Topics: Banks and banking, investment activity, public finance.

Information: Dnipropetrovsk State University DSU, Nauchmuy per. 13, Dnipropetrovsk, 320625, Ukraine, tel. 380-562-766098.

Petrochemical and Chemicals Industry of the Former USSR

June 4, 1998, Houston, Texas, United States

Organizers: Integrated Strategies, California, in conjunction with the CE Expo and hosted by McGraw Hill, publishers of *Chemical Engineering Magazine* and *Engineering News and Record Magazine*.

Information: Gordon Feller, Integrated Strategies, California, USA Office, tel. 415-491-4233, Email: june4-conference@mailexcite.com or gordonf@pacbell.net

International Environmental Law—A Comparison between Poland, the Czech Republic, and Germany in the Field of Waste and Soil Preservation Law

June 15-17, 1998, St. Marienthal, D-02889 Ostritz, Germany (Train Station: Krzewina Zgorzelecka, Poland)

Organizers: International Graduate School, Faculty of Economics, Association for International and Interdisciplinary Management, Saxonian Ministry of the Environment and Spatial Development.

Topic: Development and perspectives of current and future laws and jurisdiction. Call for papers: Applications for lectures or presentations are welcome.

Information: Dipl.-Kfm. Christian Brauweiler, IHI Zittau, Markt 23, C-02763 Zittau, Germany, tel. 49-3583-771531, fax 49-3583-771535, Email: cbrauweiler@ihi.htw-zittau.de

Fourth Annual Conference: Convergence or Divergence—Aspirations and Reality in Central and Eastern Europe and Russia

June 23-24, 1998, Buckinghamshire, United Kingdom

Organizer: Buckinghamshire Business School-Centre for Research into East European Business (CREEB).

Call for papers: Deadline February 23, 1998.

Information: Margaret Levell, CREEB, Buckinghamshire Business School, Buckinghamshire University College, Newland Park, Gorelands Lane, Chalfont St. Giles, Bucks, HP8 4AD, United Kingdom, tel. 44-1494-603159, fax 44-1494-874230, Email: creeb@buckscol.ac.uk; Internet: <http://www.buckscol.ac.uk>

Regional Economies in Transition: Institutional Development and Socio-Economic Change (session at the 38th European Congress of the Regional Science Association)

August 28-September 1, 1998, Vienna, Austria

Organizer: Norwegian School of Economics and Administration, University of Bergen.

Call for papers: Work in progress on conceptual issues (for example, the interface between new economic geography and transition processes) is especially

welcome.

Deadline: December 20, 1997.

Information: Roger Bivand, Joint Department of Geography, University of Bergen and Norwegian School of Economics and Business Administration, Breiviken 2, N-5035 Bergen-Sandviken, Norway, tel. 47-55-959355, fax 47-55-959393, Email: ersa-vienna@wu-wien.ac.at or Roger.Bivand@geog.uib.no, Internet: <http://www.wu-wien.ac.at/ersa/ersa98.html>

5th Conference of the European Association for Comparative Economic Studies: Economies in Transition and the Varieties of Capitalism: Features, Changes, Convergence

September 10-12, 1998, Varna, Bulgaria

Organizers: ROSES-University of Paris, Institute of Economics, Sofia, Bulgaria.

Topics: Distinctive general features of the varieties of capitalism—"From Capitalism to Capitalism"—the change of different models/types of capitalism; "From Transitional Economies to Capitalism"—the change of economic systems; and cooperation and integration of capitalism and economies.

Call for papers: Deadline March 1, 1998. *Information: Professor Wladimir Andreff, ROSES, University Paris I, 106-112, Boulevard de l'Hopital, F-75013 Paris, France, fax 33-1-45847889; or Professor Mitko Dimitrov, Institute of Economics, BAS, 3, Aksakov Street, BG-1040 Sofia, Bulgaria, fax 359-2882108.*

Financing Strategies for Investment Projects in the CIS in Environmental Protection and Regenerative Energy

September 25-27, 1998, Lubeck-Travemunde, Germany

Organizer: Ostsee Akademie.

Language: German.

Information: Dr. Jorg Hackman, Ostsee-Akademie Travemunde, Europaweg 3, D-23570 Lubeck, Germany, tel. 49-4502-803200, Email: ostseeakademie@tonline.de

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Discussion Papers

Csaba Csaki and Zvi Lerman, **Land Reform in Ukraine: The First Five Years**, Discussion Paper 371, August 1997, 100 p.

Working Papers

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Other Publications

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IMF Publications

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Working Papers

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Mark De Broeck, Kornelia Krajnyak, and Henri Lorie, **Explaining and Forecasting the Velocity of Money in Transition Economies, with Special Reference to the Baltics, Russia, and Other Countries of the**

Former Soviet Union, Working Paper 98/108, September 1997, 46 p.

Vito Tanzi, **The Changing Role of the State in the Economy: A Historical Perspective**, Working Paper 97/114, September 1997, 28 p.

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Paul R. Masson, Miguel A. Savastano, and Sunil Sharma, **The Scope for Inflation Targeting in Developing Countries**, Working Paper 97/130, October 1997, 53 p.

Stefano Manzocchi, **External Finance and Foreign Debt in Central and Eastern European Countries**, Working Paper 97/134, October 1997, 28 p.

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To order: Asian Development Bank, P.O. Box 789, 0980 Manila, Philippines.

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Anke van de Waal, **Personal Development and Transformation for Russian Business Managers**, November 1997, 100 p.

Pyotr Joannevich van de Waal-Palms, **Understanding Russian Banking**, Mossbusinessbank, Promstroibank, Bank Saint Petersburg, and Petrovsky Bank, November 1997, 300 p.

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To order: Katholieke Universiteit Leuven, Ch. Deberiotstraat 34, 3000 Leuven, tel. 32-16-326-598, fax 32-16-326-599.

Marvin Jackson, **Restructuring or Structural Change in Industry of Transition Countries: A Review of Issues**, Working Paper 63, 1997, 24 p.

Marvin Jackson and Alexander Repkin, **A Comparison of Structural Changes Among the Branches of Industry in Seven Transition Countries [Bulgaria, Czech Republic, Hungary, Poland, Ro-**

mania, Slovakia, and Slovenia], Working Paper 64, 1997, 52 p.

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Law Drafting and Regulatory Management in Central and Eastern Europe [Albania, Bulgaria, Estonia, Lithuania, Slovakia, and Slovenia] 18, 1997, 207 p.

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Alena Zemplerova, **The Role of Foreign Enterprises in the Privatization and Restructuring of the Czech Economy**, WIIW 238, June 1997, 38 p.

Peter Havlik and others, **Transition Countries Outlook Faltering in 1997: Some Stumble and Recover, Some Have Problems Ahead**, WIIW 239, July 1997, 65 p.

Almost a decade since the start of reforms, the transition economies are still fragile. Trouble hit the Czech Republic early in 1997 and devaluation of the Slovak currency appears inevitable. Poland could confront similar dilemmas in 1998. Only Hungary and Slovenia display accelerating economic growth. On average, the economies of the five Central and Eastern European (CEE) countries are expected to grow well below 5 percent a year, and the process of catching up with Western Europe will be slower. With Bulgaria and Romania dramatically falling back, average GDP growth for the CEE-7 was projected to drop by some 2 percentage points in 1997, to recover only in 1998. Economic recovery was once more delayed in Russia and Ukraine, and government finances in

both countries are in a precarious state. An almost decade-long economic decline is finally coming to an end in both countries.

The main challenge to faster economic growth in the region lies in the heavily constrained external positions. The deteriorating cost competitiveness, coupled with the generally sluggish demand in Western Europe, clouds the prospects for export-led growth. In contrast to the first years of recovery after 1993, it is now predominantly domestic absorption that affects the economic performance of the transition countries. With the possible exception of Hungary, private consumption and investment have been the main determinants of recent economic performance: in the contracting economies of Bulgaria and Romania demand plunged in early 1997, while it boomed in Poland and Slovakia. The more advanced CEE countries have a good chance of becoming normally functioning European market economies in the medium term, while the outlook for southeast Europe, the Balkans, and the CIS countries (including Russia) is more bleak.

Kazimierz Laski, **Macroeconomic Problems of Trade Liberalization and EU Eastern Enlargement**, WIIW 241, September 1997, 33 p.

The abrupt liberalization of foreign trade exposed the transition economies' weak competitiveness and was responsible for a large part of the sharp economic decline at the beginning of the transformation. It was also the main cause of an unsustainable import surplus in many transforming countries. To ease difficulties in foreign trade, government can intervene either by supporting the expansion of export capacity or by encouraging domestic savings. The role of capital inflows in financing the balance of trade and the current account deficit is obvious. However, capital inflows, especially

the speculative kind, may also be a factor in destabilizing the economy. CEE countries can avoid problems related to real appreciation and the potential loss of competitiveness at the time of their accession to the EU by maintaining the autonomous exchange rate policy.

Josef Fallinger, **Growth, Distribution and Employment**, WIIW 242, October 1997, 17 p.

If inequality is not mitigated by public redistributive measures, it can lead to political instability, which has a negative impact on investments and growth. If inherited wealth does not correspond to inherited skills, and if the funding opportunities open to the wealthy are better than those open to the skilled, the market will not allocate efficiently.

Political economics and market imperfections explain the negative relationship between inequality and growth. Another explanation is based on the change in demand, investment, and innovation, determined by the structure of anticipated demand. The development of demand, however, usually depends on income distribution. Distribution thus influences, through demand, the process of investment and innovation. Establishing new businesses will entail major investment costs, and a large group of consumers (a less elitist distribution) would simplify the amortization of the investment. Redistribution that levies taxes on wealthier employees in order to subsidize the training of poorer employees leads to more training and higher employment; both the rate of growth and the level of employment will then rise.

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Olga Alexandrova and Heinz Timmermann, **Rusland-Belarus-GUS: Integrationsbestrebungen und Desintegrationstendenzen**, 30, 1997, 27 p.

Roland Gotz, **Wirtschaftswachstum in Russland: Faktoren und Perspektiven**, 32, 1997, 41 p.

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Hans-Hermann Hohmann, Christian Meier, and Heinz Timmermann, **Russia and Germany in Europe: Recent Trends of Political and Economic Relations**, 38, 1997, 36 p.

Other Publications

Economies in Transition: Eastern Europe and the Former Soviet Union—Regional Overview, Country Forecast, The Economist Intelligence Unit, 1997, 53 p.

To order: The Economist Intelligence Unit, Client Relations, 15 Regent Street, London SW1Y 4LR, United Kingdom, tel. 44-171-830-1007, fax 44-1708-371-850, Email: london@eiu.com

Václav Hoffmann, Jaroslav Jirásek, Milan Kubr, and Zbynek Pitra, **Czech Manager: In the Process of Transformation**, National Training Fund, Prague 1996, 28 p.

Ethan B. Kapstein and Michael Mandelbaum (eds.), **Sustaining the**

Transition: The Social Safety Net in Postcommunist Europe, Council on Foreign Relations, New York, 1997, 198 p.

To order: Council on Foreign Relations, 58 East 68th Street, New York, New York 10021, United States, tel. 800-275-1447.

Danijela Kulis and Zarko Miljenovic, **Estimate of Revenues from the Value-Added Tax in the Republic of Croatia**, Occasional Paper 2, October 1997, 20 p.

Croatia is to introduce the value-added tax (VAT) on January 1, 1998. This research project estimated VAT revenues. Based on comparisons with countries with a single rate similar to that of Croatia (Denmark, 22 percent and Norway, 20 percent) and a similar base to that of Croatia (all goods and services), the study estimated VAT revenues at about 10 percent of Croatia's GDP. Revenues from indirect taxation are expected to decline after the introduction of the VAT. In recent years the sales tax has been yielding about 13 percent of GDP.

To order: Institute of Public Finance, Katanciceva 5, 10000 Zagreb, Croatia, tel. 385-1-433-006, fax 385-1-277-089, Email: ured@ijf.hr

Marek Lubinski (ed.), **Poland: International Economic Report 1996/1997**, World Economy Research Institute, Poland, 1997, 240 p.

To order: World Economy Research Institute, Rakowiecka 24, 02-554 Warsaw, Poland, tel. 4822-49-12-51, fax 4822-48-91-32.

Bradley J. Rorem and Renee Giovarelli, **Agrarian Reform in the Russian Far East**, RDI Reports on Foreign Aid and Development 95, Rural Development Institute, United States, October 1997, 44 p.

Agrarian reform in the Russian Far East has brought about the successful introduction of a market for a land shares leasing

scheme. Some land share owners receive supplementary income from the lease, but the majority have not yet tested the market. Landowners operate under the threat that their land will be confiscated by local officials for nonuse or irrational use. Agricultural producers should be allowed to leave land fallow not only to regenerate soil but also for the simple reason that production in any given year may not be profitable.

Further recommendations: The majority of land that is currently part of level land-redistribution funds should be privatized. Ownership of land, in the land funds, that is currently being leased to peasant farms should be transferred to the lessee for a payment equal to five times the land tax. In anticipation of a fully effective land market, the government should make it clear—through a public information campaign—that peasant farm owners are entitled to lease out agricultural land plots. In order to make long-term credit available to peasant farmers, the right to mortgage land should be made fully operational. Large agricultural enterprises that are clearly insolvent should be broken up. Policymakers should strive to develop land share rights.

To order: Rural Development Institute, 4746 11th Avenue N.E., #505, Seattle, Washington 98105, United States, fax 206-528-5881, Email: rdi@u.washington.edu

Dieter Schumacher, Harald Trabold, and Christian Weise (eds.), **Transformation des Wirtschaftssystems in Den Mittel- und Osteuropaischen Landern: Aussenwirtschaftliche Bedingungen und Auswirkungen**, DIW Sonderheft 161, 1997, 434 p.

To order: Duncker & Humblot, Berlin, Carl-Heinrich-Becker-Weg 9, D-12165 Berlin, Germany, tel. 4930-790-0060, fax 4930-7900-0631, Email: duh-werbung@t-online.de

Social Security Programs Throughout the World—1997, Research Report 65,

Social Security Administration, United States, August 1997, 394 p.

This is the 60th anniversary of the United States Social Security Administration (SSA). The SSA has been documenting details about social security systems around the world through this publication. This edition contains summaries of 172 systems in effect on January 1, 1997.

To order: Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402-9325, Email: barbara.e.kritzer@ssa.gov; Internet: http://www.ssa.gov/statistics/ores_home.html

Peter Stanovnik and Marjan Svetlicic, **Slovenia and the European Union**, Center for International Relations, Faculty of Social Sciences, University of Ljubljana, Slovenia, June 1997, 24 p.

To order: University of Ljubljana, Faculty of Social Sciences, 1001 Ljubljana, P.O. Box 2547, Slovenia, tel. 38661-1681-461, fax 38661-1685-330, Email: marjan.svetlicic@uni-lj.si

Dr. Marjan Svetlicic, **Outward Foreign Direct Investment by Central European Economies and Restructuring**, University of Ljubljana, Faculty of Social Sciences, Slovenia, 1997.

To order: University of Ljubljana, Faculty of Social Sciences, 1001 Ljubljana, P.O. Box 2547, Slovenia, tel. 38661-1681-461, fax 38661-1685-330, Email: marjan.svetlicic@uni-lj.si

Think Tanks in Central and Eastern Europe: A Comprehensive Directory, Freedom House, United States, 1997, 236 p.

Freedom House (recently merged with the National Forum Foundation) launched the Regional Think Tank Initiative in Central and Eastern Europe in 1997 to strengthen indigenous public policy institutes, or think tanks, that advocate democratic and free-market reforms in the former East Bloc. The directory lists

the region's new policy institutes.

To order: Freedom House, 511 C Street, NE, Washington, D.C. 20002, United States, tel. 202-543-3515, fax 202-547-4101.

P. Watson, **Health in Societies in Transition I: Evidence from the Nowa Huta Study**, Sociological Research Group Working Paper 23, University of Cambridge, July 1997.

To order: Sociological Research Group, Faculty of Social and Political Sciences, University of Cambridge, Free School Lane, Cambridge, England, CB2 3RQ, tel. 01223-334-521, fax 1223-334-550.

The Oil and Gas Industry of Sakhalin Island, Russian Far East Update, United States, September 1997, 52 p.

To order: Elina Erlendsson, Russian Far East Update, P.O. Box 22126, Seattle, Washington 98126, United States, tel. 206-447-2668, fax 206-628-0979, Internet: http://www.russianfareast.com/

Newsletters/Special Publications

East European Constitutional Review, published quarterly by the Central European University. This double issue, Vol. 6, no. 1-2, 1997, contains the following topics: Constitution Watch country by country updates on constitutional politics in Eastern Europe and the former USSR, Ken Jowitt explores the real causes of the Soviet Union's collapse, Andrei Plesu asks if the European Union is more than a community of consumers and producers, Bohdan Futey analyzes the new Ukrainian "Law on the Constitutional Court," and the 1997 Polish Constitution.

To order: East European Constitutional Review, Nador u. 11, 1051, Budapest, Hungary or CSCEE, the University of Chicago Law School, 1111 East 60th Street, Chicago, Illinois, 60637.

The Economics of Transition, published by Oxford University Press for the European Bank for Reconstruction and

Development, Vol. 5, no. 1, May 1997 contains the following topics: Enterprise Restructuring and Social Benefits, by S. Commander and M. Schankerman; Bank-led Restructuring in Poland (II), by C. W. Gray and A. Holle; Industrial Restructuring in Russia, by E. Fuglo and C. Senik-Leygonie; A Portfolio Approach

to a Cross-Sectoral and Cross-National Investment Strategy, by W. H. Buijter and others; and Round Table on Russia by M. D. Intriligator, A. Shleifer, and J. Lloyd. To order: Mrs. Pat Chrystal, Secretary, Economics of Transition, CERT, Heriot-Watt University, Riccarton, Edinburgh EH14 4AS, United Kingdom, tel. 44-131-

451-3497, fax 44-131-451-3498, Internet: <http://www.oup.co.uk/ectran/>

Georgian Economic Trends: Quarterly Review, TACIS, Georgia, 1997, 74 p.

To order: TACIS, Georgian Economic Trends, 16 Zandukeli St, Tbilisi, tel. 995-32-93-9161, fax 995-32-93-9160.

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Postsocialist Economies

Feltenstein, A. **Fiscal Policy During the Transition to a Market Economy.** *Economic Systems* (Germany) 21(4):309-26, December 1997.

Holzmann, R. **Pension Reform, Financial Market Development, and Economic Growth: Preliminary Evidence from Chile.** *International Monetary Fund Staff Papers* (United States) 44(2):149-78, June 1997.

Piazolo, Daniel. **Trade Integration between Eastern and Western Europe: Policies Follow the Market.** *Journal of Economic Integration* (Republic of Korea) 12(3): 259-97, 1997.

Siegmund, U. **Are There Nationalization-Privatization Cycles?** *Economic Systems* (Germany) 21(4): 370-74, December 1997.

Swaan, W. **Tacit Knowledge and Post-Socialist Transformation: Results of a Comparative Study.** *Economic Systems* (Germany) 21(4): 375-79, December 1997.

Central and Eastern Europe

Anderson, R., and K. Done. **The Czech Republic: A Year of Growing Uncertainty—Financial Times Survey.** *Financial Times* (United Kingdom), December 1, 1997.

Baldwin, R.E., J. F. Francois, and R. Portes. **The Costs and Benefits of Eastern Enlargement: The Impact on the EU and Central Europe.** *Economic Policy* (United Kingdom), pp. 125-76, April 1997.

Decision to Introduce Compulsory Certification of Imported Goods. *Slovak Monthly Report 1997* (Slovak Republic) 9:5, September 1997.

EU Accession and Public Administration Capacities. *SIGMA Public Management Forum* (France) 3(4):1, 15, 1997.

Roberts, B. M. **Output Decline in Eastern Europe: A Comparison of Explanations for Poland.** *Economic Systems* (Germany) 21(4):327-46, December 1997.

Sinn, H. W., and A. J. Weichenrieder. **Foreign Direct Investment, Political Resentment and the Privatization Process in Eastern Europe.** *Economic Policy* (United Kingdom), pp. 177-201, April 1997.

Zloch-Christy, I. **Industrial Policy: Does Eastern Europe Need One?** *Economic Systems* (Germany) 21(4): 380-82, December 1997.

Asia

Ahrens, J. **The Political Institutions of Economic Development: Success, Failure, and Prospects in East and South Asia.** *Economic Systems*

(Germany) 21(4): 348-53, December 1997.

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To Our Readers!

Transition is over? Certainly not the process but possibly the newsletter. You might be wondering why we have no subscription form in this issue. The fact is that the World Bank's financing of *Transition* is not guaranteed beyond June 1998. With the support of our friends and outside the Bank, we are trying to work out a solution that will allow us to continue to publish *Transition*, which has gained many supporters all over the world. If we do not succeed, our current paying subscribers will be reimbursed on a pro rata basis. We will keep you posted on new developments.

TRANSITION

Editor: Richard Hirschler
Telephone: 202-473-6982
Fax: 202-522-1152
Email: rhirschler@worldbank.org

Research Assistant: Jennifer Prochnow
Telephone: 202-473-7466
Fax: 202-522-1152
Email: jprochnowwalker@worldbank.org



The World Bank
1818 H Street, N.W.
Washington D.C. 20433
Telephone: 202-477-1234
Fax: 202-477-6391
World Wide Web:
<http://www.worldbank.org>
Email: books@worldbank.org

TRANSITION is a publication of the World Bank and is produced by the Macroeconomics and Growth Division of the Policy Research Department. The World Bank works to reduce poverty and improve living standards by promoting sustainable growth and investments in people.

The opinions expressed are those of the authors and should not be attributed in any manner to the World Bank, to its Board of Executive Directors, or to the countries they represent.

TRANSITION is published six times per calendar year, in February, April, June, August, October, and December. To help finance this newsletter, it is necessary to charge subscribers in OECD member countries. The annual subscription rate is \$30. *TRANSITION* will be sent free of charge to subscribers in transition and developing countries.

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Volume 8, Number 6
December 1997
ISBN 0-8213-4189-8
ISSN 1020-5470



Printed on recycled paper