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EU Accession Should Be a Partnership, Not a Dictate

by Michael Ellman

Some officials of the EU Commission in Brussels and EU member governments believe that the forthcoming enlargement of the EU is rather similar to the previous enlargements (1973, 1981, 1986, and 1995) and that no special arrangements will be required. This is a very superficial approach. If it persists it is likely to lead to prolonged accession negotiations and unsatisfactory arrangements for the existing members, the new members, and the applicants who are not accepted in the first enlargement round.

That the new applicants are transition countries automatically raises a number of special issues, which were explicitly recognized by the pre-accession conditions laid down at the Copenhagen (1993) and Essen (1994) meetings of the European Council. The applicants are much poorer than the existing members. Naturally, comparisons of per capita GNP that fail to take account of the discrepancy between market rates of exchange and purchasing power parities, and the differences in the relative size of the informal sector, give an exaggerated view of the discrepancies in income levels. Nevertheless, there is a substantial difference with this enlargement. Hence the new accession must be seen

as a "development integration." The new accession agreements should contain arrangements concerning such matters as the structural/cohesion funds, environmental and social policy, and transition periods, which help new members quickly reduce the gap between their level of development and that of the existing members.

Ten transition countries (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia) have applied for membership. [The Commission has selected Czech Republic, Estonia, Hungary, Poland, and Slovenia for negotiations in the first round.] The EU should simultaneously negotiate with countries admitted in the first round about the conditions of accession, and about medium-run arrangements with those countries that are left out in the first round.

Joining the EU today is different from joining it, say, fifteen years ago, since it has completed its single-market project and is embarking on monetary union. Countries that apply today, some of which have only recently acquired monetary independence, eventually will have to give up their national currency and adopt one whose value will be determined in Frankfurt. While

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some applicants find this an attractive prospect (it will enable them to maintain low inflation and end the depreciation of their money relative to that of their main trading partners), others do not.

When countries joined before, *they* had to change their policies in numerous areas—not the EU. With the new accession, the EU itself will have to change its policies. It seems likely that some limit (expressed as a percentage of GDP) should be introduced on the amount any country can receive from the structural/cohesion funds in order to reduce the fiscal transfers to the new members. It also may be necessary to change the Common Agricultural Policy (CAP) to reduce costs and to keep to the commitments made to the other participants in the WTO. [Some of these changes have been proposed in Agenda 2000. See following articles. The editor] Western Europe already has sad examples of what can go wrong in the process of unifying regions that differ substantially in level of economic development: southern Italy and the five provinces of Eastern Germany. Since economic integration, both regions have become depressed areas, suffered prolonged fiscal problems, and shown few signs of self-sustaining economic growth.

The trade statistics expose the risks involved. Whereas in 1990 the EU was a major net importer of agricultural products from Eastern Europe, it is now a major net exporter. Even such traditional agricultural exporters as Bulgaria and Lithuania now have agricultural trade deficits with the EU 12. This is partly a result of protectionist EU policies under the rules of the CAP, but partly a result of the superior competitiveness of EU agribusiness. This outcome is fine for West European farmers, processors, and distributors, but very adverse for East European agriculture.

What has to be done to ensure that EU enlargement will contribute to the economic development of the transition countries that join, rather than to their

underdevelopment?

- **The accession should not turn into a one-sided dictate that the applicants are obliged to accept.** It must be a partnership that takes account of the interests and aspirations of the applicants.
- **The current accession process involves institutional changes of a significantly greater scale than has been required in earlier accessions.** A relatively long transition period should be required in order to achieve these changes and build up the competitive strength of the applicant countries.
- **The existing members have a responsibility to assist the applicants in the accession process.** They should certainly not create unnecessary obstacles to a procedure that has the potential of making an important contribution to the unity and prosperity of Europe.
- **There should be clearly specified proposals for cooperative efforts between existing and future members** (for example, in the fields of transport, telecommunications, and banking).

Special arrangements for those countries not accepted in the first round might resemble a modern version of the European Economic Area (which currently includes the EU, Iceland, Liechtenstein, and Norway). Besides providing participants with access to EU markets, such an arrangement should also define a path to future EU membership for those who want it.

The main danger facing enlargement at present is that the negotiations will start next year as previously promised—but will drag on for years. The June 1997 Amsterdam summit of EU leaders showed how difficult it is to persuade EU members to improve the efficiency of their institutions if this means giving up Commission membership, favorable voting rights in the Council of Ministers, and the like, for the general interest of Europe as a whole. The self-interest of the net recipients of the structural/cohesion funds and the beneficiaries of the CAP, the unwillingness of small coun-

tries that are currently members of the EU to give up their Commissioner and favorable voting position in the Council of Ministers, the hostility of influential groups in the EU to free movement of labor from the applicants, the discrepancy in social and environmental costs—all can prolong the negotiations and hence perpetuate the division of Europe. How to overcome these barriers?

One possibility would be to set up quickly an authoritative committee (analogous to the Spaak and Delors committees, which laid the groundwork for the Treaties of Rome and Maastricht, respectively) that would examine all accession issues—such as trans-European infrastructure and communications; money, banking, and payments issues, particularly concerning the relations between the European Monetary Union (EMU) countries and the rest; energy and power; environment; competition policy; and agricultural policy—and come up with positive proposals aimed at making a success of the forthcoming enlargement. It is desirable that both the existing members and the applicants be represented on such a committee and that its proposals be accompanied by a timetable for their implementation.

Unless the interests of applicant countries are properly considered, negotiations could drag on for years. Even if accession terms are agreed, the superior competitiveness of the existing members could turn the acceding countries into new depressed *Mezzogiornos* or east Germanies. In either case, European stability could be endangered.

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Picking Up the Enlargement Tab

European Union Plans Budget for 2000-2006

The European Commission, the highest executive body of the European Union, on July 16 released its opinions ("avis") on the ten applications for EU membership from Central and Eastern Europe. It concludes that accession negotiations should open with the Czech Republic, Estonia, Hungary, Poland, and Slovenia in early 1998. The 1,200-page "Agenda 2000" took more than a year to prepare. It also carries the Commission's proposals for agricultural, structural and horizontal policies, a reinforced pre-accession strategy, and the EU's financial framework beyond 1999. The EU Council of Ministers will draft a final position for the EU summit scheduled for December in Luxembourg. There, EU heads of state and government will make the final decision on the start of the negotiations.

The Commission is proposing a total of 75 billion European currency units (\$82.6 billion), or about 10 percent of the EU budget during the period 2000-2006, for the eleven countries (Cyprus included) that are applying for membership. They propose maintaining the level of EU spending at 1.27 percent of total Union GNP between 1999 and 2006, but capping aid to any current or future member at 4 percent of GDP. The Commission also suggests allocating some ECU 45 billion (\$49.5 billion) in aid to new members as part of a regional aid budget of ECU 275 billion (\$302.5 billion). A radical reform of the EU's Common Agricultural Policy is prescribed in the document, with drastic cuts of EU-guaranteed prices for milk and cereals.

If enlarged by the ten Central and East European applicant countries, the European Union would comprise an economic area of up to 500 million consumers, compared with the current

370 million. The scale of the changes that will be brought about by the next enlargement is illustrated by area and population increases (table 1). Average per capita GDP will decrease more than it did following all previous enlargements. The ten applicants, with an overall per capita GDP estimated at 32 percent of the Community average, lag far behind Greece, Ireland, Portugal, and Spain, whose average per capita GDP stands at 74 percent of the Community average.

As a consequence of the enlargement, major categories of EU budget expenditures are expected to develop in the following way (see table 2 on page 4):

1. Common Agricultural Policy (CAP).

Agriculture is relatively more important in the candidate countries than in the EU in terms of area, contribution to GDP, and, especially, share in total employment. On average, more than 22 percent of the workforce (9.5 million people) is employed in agriculture, compared with only 5 percent (8.2 million) in the EU. Agriculture still contributes 9 percent to GDP, compared with 2.4 percent in the EU. With enlargement, the Union's agricultural area would be expanded by 60

million hectares to close to 200 million hectares. Of the 60 million hectares of added land, two thirds would be arable, increasing by 55 percent the EU's current arable area of 77 million hectares (but with quite diverse land quality and climatic conditions). The agricultural labor force, projected at around 6.6 million in 2000 for the existing EU, could be expected to at least double. Currently, the agricultural area per person employed in the candidate countries is, on average, 9 hectares compared with 21 hectares in the existing EU. Enlargement would add more than 100 million food consumers to the internal market, if all associated countries were to join, but these consumers have, on average, a level of per capita purchasing power that is only about one-third the level in the existing EU.

Agricultural expenditure for the applicant countries would include the following:

- Pre-accession aid, amounting to some ECU 0.5 billion per year, will be granted from the year 2000 in priority areas, such as modernizing farms and food distribution channels and maintaining food quality control in the applicant countries.
- Expenditures relating to the new members'

Table 1. Impact of successive EU enlargements

(based on 1995 data, in percent)

Enlargement (EU membership)	Increase in area	Increase in population	Increase		Average per capita GDP (EUR 6 = 100)
			in total GDP	Change in per capita GDP	
From 6 to 9	31	32	29	- 3	97
From 9 to 12	48	22	15	- 6	91
From 12 to 15, including German unification	43	11	8	- 3	89
From 15 to 26	34	29	9	- 16	75

Source: Agenda 2000.

Table 2. The new framework: EU budget expenditures, 2000-2006*(billion ECU, 1997 prices)*

Category	1999 ^a	2000	2001	2002	2003	2004	2005	2006
1. Agricultural policy	43.3	44.1	45.0	46.1	47.0	48.0	49.0	50.0
New members ^b	0.0	0.0	0.0	1.5	2.0	2.4	2.8	3.3
Other applicants ^b	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
2. Structural and cohesion funds	36.1	35.2	36.0	38.9	39.8	40.7	41.7	42.8
New members	0.0	0.0	0.0	3.6	5.6	7.6	9.6	11.6
Other applicants	0.0	1.0	1.0	1.0	1.0	1.0	1.0	1.0
3. Other internal actions	6.1	6.1	6.4	7.3	7.5	7.7	7.9	8.1
4. External actions ^c	6.6	6.6	6.8	7.0	7.1	7.3	7.5	7.6
5. Administrative expenses	4.5	4.5	4.6	5.1	5.2	5.3	5.4	5.5
6. Reserves	1.2	1.0	1.0	0.8	0.5	0.5	0.5	0.5
Total expenditures	97.8	97.5	99.8	105.1	107.1	105.9	112.0	114.5
New members	0.0	0.0	0.0	5.8	8.2	10.8	13.3	15.7
Other applicants	1.3	3.0	3.0	3.0	3.0	3.0	3.0	3.0

a. Earlier approved budget allocation.

b. Final selection of new members will be announced at the EC summit in December.

c. From 2000 includes ECU 1.5 billion in annual aid under PHARE to other applicants.

Source: Agenda 2000.

agro-environmental action programs, reforestation, and market modernization measures will come to between ECU 1.5 billion and ECU 3.3 billion annually, from the date of accession.

Agricultural prices in the candidate countries are generally much lower than in the EU; in 1995, farm gate prices were just 40 to 80 percent of the EU level. New member states thus will not be eligible for compensatory aids that would otherwise represent around two-thirds of additional expenditure, at least during a period after accession. Therefore, the agricultural guideline should suffice to finance additional expenses induced by enlargement.

2. Structural policies. On the basis of present regulations governing allocation of structural funds, enlargement could increase from 94 million to 200 million the population eligible for assistance under Objective 1, aimed at helping regions where per capita GNP is less than 75 percent of the Union average (table 3).

Without a change in policy, the eligible population would amount to 60 percent of the total population.

The new member states would receive from the structural and cohesion funds some ECU 45 billion between 2000 and 2006, taking into account their absorptive capacity, the required effectiveness of structural spending, and the need to ensure a progressive rise in per capita

support. The cofinancing requirement for the new member states will have to be progressively increased. (To the present fifteen member states, ECU 210 billion would be allocated from the structural funds and ECU 20 billion from the cohesion fund between 2000 and 2006.)

Pre-accession aid, to be drawn from the ECU 45 billion allocation, would be made available from the year 2000. This assistance, to be granted at a constant rate of ECU 1 billion a year would help bring the applicant countries' infrastructures up to Community standards, particularly in the transport and environment fields.

3. Other internal policies. Once the applicants have joined, pre-accession aid will have to be replaced from

within this category. Funded priority programs include the trans-European networks, research, education and training, the introduction of environment-friendly technologies, and measures to support small and medium-size enterprises.

4. External actions. Prior to enlargement, as part of pre-accession aid, the PHARE program has financed applicant countries' participation in projects coordinated with the EU. After the first

Table 3. Changes in population eligible for Objective 1 assistance from structural funds*(based on 1995 data)*

EU membership and year of enlargement	Eligible population (million)	Eligible population (percent, EU = 100)	Objective 1 population (million)	Objective 1 population (percent, EU = 100)
12 (1989)	140.0	43.3	69.7	21.4
15 (1995)	185.6	49.8	94.0	25.2
26 (2000+)	291.4	60.9	199.8	41.7

Note: The structural fund Objective 1 Program supports regions where per capita GNP is less than 75 percent of the Union average.

Source: Agenda 2000.

accessions, this aid should remain stable at ECU 1.5 billion a year and be concentrated exclusively on the countries due to join at a later date.

5. **Administrative expenditure.** EU institutions will have to be equipped to work in new languages, to assume a bigger role in a more diverse Community, and to accommodate nationals from the new member states'. If the new member states entry is a sufficiently gradual process and is accompanied by the necessary rationalization measures, the

overall administrative expenditure ceiling—after taking enlargement into account—may increase more slowly than the GNP of the enlarged Community over the period 2000-2006.

6. **Reserves.** Phasing-out of the monetary reserve by 2003 should be possible in view of the reform of the Common Agricultural Policy. The emergency aid reserve could be cut back to ECU 200 million.

Based on the EU Commission documents, Agenda 2000.

The Commission's Report Card

The evaluations on the following "report card" (p. 6-7) are excerpted from the European Commission's opinions (officially, "opinions concerning the applications for membership to the European Union presented by the ten candidate countries". The report card assesses the applicants' progress toward democratization, economic transition, and adoption of the EU's *acquis communautaire*—in other words, the laws, norms, and regulations followed by the Union. The applications of Bulgaria, Latvia, Lithuania, Romania, and Slovakia, which were left off the Commission's shortlist, will be reviewed annually.

The "grades" illustrate EC opinions, and are based on ratings given by the Hungarian *World Economy Weekly* (Budapest). The numerical grades range from 1 (failing) to 5 (excellent). These ratings do not reflect the official view of the World Bank.

The European Union's Pre-Accession Strategy and the World Bank

The World Bank is ready to collaborate with EU institutions, including the European Investment Bank, to help applicant countries meet membership criteria. The next high-level meeting on this topic will be held in Brussels in early September.

The Reinforced Pre-Accession Strategy, part of "Agenda 2000," refers briefly to possible areas of joint action. "Applicants will be required to undertake substantial investment in environmental protection, transport, energy, industrial restructuring, agricultural infrastructure, and rural society. Resources for such investments can be mobilized from international financial institutions. Investment linked to profitgenerating sectors, such as telecommunications, transport, and energy, can be jointly financed with the EIB, the EBRD and the World Bank. Funding agreements with these institutions will be concluded by the Commission. PHARE will act as a catalyst for public and private international loans by providing grants.

PHARE, the EU's aid program to Central and Eastern Europe, will continue to operate as an accession tool. It was recently reoriented toward the following top priorities, common to all applicants:

- *Reinforcing the institutions and administrations of applicant countries* (70 percent of PHARE assistance).
- *Bringing enterprises into line with Community standards* (30 percent of PHARE assistance)."

The different sources of EU support, taken together, amount to pre-accession assistance of ECU 21 billion (at constant 1997 prices) over the period 2000-2006: 3.5 billion for structural assistance in agriculture, 7 billion under the cohesion fund, and 10 billion from the PHARE program. Thus there are plenty of opportunities over the next five years for close EU-World Bank cooperation to make the enlargement a success.

Based on Agenda 2000.

Outsiders' Perspective



From the Hungarian magazine *Hócipő*.

Country	Political criteria	Economic criteria	Capacity to assume membership obligations
Bulgaria	Grade = 4 Bulgaria has stable democratic institutions that need to be reinforced at all levels of public administration, by fuller respect for the rule of law. The new government has announced a series of positive reforms, but some gaps remain in fundamental rights. Fighting against corruption, improving the operation of the judicial system, and protecting individual liberties in the face of too frequent abuses by the police and secret services are necessary. The Turkish minority seems well integrated, but this is not so for the Roma.	Grade = 2/3 Bulgaria is still at the start of structural transformation. The new government has undertaken to carry out rapid reforms in order to free prices and start privatization. This policy should permit recovery from the situation created by the recent crisis that saw a negative growth (-10.9% of GDP in 1996), worsening public deficits, hyperinflation (311% in 1996), and depreciation of the currency. GDP per capita is 24% of the EU average. Trade with the EU now represents 35% of Bulgaria's external trade.	Grade = 2/3 Bulgaria would not be able to cope with competitive pressure and market forces within the Union in the medium term. It has an unsatisfactorily low rate of adaptation of the EC rules and directives. Complete restructuring of the financial sector, in order to reestablish public and investor confidence, is of high priority. The weakness of public administration is a major problem. Bulgaria will need to make substantial efforts in order to apply the EU standards in telecommunications, taxation, statistics, consumer protection, and customs.
Czech Rep.	Grade = 4/5 The Czech Republic is a stable democracy, guaranteeing the rule of law, human rights, and respect for and protection of minorities. Efforts to improve the operation of the judiciary and to intensify the fight against corruption must be sustained. There are some weaknesses in laws governing freedom of the press. Discrimination affects the Roma.	Grade = 4 Economic growth has been sustained since 1994, though at a lower rate (4.0% in 1996). Despite tight fiscal policies, both trade and current account deficits grew in 1996. Inflation stood at 8.8% in 1996. GDP per head is about 55% of the EU average. The EU's share of Czech trade has reached 55%. The country is a functioning market economy. But further progress will need to be made over the next few years in strengthening corporate governance and the financial system. The banking sector is dominated by a few, partly state-owned banks and its competitive position is not strong. The country should be able to cope with competitive pressure and market forces within the Union in the medium term, provided that change at the enterprise level (restructuring) is accelerated. Although the quality of exported goods is improving, their value added is still low.	Grade = 4 The country has satisfactorily adapted EU rules and directives, though a considerable amount of legislative work is required, particularly in the area of financial services and taxation. The country could apply the <i>acquis</i> from the date of accession, in education, research, telecommunications, statistics, and consumer protection. But further efforts are required in agriculture, environmental protection, and the energy sector.
Estonia	Grade = 4/5 Estonia is a stable democracy, with institutions guaranteeing the rule of law, human rights, and respect for and protection of minorities. But measures need to be taken to accelerate naturalization of Russian-speaking noncitizens to enable them to become better integrated into Estonian society. Efforts to improve the operation of the judicial system and to intensify the fight against corruption need to be sustained.	Grade = 3/4 The economy has been growing since the second half of 1993 (4.0% in 1996). The government has maintained balanced budgets in public finances. External debt is low, though Estonia runs a high trade and current account deficit. Inflation rates have declined over recent years, thanks to the currency board system and a prudent fiscal stance, but still stood at 23.1% in 1996. GDP per head is about 23% of the EU average. Fifty-four percent of Estonia's exports are directed to the EU, and 66% of its imports originate in the EU. Estonia can be regarded as a functioning market economy. It has liberalized foreign trade and privatized the public sector. The legislative framework is largely in place. But land reform has been slow, and reform of the pension system has not yet started. The banking sector is healthy and expanding strongly. Estonia should be able to make the progress necessary to cope with competitive pressures and market forces within the Union in the medium term, provided in particular that the export base is broadened.	Grade = 3/4 Estonia has adopted significant elements of the <i>acquis</i> relating to the single market. It is well on the way to putting in place the necessary legislative foundation in company law, accounting, data protection, and capital liberalization. But there is still substantial work to be done on public procurement, intellectual property, financial services, taxation, and competition (especially the transparency of state aids). There are doubts about the capacity of the Estonian administration to implement this legal framework. Estonia should not have difficulty in applying the <i>acquis</i> in the medium term in education, research and technological development, small and medium-size enterprises, and with further efforts, in telecommunications. Further progress is required in the fields of statistics, consumer protection, customs, environment, and agriculture.
Hungary	Grade = 4/5 Hungary is a stable democracy, with institutions guaranteeing the rule of law, human rights and respect for and protection of minorities. Hungary's political institutions function properly. Certain improvements are still needed in the operation of the judicial system and in protection for the Roma, but the measures recently taken by the government constitute progress. The fight against corruption needs further reinforcement.	Grade = 4/5 Hungary's renewed growth (1% in 1996) has been accompanied by progress toward stabilization of public finances, external accounts, and inflation (19.8% in 1996). Its GDP per capita is equivalent to 37% of the EU average. Trade with the EU now represents 60% of Hungary's external trade. Hungary is a functioning market economy. Liberalization and privatization have progressed considerably, and there has been strong growth of new private firms. The reform of pensions and social security needs to advance rapidly. [Parliament approved in July 1997, the new pension law, reforming the system.] Hungary should be well able to cope with competitive pressure and market forces within the Union in the medium term, provided the macroeconomic conditions for strong investment growth remain in place. Its enterprises are already competitive in EU markets. Restructuring of industry and banks is well under way. It has had a consistently high level of foreign direct investment. The key task now is to avoid unsustainable budgetary or external deficits.	Grade = 4 The legislative foundation, by adopting EU rules and directives, is almost completed in such areas as competition, public procurement, intellectual property, and company and accounting law. Effective administrative reform is, however, required. Hungary should not have difficulty in applying in the medium term EU norms and regulations in education, training, research and technological development, and telecommunications. By contrast, further efforts will be needed in consumer protection and customs controls, as well as the environment. The health system should be improved and EU health and "safety at work" standards applied.
Latvia	Grade = 4/5 Latvia is a stable democracy, guaranteeing the rule of law, human rights, and respect for and protection of minorities. But measures need to be taken to accelerate the rate of naturalization of Russian-speaking noncitizens to enable them to become better integrated into Latvian society. Efforts to improve the operation of the judicial system and to intensify the fight against corruption need to be sustained.	Grade = 3 Growth turned positive again in 1996 (2.8%). Since 1995 the government has conducted a tight fiscal policy, though revenue collection is still a problem. The foreign debt ratio remains low, but the trade deficit is high. Inflation rate still stood at 17.6% in 1996. GDP per head is about 18% of the EU average. Forty-five percent of Latvia's exports are directed to the EU, and 50% of its imports originate in the EU. Latvia has made considerable progress in creating a market economy. But effective implementation is lagging behind. Not all the necessary regulatory bodies are in place or working properly. Privatization is not complete; the remaining state-owned companies are generally in poor financial condition and there is a shortage of investors. Latvia would face serious difficulties in coping with competitive pressure and market forces within the Union in the medium term. Exports consist mainly of low value-added goods. Industrial restructuring, as well as enterprise restructuring, is still needed. The banking sector is underdeveloped and weak in parts. Agriculture needs to be modernized.	Grade = 3 Latvia would face serious difficulties in coping with competitive pressure and market forces within the Union in the medium term. Public administration is weak. Progress was made to comply with the single market legislation in banking, industrial property rights, and commercial law. It could apply EU norms in the medium term in such areas as education, training, research and technological development, and telecommunications; less so in sectors such as environment and agriculture. The industry should be able to cope with integration into the single market in the medium term.

Country	Political criteria	Economic criteria	Capacity to assume membership obligations
Lithuania	Grade = 4/5 Lithuania is a democracy, with stable institutions guaranteeing the rule of law, human rights and respect for and protection of minorities. Efforts to improve the operation of the judicial system and to intensify the fight against corruption need to be sustained.	Grade = 3 Since the introduction of a new currency and the establishment of a currency board in 1993/94, the GNP is increasing (by 3.6% in 1996). Lithuania has maintained a tight fiscal stance. Foreign debt is at modest levels, and the trade deficit is under control. Inflation is down to 24.6% in 1996. GDP per head is about 24% of the EU average. The EU is Lithuania's largest trading partner, taking 37% of total trade. The country has made progress in the creation of a market economy, but it would face serious difficulties in coping with competitive pressure and market forces within the Union in the medium term. Relative price adjustments, large-scale privatization, substantial enterprise restructuring, and bankruptcy proceedings should continue. Financial discipline of enterprises is not enforced. Agriculture needs to be modernized. The banking sector is weak.	Grade = 3 Lithuania progressed in complying with the single market legislation in the areas of company law, data protection and accounting. Further work is necessary on intellectual property rights, liberalization of capital markets, financial services, taxation, and competition. Applying the EU norms in education, training, research and technological development should not present significant difficulties. In the fields of telecommunications, statistics, customs, environment, energy and agriculture substantial efforts will be needed.
Poland	Grade = 4/5 Poland is a stable democracy, with institutions guaranteeing the rule of law, human rights and respect for and protection of minorities. Efforts to improve the operation of the judicial system and to intensify the fight against corruption will need to be sustained. There are certain limitations to freedom of the press.	Grade = 4/5 By 1992 positive growth had started, and has continued since (6.0% in 1996). The budget deficit has been reduced to below 3% of GDP; and the debt-servicing burden, after rescheduling was agreed in 1991, is being steadily reduced. Inflation rate still stood at 19.9% in 1996. GDP per head is about 31% of the EU average, 70% of Poland's exports are directed to the EU, and 65% of its imports originate in the EU. Poland can be regarded as a functioning market economy. But pension and social security systems need to be reformed. Financial services are underdeveloped. The banking sector needs further reform. Poland should be well able to cope with competitive pressure and market forces within the Union in the medium term. Agriculture needs to be modernized. Polish industry is characterized by the existence of both a dynamic competitive new private sector and large, mostly state-owned sectors that need restructuring.	Grade = 4 Poland should be able to cope with competitive pressure and market forces within the Union in the medium term. Particular effort and investment will be needed to apply EU norms in agriculture, environment and transport. On the other hand, substantial progress has been made on "approximating" intellectual property, company law, taxation, accounting, and financial services. Work is still needed on public procurement, data protection, competition and liberalization of capital movements.
Slovakia	Grade = 2 Slovakia does not fulfill in a satisfying manner the political conditions set out by the European Council in Copenhagen. The government does not sufficiently respect the powers devolved by the constitution to other bodies, and too often disregards the rights of the opposition. In that context, the use of the police and the secret services is worrying. Fuller independence of the judicial system would ensure its function in satisfactory conditions. The fight against corruption needs to be pursued with greater effectiveness. The treatment of the Hungarian minority needs to be improved. It still lacks the benefit of a law on use of minority languages, even though the Slovak authorities had undertaken to adopt one, as envisaged by the constitution.	Grade = 4 Slovakia's growth in 1996 reached 6.9%, while inflation fell to 5.4%. This has been accompanied by an increase in budget deficits and by a worsening of external accounts. GDP per capita is 41% of the EU average. Trade with the EU now represent 36% of Slovakia's imports and 41% of its exports. Slovakia has introduced most of the reforms necessary to establish a market economy. Nevertheless, a restrictive Price Law has been introduced in 1996, and the draft Enterprise Revitalization Act would be a major step back from market mechanisms. The financial sector needs to be reinforced, and progress is needed in the regulation of the bankruptcy process and capital markets. Enterprise restructuring has been slow, which is gradually undermining economic growth and external balance. Slovakia could cope with competitive pressure and market forces within the Union in the medium term, if it pursued more transparent and market-based policies.	Grade = 4 Significant progress has been achieved on adopting legislation related to key areas of the single market, such as company law, banking, free movement of capital and taxation. More substantial efforts are needed to apply the acquis in the medium term on standards and certification, industrial and intellectual property, competition, public procurement and insurance; as well as in the of energy and environment sectors. Integration of Slovak industry into the European market could face difficulties over the medium term unless it is diversified away from heavy industries and enterprise restructuring goes ahead.
Slovenia	Grade = 4/5 Slovenia is a stable democracy, with institutions guaranteeing the rule of law, human rights and respect for and protection of minorities. Some improvements are needed in the operation of the judicial system, and in restoring property to former owners dispossessed under the communist regime. The effectiveness of the fight against corruption needs further strengthening.	Grade = 4 Slovenia had 3.1% economic growth in 1996. Public finances and external accounts were kept in balance, inflation fell to 9.1% in 1996. Slovenia's GDP per capita is 59% of the EU average. Trade with the EU now represents 65% of Slovenia's external trade. Slovenia can be regarded as a functioning market economy. However, competition lacks in some sectors, in particular the financial sector. Fiscal and social security reforms are not yet completed. Slovenia should be able to cope with competitive pressure and market forces within the Union in the medium term, provided that rigidities in the economy are reduced. Enterprise restructuring has been slow due to the consensual character of economic decision-making, and the efforts of workers and managers to preserve the status quo. Improvements in competitiveness have been hampered by rapid wage growth combined with low productivity growth.	Grade = 3/4 For most sectors related to the single market, and in particular for accounting, mutual recognition of professional qualifications and intellectual property, the legislative foundation is virtually in place. Further legislative effort will be needed to achieve full absorption of the acquis. Substantial work is still needed in the fields of public procurement, competition, insurance, freedom of capital movements, product conformity and standardization. Introduction of VAT is a top priority. Slovenia should not have particular difficulties in applying EU norms in the medium term in areas such as education, training, research and technical development, telecommunications, and customs. The Slovene industry can cope with the competitive pressure and market forces within the Union in the medium term. There may, however, be problems linked to certain labor market rigidities and for those sectors and companies, that have not yet undergone restructuring. Important progress will be necessary in the environment, and employment and social affairs, and energy sectors. Further administrative reform will be necessary.
Romania	Grade = 4 In Romania, the November 1996 election led to genuine alternation of power. The country has stable democratic institutions, but these still need to be consolidated by fuller respect for the rule of law at all levels of government. A number of gaps remain as regards respect for fundamental rights. Efforts are needed in the fight against corruption, to improve the operation of the judicial system and protect individual rights against the police and the secret services. The Hungarian minority seems well integrated in the light of recent improvements in their situation. But this does not seem to be the case for the Roma, who constitute a significant minority.	Grade = 3 A radical program of macroeconomic stabilization and structural reform is being implemented at a time of diminishing growth (7.1% in 1995, 4.1% in 1996), accelerating inflation (56.9% in 1996) and deteriorating budget and trading deficits. GDP per head is 24% of the EU average. Trade with the EU represents 55% of Romania's exports and 52% of its imports. Romania has made considerable progress in the creation of a market economy. While prices have been almost fully liberalized, property rights are not yet fully assured for land, the legal system is still fragile, and economic policy has not always been coherent. Further efforts to consolidate the administrative and legal framework and to address persistent macroeconomic imbalances, are required to ensure a stable environment.	Grade = 2/3 Compliance with the EU laws, norms and standards is slow. The legislation has only taken on a small part of the acquis. The financial sector needs complete restructuring, in order to re-establish essential public and investor confidence. The public administration is weak. Romania should not have significant difficulty in applying the acquis in the medium term in such areas as education, research and technological development, small and medium-size enterprises; and consumer protection. But substantial efforts will be needed in the fields of telecommunications; taxation and customs, environment, transport, employment and social affairs, as well as agriculture. It is uncertain whether Romania will be in a position to assume the obligations of membership in the medium term.

Romania's New Government Means Business— The First Seven Months

by Thomas O'Brien

On the night of November 26, 1996, huge crowds gathered in University Square in Bucharest, celebrating the election of President Constantinescu, and a new government formed by the coalition Union of Democratic Forces. Several months later, in July, President Clinton joined Constantinescu before crowds in the same square, and a nationwide poll confirmed that the great majority of Romanians—some 70 percent—accepted the sacrifices demanded by the government's new reform program, believing it would bring brighter prospects for a healthy economy.

The political cycle of reform in Romania seems to stand in contrast to many of its neighbors. Ceausescu's autocratic rule came to a close with the revolution of December 1989, but the legacy of rigid central planning has been felt through the 1990s. The painful social and economic dislocation that has accompanied reform in the transition economies of Central and Eastern Europe has been kept at bay in Romania, at least temporarily, through a cautious and hesitant approach to economic reform. But that hesitant approach has also prevented sorely needed adjustments; the economic situation has deteriorated sharply through 1996 and the first quarter of 1997.

The radical change in the political landscape signaled at the end of 1996 brought with it a bold and wide-reaching reform agenda. This agenda was welcomed by a public that was dissatisfied with the previous slow pace of reform, and wished to secure a sustainable increase in their living standard. The public perceived that market-friendly measures had brought economic success to Hungary and Poland; and that stalling on reform had

brought economic failure to Bulgaria. Furthermore, reforms were felt to be essential to unlocking the door to NATO and acceding to the EU (a widely shared aspiration—indeed, 80 percent of Romania's population supports the goal of EU accession, the highest such rating among countries waiting in line).

The government's reform program, in place since mid-February of this year, has gotten off to a good start. Its major goals are to:

- *Establish a sound macroeconomic framework to lower inflation and allow private sector-led growth.*
- *Accelerate structural reforms in key economic sectors, thereby underpinning stabilization efforts and promoting increased productivity and output.*
- *Protect vulnerable groups from the worst vagaries of the transition.*

Macroeconomic Stabilization

So far, the government has liberalized the foreign exchange market, including restoring exchange-dealing licenses to sound commercial banks; sharply tightened monetary policy; eliminated the national bank's directed—politically motivated—soft credits; maintained an incomes policy for the public sector; and targeted a sharply reduced fiscal deficit, from 8.3 percent of GDP in 1996 to 3.7 percent in 1997. [To reach the 1997 deficit targets Prime Minister Ciorbea announced further cuts in expenditures for defense, industry, scientific research, and agriculture, but more spending on health, education, and labor. The editor.]

As a result, the leu's exchange rate, which veered to nearly 9,000 lei to the dollar in late February during the period

of greatest market turbulence, has been stable at around 7,100 to 7,500 lei per dollar since early March; and the premium between the market and official rate has all but disappeared. The national bank's net foreign assets have increased by more than \$1 billion—about 1.3 months of import cover—over the first half of 1997. Consumer prices, which rose about 20 percent a month during the first quarter as administered prices were freed or realigned, slowed to a monthly increase of 7 percent in April, 4 percent in May, and a little less than 2.5 percent in June (consistent with the year-end target of 2 percent monthly inflation). The government's macroeconomic program has won the support of the IMF, which has provided a new \$430 million (equivalent) standby arrangement, extending over thirteen months from late April.

Structural Changes

The government has liberalized trade, accelerated privatization programs, and begun liquidating the most problematic nonviable state-owned enterprises (see box on next page). It has also begun downsizing the oversized petroleum and mining sectors. ("It's not the government that is closing down factories, but market laws," Prime Minister Ciorbea has pointed out.) Utility tariffs—such as electricity, gas, and heating—have been increased to market levels, while utility companies are being pressured to restructure and to move toward financial equilibrium. Enterprises—now deprived of budget subsidies—are being forced to find ways to restore financial discipline. Privatization of state-owned banks has begun; and banks will be more tightly supervised in the future.

In the agriculture sector, price and trade liberalization has also taken off and budget subsidies have been reduced drastically. Simultaneously, privatization (or liquidation) of state-dominated agricultural enterprises, including pig and poultry farms and grain-trading firms, has been put on the agenda.

The World Bank is supporting these steps through a reactivated Finance and Enterprise Sector Adjustment Loan of

\$280 million and a new Agriculture Sector Adjustment Loan of \$350 million.

Over the medium term Romania faces equally daunting challenges, which are recognized in the government's published economic development strategy, "Romania 2000." Structural reform and development of the private sector will require continued efforts. Perhaps the single biggest test will be acceleration and deepening of the program for restruc-

turing and privatizing state-owned enterprises (see box).

And in the banking sector, though most prudential regulations have been established to EU standards, the national bank's supervisory and enforcement powers and capacity need to be further strengthened. Tough action will have to be taken to resolve difficulties with weak and problem banks. Competition among banks can be promoted by privatization

At Stake: Transforming Romania's Loss-Makers

On August 8 Romania's Prime Minister Victor Ciorbea announced the immediate closure of seventeen factories—machine plants, food processing facilities, and three oil refineries—resulting in 30,000 job losses. The closures will be followed by liquidation of other loss-making enterprises. Sorin Dimitriu, the chairman of the State Property Fund, disclosed that the list of loss-makers slated for liquidation include more than 200 companies, many of them large. Total losses of thirty large state-owned enterprises have been running at \$37 million a year and their debts total \$268 million. The government hopes to reduce spending by closing inefficient, loss-making factories. Romania's eleven oil refineries, with a total annual refining capacity of 34 million metric tons, are producing well beyond Romania's consumption needs and have accumulated large arrears to the state budget. The reform government has pledged to reduce Romania's vast capacities by about two-thirds as part of plans to dismantle the National Oil Company and replace it with a more efficient operation.

"The liquidation procedure can go on for months, but we cannot sit and wait for those companies to incur more and more losses," Ciorbea said. "Any single day we delay threatens the macrostabilization we have achieved." To stop production, the government ordered immediate termination of energy, water, and raw materials to all seventeen factories. Ciorbea said that his government's largest privatization agency would negotiate agreements with forty international investment banks on privatizing several dozen large Romanian firms. Laid off workers will receive compensation equal to between six and twelve months' wages. (The average wage in Romania is about \$80 a month.)

State-owned enterprises still account for about half of Romania's GDP, a higher share than in most quick-reform-

ing transition countries. As a whole, these enterprises continue to rack up losses—often competing in tight or declining markets, with high levels of staffing, poor capital stock, and old-fashioned management and operations. About 75 percent of the losses in 1996 were concentrated in sixty-eight of the largest and politically most sensitive enterprises. The rest of the losses were spread over some 5,000 small and medium-size enterprises.

The plight of the flagship plant Roman, manufacturer of Romania's DAC trucks in the Transylvanian city of Brasov, illustrates the difficulties faced in dealing with loss-making state enterprises. Before the 1989 revolution the plant employed 23,000 workers and produced tens of thousands of trucks a year for the Soviet bloc and its allies. By last year, faced with a vastly altered competitive marketplace, the workforce was down to 13,800, while production had dropped even faster, to just 2,800 vehicles annually. Currently, the plant is still operating and its fate remains unresolved.

There are already examples of successful attempts to rein-vigorate economic performance at the enterprise level—even in agriculture. Agricola International S.A., based near the city of Bacau, has transformed what was once an old, slow-moving state-owned farm into a modern, profit-making commercial agribusiness. Driven by strong Romanian management, the company attracted the attention of a German partner, which has taken a large equity stake in the business. By rationalizing lines of business, contracting some activities to local farmers, and introducing financial discipline, Agricola has been able to expand production, sell about one-third of its output abroad, and triple its profit over the past three years.

Based on news agency reports.

(the Romanian Development Bank and Bancpost being the two early candidates), seeking out well-qualified strategic investors, and improving legislation regulating bank insolvency.

In the agricultural sector, a functioning land market, improved collateral mechanisms, and new, private sector-driven investments in infrastructure are needed. More generally, the commercial legal code should support new small and medium-size enterprises—likely engines of future job creation and economic growth. Capricious bureaucratic involvement in business must be eliminated.

Antipoverty Measures

The fight against poverty stands as a top priority. One in five Romanians is poor, according to a survey supported by a World Bank poverty assessment, and up to one-third of families barely have enough income to cover essential needs, according to a recent United Nations Development Program report. The new administration is accorded much greater attention to the poverty agenda. In a very tight 1997 budget the allocations for key welfare programs—including child allowances, income guarantee schemes, agricultural pensions, and unemployment and severance payments—have been increased by 25 percent. The World Bank has provided a \$50 million Social Protection Adjustment Loan to support this first-phase initiative, which is an integral part of the reform package.

The near-term social protection measures must be accompanied by longer-term initiatives to develop the nation's human resources.

In the education sector, curricula must be updated to better reflect students' needs in the new society, and the school system must be streamlined. And in the health sector—with Romanian health indicators among the worst in the region—

reform of financial management, greater attention to primary services, and selective new investment are all needed.

In the labor market, legislative and institutional changes should help safeguard women's rights; and improved training and information services should contribute to enhanced labor mobility. While the funding of the pension system is by no means as precarious as in other economies in the region, reform is vital to ensure long-term viability of the state pension fund, and to encourage well-supervised private pension provision.

In strengthening and rationalizing the role of the state, the government has made decentralization a guiding principle. In practice, this means downsizing the government bureaucracy and handing over power and responsibility to local levels, to the private sector, and to citizens. Public spending commitments should be reviewed. The central administration needs a broad overhaul with the aim of enhancing public services, streamlining tax policy, and improving economic management. Civil service reform should result in better skills and higher standards of professionalism, as well as improved pay scales. Changes in taxation should ensure that personal and corporate taxes are consistent with evolving EU norms.

Dialogue with the Public

The going will continue to be tough in the coming months: the government will have to withstand the inevitable pressures for public spending beyond the constrained target, against a background of modest revenue performance. The limited implementation capacity of the professional civil service, and the danger of increased social tension, linked to the political and economic power of vested interest groups, pose the main dangers to successfully advancing the reform agenda.

The new administration has already launched a campaign to educate the public and gain their support in resisting pressures from incumbent privileged groups—particularly special interests in agriculture, and state-owned heavy industry and mining—to maintain the status quo.

Explaining the need for, and benefits of reform to the population should help maintain the program's momentum. Securing some early benefits (such as the taming of inflation by end-1997) will also help. Although 1997 has been a difficult year for the economy, a slowing of inflation, to an annual rate of around 4 percent, should be achievable if reforms take hold. This is the surest way to improve living standards and make the inroads against poverty that the Romanian people desire.

Thomas O'Brien, Economist in the World Bank's Europe and Central Asia regional office, works on issues involving Romania.



From the Russian daily *Izvestia*.

New Phase in World Bank-NGO Relationship?

Workshop in Hungary Results in Promising Dialogue

by Eliza K. Klose

Environmental NGOs in Central and Eastern Europe (CEE) and the Newly Independent States (NIS) of the former Soviet Union have made significant strides since the collapse of communism. Their activities include environmental cleanup; establishing nature reserves and promoting eco-tourism; supporting alternative energy projects; identifying priorities and drafting laws; providing public feedback on projects of the World Bank and other development institutions; monitoring public officials and the private sector; furthering education and information dissemination; and providing services, such as environmental monitoring and impact assessments. Financial and technical assistance from the West—from private foundations, government agencies, and colleague NGOs—has fostered these operations.

But circumstances for NGOs vary dramatically from country to country. Continued NGO viability in the region depends on the political and economic conditions as well as the tax and legal frameworks in each country. There is a huge gap, for example, between what NGOs in the Czech Republic, Hungary, and Poland (the "Visegrad region") can aspire to, compared with what may be accomplished by NGOs in such countries as Albania, Belarus, Bosnia, or Uzbekistan.

Most Central European governments are stable, have established legal incentives for philanthropy, and are willing to dedicate some portion of tax revenues to support nonprofit activities. (A small percentage of Hungary's annual fuel tax, for example, is set aside to support an environmental fund that NGOs can bid

for. Also in Hungary, taxpayers have the option of supporting a preferred NGO with 1 percent of their personal income tax.) Thus, NGOs in the Visegrad region can reasonably be expected to sustain their activities in the near future, even though much of the West's official (government) assistance to environmental NGOs in Central and Eastern Europe is scheduled to end in 1998.

In the Balkans and the NIS, however, most governments are not yet prepared to support local philanthropy, much less NGO activity (except perhaps in Georgia). Thus, the capacity of the region's environmental NGOs to influence governments is limited, compared with their Central European colleagues.

Nonetheless, environmentalists have found effective ways to educate and unite local citizens around environmental concerns, addressing the severe pollution problems left behind by the Soviet system, along with new threats posed by the opening of indigenous markets and natural resources to Western businesses. But their situation is precarious. The issue for these NGOs is not just sustainability—it is simple survival. Donor and lending agencies—if they are really concerned—must find flexible, innovative, and long-term ways to support these NGOs.

At the recent international workshop of environmental NGOs and donors, in Szentendre, Hungary (see article, p. 12; box, p. 13), NGO activists presented the following recommendations to donors and lending institutions in order to preserve the momentum of the green movements in Central and Eastern Europe and the former Soviet Union:

- Establish an NGO/Donor Working Group to see that the dialogue continues. The working group could also serve as a mechanism for sharing information and monitoring progress on the workshop recommendations. [In the meantime, this recommendation has been accepted by the donors. The Editor]
- Develop a mechanism for regular exchange of information.
- Set up an NGO endowment fund to ensure financial stability; find ways to fund NGO emergency needs.
- Provide training to enhance the organizational and professional capabilities of NGOs.
- Fund studies of the economic readiness for philanthropy and the legal and policy conditions for NGOs in CEE and the NIS.
- Increase the transparency of development bank policies and project planning and provide better public access to information.
- Encourage governments to improve conditions for NGOs and increase citizen participation in environmental decisionmaking.

Specifically, the World Bank has been asked to:

- Provide adequate and timely information about projects.
- Improve performance of local offices and their NGO liaison (some Bank officials have thwarted NGO efforts to access information).
- Translate key project documents into local languages.
- Include NGOs in planning country assistance strategies, making better use of NGO expertise; reimburse them if they provide consulting services, or undertake environmental assessments.
- Do a country-by-country study on leg-

islation regulating NGOs and their funding, including tax incentives for private contributions.

None of these requests is particularly new in the NGO-World Bank dialogue, but to date few have been implemented in the CEE/NIS region. If the Bank does address them in a prompt and visible manner—as was the impression given in presentations by Bank officials at Szentendre—it will do much to enhance its credibility with the NGO community. The NGOs, for their part, should help the World Bank and other donor and lending organizations by facilitating work with citizen activists and local communities. In many instances, competition among NGOs severely constrains the Bank's attempts to deal with the public.

If donors and lending organizations, particularly development banks, will take steps to follow the NGO recommendations made in Szentendre, it will help to build the mutual respect and open dialogue that are essential to improved cooperation between NGOs and the donor and lender community.

Improved cooperation with donors and lenders will, in turn, increase the likelihood of government support for NGOs, especially in those transition countries that are most reluctant to take the public into account. Without the support of governments—through improved tax and legal conditions—NGOs cannot develop, and without the support of the public, no society can become strong and viable. Thus, fostering the sustainability of NGOs is an essential step in fostering stable societies.

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Highlights of the Szentendre Workshop

To review the impact of environmental NGOs in the transition countries of Europe and Central Asia and the role of foreign assistance in enhancing their efforts, representatives of forty key NGOs met with delegates from donor organizations (World Bank, USAID, EBRD) in May, at the Regional Environmental Center (REC) for Central and Eastern Europe in Szentendre, Hungary. The meetings were initiated and in part financed by the World Bank (with other financing from bilateral donors and USAID).

Agreement—Disagreement

During the discussions between NGOs, donors, and lenders—the first meeting of its kind—several common themes and points emerged:

•**Environmental NGOs contribute to both environmental protection and the building of civil society.**

•**Cooperation between NGOs, donors, and government bodies is highly desirable.** International funding to environmental NGOs should continue. Environmental activists in CEE and the NIS need continued financial support to operate and to carry out their social and environmental programs. Ways of achieving an improved relationship with the World Bank and the EBRD need further exploration. Government agencies at local, regional, and national levels must be encouraged to cooperate closely with citizen groups in setting priorities and making decisions.

•**Transparency and access to information are crucial.** Environmental NGOs place a high value on transparency and access to information. Lenders, such as the World Bank and the EBRD, have moved in recent years to increase the amount of information they make available to the public, even if obstacles to transparency and the flow of information still exist. Local government and bank officials often withhold information that

is already available through other channels (principally, the internet). Moreover, key documents are written in English and rarely translated into local languages, making them inaccessible to many NGOs. Good-faith distribution of information requires that funders and lenders work actively and devote funds to ensure that NGOs gain access to the information they need.

•**NGO outreach must be enhanced.** Green NGOs tend to work and cooperate with a limited range of organizations. It is important that they reach out to other environmental groups, collaborate actively with other civic organizations, and improve their efforts to inform, involve, and motivate the general public.

•**NGOs need more revenue, particularly from local sources.** NGOs need to diversify their income sources; they should reach out to the private sector, local foundations, and local governments for financial support; solicit the public; collect membership fees and consulting fees; and raise money through sales of various goods. Most green groups, however, lack the staff and know-how to engage in extensive fund-raising. Currently, most international funding is channeled to specific program needs such as environmental cleanup, policy development, or information dissemination. Future funding should be more flexible and creative. NGOs that work as consultants to World Bank projects, for instance, should be able to cover some of their overhead costs in project work.

On many important points, workshop participants offered diverging points of view:

•**Funding: equity versus efficiency.** Several participants criticized inequities in funding to NGOs, that is, a distribution of financial support that favors urban over rural, north over south, west over east, big over small, existing recipients over new groups, organizationally savvy groups over novices. Funders

and lenders justified their grant policies with the need for long-term cost-effectiveness, but they also referred to a new strategy that shifts priorities from traditionally favored regions and NGOs (CEE) to less-advantaged regions and organizations (the Balkans and the NIS).

•**Reductions in USAID funding.** NGOs criticized USAID for pulling out of projects in Central and Eastern Europe prematurely. USAID officials explained that many of their grant programs are winding down because the agency's original funding authorization from the U.S. Congress was limited.

•**Indigenous fund-raising.** Many funders and lenders suggested that the time was ripe for NGOs to turn to local corporations, governments, and individuals for donations; the NGOs could thus

foster the rise of a culture of philanthropy in civil society. But NGOs pointed out that existing tax codes rarely encourage charitable giving by individuals or corporations. Legislative and policy conditions for NGOs vary across the region. (Conditions for NGO development appeared generally more favorable in the Czech Republic, Hungary, and Poland than elsewhere.) The major obstacles to philanthropy are economic; the discretionary income of the general population is generally not high enough to support philanthropy, especially given the lack of a local tradition of private charity.

World Bank-NGO Exchange

In the past, the relationship between the World Bank and environmentalists has

been tenuous and, at times, confrontational. NGOs often criticized Bank projects as well as certain aspects of the Bank-NGO relationship. Bank representatives came to the workshop with the objective of improving the relationship. At the outset, some NGO representatives were ambivalent and others were opposed to collaborating with the Bank, believing that the institution was immutable. As the Szentendre workshop progressed, however, and the parties became acquainted and grew more familiar with each other's concerns, the tone of the discussion became more positive.

In responding to the NGOs' priority list, World Bank representatives of the ECA Region confirmed that:

•The Bank is developing closer links with

A Broader Framework—The Bank's View on NGO Partnership

Following are excerpts from Marcelo Selowski's closing statements at the Szentendre workshop:

•"The project" is the organizing principle underpinning the Bank's collaboration with NGOs. We want to involve NGOs to the extent that such involvement improves the quality and benefits of the Bank's projects.

•The governments are our primary clients: they secure our loans. We must work with them, in full collaboration. However, by working with NGOs at the project level, the Bank can promote NGO-government dialogue by pointing out the contribution a particular NGO is making to a project.

•The Bank's ECA (Europe and Central Asia) regional office will make special efforts to timely inform NGOs about Bank projects that have environmental impact in an effort to involve them at an earlier stage. Liaison officers in the resident missions have a crucial role to play in this. Within budgetary constraints, the ECA office will try to relieve these staff of some other operational responsibilities so as to allow them to better focus on their liaison role.

•There are some limits to public consulting—it cannot be an open-ended process. This will be even truer as more NGOs become involved across more sectors.

•Bank criteria for setting environmental priorities are guided by the Environmental Action Plan for Central and Eastern Europe. Preventing severe damage to human health from industrial pollution and lead is a key priority. Balancing green

(nature conservation) and brown (urban, industrial) environmental issues is crucial.

•Many environmental NGOs also deal with social issues in their communities. The Bank has recently approved mandatory social assessment guidelines. The Global Environment Facility has had such guidelines in place for years. The Bank needs to develop expertise in this area. When assessments are very local and specific, NGOs can play a role.

•Decentralization will in the future be a major area of Bank involvement in the transition countries. The role of local governments in raising revenues for and implementing programs in rural development, infrastructure, and the social sector will become increasingly important. The more local the operational approach, the more the Bank stands to gain from partnerships with NGOs in project design and implementation. Thus, we expect an increase in Bank collaboration with NGOs in the future.

•The Bank has to make difficult trade-offs in allocating its resources. This influences the choices we make as to what environmental issues we can work on. As NGOs evaluate the Bank's contribution to the countries in transition, hopefully they will consider the Bank's operations within the larger, overall context of social and economic development.

Marcelo Selowsky is Chief Economist of the World Bank's ECA Regional Office.

the nongovernmental sector. The Bank wants to make its operations as transparent as possible.

•NGOs can participate in World Bank projects both as volunteer and paid consultants.

•Headquarters staff is being reduced and reorganized to promote efficiency, and more tasks are being devolved to country-level offices (resident missions). Those should become important contact points through their NGO liaison officers. Green NGOs will be able to develop

strong working relationships with country and project managers in the resident missions.

•The Bank is offering an increasing number of grant-making and community assistance programs, for which NGOs are eligible. These include:

—*The Small Grants Program*. Grants totaling some \$600,000 a year support conferences and seminars, special publications, networking activities, and education- and information-related activities. Individual grant amounts range from

\$10,000 to \$15,000.

—*The GEF Small and Medium-size Grants Program*. Grants are available to a wide range of applicants to help them access resources of the Global Environment Facility. Topics supported: biological diversity, climate change, international waters, and the ozone layer. The proposals are funded for up to \$1,000,000.

—*Forest Market Transformation Initiative*. This coalition of conservation NGOs, private sector forest industry leaders, researchers, development practitioners

Green Media Is Vulnerable in Transition Economies

by Diana Urge-Vorsatz

Recent surveys show that in Central and Eastern Europe, environmental awareness is still at an alarmingly low level: the topic "environment" is still at the bottom of political, economic, social—and even individual (citizen)—priority lists. This is despite high pollution levels, soaring death rates, falling life expectancies—and other far-reaching consequences of environmental pollution.

Transforming environmental attitudes in the Central and East European societies rests on two pillars: education and the media. But should the market-oriented media feel responsible for educating the public? And is it acceptable for the government-owned print and electronic (radio and TV) media to continue "educating the masses," after forty to seventy years of socialist media-manipulation, brainwashing, and indoctrination? Can environmental journalists afford to be biased in their enthusiasm, or should they be content with impartial, comprehensive reporting?

During a recent international conference titled "Media and the Environment" at the Central European University (CEU) in Budapest, all these soul-searching questions were raised, but only a few were answered. It became apparent, however, that in the transition countries the flow of high-quality environmental information is still severely impeded in the media.

•The private media is profit-driven; consequently, it is ready to voice environmental concerns as long as it means business. For example: Gradual, slow environmental processes, such as the loss of biodiversity or the depletion of the world's fossil fuel resources, do not make for eye-catching headlines, and thus, they do not enjoy wide media attention. In contrast, environmental catastrophes—such as oil spills, nuclear accidents, and poisonous smog—are spectacular

enough to make front-page headlines.

•The national, state-owned media is in theory able to disseminate information regularly on key environmental issues, and to engage the wider public in dealing with environmental problems. But in practice the national media in Central and Eastern Europe currently pays little attention to these issues, giving low priority to environmental columns and programs. This is partly explained by the national media's scarce financial resources, and partly by the scarcity of journalists who are qualified to cover environmental issues.

•Most local media—grassroots, NGO publications; local, citizen-initiated newsletters, and magazines; radio and TV broadcasts—are committed environmentalists. They embrace the ideals of public participation in decisionmaking, and the right of unrestricted access to information. But fierce competition for the limited funds available to such media (through foundations, membership fees, or private charity) often hurts their quality and their influence.

What can be done? Strong public pressure should persuade government and business to take bolder steps to improve environmental conditions. The twin pillars of education and the media must support the call to environmental action. International financial institutions, including the World Bank, should help promote environmental awareness in the transition economies, through support for "green" education and training courses, environmental publications and radio and TV programs, and environmental training for journalists.

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and financiers, and the World Bank tries to induce a shift in private sector behavior in the remaining intact forest frontier areas, including in Russia.

—*The Russia GEF Biodiversity Conservation Project*. A local Biodiversity Activities component of \$2.5 million is earmarked to finance projects in the Baikal region. Grants of \$1,000 to \$50,000 are available to NGOs.

•The Bank has agreed to participate in a working group to continue the dialogue initiated through the workshop meetings. NGO representatives and donors—private foundations, bilateral donors, and international finance institutions—will meet shortly.

Short-term Steps

World Bank representatives offered a series of initial steps in the short term to respond to NGO concerns:

•The Bank and NGO representatives can work jointly on guidelines for the NGO liaison officers in the resident missions, with the goal of building a strong, committed liaison staff. [Consultations have already begun with an assigned representative of the NGO group. The editor.]

•NGOs can be provided timely information about the environmental aspects of new Bank projects.

•Key documents can be translated into local languages, to the extent that budget and human resource constraints allow.

•The Bank can better utilize NGO expertise in designing and implementing new Bank projects. At the same time, the Bank recognizes that NGOs need more training and skills development to be able to collaborate as partners or consultants. The Bank can encourage greater complementarity between the demand for NGO services and the training activities that donors decide to finance. Training opportunities at the Bank's Economic Development Institute (EDI), particularly in financial and business management, can also enhance NGO capacity. The newly created NGO-

Donors Working Group is likely to become a valuable forum for discussing joint actions to address the need for training and capacity building.

•The Bank can seek a better understanding of the legal and tax status in which many NGOs operate. The Bank will make special efforts to finance a comparative study that will analyze how tax regimes in the various transition countries encourage (or discourage) philanthropy, a potential source of NGO funding.

For more information about:

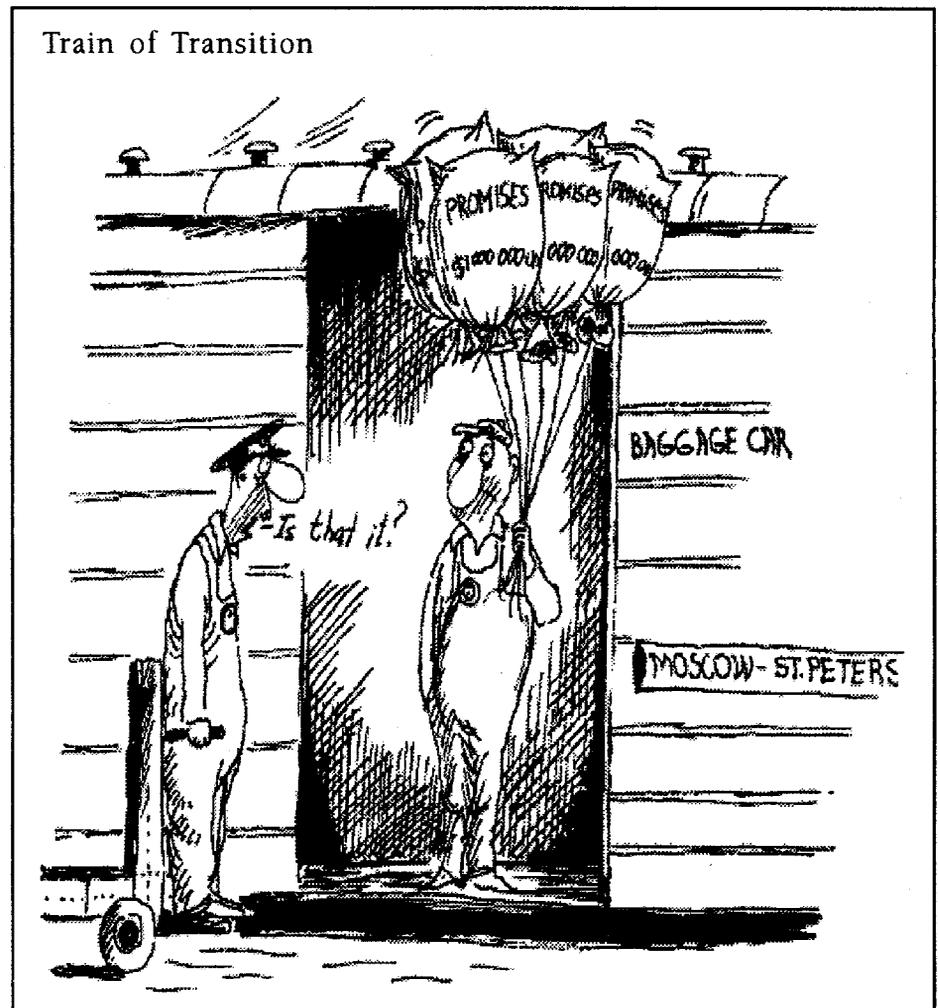
•the Small Grants Program, contact Peter Hemsch, the World Bank, tel. 202-473-3501, fax 202-522-2654, internet: "Phemsch@worldbank.org".

•the GEF Small and Medium-size Grants Program, see the GEF Website: "<http://www.worldbank.org/html/gef>".

•the Forest Market Transformation Initiative, contact Ken Newcombe, the World Bank, Environment Department, fax 202-477-0560, or Sue Hall, Executive Director, Strategic Environmental Associates, fax 509-538-2550.

•the Russia GEF Biodiversity Conservation Project, contact Elena Mikhailenko, GEF Project Manager in Moscow, fax 7095-5773.

Based on "NGOs and the Future—NGO/Donor Workshop Szentendre," a summary report by Eliza Klose, with Irmgard Hunt and D.J. Peterson; and on World Bank sources.



From the Russian weekly *St. Petersburg Press*.

A New World Bank-NGO Initiative: Joint Review of Structural Adjustment

The World Bank, in conjunction with national governments and a worldwide network of almost 1,000 civil society organizations, has launched a review to assess the economic and social impact of structural adjustment policies on various social groups (primarily the poor, the elderly, low-income large families, small farmers, small businesses, minorities) in the borrowing countries. The project, known as the Structural Adjustment Participatory Review Initiative (SAPRI), will be carried out first in Hungary and in several developing countries: Bangladesh, Ecuador, El Salvador, Ghana, Mali, Uganda, and Zimbabwe, and probably others.

Over the next twelve to eighteen months a national steering committee, composed of representatives of nongovernmental organizations, labor unions, farmers' associations, women's groups, chambers of commerce, manufacturers' associations, churches, as well as government ministries and the World Bank, will be set up in each of the participant countries to coordinate the review. They will hold public forums, conduct field investigations, and pull together several aspects of economic adjustment programs.

Concrete actions related to changes in national adjustment policies, the opening of the adjustment-planning process to broad local participation, and modifications in the Bank's own adjustment-planning instruments will be on the agenda. The findings and follow-up actions of the participating countries will be presented at a major forum (perhaps held in a participating country's capital) and discussed with senior Bank management and

policymakers in the review countries. This gathering will be similar to the national forums and will be public and fully transparent.

SAPRI grew out of discussions between World Bank staff (led by Lyn Squire, director of development policy) and representatives of nongovernmental citizen groups (led by the Washington, D.C.-based Development Group for Alternative Policies, or Development GAP). It is hoped that the initiative will demonstrate that participation of a wide spectrum of civil society can improve economic policymaking and help identify practical and necessary steps to improve the lives of ordinary people.

World Bank President James Wolfensohn, at the first global forum of SAPRI, held in Washington, D. C., in early July, noted that the program must be a joint exercise, a three-way partnership between the World Bank, governments, and community groups. "Structural adjustment covers many things. It was designed to try to develop a macroeconomic framework that is positive for all the people in the country. If we learn that some of the things we are doing do not have that effect, we are ready to change them," he told the SAPRI meeting.

As Wolfensohn stated, "I'm concerned about the 100 million people who are being added to our planet every year. I'm concerned about the 3 billion people who live on less than two dollars a day and the 1.3 billion people who live on less than one dollar a day—their exponential growth, and the reduction in equity and increase in poverty that we have to arrest."

Doug Hellinger, the Development GAP's Executive Director, who coordinates the SAPRI international citizens' network, explained during the two-day conference that the aim is "to give a voice to those who have been excluded from economic policymaking, and to give governments greater flexibility to respond to the needs of their own people." He credited Bank President James Wolfensohn, who in his two years in office has made an unprecedented effort to open the Bank's operation to public scrutiny and to lead the institution toward greater involvement with local groups and institutions in member countries.

At an estimated cost of about \$4 million, the initiative is being financed by the Norwegian government and private foundations, with the World Bank and NGOs adding their labor and facilities. Prospective funding from the European Union, Sweden, and other countries is being discussed.

For further information contact, at the World Bank, Rajiv Kochar, tel. 202-473-1395, Email: rkochar@worldbank.org; or Branko Milanovic, tel. 202-473-6968, Email: bmilanovic@worldbank.org. The SAPRI website is under construction;

The Development Group for Alternative Policies may be reached at tel. 202-898-1566, e-mail: dgap@igc.apc.org, website: <http://www.igc.org/dgap/saprin/index.html>.

Based, in part, on reports of RFE/RL, IPS, and Reuters.

The Ruble's Roller Coaster Ride

by William Easterly and Holger C. Wolf

The ride of the ruble has been nothing if not exciting. The ruble's value, compared with the dollar, took a steep dive between 1992 and 1994, including a near crash on Black Tuesday—October 11, 1994. Then, in the spring of 1995, the ruble staged a remarkable comeback. It appreciated by some 7 percent in nominal terms from April through June 1995, an unusual occurrence in an economy with high inflation. Russia's central bank bought a substantial amount of dollars, implying that the ruble would have appreciated even more without this intervention. Partly in response to the ruble recovery and a buildup of reserves, an exchange rate band was introduced in July 1995, as an additional anchor of the stabilization effort.

The band—initially ranging from 4,300 to 4,900 rubles per dollar (with the spot rate at 4,565) and since revised upward—has been largely successful: the ruble's roller coaster ride has come to a halt. The wild climb observed in the early years of Russia's transition has been replaced by a gently sloping nominal depreciation trend, leaving the exchange rate in mid-July 1997 at around 5,800 (Rb 5.80 to the dollar, if the new ruble—see the box on p. 18—were introduced now).

In explaining the evolution of the ruble exchange rate, two periods must be distinguished: in the first three years following the dissolution of the FSU, the ruble was driven primarily by changes in the growth rate of money supply; since early 1995, changes in money demand have been the deciding factor.

Early Puzzles: 1992 to 1994

Data reveal a fairly stable relationship between money supply and prices in both this and the following period. Infla-

tion declined one-to-one, with declining money growth rates after a four-month lag (figure 1). This was a simple confirmation of the monetarist view of inflation. However, there was a puzzle in the 1992-94 period. Real money balances (total value of privately held cash and bank deposits, corrected with the inflation rate) were falling while the ruble was appreciating in real terms (ruble depreciation has been slower than the inflation rate, figure 2). Since falling real money balances are usually taken as a sign of falling demand for money, and real appreciation is usually taken as a sign of rising money demand, the signals were contradictory. Anyway, how could demand for money be falling when inflation was falling?

The puzzle is explained by overshooting. Overshooting results from slowly-adjusting inflation. Inflation responded to monetary tightening, with about a four-month lag. In the meantime, real money balances declined, since money growth slowed but inflation did not. The exchange rate—in contrast—responded immediately to monetary tightening with real appreciation. The decline of monetary growth thus caused a temporary decline in real balances and a temporary real appreciation until prices could adjust. However, monetary policy was tightened further each period, so prices never caught up over this time. Since nominal money supply growth slowed, real balances continued to decline, and the real exchange rate continued to appreciate as inflation persisted for several months at its previous rate.

Why did the strict one-to-one relationship between nominal money growth and inflation persist, implying no change in money demand? Normally, as inflation slows down, faith in the currency returns and the inflation rate trails behind the

money growth rate. But this didn't happen in Russia, suggesting that the progress of stabilization continued to be viewed with skepticism.

Behind the Ruble Appreciation: 1995 to 1997

The agreement on the IMF-supported program in March 1995—followed by monthly performance reviews required for tranche releases—provides a possible, and plausible, break point for expectations. This was precisely the point at which the ruble reversed its long decline and staged a comeback. A popular view at the time attributed the ruble appreciation to a sharp increase in demand for the Russian currency, in response to improved credibility in the wake of the IMF program.

The argument is plausible. However, the mere fact of the ruble appreciation wouldn't prove by itself that there was a reversal of inflationary expectations. The observed reversal in early 1995 is equally compatible with the overshooting model outlined above; in the presence of "sticky" inflation, the added monetary tightening—entailed in the IMF-supported program—would have led to a real balance contraction, a real interest rate hike, and hence upward pressure on the currency. The distinction was of obvious importance for the conduct of monetary policy. To put it most simply, if money demand had finally increased then having money supply grow faster than prices was no cause for concern. If demand for money had not responded, then money supply growth higher than inflation would soon lead to a resurgence of inflation.

In the early summer of 1995, indirect evidence suggested that a structural shift

Will the Hard Ruble Crowd Out the Dollar?

Declaring an end to the era of inflation, Russian President Boris Yeltsin in early August announced that the central bank will lop three zeros off the ruble next year with the introduction of a new ruble note. Starting January 1, 1998, the central bank is to issue new notes and coins, including a shiny new kopek, which will be used in parallel with the old bills for one year. An old 1,000 ruble note will be equal to a new 1 ruble note. By the start of 1999 the government plans to phase out use of the old notes, but old rubles can be exchanged for new notes until 2002. The new hard ruble signals an end to inflation and the economic slump of years past, central bank Chairman Sergei Dubinin said. Once-rampant inflation, which peaked in 1992, has been brought largely under control, with the government forecasting a 12 percent rate this year. The redenomination will not affect Russia's monetary policy next year, the chairman confirmed.

The central bank will also maintain its exchange rate policy of "gentle ruble decline" in 1998, targeting a gradual depreciation of the ruble against the dollar at a rate a little lower than the inflation rate. Monthly inflation in the first quarter of this year averaged 1.5 percent, while the depreciation of the ruble was less than 1 percent. A real appreciation of the currency is not in Russia's economic interests—it hurts exports. The central bank will stick to its policy of a gradual and pre-announced depreciation of the ruble within the currency band, Dubinin pointed out.

Introduction of the new ruble could give a boost to the government's economic reforms by removing inflationary expectations and persuading Russians to choose rubles over dollars, luring some of the so-called mattress money into ruble bank accounts, notes Stephanie Baker in a report filed in Moscow for RFE/RL. "It should encourage people to hold their savings in rubles," she writes, quoting Roland Nash, an economist at the Moscow investment bank Renaissance Capital, "which should free up some capital to invest in the real economy."

For the time being, however, a large and increasing share of average Russian household income is spent purchasing

dollars. An article in *Delovoy Mir* ("Rumors about Poverty of Russians Exaggerated," July 23, 1997) quotes a recent report of the Russian Federation State Statistics Committee: from January to April 1997 Russians spent about 107,600 billion rubles, or about 21.4 percent of their money incomes, on buying foreign currency. This is 6.4 percent higher than for the same period last year. According to modest estimates, Russians have \$20 billion to \$30 billion on hand, an amount that is roughly equivalent to the total amount of cash rubles in the country. About 6 percent of Russia's adult population expressed the desire to spend their vacations this summer at foreign resorts (including the Baltics). Considering that the average cost of such a vacation is \$450 to \$600, this means that at least \$3 billion has been accumulated just for the purpose of visiting foreign countries. It is purchases of currency and not consumer goods that accounts for the bulk of cash expenditure in excess of incomes.

Despite the central bank's efforts to de-dollarize the economy and increase the cash money supply, Russians are in no hurry to part with their U.S. currency, and are using it as a means of saving as well as making payments. Data collected by the central bank show that the average amount of foreign currency purchases made at currency exchange points in commercial banks exceeds \$1,000, which is what led central bank First Deputy Chairman Sergey Aleksashenko to believe that "it is not ordinary citizens who are purchasing dollars."

In the first half of 1997 10 percent of the country's richest citizens accounted for 32.3 percent of all money income—compared with about 29 percent last year; the poorest 10 percent accounted for 2.6 percent of money income compared with 2.2 percent in 1996. The minimum wage—in other words, the poverty line—in Russia averaged 410,000 rubles (\$70) per person per month in the first half of this year. Twenty-one percent of the country's citizens—31.1 million Russians—had money incomes below the subsistence level.

in demand had indeed occurred: the term structure of interest rates and of ruble-dollar futures suggested expectations of declining inflation and depreciation rates, while robust gains in the stock market—even in dollar terms—suggested a

broadly based increase in demand for ruble assets.

The next year and a half have borne out that the spring of 1995 was a turning point for inflation and for money demand. In-

flation rates have gradually declined from 5 percent per month in the summer of 1995 to a recent 1.5 to 2 percent. The nominal exchange rate has remained within the band, gradually depreciating. The rate of depreciation has fallen short

Figure 1. Ruble money growth and inflation

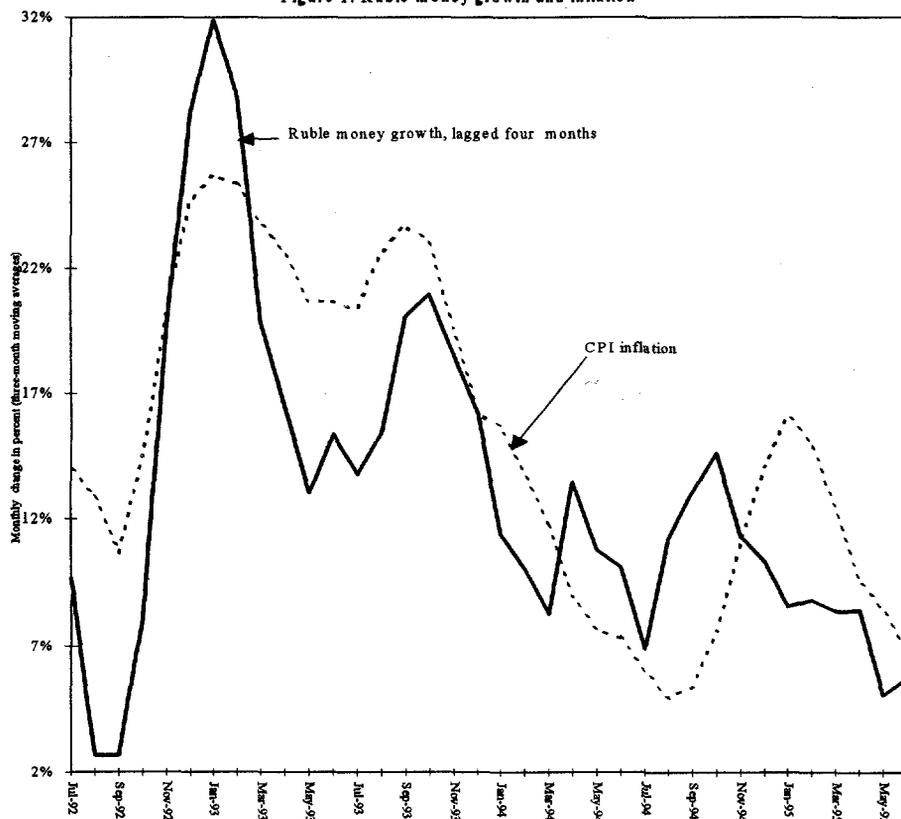
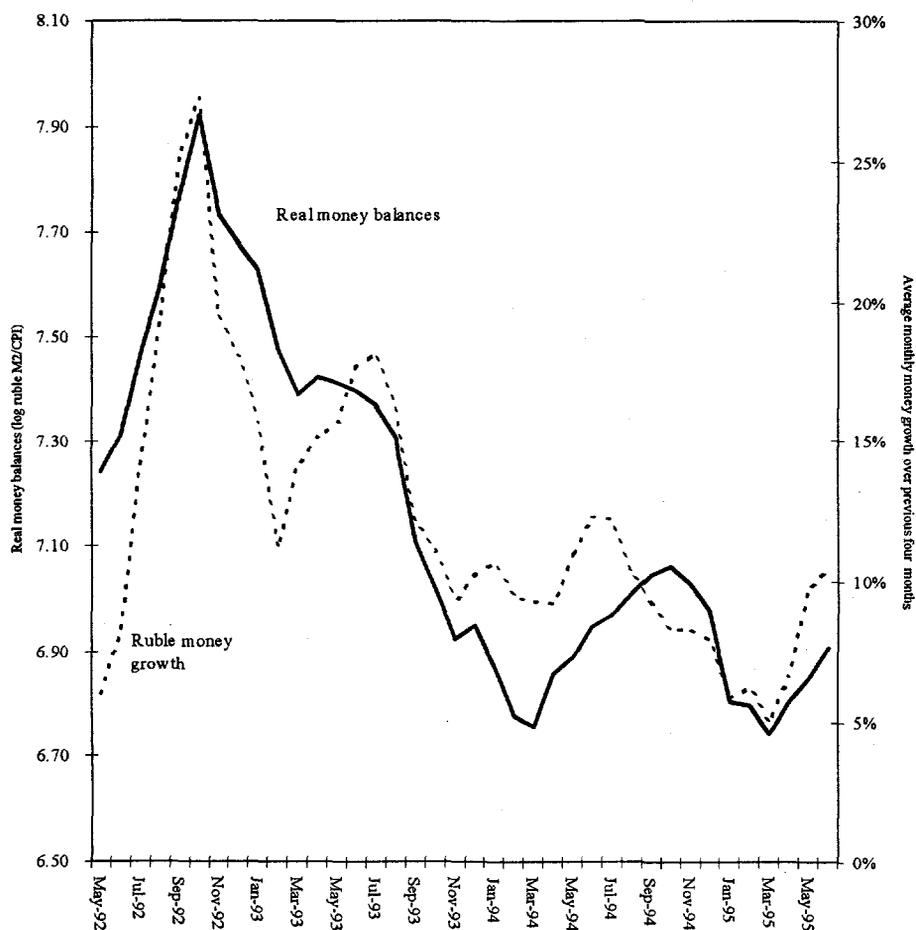


Figure 2: Ruble money growth and real money balances



of the inflation rate; since the introduction of the band, the real exchange rate has appreciated by 24 percent. Part of the real appreciation probably reflects continued strong demand for ruble-based assets: the Moscow stock index has logged a 169 percent dollar return since the fall of 1995.

Interpretation Traps

But we now see an upward trend in real money balances, which—given the stabilization of the rate of money growth—probably reflects increased money demand. Real money balances and the real exchange rate started moving in opposite directions precisely in the spring of 1995. The strict one-to-one relation between monetary growth and inflation has been broken. Money growth has proceeded faster than inflation—real M2 has increased some 20 percent since June 1995—allowing remonetization of the economy.

This episode shows how confusing it can be to interpret simple statistics like real money balances, the real exchange rate, and inflation during stabilization. If real money balances increase, is it because money supply is being expanded too rapidly, or is it because demand for money is suddenly rising? The analyst must use other information like the real exchange rate, real interest rate, and even the term structure of interest rates and the stock market, to assess whether stabilization is finally achieving success. Using such information, we can now look back and see that the wild roller coaster ride of the ruble was finally leveling out with the beginning of the IMF-supported stabilization program in the spring of 1995.

William Easterly is Lead Economist, and Holger C. Wolf is Consultant with the World Bank's DEC Research Group. This article is based on the authors' article in the International Journal of Finance and Economics, 1996, vol. 1, 251-61.

World Bank, IMF Escalate War against Corruption

Latest Ranking by Transparency International

Corruption has gotten worse in the Czech Republic, Poland, and Russia, but has improved in Hungary, according to the 1997 index of corruption perception, released by Transparency International, a corruption-fighting organization founded in 1993 and based in Berlin. (Website: <http://www.transparency.de/press/1997.31.7.cpi.html>)

The index ranks only the 52 countries (of almost 200 sovereign states) for which sufficient information is available from coverage by at least four major surveys. Most people perceive Denmark to be the least corrupt nation, and Nigeria the most corrupt. Rankings range from 0 (most corrupt) to 10 (least corrupt).

Seven transition economies were rated:

Transparency International's Corruption Perception Index, 1997

Rank	Country	Score	
		1997	1996
1	Denmark	9.94	9.33
27	Czech Republic	5.20	5.37
28	Hungary	5.18	4.86
29	Poland	5.08	5.57
37	Romania	3.44	—
41	China	2.88	2.43
43	Viet Nam	2.79	—
49	Russia	2.27	2.58
52	Nigeria	1.76	0.69

—Not available.

Transparency International chairman Peter Eigen notes that much of the corruption comes from the massive use of bribery and kickbacks by multinational corporations, headquartered in leading industrial countries, trying to buy contracts in developing countries and economies in transition.

Transparency International's index is based on seven international surveys of business people, political analysts, and the public about their perception of corruption in different countries. (Corruption can be defined as the abuse of public office for private gain.) Developed by Johann Graf Lambsdorff, an economist at Göttingen University, Germany, the index draws on surveys undertaken by Gallup International, the World Competitiveness Yearbook, Political and Economic Risk Consultancy in Hong Kong, DRI/McGraw Hill Global Risk Service, Political Risk Services of Syracuse, New York, and data gathered directly from Internet sources.

The International Monetary Fund, in new guidelines released in August, has warned its member countries that financial assistance may be withheld or suspended if government corruption is preventing their economies from moving out of trouble. The guidelines specifically mention as causes for corruption the diversion of public funds through misappropriation, involvement of public officials in tax or customs fraud, the misuse of official foreign exchange reserves, and abuse of powers by bank supervisors, as well as corrupt practices in regulating foreign direct investment. The IMF has also taken a stand against countries that consider bribes to foreign governments to be a legitimate business expense (and even allow a tax deduction for bribes). The IMF sees two main ways in which it can promote good governance:

- Improving the management of public resources, including reform of treasuries, budget preparation, tax administration, and accounting and audit procedures.
- Creating a transparent and stable economic and regulatory environment, for example, in tax codes and commercial law.

The World Bank has also called for measures to fight corruption in *World Development Report 1997: Rethinking the State*. It advocates incentives for public officials to perform better, (improving their pay, reforming the civil service, restraining political patronage, establishing effective rules), and steps to keep arbitrary actions in check through increased competition, and citizen partnerships with the private sector.

A recent conference of the Council of Europe, in Prague, spotlighted other endemic causes of corruption, primarily in the transition economies. The spread of corruption and organized crime in Ukraine and other former Soviet republics threatens to undermine the fragile foundations of their emerging civil societies, Ukraine's Justice Minister Serhiy Holovaty told the conference. Former Soviet elites in those countries continue to cling to power. Having wielded tremendous administrative control over the lives and activities of citizens under communism, the *nomenklatura* is now the virtually uncontrolled arbiter of the distribution and use of state property.

Today, because of the absence of accountability within hierarchical power structures, the scope for fraud, corruption, and embezzlement is broad. The *nomenklatura* is not interested in serious economic and administrative reform because its members profit handsomely from the unregulated environment. According to Holovaty, the link between organized crime and corruption has a special character in the former Soviet republics: "Organized crime and certain aspects of government activity are often indistinguishable." As a result, he argues, there is an "increasing institutionalization of corruption, enormous loss of revenue to state budgets,

retardation of the development of the private sector, monopolization of certain aspects of economic activity, and pervasive unjust enrichment."

Similarly, Czech Justice Minister Vlasta Parkanova, who chaired the proceedings, warned that corruption in the Czech Republic has proliferated not just in public administration

but also in the political and law enforcement communities. Pal Vastagh, justice minister of Hungary, noted that corrupt practices that had developed under Communist rule continued to flourish in post-Communist Hungary. Deputy Secretary-General Peter Leuprecht told the meeting that the Council's four-year-old drive to aid international efforts

at combating corruption has been considerably hampered by some member governments lack of political will, stemming from "the penetration of criminal organizations in government."

Based, in part, on reports by Robert Lyle, Joel Blocker, and RFE/RL and other news agencies.

Letters to the Editor

Peculiarities of Russia's Employment Statistics

In the April 1997 issue of your publication, it was reported that the unemployment rate in Russia was 9.7 percent at the end of 1996, including registered unemployed, part-time workers and workers on unpaid leave (*Transition*, April 1997, p. 27). The ILO claims even higher rates, putting unemployment at 22 percent of the labor force in Russia. Similarly high figures are published regularly. Although unemployment and underemployment have become a painful reality for many, such statistics do not adequately reflect the labor situation in Russia, as well as in many other transition economies.

While according to GOSKOMSTAT data more than 40 percent of workers on administrative leave in Russia receive no compensation, other surveys show that most such workers are able to find alternative sources of income. By one survey, 71 percent of workers on administrative leave have earnings from other sources, including 16 percent who remained at the same workplace "on their own" (*Segodnya*, December 22, 1995).

The situation is similar with regard to the unemployed. According to surveys made by the Public Opinion Research Center (VCIOM)—conducted between September 1994 and March 1996—on average, 24 percent of the unemployed were engaged in activities that provided them additional earnings. Most "employed unemployed" were involved in

construction and repair work (57 percent) and in commerce (12 percent). About 8 percent of these "unemployed" even owned a private shop, cafe, or kiosk. Apparently, many people define "employment" as a contract-based job in the formal sector.

Surprisingly, the share of the unemployed who rated their economic situation "good" and "very good" was higher than among other social groups. And the share of the unemployed whose income was growing more rapidly than the inflation rate was also higher than among the population as a whole. Apparently, unemployed workers have more time and opportunity to undertake activities in the shadow economy, which can be much more rewarding than wage employment in the formal sector.

Households try to support themselves in many ways. Employment in domestic economics has expanded, including at family plots (almost 60 percent of households own a small lot). In 1995 the share of household output in total agricultural production reached 43 percent. Some surveys have shown that in 1995, for the first time, incomes from entrepreneurship and property exceeded income from wages.

In the formal sector, from 1991 through 1996, employment declined by 11 percent, but measured GDP in real terms fell by 40 percent. As a result, labor

hoarding, which was already extensive in the prereform period, has increased even more. Because of the inflated workforce, the wage structure became compressed, real wages decreased, many workers were put on unpaid leave, and huge wage arrears accumulated. Privatization has not led to rapid restructuring of enterprises or downsizing of their workforces.

Huge wage arrears, which reached 53 trillion rubles (about \$9 billion) in April 1997, have produced a high proportion of working poor in the population. Transitional income transfers to working families have been suggested to relieve the pain. But the government is already unable to meet its obligations—how could it finance such transfers? Is it appropriate to cushion the blow caused by deficiencies in wage and employment policies by introducing new social benefits?

It would better serve Russia's interest if the government supported downsizing of those enterprises that need to retrench excess labor and encouraged job creation by legalizing and promoting activities in the informal sector. This could include removing bureaucratic barriers to the registration of small businesses and the self-employed, as well as introducing tax and other incentives.

Arvo Kuddo, Labor Economist at the World Bank's ECA Regional Office.

Speedy Reforms Pays Off, but Social Costs Must Be Considered

In their article "Reform Boosts Growth and Foreign Investment" (*Transition*, June 1997), Marcelo Selowsky and Ricardo Martin make a convincing case in favor of "good policies": sound policy reforms boost economic growth and foreign direct investment. Even the

immediate negative impact of liberalization policies on output—for example, in the Baltic and CIS states—does not, in their view, "change the general proposition that fast stabilization, liberalization, and privatization bring benefits earlier."

My findings (reported in the table), based on in-depth studies of twelve reforming economies (China, the Czech Republic, Estonia, Hungary, India, Kazakhstan, Latvia, Lithuania, Poland, Russia, Uzbekistan, and Viet Nam), provide similar encouraging results. (These findings

Reform Speed and Transition Record: 1991-95

Speed of reform	GDP growth in 1995	Unemployment rate in 1995	Inflation		Foreign exchange regime in 1995	Trade policy regime in 1995	Foreign investor perception by end-1995	FDI as share in gross fixed investment in latest year	
			Rate in 1995	Decline over reform period					Decline from peak to next year
I. High speed									
1. Poland	3	9	5	4	4	7	4	6	8
2. Estonia	4	6	3	1	1	2	2	2	2
3. Latvia	9	3	4	2	3	3	3	5	3
4. Lithuania	7	4	7	3	7	4	6	8	7
5. Czech R.	6	1	1	8	5	1	1	4	6
6. Viet Nam	2	-	2	5	6	6	10	7	4
II. Medium speed									
7. Hungary	8	7	6	10	10	9	5	3	1
8. India	5	-	-	-	-	8	7	11	10
9. China	1	-	-	-	-	5	11	1	5
III. Low speed									
10. Russia	10	5	9	7	9	11	9	9	9 ^c
11. Kazakhstan	12	8	8	6	2	10	8	10	11 ^c
12. Uzbekistan	11	2	10	9	12	12	12	12	12 ^c
Correlation coefficient with reform speed ranking	0.48 (12)	-0.25 (9, without Asia)	0.62 ^b (10, without India and China)	0.75 ^a (10, without India and China)	0.5 (10, without India and China)	0.74 ^a (12)	0.78 ^a (12)	0.52 ^b (12)	0.58 ^a (12)
Correlation coefficient with 1995 foreign exchange regime ranking							0.69 ^a (12)	0.66 ^a (12)	0.61 ^a (12)
Correlation coefficient with 1995 trade policy regime ranking								0.46 (12)	0.48 (12)
Correlation coefficient with (end-1995) foreign investor perception ranking									0.85 ^a (12)

Note: The correlation coefficients are the pairwise Spearman rank correlation coefficient estimates. The sample size is stated in parentheses under each estimate.

a. These estimates are statistically significant at the 5 percent level.

b. These estimates are statistically significant at the 10 percent level.

c. These rankings are not based on any calculations. I have assumed that the Russian share of FDI in gross fixed investment in 1995 was higher than that in India, Kazakhstan, and Uzbekistan, in that order.

Rank 1 is assigned to the country with the highest 1995 GDP growth rate and FDI share in gross fixed investment (in the latest year), the most liberal 1995 foreign exchange and trade policy regimes, and the most positive foreign investor perception by end-1995. Rank 12 is assigned to the country with the lowest 1995 unemployment and inflation rates, and the sharpest decline of the inflation rate during the period and from its peak to next year.

The decline in the inflation rate for each country over the reform period is calculated as the proportionate difference between the highest inflation rate and the 1995 inflation rate. Inflation rate decline from peak to next year is measured as the proportionate drop between the highest and next year's inflation rates.

China, Viet Nam, and India are omitted from the sample in estimating the correlation between reform speed ranking and 1995 unemployment rate ranking because the unemployment problem in these Asian economies is not comparable with that in the remaining countries. The former is essentially structural, whereas the latter resulted from macroeconomic stabilization and privatization measures.

India and China are omitted from the sample in estimating the correlation coefficient between reform speed ranking and the three inflation rate rankings because these two economies were not marked by the extreme initial inflation rates prevailing in the remaining countries. Viet Nam's inflation rate in 1988 was 400 percent.

Source: Data are available from Padma Desai's introduction in *Going Global: Transition from Plan to Market in the World Economy* (MIT Press, 1997).

are discussed at length in my introduction in the forthcoming volume, "Going Global: Transition from Plan to Market in the World Economy," to be published by the MIT Press.)

The estimates generally support the conclusions reached by Selowsky and Martin:

- The correlation coefficient between reform speed and 1995 GDP growth rate is 0.87 if the three Asian economies (which did not experience an output decline) are omitted.

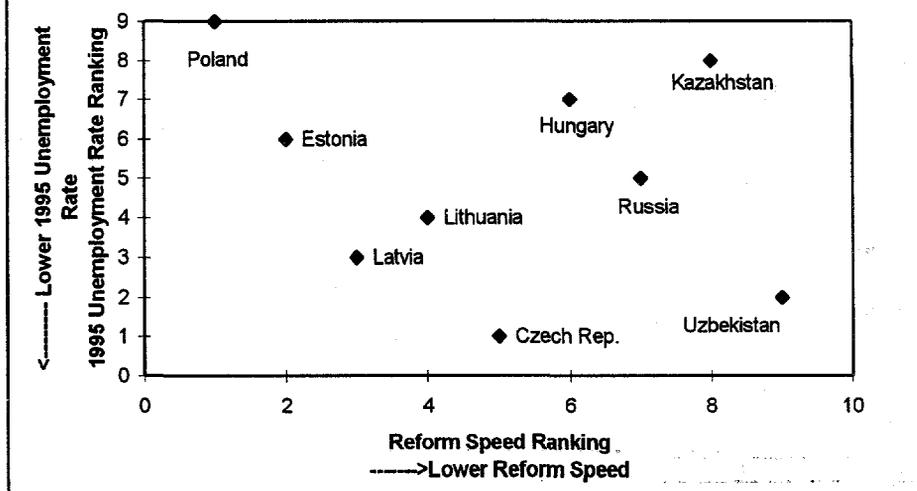
- The coefficient between reform speed and inflation decline is 0.75 if China and India (which did not experience high inflation) are omitted. On the other hand, links of reform speed with the 1995 inflation rate (with a coefficient of 0.52), and with the decline of inflation rate from its peak to the next year in a single swoop, are rather weak (0.50).

- Correlations between reform speed and foreign exchange regime, trade regime, FDI environment, as well as FDI share in gross fixed investment, range from 0.52 to 0.74. It is reasonable to conclude that speed pays off in terms of increased globalization.

- Globalization has also proceeded in lockstep: an exchange rate regime, marked by a convertible currency in place, evidently plays a role in enhancing foreign investors' positive view and actual response, that is, increased investments. (The coefficients are 0.66 and 0.61.) The exercise also suggests a link between the foreign exchange and trade regimes in 1995 (0.69).

- Speedy reform and lower unemployment rates do not go together: the correlation coefficient between reform speed and the 1995 unemployment rate is -0.25, although statistically not significant. (The three Asian economies, where defining and measuring unemployment presents problems, are omitted.) Speed is good for growth turnaround but may result in higher unemployment (see figure). The correlation coefficient between the GDP growth rate and the unemploy-

Figure. Country Ranking According to Reform Speed and 1995 Unemployment Rates

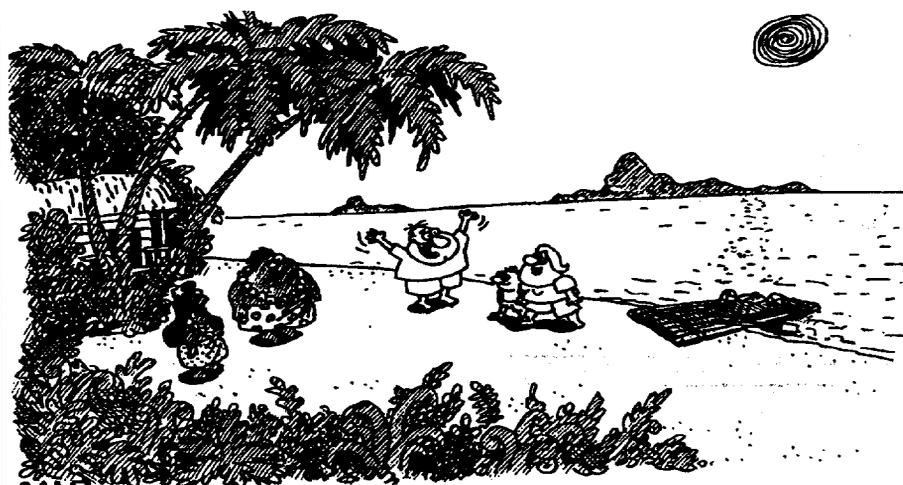


ment rate for Estonia, Latvia, Lithuania, and Poland, the celebrated cases of shock therapy, is negative, at -1. Such a trade-off implies that though speedy reforms may produce good outcomes such as growth and globalization, they may come at the cost of short-term unemployment. Further, rising unemployment may itself endanger the sustainability of reforms by provoking a political reaction.

- The choice of speedier reforms is desirable in those economies where, in the pursuit of successful transition, the risk is judged to be unimportant, and the short-term costs are deemed to be socially acceptable.

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Happy People



"We found paradise on earth. They say they have no idea who is the island's finance minister."

From the Hungarian magazine *Hócipő*.

Milestones of Transition

The Central European Free Trade Agreement

The latest report from the Slovak Statistical Office indicated several positive economic developments last year in countries in the Central European Free Trade Agreement (CEFTA), including rising GDP, falling unemployment and a slowdown in inflationary trends. In 1996 Slovakia had a 6.9 percent GDP growth rate while Poland had 6 percent, the Czech Republic 4.4 percent, Slovenia 3.1 percent, and Hungary 1 percent. Poland had the highest unemployment last year (12.4 percent), Slovakia ranked second with 10.9 percent, and Hungary was third with 9.2 percent. Consumer prices in Slovakia grew 5.8 percent last year. In the Czech Republic the average year-on-year growth was 8.8 percent, in Slovenia 9.7 percent, in Poland 19.9 percent, and in Hungary 23.6 percent. All the surveyed countries had a foreign trade deficit.

Exchange rates of the national currencies against the U.S. dollar fell in all CEFTA countries: the Slovak crown weakened by 7.9 percent, the Czech crown lost 2.7 percent, Slovenia's currency lost 12.3 percent, Poland's zloty fell 16.5 percent, and the Hungarian forint dropped 18.4 percent. Slovakia's foreign debt grew 34 percent last year, the second highest increase after Slovenia (34.7 percent). In the Czech Republic foreign debt grew 23.3 percent, while it fell 12.7 percent in Hungary and 7.7 percent in Poland. (Romania became an official member of the CEFTA on July 1, joining the Czech Republic, Hungary, Poland, Slovakia, and Slovenia. Estonia, Latvia, Lithuania, Macedonia, and Ukraine have expressed interest in joining.

Czech Republic

In July the Czech Republic's central budget showed a 6 billion crown surplus, and the January-July budget closed with an aggregate 8.8 billion crown deficit. Experts forecast a full-year budget deficit of 10 billion to 15 billion crowns. The monthly consumer price rise in July was 3.5 percent. Year-on-year inflation was 9.4 percent, up from 6.8 percent in June. The huge jump was mainly the result of one-off rent and energy price hikes, which accounted for 84 percent of the inflation rise.

The Czech foreign trade deficit widened in June by 9.6 billion crowns (\$280 million) to reach a six-month total of 74.4 billion crowns (more than \$2 billion). The half-year trade deficit is 9 percent larger than in 1996. However, the June monthly rise is the smallest so far this year. The figures suggest that the late-May devaluation and the package of import-curbing measures are taking effect. Nonetheless, Prague's import requirements may rise as a result of current flooding, while exports will be hit by the new Slovak import surcharge.

Of the 422 Czech investment funds and companies, 305 (72 percent) registered losses last year. Total losses amounted to 37.3 billion crowns (due to losses in securities trading, over-estimation of securities in portfolios, and buildup of reserves). Last year the funds employed 1,540 people, 6.5 percent less than in 1995. The average monthly wage per employee reached 22,848 crowns, 2.4 times the average wage (\$1 = Kc 34.84).

Hungary

Hungary's current account deficit for the first half of 1997 was \$800 million, down from \$934 million in 1996, according to national bank figures (see table, above).

Item	Jan-June	
	1996	1997 ^a
Trade deficit	-1,194	-997
Exports	6,767	9,376
Imports	7,961	10,372
Revenue	-254	-153
Tourism	406	551
Investment	-816	-645
Other payments	156	-59
Unreturned transfers	513	350
Current account balance	-934	-800
Direct capital investment	723	1,082

Note: All amounts are millions of U.S. dollars.

a. Projected.

Hungary will become the most dynamic economy in the region in the next two years, according to a report prepared by a Dresdner investment bank, Dresdner Kleinwort Benson. The report attributed the improvements to the government's austerity package, introduced in 1995. Analysts were optimistic enough to project 5 percent GDP growth next year. But the investment bank also expects an increase in the central budget deficit next year. The report's projections are as follows:

Indicator	1996	1997	1998
GDP	1.0	3.5	5.0
Industrial output			
(% change)	3.3	6.0	—
Unemployment (%)	10.5	10.0	9.5
Inflation (%)	20.0	17.0	15.0
Trade balance			
(billions of US\$)	-2.7	-3.0	-3.5
Current account			
(billions of US\$)	1.7	-2.0	—

— Not available.

The European Investment Bank (EIB) is expected to grant more loans to Hungarian companies, in a wider range of sectors and with easier access. That will also apply to companies in other countries on the EU accession list, Chris Knowles, head of the EIB

telecoms department, said in Budapest. Knowles was in Budapest to sign a loan guarantee agreement with Matav, the Hungarian telecommunications company. EIB loans committed to Hungarian companies total ECU 872 million.

The National Bank of Hungary is likely to propose lifting restrictions on long-term capital movements as of 1998, but the freeing of short-term movements is not expected yet, an official of the Bank's regulatory department announced. The central bank would like to monitor how the economy responds to a growth upswing this year before considering further large-scale currency liberalization.

Poland

The Polish Sejm approved the first three elements of the government's plan for radical reform of the country's pension system: the creation of private pension funds, the creation of company pension programs, and the use of state assets to fund pension reform. By 2010 pensioners will account for 11 million of some 40 million citizens, compared with a pensioned population of 9 million today. Under the proposal the government will create between ten and twelve private pension funds to relieve the underfunded, state-run social insurance system.

Citizens under 30 will make mandatory payments into the new private funds, while those between 30 and 50 will be able to voluntarily transfer payments from the state-run system to the private sector. The government will supervise the operation of the private funds. The new pension funds are scheduled to start in January 1999. An average Polish pension is now 608 zloty (\$200), or some 60 percent of the national average wage.

Central Asia

The Armenian government raise electricity prices for consumers by 12 percent to the dram equivalent of \$0.042 per kilowatt-hour, beginning on September 1. Energy prices for enterprises will rise by 20 percent, but enterprises will be entitled to a 50 percent price discount at night. Energy ministry officials said that the increases are in line with an earlier agreement signed with the World Bank. The officials said that electricity prices will have to be raised to \$0.06 per kilowatt-hour by January 1999 in order to make Armenia's energy sector profitable.

In Georgia energy prices for both commercial enterprises and domestic consumers rose to 4.5 tetri (\$0.035) per kilowatt-hour beginning on August 1.

Tajik wages are now worth less than at the start of the year. The Tajik state statistics agency reported that real income dropped by 1.8 percent from April to May and has dropped by 37.9 percent since the beginning of 1997. The official average wage is reportedly 3,699 Tajik rubles per month, but a kilogram of beef costs 1,200 rubles, a liter of vegetable oil more than 1,000 rubles, and a kilogram of sugar 650 rubles (\$1 = 320 Tajik rubles).

Kyrgyz President Askar Akayev has signed a decree whereby 8 percent of shares in leading enterprises will be distributed free of charge among pensioners, invalids, World War II veterans, and low-income families. This will include shares in leading companies scheduled to be privatized, such as Kyrgyztelekom, Kyrgyzenergo, the national airline, and the two largest publishing houses, Uchkun and Akyl. The measure is intended to "ensure social justice."

Russia

Russia's monthly inflation rate eased to 0.9 percent in July, from 1.1 percent in June. Presidential administration deputy head Alexander Livshits told *Echo Moskvy* that he was uncertain whether the Russian economy would begin to grow in 1998. The government is still "officially" expecting economic growth of about 2 percent next year.

Prime Minister Viktor Chernomyrdin said Russian budget revenues for the first half of 1997 were 64 percent on target, while spending totaled 68 percent of planned levels. Whereas 58 percent of taxes were collected in the first quarter, the figure for the second quarter saw 87 percent. Finance ministry officials admitted that the tax situation improved after the Gazprom natural gas company paid off its arrears, but described that company's payment as a one-off move that was unlikely to change the general trend. The continuing crisis in industry, where 48 percent of enterprises were loss-makers, is narrowing the tax base.

President Yeltsin has signed a decree liberalizing the export of gold and silver bullion as of October 1. Yeltsin also signed into law a bill imposing a 0.5 percent tax on purchases of foreign currencies and foreign currency payment instruments.

Investors will soon get their first chance to buy Russian corporate debt on an open exchange, Andrei Kozlov, deputy chairman of the Russian central bank, disclosed. Issues of ten top companies are expected to be listed on the Moscow Interbank Currency Exchange, Russia's largest exchange, by 1998. The number of issues should increase within the next eighteen months. Russian corporate securities often offer yields nearly double those of government paper, but the market is virtually unregulated and suffers from a severe information deficit. The central bank requires foreign-

ers to use special bank accounts when investing in Russia, but it has not said what kind of bank account they need for short-term corporate debt. Special bank accounts have been designated for equity and treasury investments. Only a few Russian companies have received inter-

national debt ratings in preparation for eurobond issues.

China

As a result of double-digit growth in consumption and investment, annualized

GDP grew 9.5 percent in the first six months of 1997. The annualized retail price index rose a negligible 1.8 percent between January and June and is expected to rise just 3 to 4 percent for the whole year, lower than the official target of 6 percent. Prices have been falling

The Omnipotent Oneximbank: Taking Over Russia's Industry?

Alfred Kokh, Russia's privatization chief, has resigned. Under his reign numerous state assets were sold off cheaply to top banks in deals that critics charge were rigged. The resignation, writes *Wall Street Journal* correspondent Betsy McKay, signals a new era of openness and transparency in the privatization process. As the government focuses on raising revenue to pay off rising debts, upcoming deals are likely to be modeled on the Svyazinvest sale, which, despite the public outcry from a consortium of banks that lost the bid, fetched a price well above the stake's market value. Kokh, who stepped down as both chairman of the State Property Committee and deputy prime minister, was replaced in both posts by economist Maxim Boycko, who has served as Boris Yeltsin's deputy chief of staff.

Selling off its economic assets will help the Russian government pay off a massive backlog of wage arrears by the end of the year. In July, Yeltsin instructed the government to pay off its debts to the armed forces within two months and all wage arrears to teachers, doctors, and other state employees within three months. First Deputy Finance Minister Aleksei Kudrin estimated in May that wage arrears total 53.7 trillion rubles (\$9.3 billion). Of that, he said, 11.2 trillion rubles are owed to federal, regional, and local government workers and the rest to non-state enterprise workers. Several sales over the past few weeks helped the government exceed its privatization revenue target of 10 trillion rubles (\$1.7 billion) this year.

Russia's Oneximbank, headed by former First Deputy Prime Minister Vladimir Potanin, has pledged to pour more than \$1 billion into the budget in auctions for telecommunications holding company Svyazinvest and metals giant Norilsk Nickel. The Onexim-MFK Group consortium, including financier George Soros (who invested \$980 million), won a 25 percent stake of the Svyazinvest for \$1.9 billion. Svyazinvest holds controlling shareholdings in eighty-five of Russia's eighty-seven regional telecommunications providers as well as in RAO Rostelecom, the long-distance and international telecommunications giant. Oneximbank is already considering taking part in the fall tender for another 24 percent of Svyazinvest. On August 5 Svift, a closed joint stock company affiliated with the Oneximbank, won an auction for a

38 percent stake in Norilsk Nickel one of the world's major producers of nickel and platinum group metals. Svift's winning bid was for about \$250 million. The winner has to invest an additional \$300 million and also pay back a \$170 million loan Oneximbank extended to the government in November 1995. (In exchange for that loan, Oneximbank gained management rights over the 38 percent Norilsk stake.)

Oneximbank ranks as one of Russia's biggest commercial banks, with assets of 21,000 billion rubles (\$3.5 billion) at the beginning of the year, John Thornhill points out in his article in the *Financial Times* (August 7). The bank was one of the first to receive a rating from a Western credit agency—Ba3 from Moody's—enabling it to issue a \$200 million eurobond in July. The bank is part of the broader Interros Group, an industrial holding concern controlling twenty-four companies with a combined turnover of \$10 billion. Prominent among them is Sidanco, Russia's fifth-biggest oil producer with reserves greater than those of Mobil. Oneximbank also has a large stake in MFK-Renaissance—one of Moscow's biggest investment banks, with a strong presence in local debt and equity markets—and the ability to provide its parent company with additional financing power.

The MFK arm of the group, known as International Company for Finance and Investment, owns 17.5 percent of the Novolipetsk Metallurgical Combine, one of Europe's biggest steel producers. The group is also a major shareholder in Komsomolskaya Pravda, one of Russia's biggest newspapers. The Onexim-MFK Group is considering bidding in the government's sale this fall of 51 percent of RAO Rosneft, the last state-owned integrated oil company in Russia. Rosneft has oil businesses ranging from the rights to some of Russia's biggest untapped wells to a network of gas stations across Russia's eleven time zones. Vladimir Potanin, head of this huge business empire, graduated in 1983 from the Moscow State Institute for International Relations, the training school for future diplomats. He then worked for the Soviet foreign trade ministry for eight years. As the Soviet Union collapsed, he established his own bank: the United Export-Import Bank—the Oneximbank.

across the board, in part because of two consecutive years of bumper harvests, which have brought down food prices. Annualized exports grew 26.2 percent in the first six months of 1997, to \$80.8 billion, while imports dropped 0.3 percent, to \$63.1 billion. The rise in exports appears to be partly attributable to the dumping of excess production on world markets.

A recent survey by the State Statistical Bureau estimated that about 50 percent of industrial state-owned enterprises incurred net losses in 1996 amounting to 1.3 percent of GDP. Two years ago only one-third of such enterprises were loss-makers. In industry, years of double-digit growth in fixed-asset investment have led to overcapacity. While stockpiles are rising, investment in industries such as metallurgy, petrochemicals, and textiles has been falling.

People's Democratic Republic of Korea

On August 1 the Republic of Korea gave the green light to five local companies, among them Samsung Electronics, the country's largest electronics company, and Kolon International, a leading manufacturer of textile products, to invest in North Korea. The other companies are apparel and food-processing companies. The move brings to twenty the number of South Korean firms that have been allowed to pursue business in the North. Only two have so far invested in the North for joint ventures: Daewoo, with a \$5 million investment in a clothing company in North Korea's western port of Nampo; and Taechang, which invested \$6 million in a project to produce mineral water in the eastern province of Kangwon.

Pyongyang could break out of isolation and economic ruin if it takes sincere steps towards detente, former U.S. Senator Sam Nunn and former U.S. ambassador to South Korea James Laney

told North Korean leaders during a recent visit. Nunn said that if North Korea sought cooperation with the West, it could expect reconstruction assis-

tance from the World Bank and the Asian Development Bank.

We appreciate the contributions from Radio Free Europe/Radio Liberty Newslines.

World Bank/IMF Agenda

MIGA: Investment Guarantees on Record Level

The Multilateral Investment Guarantee Agency (MIGA) broadened its investment guarantees against political risks into eleven new countries in fiscal 1997, including Azerbaijan, Georgia, and Romania. The insured projects were mainly in infrastructure, where financing is increasingly based on public-private partnerships. The agency issued seventy guarantee contracts covering \$614 million in twenty-five member countries. MIGA also negotiated the establishment of an investment guarantee fund for Bosnia that provides long-term guarantees for small and medium-size investments in the region. In the past fiscal year, ninety-five countries benefited from MIGA's investment marketing services, including countries in Eastern Europe and Central Asia. Next year MIGA guarantee capacity could reach its limit if it does not negotiate more room through innovative cofinancing arrangements. MIGA has already begun to share out part of its risks through private insurers and investment guarantee funds.

Ready for Hong Kong? Hong Kong Is Ready

Hong Kong is getting ready to accommodate, feed, and protect 12,000 to 14,000 participants from 181 countries attending the World Bank-IMF annual meetings, September 23-25. The joint annual meetings of the two Bretton Woods institutions, taking place a little more than ten weeks after the territory's handback to China, will "enhance Hong

Kong's status as an international business center," said James Lau of the Hong Kong Monetary Authority (HKMA), hosting the event. On the occasion, the World Bank will release its report *China 2020: Development Challenges in the New Century*, on the future of China. A series of seminars will be organized on the theme "Asia and the World: Capital, Competitiveness, and Community." The official budget for the meetings is expected to reach HK\$485 million. The June 30 handover ceremonies, according to the *South China Morning Post*, had a government allocation of HK\$233 million.

Bosnian Central Bank Plans Convertible Mark

The Central Bank of Bosnia has started operations, according to an announcement, August 11, the head of the bank, Serge Robert, a French banker. Transactions will be electronic until the three sides can agree on a design for a common currency. New bills are expected to go into circulation three months after the design is approved. The new monetary unit will be called the "convertible mark" and pegged on a one-to-one basis to the German mark, which has long been the unofficial second currency throughout the former Yugoslavia. Current Bosnian dinars can be exchanged at the rate of 100 dinars for one convertible mark.

New Pledges To Bosnia

Participants at the third international donors conference for Bosnia—held in Brus-

continued on page 29

World Bank Lending, FY 1997: China and Russia—Largest Borrowers

Transition economies in Europe and Central Asia saw \$5.1 billion in World Bank projects approved for the 1997 fiscal year ending June 30. This is nearly a \$1 billion increase over

the preceding fiscal year, when \$4.2 billion went to the region. The social sector received the largest share, with loans totaling \$935 million. Russia was the largest borrower in the re-

World Bank Lending to Europe and Central Asia, FY 97

(millions of U.S. dollars)

<i>Country/project</i>	<i>(Principal amount)</i>	<i>Country/project name</i>	<i>(Principal amount)</i>
Armenia		Lithuania	
Highway Project-Supplemental Financing	15.00	Social Policy & Community Social Services Development	3.70
Enterprise Development Project	16.75	Structural Adjustment Loan	80.00
Azerbaijan		Highway Project	19.00
Farm Privatization Project	14.70	Energy Efficiency/Housing Pilot Project	10.00
Gas System Rehabilitation Project	20.20	Macedonia, former Yugoslav Republic of	
Bosnia and Herzegovina		Structural Adjustment Loan	30.00
Emergency Industrial Re-Start Project	10.00	Structural Adjustment Credit	30.00
Local Initiative Project	7.00	Moldova	
Essential Hospital Services Project	15.00	Port Access and Management Project	9.00
Transition Assistance Credit	90.00	Poland	
Emergency Housing Repair Project	15.00	Port Access and Management Project	67.00
Emergency Electric Power Reconstruction Project	35.60	Romania	
Emergency Public Works and Employment Project	10.00	Agricultural Sector Adjustment Loan	350.00
Emergency Landmines Clearance Project	7.50	Social Protection Adjustment Loan	50.00
Emergency Demobilization and Reintegration Project	7.50	Second Roads Project	150.00
Bulgaria		Reform of Higher Education and Research Project	50.00
Critical Imports Rehabilitation Loan	40.00	Bucharest Water Supply Project	25.00
Social Insurance Administration Project	42.00	Russia	
Rehabilitation Loan	102.00	Social Protection Adjustment Loan	800.00
Croatia		Structural Adjustment Loan	600.00
Enterprise and Financial Sector Adjustment Loan	95.00	Electricity Sector Reform Support Project	40.00
Coastal Forest Reconstruction and Protection Project	42.00	Health Reform Pilot Project	66.00
Emergency Transport and Mine Clearing Project	102.00	Education Innovation Project	71.00
Georgia		Enterprise Restructuring Services Project	85.00
Power Rehabilitation Project	52.30	Bureau of Economic Analysis Project	22.60
Oil Institution Building Project	1.40	St. Petersburg Center City Rehabilitation	31.00
Agricultural Development Project	15.00	Slovenia	
Hungary		Investment Recovery Project	49.30
Quick Start Gas Turbine Project	60.00	Tajikistan	
Enterprise and Financial Sector Adjustment Loan	225.00	Pilot Poverty Alleviation Project	12.00
Public Finance Management Project	7.75	Agricultural Recovery and Social Projection Project	50.00
Kazakhstan		Turkmenistan	
Real Estate Registration Pilot Project	10.00	Urban Transport Project	34.20
Pilot Water Supply Project	7.00	Water Supply and Sanitation Project	30.30
Treasury Modernization Project	15.80	Ukraine	
Uzen Oil Field Rehabilitation Project	109.00	Coal Sector Adjustment Loan	300.00
Kyrgyz Republic		Export Development Project	70.00
Rural Finance Project	16.00	Agriculture Sector Adjustment Loan	300.00
Public Sector Resource Management Adjustment Credit	44.00	Electricity Market Development Project	317.00
Latvia		Social Protection Support Project	2.60
Welfare Reform Project	18.10	Uzbekistan	
Highway Project	20.00	Pilot Water Supply Engineering Project	5.00
Structural Adjustment Loan	60.00	Total	5,035.40

gion, receiving loans of \$1.7 billion, including an \$800 social sector development loan—the largest ever in the region. China, with \$2.8 billion in loans, re-

FY 97 Lending to East Asia's Transition Economies

<i>Country/project</i>	<i>(Principal amount)</i>
Cambodia	
Agriculture Productivity Improvement Project	27.00
Disease Control and Health Development Project	30.40
China	
Xiaolangdi Multipurpose Development Project Stage II	430.00
Waigaoqiao Thermal Power Project	400.00
National Rural Water Supply Project	70.00
Qinba Mountains Poverty Reduction Project	150.00
Wanjiashai Water Transfer Project	400.00
Inner Mongolia (Tuoketuo) Thermal Power Project	400.00
Fourth Basic Education Project	85.00
Heilongjiang Agricultural Development Project	120.00
Second National Highway Project	400.00
Second Xinjiang Highway Project	300.00
Vocational Education Reform Project	30.00
Lao People's Democratic Republic	
Third Highway Improvement Project	48.00
Mongolia	
Banking and Enterprise Sector Adjustment Credit	10.00
Banking, Enterprise, and Legal Technical Assistance Project	20.00
Viet Nam	
Water Supply Project	98.61
Second Highway Rehabilitation Project	195.60
Rural Transport Project	55.00
Total	3,269.61

Source: World Bank Annual Report 1997.

mained the World Bank's largest borrower. It received almost two-thirds of the \$4.9 billion that went to East Asia in FY 1997. Cumulative lending to China since the country rejoined the Bank in 1981 is now \$28.12 billion. Infrastructure lending accounts for nearly half the total portfolio, with agriculture, social sectors, environment, and industry making up the remainder.

Russia is the second-largest borrower. Ukraine is sixth (\$989.6 billion), and Romania ninth, (\$625 billion). In FY 1997 the World Bank approved a total of \$19.1 billion in new loans, less than in FY 1996 (\$21.4 billion), and FY 1995 (\$22.5 billion). But gross disbursements increased to nearly \$20 billion, up from \$19.3 billion in FY 1996 (compared with \$21.4 billion in FY 1995).

continued from page 27

sels, July 23-24, and cochaired by the World Bank and the European Union—pledged \$1.2 billion for continued financing of the reconstruction effort. The pledges, from forty-eight countries and thirty international organizations, are for projects involving housing, banking sector restructuring, social services, and telecommunications repairs. The two earlier donors conferences, in December 1995 and April 1996, together secured \$1.85 billion for the first year of the reconstruction program. By mid-1997, projects worth some \$926 million had reportedly been implemented under the Priority Reconstruction Program. Disbursement details:

- The Muslim-Croat Federation has received some 98 percent of the funds, with just 2 percent channeled to the Bosnian Serb Republic (RS). Within the Federation, most funds were directed to projects in Bihac, Sarajevo, and Tuzla.
- Projects focusing on the repair of transportation and electric power networks, housing reconstruction, and support for government institutions have accounted

for 77 percent of the amounts tendered, contracted, and disbursed.

- Multilaterally administered programs and projects have accounted for 61 percent of reconstruction aid, compared with 39 percent in bilateral funding through national aid agencies, nongovernmental organizations, and other bodies. The EU has been the largest donor so far, while the World Bank as a lead agency has provided one-third of the total project costs.

Terms for Albanian Aid

The IMF will provide post-conflict emergency assistance for Albania, but long-term aid will depend on whether the authorities restore security, consolidate their control over all parts of the country, close down investment pyramid schemes, establish satisfactory tax records, and cut the budget deficit. On August 6 an IMF spokesman said that plans to help Albania have been worked out and that an IMF delegation will go to Tirana in mid-August. The European Commission and the World Bank are to hold a meeting of donor countries in Brussels once the Albanian government defines an IMF-approved reform program.

No Tariff Increase Means No Electricity Loan for Ukraine

The World Bank has suspended disbursements of a \$317 million Electricity Market Development Loan to Ukraine as a result of the failure of the Ukrainian authorities to bring electricity tariffs to a full cost recovery basis as previously agreed. The indefinite postponement of the tariff adjustment has jeopardized the financial viability of the thermal generation companies that are financed by the loan disbursements, the Bank said. The loan, approved last October, was to build up fuel stocks and spare parts, and to install metering and other modern equip-

ment over three years to bring Ukraine's electric utility industry up to standards, particularly because of the loss of the Chernobyl nuclear plant. The action will not automatically affect other loans to Ukraine, will be assessed on a case-by-case basis.

IMF, Ukraine Agree on Standby

Ukraine reached agreement in principle with the IMF on a one-year standby loan of around \$525 million. Depending on the decision of the IMF board of directors, the loan will be disbursed through July 1998, with the first IMF review scheduled for November. Ukrainian officials hope that the loan will be transformed into an extended fund facility later this year. The IMF has made such a change conditional on accelerating reforms in Ukraine. Following the approval of the extended fund facility, Ukraine will resume talks on new World Bank loans. Ukrainian GDP fell 7.5 percent in the first half of 1997 from the same period in 1996, according to the Ministry of Statistics.

Flood Assistance to Poland

The Polish government plans to borrow up to \$300 million from the World Bank and the European Investment Bank to help rebuild the southern part of the country, where floods swamped more than 5,000 square kilometers. Basil Kavalsky, country director for Poland and the Baltic States, said that before any loan decision could be made the Bank's mission had to examine the scope of damages and assess assistance needs. But he encouraged the government to start repairing the infrastructure immediately, saying that the Bank's future loan would reimburse costs borne now. Kavalsky said that the floods were unlikely to cause any significant slowdown of economic growth this year, but suggested that inflation might be higher than the 13 percent forecast by the government for December.

Hungary Launches Regional Health Project from World Bank Loan

The Hungarian government is using a World Bank loan to launch a \$27 million grant program for the modernization of health care facilities throughout the country. Of the total, \$18 million will come from the World Bank's \$91 million health care modernization loan and \$9 million from the central budget. The Ministry of Welfare will invite regional consortia, which cover at least two counties with 900,000 to 3 million inhabitants, to participate. Regions may bid on programs to make local health services more up-to-date and less costly, such as the use of outpatient surgery home care, in lieu of hospital treatment, where possible.

World Bank Lends \$150 Million for Higher Education in Hungary

The World Bank will provide a \$150 million loan to help reform higher education in Hungary, Culture and Education Minister Bálint Magyar announced. The loan will be supplemented with budgetary resources, and thus some \$250 million will be available for a six-year reform program aimed at making the system of higher education more responsive to the economic and social needs of the country. That includes promoting the integration of universities and colleges.

Qualified IMF Endorsement to Bulgaria

In mid-July the IMF Executive Board approved the release of a \$137 million second tranche of a \$510 million, fourteen-month standby agreement. On July 25 the board completed its first review of the country's economic program following the loan's approval in April. The IMF said that Bulgaria needs to fully implement measures to strengthen the Central Bank's supervision of the banking system. The IMF recognized that the swift adoption of a currency board was

a strong signal of the government's commitment to enforce financial discipline. It recommended a tougher approach on liquidations and bank restructuring. Bulgarian authorities expect to receive the next IMF loan tranche of \$84.5 million by mid-August.

In One Sentence

- The World Bank on July 29 approved a \$10 million IDA credit to Armenia that will be used to improve primary health care and the efficiency of public health expenditures.
- Also on July 29, the Bank approved a \$70 million loan to Romania to help finance the repair of about 900 seriously damaged pre-university schools, mostly in rural areas.
- The IBRD will charge a lower rate for its variable-rate loans over the next six months: as of July 1, the interest rate will be cut to 6.54 percent, down from the earlier 6.70 percent.
- On July 15 the Bank approved a \$20.9 million IDA credit to Georgia that will strengthen local governments' organizational, management, and financial base.
- The IMF has approved a \$45 million Extended Structural Adjustment Facility (ESAF) loan to Mongolia and expects an annual 6 percent GNP growth by 2000, and a single-digit inflation rate.

Adjustment Credit to Azerbaijan

A \$70 million structural adjustment credit was approved to Azerbaijan on July 24. It will support government efforts to reform the banking sector, fully liberalize domestic and foreign trade, and improve social policy.

IMF Satisfied with Russia's Economy—Chubais

First Deputy Minister Anatoly Chubais said an IMF mission visiting Russia was satisfied with its economic performance and would recommend payment of the \$700 million second installment of last

year's \$10 billion Extended Fund Facility loan. Both the Russian government and the IMF agreed that the system for collecting taxes needed to be improved further, and one possibility was for the IMF to provide consultants to the Federal Tax Service. The Tax Service said in the first half of 1997 it collected 123.9 trillion rubles, half as much as in the same period of 1996 and 87.4 percent of the Finance Ministry's target of 138.3 trillion rubles. Tax collection was up almost a third in June from May, the Service said.

World Bank Probe Clears Russian Group

A World Bank inquiry has found no financial improprieties in the use of World Bank funds at the Institute for a Law-Based Economy (ILBE), a Moscow-based think tank. ILBE was set up in 1995 by Harvard University's Institute for International Development, to promote legal reform in Russia (helping to train Russian advisers, write economic legislation, and so on). ILBE won a \$4 million contract to manage a \$31 million World Bank Privatization Implementation Assistance Loan. The inquiry was launched after the U.S. government alleged in press reports in May that two top Harvard University advisers to the Russian government, Andrei Shleifer, Russian project director, and Jonathan Hay, Moscow field manager and adviser to Russia's Federal Securities Commission, had violated conflict-of-interest regulations and used their positions for personal gain. Harvard immediately relieved them of their duties in the project. Both men were instrumental in helping form ILBE and Hay was involved in its management. The Bank's inquiry, which investigated spending under the loan, established that there was proper documentation for all billings to the World Bank, and contrary to press reports, there was no misuse of World Bank funds. A separate U.S. government investigation has been under way since March.

Based on RFE/RL reports and other news agency reports and on World Bank sources.

Conference Diary

**Integration and Transition in Europe:
The Economic Geography of Interaction**
September 11-14, 1997, Budapest,
Hungary

Organizer: The Department of Planning and Regional Development, University of Thessaly, Greece.

Information: George Petrakos, Department of Planning and Regional Development, University of Thessaly, Pedion Areos 38334 Volos, Greece, tel. 30-421-82845, fax 30-421-63793, Email: petrakos@helle.uth.gr

**A New Vision of Development Cooperation for the 21st Century—OECD/
World Bank Symposium**

September 17, 1997, Tokyo, Japan

Topics: Joseph Stiglitz will lay out the main themes of the proposed Policy Research Report on aid effectiveness, highlighting key research results that guide our thinking. The vice president of OECD will speak on "Addressing Global Issues." This symposium will be followed by a one-day technical workshop directed at a more specialized audience, with participants from aid agencies, research institutes, and academia. The workshop will reflect the themes highlighted in the symposium and allow a more technical discussion of various studies and research efforts.

Information: Raquel Luz, World Bank, 1818 H Street, N.W., Room N11-053x, Washington, D.C. 20433, United States, tel. 202-473-9059, fax 202-522-1152, Email: rluz@worldbank.org

The Fulfilment of EU Convergence Criteria: The Case of Poland

September 15-17, 1997, Warsaw, Poland

Organizers: Polskie Towarzystwo Ekonomistów (PTE); the Institute for Economic Research (Halle).

Languages: Polish, English.

Information: Hubert Gabrisch, Institut fuer Wirtschaftsforschung Halle, Delitzscher Str. 118, 06118 Halle (Saale), Germany, tel. 49-345-7753-831, fax 49-345-7753-820, Email: gabrisch@iwh.uni-halle.de

Institutions in Transition

September 18-20, 1997, Radenci,
Slovenia

Organizer: Institute of Macroeconomic Research and Development, Ljubljana (IMAD).

Call for papers: Contact conference organizer below.

Information: Irena Rink, IMAD, fax 38661-1782070, Email: irena.rink@zmar.sigov.mail.si

First Paris Workshop: The Second Stage of the Transition

September 29-30, 1997, Paris, France

Organizer: Reforming and Opening Post-Socialist Economic Systems (ROSES)-University Paris I, GASI-University Marne la Vallée.

Call for papers: Deadline September 1, 1997.

Information: Vladimir Andreff, University of Paris 1, Panthéon Sorbonne Sciences Économiques, 90 rue de Tolbiac, F-75634 Paris Cedex 13, France, tel. 33-1-40771848, fax 33-1-45847889, Email: waroses@grenet.fr

Regenerative Energy in the Running—Economic Alternatives for Central Europe?

October 1, 1997, Zittau, Germany

Organizer: Saxon Institute for Regional Economy and Energy Economics.
Language: German.

Information: Daniel Ludwig, Saechsisches Institut fuer Regionaloekonomie und Energiewirtschaft, Theodor-Koerner-Allee 16, 02763 Zittau, Germany, tel. 3583-611259/611420, fax 3583-510626, Email: sire@orion.hrz.htw-zittau.de

Russian Economy in Transition

October 2-3, 1997, Helsinki, Finland

Organizer: Working Group on Technology, Economy and Society of the Finnish-Russian Commission for Scientific and Technological Cooperation.

Topics: This conference features Russian and Western experts, with sessions on Russia's economic and sociopolitical situation and outlook, Russian forest industry cluster, regional aspects of transition, and Russia's foreign economic relations.

Information: Pentti Vartia, Research Institute of the Finnish Economy (ETLA), tel. 358-9-609900; or Vesa Korhonen, Unit for Eastern European Economies, Bank of Finland, tel. 358-9-1832834, fax 358-9-1832294, Email: vesa.korhonen@bof.fi

EUROGRAD '97

October 16-18, 1997, St. Petersburg, Russia

Organizer: Eurograd Institute.

Languages: Russian, English, German, French (simultaneous interpreting).

Topics: Problems of reform in Russia's regions, public-private partnerships in the municipal administration of cities in western Europe, and the role of international cooperation in reform in Russia. Perspectives on: the experiences of St. Petersburg and Russia's regions in the reform of municipal housing, the experiences of the cities of western Europe in the administration of housing complexes, and new technologies for saving heat, energy, and water in housing and municipal economies.

Information: Boris Grintchel, Institut EUROGRAD 14, pr. Izmailovski, PB 242, 198005 St. Petersburg, Russia, tel. 7-812-112-6478/-6772, fax 7-812-112-6506, Email: root@eimi.spb.ru

Fifth Annual Conference of the Central and East European Management Development Association (CEEMAN): Developing and Mobilizing East and

Central Europe's Human Potential for Management

October 16-18, 1997, Sinaia, Romania

Organizers: CEEMAN, International Management Foundation.

Topics: Strong features of Central and East European economies; increasing leadership, initiative, and teamwork; developing economies such as China, India, Hong Kong, and Singapore; potential development in Romania.

Information: CEEMAN, Brdo pri Kranju, 4001 Slovenia, tel. 386-64-221-761, fax 386-64-222-070, Email: ceeman@iedc-brdo.si

Romania Investment Summit

October 29-30, 1997, Bucharest, Romania

Organizer: International Herald Tribune.
Topics: Future investment potential in Romania.

Information: Ursula Lewis, International Herald Tribune Conference Office, 63 Long Acre, London WC2E 9JH, United Kingdom, tel. 44-171-420-0309, fax 44-171-836-0717, Email: ulewis@iht.com

Congress on the Eastern Enlargement of the European Union: Social and Cultural Consequences for Poland

November 20-21, 1997, Warsaw, Poland

Organizers: German-Polish Society Association in cooperation with the Friedrich Ebert Foundation-Representation in Poland, BAO BERLIN Marketing Service GmbH, Polish Robert Schuman Foundation.

Languages: German and Polish (simultaneous interpreting).

Information: Heinrich Machowski, Deutsches Institut fuer Wirtschaftsforschung, Kooperationsbuero Osteuropa-Wirtschaftsforschung, Koenigin-Luise-Strasse 5, 14191 Berlin, Germany, tel. 49-30-897708-36, fax 49-30-897708-99, Email: coop@diw-berlin.de

Economic and Social Technologies in Transitional Society

December 2-3, 1997, Perm, Russian Federation

Organizers: Perm State University, Administration of Perm Region.

Topics: Scientific basis for social and economic technologies and models during transformation.

Information: International Conference, Economic Theory Department, Perm University, 15 Bukireva St., Perm 614600, Russia, tel. 7-3422-396286, -396588, fax 7-3422-337176, Email: info@psu.ac.ru

Civil Society in Russia: Citizen Participation, Self-Help and Self-Organization in System Change and the Perspectives for Cooperation in Europe as a Whole

December 12-14, 1997, Loccum, Germany

Language: German

Information: Dr. Joerg Calliess, Dr. Christoph Huettig, Evangelische Akademie Loccum, Postfach 2158, 31545 Rehburg-Loccum, Germany, tel. 49-(0)5766-81-0, fax 49-(0)5766-81-188/128, Internet: <http://www.evka.de/extern/loccum/loccum.html>

The Envisioned Enlargement of the European Union and its Globalisation

January, 1998, Chicago, Illinois, United States

Organizer: European Association for Comparative Economic Studies (EACES) Executive Committee.

Information: Vladimir Andreff, University of Paris 1, Pantheon Sorbonne Sciences, Economiques, 90 rue de Tolbiac, F-75634 Paris Cedex 13, France, tel. 33-1-40771848, fax 33-1-45847889, Email: waroses@grenet.fr

We appreciate the contributions of the Cooperation Bureau for Economic Research on Eastern Europe, Koenigin-Luise-Str. 5, D 14195, Berlin, Germany, tel. 4930-897708-68, fax 4930-897708-99, Email: tribakova@diw-berlin.de, or dbowen@diw-berlin.de.

New Books and Working Papers

The Macroeconomics and Growth Division regrets that it is unable to provide the publications listed.

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Policy Research Working Papers

Christiaan Grootaert, **Poverty and Social Transfers in Hungary**, 1770, May 1997, 77 p.

In 1993, Hungary spent 27.7 percent of its GDP on social expenditures, well above the average for the European Union (21.8 percent) and the OECD (22.3 percent). [The 1995 austerity package drastically cut budget expenditures, including social outlays in Hungary. The editor.] Cash transfers were 19 percent of GDP, with more than half going to pensions. Various family and child allowances accounted for 4.2 percent of GDP, and unemployment benefits amounted to 2.4 percent. Reform of the social safety net has become urgent.

In 1993, 58 percent of the Hungarian population had an expenditure level below the subsistence minimum. Poverty has therefore been measured against the minimum pension (absolute poverty line) and at two-thirds of mean household expenditure (relative poverty line). In 1993, 4.5 percent of the population had an expenditure level (per equivalent adult) below the minimum pension, and 25.3 percent below the relative poverty line.

To order: Gracie Ochieng, Room S5-042, tel. 202-473-1123, fax 202-522-3247, Email: gochieng@worldbank.org

Szczepan Figiel, Tom Scott, and Panos Varangis, **How Government Policies Affect the Relationship between Polish and World Wheat Prices**, 1778, June 1997, 35 p.

Government intervention is the main reason for the low correlation between cash prices for Polish wheat and wheat futures prices in Chicago and London. It reduces incentives for Poland's private sector to use existing wheat futures contracts in foreign commodity exchanges to hedge against price risks, and prevents the development of Poland's own wheat futures exchange.

To order: Jean Jacobson, Room N5-026, tel. 202-473-3710, fax 202-522-3564, Email: jjacobson@worldbank.org

Constantine Michalopoulos and David Tarr, **The Economics of Customs Unions in the Commonwealth of Independent States**, 1786, June 1997, 30 p.

The customs union's proposed for Belarus, Kazakstan, Kyrgyzstan, and Russia, all members of the Commonwealth of Independent States (CIS) and the Free Trade Area established among the twelve CIS members, are likely to lock those countries into the old technology of the former Soviet Union. The effects of such organizations will be especially negative for the countries that have already established relatively liberal trade regimes.

To order: Minerva Patena, Room N5-048, tel. 202-473-9515, fax 202-522-1159, Email: mpatena@worldbank.org

Bernard Hoekman and Simeon Djankov, **Competition Law in Bulgaria after Central Planning**, 1789, June 1997, 24 p.

Bulgaria's Commission for the Protection of Competition tended to deal with "unfair" trade practices and contract enforcement problems between 1991 and 1995, rather than focusing on hardcore anticompetitive behavior. Retaliations for egregious violations of the law were not dire enough to pressure firms to abide by the law. Recently proposed amendments to the law may strengthen the law's deterrent effect.

To order: Jennifer Ngaine, Room N5-056, tel. 202-473-7947, fax 202-522-1159, Email: trade@worldbank.org

Alain de Crombrugghe, **Wage and Pension Pressure on the Polish Budget** 1793, June 1997, 48 p.

Poland's current economic recovery should create jobs, not raise wages. Engineering equitable opportunities for all requires moderating the claims of the best protected groups—and reforming the pension system.

To order: Mani Jandu, Room N7-032, telephone 202-473-3103, fax 202-522-0304, Email: mjandu@worldbank.org

Xiaonian Xu and Yan Wang, **Ownership Structure, Corporate Governance, and Corporate Performance: The Case of Chinese Stock Companies**, 1794, June 1997, 54 p.

A typical listed stock company in China has a mixed ownership structure, with three predominant groups of shareholders each holding about 30 percent of the stock: the state, legal persons (institutions), and individuals. (Employees and foreign investors together hold less than

10 percent.) Ownership is heavily concentrated: the five largest shareholders accounted for 58 percent of outstanding shares in 1995, compared with 57.8 percent in the Czech Republic, 42 percent in Germany, and 33 percent in Japan. The mix and concentration of stock ownership significantly affect a company's performance:

- There is a positive, significant correlation between concentration of ownership and profitability.

- The effect of concentrated ownership is even more profound if most owners are institution-dominated companies and not state-dominated companies.

- Profitability is positively correlated with the proportion of institutional shares; it is either negatively correlated or uncorrelated with the proportion of state shares and of tradable A-shares held mostly by individuals.

- Labor productivity tends to decline as the proportion of state shares increases.

Thus, institutional shareholders seem to have a positive impact on corporate governance and performance, state ownership seems to lead to inefficiency, and an overly dispersed ownership structure can create problems in the Chinese setting.

To order: Joyce Chinsen, Room G5-031, tel. 202-473-4022, fax 202-522-1714, Email: jchinsen@worldbank.org

Barbara Fakin and Alain de Crombrughe, **Fiscal Adjustments in Transition Economies: Social Transfers and the Efficiency of Public Spending: A Comparison with OECD Countries**, 1803, July 1997, 32 p.

To order: Mani Jandu, Room N7-032, tel. 202-473-3103, fax 202-522-0304, Email: mjandu@worldbank.org

Francisco H. G. Ferreira, **Economic Transition and the Distributions of Income and Wealth**, 1808, August 1997, 44 p.

Using a model of wealth distribution, dynamics, and occupational choice,

Ferreira investigates the distributional consequences of policies and developments associated with the transition from central planning to a market system. The model suggests that even an efficient privatization designed to be egalitarian may lead to increases in inequality (and possibly poverty), both during the transition and in the new steady state.

Creating new markets in services that are likewise supplied by the public sector may also contribute to an increase in inequality. So can labor market reforms that lead to a decompression of the earnings structure and to greater flexibility in employment. The results underline the importance of retaining government provision of basic public goods and services, removing barriers that prevent the participation of the poor in the new private sector, and ensuring that suitable safety nets are in place.

To order: Michael Geller, Room N7-078, tel. 202-473-1393, fax 202-522-0056, Email: wdr@worldbank.org

Aymo Brunetti, Gregory Kisunko, and Beatrice Weder, **Institutions in Transition: Reliability of Rules and Economic Performance in Former Socialist Countries**, 1809, August 1997, 47 p.

Indicators of the predictability of rules, political stability, the security of property rights, the reliability of the judiciary, and the lack of corruption are used to investigate differences in economic performance. The results suggest that the predictability of the institutional framework may explain a large part of differences in foreign direct investment and in economic growth among transition economies.

To order: Michael Geller, Room N7-078, tel. 202-473-1393, fax 202-522-0056, Email: wdr@worldbank.org

Shaikh I. Hossain, **Tackling Health Transition in China**, 1813, August 1997.

Between 1965 and 1995, China's infant mortality rate declined from 90 per 1,000 live births to 36—less than half the rate predicted for the country's income level. During the same period, life expectancy at birth rose from 55 to 69 years, higher than in many comparable Asian countries. And the maternal mortality rate fell from 26 to 15 per 100,000 deliveries, a rate comparable to that in similar Asian economies. These favorable results conceal more recent trends, however. Since the early 1990s, mortality rates have increased in many provinces, particularly among infants and children under 5.

The recent erosion in health gains stems from three factors:

- Changes in government financing of the health sector have increased inequity, inefficiencies, and costs for medical treatment.

- China's public health programs are traditionally not well prepared to prevent communicable diseases and injuries.

- The shift to a more market-oriented economy has changed environmental and behavioral risk factors, thus diversifying the types of disease across regions.

To order: Lilac Thomas, Room T7-015, tel. 202-458-1288, fax 202-522-1778, Email: shossain@worldbank.org

Shaikh I. Hossain, **Making Education in China Equitable and Efficient**, 1814, August 1997, 32 p.

To order: Clydina Anbiah, Room T7-015, tel. 202-458-1275, fax 202-522-1778, Email: shossain@worldbank.org

Other World Bank Publications

World Development Report 1997: The State in a Changing World, 1997, 265 p.

Five fundamental tasks lie at the core of every government's mission, without which sustainable, shared, poverty-reducing development is impossible:

- Establishing a foundation of law.

•Maintaining a nondistortionary policy environment, including macroeconomic stability.

•Investing in basic social services and infrastructure.

•Protecting the vulnerable.

•Protecting the environment.

Some new insights are emerging about the appropriate mix of market and government activities in achieving these tasks. Markets and governments are complementary: the state is essential for putting in place the appropriate institutional foundations for markets. And government's credibility—the predictability and consistency of its rules and policies—can be as important for attracting private investment as the content of those rules and policies.

Countries in transition face a special challenge of changing roles and capabilities. Some transition countries retain inherent capabilities, like qualified people and usable equipment, but they are not organized to perform their new roles. The task of improving effectiveness in transition countries is easier because capability does not start from a low base, but more difficult because rebuilding capability means changing attitudes, not simply assigning new responsibilities.

The job of reorienting the state toward the task of "steering, not rowing" is far from complete in Central and Eastern Europe. But most countries are on the way to improving capability and accountability. Low state capability in many countries of the CIS is a serious obstacle to further progress in most areas of economic and social policy. Reorientation of the state is still at an early stage, and a host of severe problems have emerged from a general lack of accountability and transparency.

To order: Public Information Center, Room GC1-300, 1818 H Street, N.W. Washington, D.C. 20433, tel. 202-458-

5454, fax 202-522-1500 E-mail: pic@worldbank.org

Belarus: Prices, Markets, and Enterprise Reform, A World Bank Country Study, 1997, 248 p.

Michael Cernea and Ayse Kudat, **Social Assessments for Better Development: Case Studies in Russia and Central Asia**. Environmentally Sustainable Development Studies and Monograph Series no. 16, 1997, 228 p. [from Azerbaijan, Kazakstan, Kyrgyz Republic, Russia, Tajikistan, Turkmenistan, and Uzbekistan].

Social assessments were used in the formulation of individual projects, such as restructuring Russia's coal sector, helping to create a water supply system in Baku, and responding to environmental degradation in Uzbekistan's Aral Sea region.

China's Management of Enterprise Assets: The State as a Shareholder, A World Bank Country Study, 1997, 111 p.

China's reform of industrial state-owned enterprises (SOEs) seeks to maintain state ownership of key enterprises while improving their performance by establishing market-oriented incentives. The state tries to carry out the shareholder functions that are performed by private owners in market economies. SOE performance could be improved through diversified ownership, integrated cross-regional and cross-sectoral shareholding, and simplified organizational structures. Further developing property rights, eliminating policy-induced barriers to entry and exit in competitive sectors, and requiring independent audits of financial accounts would also help.

Global Economic Prospects and the Developing Countries, 1997 [forthcoming in September 1997].

The eighth edition of this annual report reviews the long-term prospects for developing countries in light of changes in the global environment and provides a detailed discussion of selected aspects of the global integration process in those countries.

Jeni Klugman (ed.), **Poverty in Russia: Public Policy and Private Responses**, 1997, 296 p.

Magda Lovei (ed.), **Phasing Out Lead from Gasoline in Central and Eastern Europe: Health Issues, Feasibility, and Policies**, 1997, 94 p.

The use of lead additives in gasoline is declining rapidly worldwide. Many countries have completely eliminated leaded gasoline, but in Central and Eastern Europe lead still ranks as one of the most serious and widespread environmental hazards.

Jacob P. Meerman, **Reforming Agriculture: The World Bank Goes to Market**, 1997, 180 p.

Assessing World Bank experience with the fifty agricultural sectoral adjustment loans approved by the Bank's Board of Directors since 1979, the report finds that shifting the focus in the 1990s from supporting public production and public control to supporting market liberalization, has substantially improved the quality of recent operations.

Raylynn Oliver, **Model Living Standards Measurement Study Survey Questionnaire for the Countries of the FSU**, Living Standards Measurement Survey Working Paper 130, 1997, 144 p. (The questionnaires are available in English and Russian, and in electronic format.)

Shahid Yusuf and Weiping Wu. **The Dynamics of Urban Growth in Three Chinese Cities**, Oxford University Press, 1997, 248 p.

The OECD believes that China will be the world's largest economy by 2020. China's urban economy has been the driving force behind accelerated growth. By the same token deterioration in urban centers could constrain future expansion. The interplay between geography, size, and industrial structure determines the industrial vigor of cities. The experiences of Shanghai, Tianjin, and Guangzhou show that all these factors must be made to work for the city through effective policymaking.

CEPR Publications

To order: Center for Economic Policy Research, 25-28 Old Burlington Street, London W1X 1LB, United Kingdom, tel. 44-171-878-2900, fax 44-171-878-2999, Email: cepr@cepr.org

Willem H. Buiters, Ricardo Lago, and Hélène Rey, **Enterprises in Transition: Macroeconomic Influences on Enterprise Decision-Making and Performance**, Discussion Paper 1601, April 1997, 41 p.

Vivek H. Dehejia, **Optimal Restructuring Under a Political Constraint: A General Equilibrium Approach**, Discussion Paper 1619, April 1997, 12 p.

Center for East European Studies (CEES) Publications

To order: Center for East European Studies, Copenhagen Business School, Dalgas Have 15, DK-2000, Frederiksberg, Denmark, tel. 45-3815-3030, fax 45-3815-3037, Internet: <http://www.econ.cbs.dk/institutes/cees>

Saul Estrin and Klaus E. Meyer, **The East European Business Environment: Opportunities and Tripwires for Foreign Investors**, Working Paper 2, February 1997, 24 p. The legacy of the socialist past cannot be shed overnight. Foreign investors entering the region

need to be aware of the economic history of their partners.

Klaus E. Meyer, **The Determinants of West-East Business: An Analysis of Ownership Advantages**, Working Paper 3, March 1997, 39 p.

Snejina Michailova, **Bulgaria in the Process of Systematic Transformation—An Overview**, Working Paper 4, June 1997, 45 p.

Niels Mygind, **Different Paths of Transition in the Baltics**, Working Paper 5, May 1997, 39 p.

Niels Mygind, **The Economic Performance of Employee-Owned Enterprises in the Baltic Countries**, Working Paper 6, May 1997, 46 p.

There is no indication that employee-owned enterprises perform worse than comparable enterprises in the private sector. Employee-owned enterprises might be more sluggish in shedding labor, but productivity and profitability is often better than for other enterprises.

Klaus E. Meyer, **Enterprise Transformation and Foreign Investment in Eastern Europe**, Working Paper 7, June 1997, 20 p.

Snejina Michailova, **Interface between Western and Russian Management Attitudes: Implications for Organizational Change**, Working Paper 8, June 1997, 28 p.

WIIW Publications

To order: WIIW, Vienna Institute for Comparative Economic Studies, Oppolzergasse 6, A-1010, Vienna, Austria, tel. 431-533-6610, fax 431-533-6610-50.

Leon Podkaminer, Hermine Vidovic, and others, **Weiterhin Divergierende Entwicklung in den Reformländern**, WIIW no. 167, May 1997, pp. 321-41.

Matija Rojec, **The Development Potential of Foreign Direct Investment in the Slovenian Economy**, WIIW no. 235, April 1997, 44 p.

Foreign companies in the Slovenian manufacturing sector outperform their domestic rivals because of optimum company size (which determines production techniques, product line, skill intensity, and salary level), high capital intensity, proper assets structure, large export orientation, healthy structure of financial sources, and solvency.

Rural Development Institute Publications

To order: Rural Development Institute, 4746 11th Avenue N.E., no. 505, Seattle, Washington 98105, United States, tel. 206-528-5880, fax 206-528-5881, Email: rdi@u.washington.edu

Roy L. Prosterman, Robert G. Mitchell, and Bradley J. Rorem, **Prospects for Peasant Farming in Russia**, RDI Reports on Foreign Aid and Development no. 92, United States, January 1997, 37 p.

Russia's 1996 grain harvest would have been 150 million tons, instead of 69 million tons, had Russian farms been as efficient as Finnish ones. Russia's 26,000 giant agricultural enterprises, still collectives in all but name, produce even less today than they once did: in 1996 the old Soviet farms produced 35 percent less grain per hectare than Canadian farms and 60 percent less than Finnish family farms. There has been no net increase in the number of peasant farms in Russia since the beginning of 1994.

Most collective and state farms have been privatized and re-registered as jointstock companies and other forms, but they continue to function as inefficient behemoths whose hundreds of members have little incentive to maximize production, reduce production

costs, or preserve capital assets. They still suffer from the inefficiencies of collective agriculture. Only about 6 percent of Russia's agricultural land is in peasant farms, but those farms are already producing far better yields than the large collectives.

The land of the old collectives and state farms is being distributed as land shares, but in most places it is being leased back to the collective at rates equivalent to the land tax. Even the least productive land yields 100 times more than that value. This availability of cheap rental land depresses the lease value of land shares and interferes with the emerging land share rental market. Even these low lease payments are a valuable income supplement for landowners—especially pensioners, who generally own around 40 percent of land shares. (While Russian peasant farmers paying 11 to 15 percent of total yield in rent and large enterprises pay around 3 percent, similar rents in the United States are equivalent to 25 percent of yield.)

The Russian government should undertake an intensive program to inform pensioners and other landowners about their rights and options. Most of them continue to lease land back to the old enterprises (it seems less risky, and they want to avoid offending old leaders who might cut their pensions). But this is merely a continuation of collective farming. Another major impediment to peasant farmers is the unavailability of machinery.
(Excerpted from a report by Robert Lyle for RFE/RL)

Leonard J. Rolfes, Jr. and Bradley J. Rorem, **Legal Assistance in Rural Russia: A Report on the Activities of the "Center for Land Reform Support of Vladimir Oblast,"** Rural Development Institute Reports on Foreign Aid and Development no. 93, United States, May 1997, 17 p.

The Center for Land Reform Support of Vladimir Oblast (province), created in August 1996 and funded by the United States Agency for International Development, is providing free legal advice and assistance to peasant farmers and agricultural land share owners exercising their land rights. The Rural Development Institute oversees and provides guidance to the Center.

SIGMA Publications

To order: SIGMA, Head of Publications Service, OECD, 2 rue André-Pascal, 75775 Paris Cedex 16, France.

Budgeting and Monitoring of Personnel Costs, SIGMA Papers 11, 1997, 56 p.

Personnel costs often constitute the main cost factor in state budgets, and thus their control is critical to ensuring the most effective and efficient use of limited budgetary resources.

Public Management Forum, a bi-monthly newsletter for Public Administration Practitioners in Central and Eastern Europe.

Other Publications

Beyond the MFN Debate: A Comprehensive Trade Strategy toward China, Asian Studies Center Backgrounder no. 148, May 16, 1997, 29 p.

To order: Heritage Foundation, 214 Massachusetts Avenue, N.E., Washington, D.C. 20002-4999, United States, tel. 202-546-4400, Internet: <http://www.heritage.org>

Péter Bod, **German Capital In Hungary: Is There a Special Relationship?** Discussion Papers in German Studies no. IGS97/4, University of Birmingham, United Kingdom, 1997, 34 p.

To order: University of Birmingham, Institute for German Studies, Edgbaston, Birmingham B15 2TT, United Kingdom, tel. 0121-414-7182, fax 0121-414-7329.

László Csontos, János Kornai, and István György Tóth, **Tax-Awareness and the Reform of the Welfare State: Results of a Hungarian Survey,** Harvard Institute of Economic Research Discussion Paper Series 1790, Cambridge, Massachusetts, United States, January 1997, 22 p.

Kim R. Holmes and James J. Przystup (eds.), **Between Diplomacy and Deterrence: Strategies for U.S. Relations with China,** Heritage Foundation, United States, 1997, 264 p.

To order: Heritage Foundation, 214 Massachusetts Avenue, N.E., Washington, D.C. 20002-4999, United States, Internet: <http://www.heritage.org>

Marvin Jackson, **Intra-Balkan Trade and Economic Cooperation: Past Lessons for the Future,** Leuven institute for Central and East European Studies Working Paper 62/1997, 24 p.

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