"The Management of the Fund Favors Greater Transparency"
Stanley Fischer Responds to IMF Critics

It became almost fashionable to criticize the International Monetary Fund (IMF) as being insensitive to social problems or just the opposite, much too eager to help countries in order to keep them addicted to borrowing. Critics also accuse the IMF of offering the wrong medicine in South East Asia and for not going far enough in becoming more transparent in its operations. Stanley Fischer, First Deputy Managing Director of the IMF, responds to these charges and explains recent policies of the organization in the following interview with Transition editor Richard Hirschler.

Q. Now that the agreement with Indonesia finally has been worked out, can you explain why the IMF successfully opposed the setting up of a currency board there? After all, currency boards—with the support of the Fund—are functioning usefully in several transition economies, such as Bulgaria and Lithuania....

A. As you say, we have supported currency boards in some countries. The introduction of a currency board can stabilize a currency—provided certain preconditions are satisfied. Essentially the preconditions boil down to the arrangement being credible. Otherwise the first thing that will happen when the currency board is introduced is an attack on the currency. With the corporate debt issue at that point unresolved in Indonesia, with a weak banking system, and with a ratio of broad money to GDP of about 50 percent—meaning that there were a lot of rupiah claims that could have been converted into claims on the Indonesian reserves, we didn’t think a currency board would have been credible. There is an additional element needed for credibility: namely, that market participants have to believe that if the currency is attacked, it will be defended. That means high interest rates, possibly—as in the Hong Kong case—extremely high interest rates. Nothing that had happened in the past few months made us confident that an Indonesian currency board would be defended in that way.

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Two other points. First, to say that a currency board could stabilize the currency is not to say that it is the best possible monetary arrangement in all circumstances. It might however be the best arrangement for a country that has been through severe monetary instability and needs a simple and clearly understood rule that will minimize political interference and maintain stability.

Second, we were careful not to rule out the possibility that a currency board could make sense for Indonesia somewhere down the road, when the major uncertainties have been dealt with. Of course, by that stage there would be less need for a currency board.

Q. Changing the topic, the IMF's Russia policy is often criticized from two sides: some say the Fund is too lenient toward Russia, others say that it is too tough. Those demanding a firmer position, bring up that the IMF went ahead in January and disbursed a tranche of $690 million from the three years, $10 billion EFF (Extended Fund Facility) loan program, despite Russia's poor tax-collection record in 1997. For example, in 1997 cash revenues for Russia's federal budget were expected to reach 9.1 percent of GDP, much less than the projected figure of 13.7 percent. For 1998 the Fund rather relaxed the fiscal revenue target, not to risk Russia's success to meet them, claim these critics.

A. The $690 million tranche that was disbursed in January was originally scheduled for November 1997. It was delayed because fiscal revenues were off track. We agreed to disburse it after the Russian government had presented a plan and implemented some of its measures that we believed would increase government revenues. Now the next tranche is also being delayed, as we review the outcome for the first quarter, and the plans and commitments of the new government. We have agreed with the Russian government on cuts in government spending as well as lower revenue targets. Of course we have modified the fiscal targets over the past few years as the extent of the collapse of the Russian revenue system has become clearer, but we are working with them to try to restore revenues. The new tax code should help in that regard; and so will stronger efforts to collect taxes that are owed. The indications are that cash revenues will be higher in 1998 than in 1997.

Q. Other critics blame the IMF for pushing for an overzealously restrictive fiscal policy that prevents—among other things—Russian enterprises from paying wages and contributes to social tension in the country.

A. Unfortunately, Russian fiscal policy—measured by the government deficit—has been too lax, not too tight. Russia's excessive dependence on deficit financing, past and present, has built up the government debt and left the economy vulnerable to shifts in external confidence. And the root cause of Russia's fiscal problems is the failure to collect taxes.

The most important thing that needs to be done to begin getting wages paid is to stop the general culture of nonpayment in Russia. That's a large part of the problem in collecting taxes, and one reason we have continued to emphasize the need for monetary payments of taxes rather than tax offsets and other barter-related means of payment. The sooner the Russian government begins to collect taxes, the tougher it will be in insisting that firms meet their obligations to the government, to workers, to other creditors, the better it can deal with the social problems confronting the country, and the more likely it is that wages will be paid on time.

Q. During the Asian crisis, the IMF has been again criticized as being insensitive to the severe consequences of its prescribed medicines—devaluation, higher interest rates, higher prices, bank closures, unemployment...

A. By the time Korea and Thailand turned to the Fund for assistance, they had come close to exhausting their foreign exchange reserves. As soon as that was understood by investors, domestic and foreign, it was inevitable that there would be a sharp currency depreciation and major economic disruptions in those countries. The first task was to restore confidence in the currencies. That required a sharp increase in interest rates, to stem the outflow of capital and to encourage domestic residents and corporations, including the banks, to bring money home.

Confidence in the Korean and Thai currencies is now being restored, as they carry out their programs. Each has appreciated by 25-30 percent relative to their low points in January. The rupiah too has appreciated relative to its low point, but it has a long way further to go. Provided Indonesia implements the program it has agreed with the Fund and the Bank, the rupiah will strengthen.
Of course, higher interest rates made the situation of weak banks and corporations more difficult. But they were already in difficulty, and the alternative of a larger devaluation would have been worse, both for the countries and for the international economy. The argument that there was some alternative policy, with low interest rates, that would have been better seems to overlook the international context. A country in external crisis has limited access to foreign borrowing, and the official sector does not have enough money to enable a country that has lost essentially all its reserves to replenish them and restore confidence without a major change in policies.

As to whether the restructuring is being done too quickly, that is a matter for both economic and political judgment. Much restructuring is needed in both the financial and corporate sectors. It will take years to complete. It is most unlikely that going slow at the beginning would have reduced the total amount of dislocation and distress suffered during the process; the opposite is more likely.

**Q.** Some members of the U.S. Congress question the IMF's "raison d'être"... To ask a profane question, why does the world need the IMF?

**A.** In the first instance, the Fund is the vehicle the international community has chosen to deal with international financial crises when they occur—and they will continue to occur, though we must try to make sure they are as infrequent as possible. In the well-chosen words of our Articles of Agreement, we make our resources temporarily available to members "under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity." In the East Asian crisis, the inevitable economic slowdown would have been more profound, the fall in living standards steeper, the extent of contagion of the crisis wider without the assistance of the international community—provided by the IMF, the Bank, the Asian Development Bank, and bilateral contributors.

The IMF, with its nearly global membership, can provide conditional lending and policy recommendations, as well as technical assistance when a bilateral approach would be less acceptable. We have done that in the East Asian crisis, in Mexico a few years ago, in the 26 transition countries in this decade, and in many other circumstances. And I hope we will have the resources to be able to continue to do so, together with the World Bank and other institutions.

A major challenge right now is to improve our surveillance, to try to avert crises by keeping close watch on member countries' economies and, through discussion with them and other member governments of the Fund, try to ensure that emerging problems are dealt with in time. Often we see problems and the country takes action and a crisis is averted. That does not get headlines. Sometimes—as in the case of Thailand—we see problems and are unable to persuade the country to take action; sometimes, as in the case of Korea, we see parts of the problem, such as the weakness of the financial sector, without drawing the full implications. That is why we were not fully prepared for the ferocity of the East Asian crisis.

We face a dilemma in deciding whether to go public when we believe a crisis is likely. The problem is that we could be wrong, and could be precipitating a crisis that would not otherwise have happened.

**Q.** The IMF encourages member countries to introduce greater transparency and fuller disclosure. But many experts urge more transparency also in the Fund's operations to improve its efficiency.

**A.** The management of the Fund favors greater transparency, and the Board has been moving steadily in that direction in recent years. Provided the country agrees, we publish background papers about recent economic developments in member countries; many countries now agree to the publication of a PIN—press information notice—that summarizes the Board's discussion of the Article IV surveillance report on that country; and letters of intent for the recent Asian programs have been published. This all sets an important trend, and I hope especially that the precedent of publication of letters of intent will be followed in future years. This material is available on the Fund's website (www.imf.org).

This is a gradual process, and I hope we can do more. That is not only because the public, including the investing public, can do a better job when it is better informed. It is also because it will be good for us, for staff and management, to have our recommendations presented to the public and debated by a wider audience.

**Q.** The need of monitoring capital flows became a major issue. Will the IMF play a central role in this?

**A.** The Interim Committee did ask us at the April 1998 meeting to play a larger role in monitoring international capital flows, and we will. This must be a central element in our overall surveillance of the international economy. To do that, we will need better data on debt exposures, especially short-term foreign-currency denominated debt, both interbank and corporate. The BIS is already planning a major improvement in those data.

One of the lessons of the Asian crisis is that countries need to be careful how
they liberalize capital flows. By liberalizing at the short end, both Korea and Thailand increased the vulnerability of their economies to change in investor sentiment. I believe countries should and will liberalize their capital accounts. But they need to do so carefully, once their macroeconomic policies and their financial systems are strong enough. As they open up, they will have to be sure that they have the right prudential controls in place to ensure their economies do not become vulnerable to short-term capital flow reversals. It may also be necessary for countries to impose market-based (not administrative) controls on short-term capital flows, à la Chile.

In addition, countries should be encouraged to adopt international standards in areas such as bankruptcy codes, securities market regulation, and corporate governance, including accounting. The IMF, as well as the World Bank, would help monitor the implementation of these standards.

Conditionality—This Time, Attached to the IMF
The U.S. Congress’s Waiting Game

For months now the Clinton administration has been warning Congress that failure to provide the International Monetary Fund with more money would be a reckless act, exposing the global economy to new crises and endangering the livelihoods of American workers in the process. But congressional approval of a proposed $18 billion contribution to the IMF is looking uncertain. Both the Senate and the House of Representatives have considered supplemental appropriations bills containing the $17.9 billion the Clinton administration has requested for the IMF. Both bills request specific reforms in IMF operations or policy.

The Senate passed a supplemental appropriations bill on March 26, 1998, to grant the Clinton administration’s request for $17.9 billion for the IMF. It requires the Secretary of the Treasury to certify that the world’s seven largest economies—the so-called Group of Seven (G-7) countries—agree to use their influence to push two specific reforms in IMF policies. These reforms would obligate recipients of IMF assistance to:

- End government subsidies and directed lending.
- Comply with international trade agreements.

The reform provisions for the IMF in the House bill are very similar to those originally present in the Senate bill: before the funds appropriated in the bill can be disbursed, transferred, or made available to the IMF, the Secretary of the Treasury must certify that the IMF’s Board of Executive Directors passed a resolution requiring every user of IMF resources to:

- Comply with all international trade agreements and obligations to which the borrower is a party.
- Eliminate government-directed lending or subsidies.
- Guarantee that countries would not discriminate between domestic and foreign creditors or debtors when resolving debt problems.

In addition, the House bill includes three directives that:

- The Department of the Treasury report on advances in financial transparency, application of internationally accepted accounting practices, elimination of subsidies, and improving the effect of IMF assistance on workers’ rights.
- The President ensure that no U.S. resources are “made available, directly or indirectly, to promote unfair competition against the American semi-conductor industry.”
- The IMF member countries establish an advisory commission on the international financial system.

Representatives Jim Saxton (R-NJ), Richard K. Armey (R-TX), and Tom Campbell (R-CA) have submitted new legislation to Congress, the IMF Transparency and Efficiency Act of 1998 (H.R. 3331), which would require the IMF’s Board of Executive Directors to initiate three specific reforms:

- Increase transparency by requiring the IMF to make available for public scrutiny:
  - An edited copy of minutes from every meeting of the IMF Board of Governors and Board of Executive Directors, within three months of the meeting date.
  - An edited copy of every loan and program document, a written review of program and loan performance, and all documents related to any loan program of the IMF, within three months of submission of the document, review, or assessment.

The IMF is entitled, however, to censor its meeting minutes, loan agreements, and performance reports before present-
ing them for public scrutiny, allowing the Fund to strike passages compromising national security or releasing proprietary information, or information that, if released, would disrupt markets.

- Eliminate interest rate subsidies on IMF loans by charging market-determined interest rates, ensuring that IMF loan recipients are held to the same standards for loans as private individuals and companies.

- Establish an independent, 24-member advisory board, appointed by the legislatures of the members of the IMF’s Board of Executive Directors, to review the research, operations, and loan programs of the IMF. The advisory board would release public reports annually on its activities and conclusions.

Effective six months after the enactment of the bill, the Secretary of the Treasury would be required to submit a written certification to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Banking and Financial Services on the status of the reforms specified in the legislation. Once the Secretary of the Treasury had submitted the certification, Congress would enact a joint resolution verifying and approving it. The certification must be renewed annually.

House Speaker Newt Gingrich said on April 30 that Congress could act by midsummer on $18 billion pledged to the International Monetary Fund—if the White House makes full disclosure of controversial campaign contributions from Indonesian business interests, and if IMF employees pay income taxes. “We will support and provide money for an IMF which is transparent, agrees that policies other than higher taxes are legitimate, and is willing to work out how its own staff understand what taxation is all about,” the Georgia Republican said. IMF employees effectively do not pay federal, state, or local income taxes under exemptions enacted by Congress in the 1940s, following the creation in 1944 of the IMF and the World Bank. U.S. citizens employed by the IMF pay federal income taxes, but they are reimbursed quarterly by the IMF.

Congressional Democrats, led by House Democratic leader Richard Gephardt, are demanding that the administration abandon efforts to change the IMF charter—agreed during the spring meetings of the World Bank and the IMF, in April. The proposed change would extend the IMF’s jurisdiction to the liberalization of capital movements. Democrats instead want IMF loans to support social safety nets aimed at protecting those most injured by economic adjustment, provide education and training, establish core labor standards, and promote democracy and human rights. Adding a commitment to the completely free movement of capital will worsen inequality, unless it is accompanied by policies that substantially mitigate its impact, the Democrats wrote in a letter to Robert Rubin, Secretary of the Treasury. If their demand is not met, they will withdraw their support for the U.S. share of IMF capital expansion.

“There is little dispute the fund’s resources have been depleted by the crisis in Asia, where the IMF has pledged to lend $35 billion of its own money toward the more than $100 billion in rescue packages for Thailand, South Korea and Indonesia. Those commitments leave the IMF, a sort of international credit union that is funded by deposits from its 182 member nations, with about $40 billion in U.S. dollars, Japanese yen and other hard currencies. Less than half of that is available, in practical terms, for lending to financially strapped countries, because of the need to maintain a cushion of reasonable size. Thus the IMF is in no position to handle another Asia-size crisis that might arise, for example, in Latin America or Eastern Europe—at least not by using its own money as aggressively as it did with the Asian tigers,” writes Paul Blustein, staff reporter of the Washington Post, in the April 25 issue.

From the World Press Review.
Will Wage Arrears Continue in Russia?

Total wage arrears in all sectors of the Russian economy reached 57.8 billion rubles ($9.51 billion) as of March 1, official statistics show. Of that figure, the federal and regional governments owe 7.6 billion rubles ($1.2 billion). The government declared last summer it had paid off billions of rubles to long-suffering pensioners, and later set a schedule to pay off debts to the military and other key groups. President Yeltsin set a deadline of January 1, 1998 for all arrears to be paid off. The government said it has pieced together the funds, and blamed regional authorities when some workers remained unpaid after the New Year. Just three months later, debts to both public and private sector employees were piling up again.

Prime Minister Kiriyenko said responsibilities had to be clearly divided between the federal and regional authorities in order to avoid the confusion that had reigned at the beginning of the year.

Wage arrears began to grow rapidly in mid-1995. In the midst of faltering state authority and the collapse of contractual obligations and their enforcement, the government resorted to more wage cuts, enterprises withheld tax and wage payments, and local governments diverted federal funds earmarked for employee remuneration. The level of arrears in March 1997 reached 27.7 percent of total state sector wages. Wage arrears afflicted virtually every region. Many workers were waiting six to eight months for their wages. More than half of employees in state enterprises were claiming at least two months' unpaid wages.

Stubborn Liabilities

Wage arrears are much higher at the regional and local government levels, where the bulk of public sector employment is concentrated: teachers, police, public health workers, and the like. The bulk of employment at the federal level is in the military. The transfer was financed through increased privatization revenues, a sharp rise in tax collection (for the full year however, tax collection remained at 60 to 65 percent of planned levels), greater customs receipts, and substantial loans from multilateral lenders, particularly the World Bank.

Government debts to private contractors for goods and services, particularly in the defense industry, still total an estimated 19 billion rubles, government officials acknowledge. As a consequence, millions of private sector workers have not received wages for months, with arrears amounting to around 30 billion rubles. And there are other budget arrears to address, including 13.5 billion rubles of unpaid child benefits (the responsibility of local budgets) and arrears in support for northern regions and other special subsidies and payments. In the Russian armed forces arrears in salaries, social benefits, and food allowances stood at 18.6 billion rubles ($3.1 billion) in December 1997. As the newspaper Novye Izvestia remarked sarcastically in January, “A new year has started. Time to make more debts.” What are the chances that wage arrears will continue?

A Piethora of Veksels

A cinema in Altai, Siberia, allowed customers to pay two eggs for a ticket; when eggs ran short locally, the price of entry was payable in empty bottles. On a larger scale, tax officials say that across the fuel and energy industries, only 20 percent of transactions are settled in ready money. The balance is paid, if at all, in barter, bills of exchange, mutual offsetting of debts, and tax credits. The proportion of interenterprise transactions being conducted on a barter basis was estimated at between 40 and 70 percent, as of the end of 1996.

The nonpayment of wages is part of a much wider phenomenon of nonpayment. The overdue debt of enterprises and organizations in industry, transport, construction, and agriculture almost doubled during 1996 to a total of 538 billion rubles, almost 25 percent of annual GDP, an average of almost five months of overdue payments. Overdue debts continued to pile up in 1997, reaching 700 billion rubles ($127 billion) in December 1997. This is more than twice the amount of money in circulation.

Unpaid bills pervade every corner of Russian life. Companies cannot pay their suppliers; suppliers cannot pay their workers; workers cannot pay their utility bills or their rent—and almost everyone holds off on paying taxes. The vicious cycle of nonpayment has become particularly acute in the past 18 months, largely as a consequence of the central bank’s tough measures to fight inflation. Those policies abruptly choked off the money supply and reduced inflation to less than 15 percent, from more than 200 percent in 1994. But the other result is the cash shortage

This has led to a $15 billion market in IOUs (“I owe you” promissory notes), known in Russia as veksels. (Veksel comes from the German word “wechsel,” for exchange. Germany resorted to IOUs for a brief period after World War II.) Many veksels are redeemable for cash, while others are good for oil, electricity, tires, chemicals, or cement. The use of veksels exploded during 1996-97. Companies issue them to pay their suppliers, who then barter them for other goods or resell them to speculators for cash. Banks and brokerage companies trade more than $100 million worth of such notes each month, and post prices for
them on the Internet. Even a few American investors are snapping them up, viewing them as a Russian variant on American high-yield junk bonds.

Gazprom has issued its suppliers about $170 million worth of IOUs, which are redeemable primarily for natural gas. Whether the IOUs get swapped for natural gas or for money, they are valuable. Analysts at Renaissance Capital Group, a Moscow-based investment firm, calculate that Gazprom veksels yield a profit of roughly 25 percent a year. Conventional government bonds in Russia yield about 18 percent a year.

The IOUs are notoriously intricate, with each one tied to the bill-paying problems of a particular company and many of them loaded with quirky conditions. A number of IOUs never trade in the open market but are simply swapped between companies that do business with each other on a regular basis. The International Monetary Fund has been sharply critical of veksels, saying they distort the true indebtedness of the country and the companies and give companies a way to avoid taxes—as the profit on IOUs takes place almost entirely outside the official economy and is generally not taxed.

Cashless Society

In 1996 about 15 percent of Russia’s employee wages were paid in kind, as were many social benefits, such as unemployment benefits. The situation has provoked much dissatisfaction. For example, fishermen of the Preobrazhensk Trawler Fleet in Primorskii Krai have been regularly receiving their wages in vodka. In an open letter the fishermen’s wives accused Preobrazhensk of “deliberately addicting” their husbands to alcohol, and this while the families did not have enough money to buy food. They have demanded that the company stop its remuneration practices.

In November 1997 workers at a cash-strapped Russian clock factory in Penza, received a bonus—and needed three days to get the loot home. But they didn’t feel that much richer because the bonus was paid in toilet paper, with each worker getting about 150 rolls, according to the daily Izvestia. Workers had trouble “spending” the bonus, the report said. One worker tried to pay her rent in toilet paper, but municipal housing officials refused to accept it.

Underlying Causes

According to some experts, more firms would pay their wage debts in cash if the system obliged them to do so. But Russian law is weak, officials are malleable, and few penalties await managers who shun their obligations. Nonpayment of wages is tolerated the more readily because it keeps unemployment down. If everyone who worked had to be paid a cash wage, unemployment would shoot far above the current rate of about 9.3 percent. Russia’s employees—long accustomed to receiving an array of benefits, including school, hospital and day-care services, and low-cost housing, through the workplace—settle for receiving these entitlements in preference to losing their jobs.

Others argue that the strapped manufacturing industry in Russia can hardly afford to pay due wages. Fifty-six percent of Russian manufacturing enterprises made losses in 1996. One-third of all enterprises were insolvent and fewer than one-third had assets more than double their liabilities, the ratio they are required to maintain under the Russian law on insolvency. Considering that most enterprise assets include a large inventory of obsolete products and overdue debts of trade partners, the financial situation of the enterprises is even worse than the financial balances show.

Experts point fingers at the Russian banking system, which has been unable to provide financial services to the enterprise sector. The shortage of cash has prevented even profitable enterprises from paying wages. Russian companies have had no chance to borrow short-term from banks in order to finance their working capital. Moreover, Russia’s banks and financial institutions are not equipped to evaluate the financial position of enterprises as a condition of extending credit and loans, so they cannot initiate bankruptcy proceedings. The very limited involvement of Russian commercial banks in the manufacturing sector means that they are not able to play the regulatory and financing role that banks play in developed economies. Bankruptcy is still an uncommon practice in Russia.

The shortage of cash to pay wages worsened by competition with tax authorities for the cash resources of enterprises—which make up a disproportionate part of government revenue. The government has been working to reduce arrears in the payment of taxes, to limit the budget deficit. Until August 1996 the tax authorities had first claim on all money coming into company accounts. An amendment to the Civil Code has meant that since August 1996 the payment of wages has taken precedence over tax payments. However, the penalty for nonpayment of taxes is far higher than any penalties incurred for nonpayment of wages. Thus the amendment is effective in hardly discouraging the nonpayment of wages and there is no sign that barter is in decline.

The envisaged reform of the tax and social insurance systems has a vital role to play in relieving the financial burden on manufacturing enterprises and hence easing the arrears problem. Nonpayment is in part a result of shortcomings in the government’s economic strategy. The government has pursued a strategy of stabilization and structural adjustment, based on restrictive monetary policies, high interest rates, and lack of credit.
But, without a banking and financial system to monitor the performance of enterprises, extend credit to those with prospects for the future, and initiate bankruptcy procedures against those that are unsalvageable, this strategy can hardly be effective. Enterprises find themselves outside the reach of financial regulation but also deprived of the appropriate financial and regulatory framework, with greater government involvement, be developed in Russia.

Based on reports from Oxford Analytica, the international research group (Oxford-U.K.) as well as news agency reports.

Meat, Beer, Eating Out—Call the Repairmen ...

Comparing Prices and Wages in Eastern Europe

How many hours of work does the average wage earner have to put in to buy an identical consumer basket of staple goods and services? The Budapest-based magazine, World Economy Weekly annually publishes a cross-country comparison with calculations based on gross average wages in industry, prices for

Comparing Prices and Wages in Eastern Europe, December 1997

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<th>Goods &amp; Services</th>
<th>Bulgaria</th>
<th>Czech Republic</th>
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<td>38'</td>
<td>52'</td>
<td>1h22&quot;</td>
<td>55'</td>
<td>1h26&quot;</td>
<td>12'14&quot;</td>
</tr>
<tr>
<td>One pack of domestic cigarettes</td>
<td>29'</td>
<td>35'</td>
<td>22'</td>
<td>18'</td>
<td>22'</td>
<td>22'</td>
<td>29'</td>
<td>32'</td>
<td>27&quot;</td>
<td>9'47&quot;</td>
</tr>
<tr>
<td>One bottle of beer</td>
<td>26'</td>
<td>9'52&quot;</td>
<td>10'42&quot;</td>
<td>15'54&quot;</td>
<td>10'28&quot;</td>
<td>32'29&quot;</td>
<td>17'55&quot;</td>
<td>13'19&quot;</td>
<td>39'25&quot;</td>
<td>2'45&quot;</td>
</tr>
<tr>
<td>Women's dress made domestically</td>
<td>50h35'</td>
<td>57h8'</td>
<td>44h38'</td>
<td>24h5'</td>
<td>49h14'</td>
<td>73h10'</td>
<td>58h39'</td>
<td>64h29'</td>
<td>46h18'</td>
<td>9'7&quot;</td>
</tr>
<tr>
<td>Men's suit made domestically</td>
<td>68h55'</td>
<td>79h4'</td>
<td>71h25'</td>
<td>42h9'</td>
<td>65h32'</td>
<td>87h49'</td>
<td>74h39'</td>
<td>87h40'</td>
<td>62h38'</td>
<td>18h14'</td>
</tr>
<tr>
<td>Men's Shoes Electricity (1 kw/h)</td>
<td>2'18&quot;</td>
<td>2'22&quot;</td>
<td>2'40&quot;</td>
<td>5'12&quot;</td>
<td>2'34&quot;</td>
<td>1'35&quot;</td>
<td>1'5&quot;</td>
<td>1'8&quot;</td>
<td>2'21&quot;</td>
<td>1'31&quot;</td>
</tr>
<tr>
<td>Gas (1 cubic meter)</td>
<td>8'46'</td>
<td>2'57'</td>
<td>4'10&quot;</td>
<td>1'39&quot;</td>
<td>4'37&quot;</td>
<td>1'19&quot;</td>
<td>2'9&quot;</td>
<td>3'28&quot;</td>
<td>3'54&quot;</td>
<td>1'40&quot;</td>
</tr>
<tr>
<td>Brick (1 piece)</td>
<td>4'35'</td>
<td>5'54&quot;</td>
<td>7'39&quot;</td>
<td>1'50&quot;</td>
<td>3'56&quot;</td>
<td>13'10&quot;</td>
<td>5'7&quot;</td>
<td>7'4&quot;</td>
<td>5'53&quot;</td>
<td>1'40&quot;</td>
</tr>
<tr>
<td>Cement (100 kilo)</td>
<td>7h20'</td>
<td>4h7&quot;</td>
<td>2h14&quot;</td>
<td>1h55&quot;</td>
<td>3h25&quot;</td>
<td>8h46&quot;</td>
<td>5h51&quot;</td>
<td>3h44&quot;</td>
<td>12h10&quot;</td>
<td>43'28&quot;</td>
</tr>
<tr>
<td>Regular gasoline (1 liter)</td>
<td>36'41&quot;</td>
<td>22'2&quot;</td>
<td>11'30&quot;</td>
<td>13'35&quot;</td>
<td>23'9&quot;</td>
<td>21'57&quot;</td>
<td>17'36&quot;</td>
<td>25'28&quot;</td>
<td>27'37&quot;</td>
<td>3'28&quot;</td>
</tr>
<tr>
<td>Inland mail</td>
<td>4'24&quot;</td>
<td>4'32&quot;</td>
<td>3'28&quot;</td>
<td>2'53&quot;</td>
<td>4'8&quot;</td>
<td>17'33&quot;</td>
<td>3'12&quot;</td>
<td>4'39&quot;</td>
<td>7'53&quot;</td>
<td>2'8&quot;</td>
</tr>
<tr>
<td>Local telephone call of 3 minutes</td>
<td>2'13&quot;</td>
<td>40'</td>
<td>1'22&quot;</td>
<td>4'8&quot;</td>
<td>17'33&quot;</td>
<td>3'12&quot;</td>
<td>4'39&quot;</td>
<td>free</td>
<td>44&quot;</td>
<td></td>
</tr>
<tr>
<td>Bus fare (local)</td>
<td>7'20&quot;</td>
<td>11'11&quot;</td>
<td>13'40&quot;</td>
<td>7'13&quot;</td>
<td>8'46&quot;</td>
<td>17'33&quot;</td>
<td>6'24&quot;</td>
<td>8'2&quot;</td>
<td>11'48&quot;</td>
<td>5'12&quot;</td>
</tr>
<tr>
<td>Dry Cleaning</td>
<td>3h51'</td>
<td>1h9&quot;</td>
<td>4h2&quot;</td>
<td>2h2&quot;</td>
<td>2h12&quot;</td>
<td>8h46&quot;</td>
<td>2h27&quot;</td>
<td>2h18&quot;</td>
<td>6h30&quot;</td>
<td>42&quot;</td>
</tr>
<tr>
<td>(men's suit)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Train fare (2nd class, 100 km)</td>
<td>44&quot;</td>
<td>52'</td>
<td>1h12&quot;</td>
<td>1h36&quot;</td>
<td>1h16&quot;</td>
<td>2h5'</td>
<td>38'</td>
<td>50'55&quot;</td>
<td>2h18&quot;</td>
<td>39&quot;</td>
</tr>
<tr>
<td>Gas and water repair (1 hour fee)</td>
<td>2h26&quot;</td>
<td>2h48&quot;</td>
<td>4'3&quot;</td>
<td>3h36&quot;</td>
<td>4h58&quot;</td>
<td>2h5&quot;</td>
<td>3h12&quot;</td>
<td>2h53&quot;</td>
<td>13h6&quot;</td>
<td>4h5&quot;</td>
</tr>
<tr>
<td>Total 1997</td>
<td>143h</td>
<td>190h</td>
<td>154h</td>
<td>95h</td>
<td>158h</td>
<td>269h</td>
<td>183h</td>
<td>193h</td>
<td>227h</td>
<td>41h</td>
</tr>
<tr>
<td>Total 1996</td>
<td>389h</td>
<td>206h</td>
<td>171h</td>
<td>121h</td>
<td>184h</td>
<td>622h</td>
<td>226h</td>
<td>208h</td>
<td>295h</td>
<td>46h</td>
</tr>
</tbody>
</table>

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goods and services, and exchange rates. In 1997, as in the previous year, Croats, Hungarians, and Poles had to work the fewest hours to purchase the contents of this consumer basket. (These statistics tell nothing about the intensity of the work effort, of course, but they do reveal differences in productivity.) In comparison, Russians and Ukrainians had to work the most hours, also repeating the 1996 results. But in general, workers across the board had to work less in 1997 than in 1996—or, to put it another way, the same workload entitled them to more goods and services than a year before.

The cross-country comparison serves primarily to rank the countries on this issue. Certainly, the reliability of such a survey—measuring exactly how much of a working hour is required to buy a specific item—can be debated. It reveals clearly, however, that the gap between the leading and the laggard country is closing: in 1995 the gap stood at 558 hours, while by 1997 it had dropped to 178 hours. If workers were paid in dollars, in Ukraine their gross average monthly wage would come to a meager $88; in Croatia they would pocket $596, in Poland, $379, and in Hungary, $308.

The table also lists the data for the comparable Central European state, Austria. It will be long shot, even for the leaders on the list, to catch up with Austria, where the average wage is about $3,600.

**Accession to the EU—A Reform and Growth Strategy for Poland**

by Daniel F. Oks

On March 31, 1998, the Czech Republic, Estonia, Hungary, Poland, and Slovenia, began formal accession negotiations with the European Union (EU). The World Bank is assisting applicant countries, including those that have not been invited to negotiate in the first round, to design preaccession reform strategies that would promote simultaneously economic growth and effective integration to the EU. One key vehicle for such support is the preparation of country economic reports focused on EU accession. The first of these reports was prepared for Poland.

In view of the complexity and sensitivity of many EU accession requirements, close collaboration with both Polish authorities and the European Commission was sought from the outset. The report focuses on the implications for economic strategy of formal EU membership requirements, such as reform of Poland’s legal, institutional, financial, and physical infrastructure. However, because a vibrant and growing economy is one of the surest signs that Poland can meet the challenges of EU membership, the report also addresses other factors that govern economic growth even though they are not formal EU requirements. These include, for example, privatization, pension reform, and opening of labor markets.

Poland’s accession to the EU will drive the pace and direction of policy and institutional reforms over the next decade. Membership will require that Poland adjust its institutions, laws, and regulations—including the capacity to implement and enforce them—as required by the EU’s acquis communautaire (the laws and regulations that are accepted by all member states).

**Proposed Preaccession Strategy**

The key elements of the macroeconomic and structural reform strategy proposed for the preaccession period:

- **Macroeconomic strategy.** A precondition of the reform and fast-growth strategy is increasing the saving rate by about 5 percent of GDP over the next five years. Structural strengthening of public finances—particularly through social security reform, closure of unprofitable mines, and faster privatization—is crucial to improve public saving, provide incentives for private saving, and bring down inflation.
- **EMU membership—and achieving price stability.** The Copenhagen criteria applicable for Eastern applicants do not require that new members join the European Monetary Union (EMU), but it does require that they adhere to the objectives of the EMU. In practical terms this suggests that applicants implement the reforms needed to achieve price stability on a permanent basis.
- **Mobilizing capital flows and domestic saving to finance investment** is the key to rapid productivity growth and a quick catch-up with the EU. Fast productivity growth, by facilitating a sustainable appreciation of the real exchange rate, and particularly if accompanied by a flexible exchange rate policy regime, is at the core of the disinflation strategy pursued by Poland.

**Three Kinds of Reform**

The structural reform strategy combines three different types of reform:

1. Win-win policies and reforms: early implementation is desirable for EU accession but these reforms are essential in their own right to support
Poland's economic growth. An example is the deregulation of infrastructure—energy, telecoms, transport—where EU directives envisage an enhanced role for markets and private sector participation. It is likely to attract substantial investment and help improve Poland's competitiveness. For instance, Poland is already implementing a new energy law that will factor in compliance with EU regulations. It is important, however, to privatize energy operators, and rapidly establish an energy regulatory agency. In the case of transport, fiscal harmonization will require higher gasoline taxes; this can be used to fund the upgrading of Polish roads needed to handle heavier EU traffic.

As in infrastructure, complying with the EU acquis in the financial sector would also be pro-growth and pro-accession—that is, a win-win policy. It would help lower the cost of capital for Polish firms, encourage much-needed investment, and improve the range and quality of services open to Polish savers, even if EU accession were delayed. The upgrading of Poland's financial regulations and supervision is the most important requirement for EU accession. Since supervision is to be performed by the home country, it should be recognized as adequate by all countries in which the institution under supervision is active. (For example, supervision requirements for a French bank's affiliate in Warsaw should match those of other EU member states where the bank has subsidiaries.) Unlike in the case of goods, the dismantling of barriers in not enough. Enhanced regulation and supervision is also crucial to deal with the potential fragility of financial institutions in the highly competitive EU single financial market and to mitigate the risks that may accompany large, inadequately intermediated capital flows.

2. Policies and reforms that are not a formal requirement for accession but are essential to growth and stabilization strategy (such as privatization and pension reform). Many large, socially sensitive or politically powerful state-owned enterprises (coal, steel, chemicals) and financial institutions have avoided major restructuring; their losses continue to be a drag on competitiveness and thus on the economy's growth potential. Without faster privatization, state-owned firms will find it increasingly difficult to compete in Europe-wide markets and could cause fiscal and unemployment setbacks. EU competition regulations limit the amount of state aid permitted, so restructuring and privatization of these institutions would eventually become an implicit EU requirement anyway.

Public finances also remain vulnerable to adverse trends in social spending, representing almost two-thirds of public expenditure. Key reforms of pension, health, and education could lead to a critical improvement in both public and private savings while reducing the high cost of hiring workers. (Social security taxes represent at present 48 percent of the worker payroll).

3. Policies and reforms whose adoption will require more time and careful sequencing of actions in order to maximize their benefits to Poland. (EU Common Agricultural Policy and environmental standards.) Total investment needs for environmental protection were estimated to be between ECU 50 billion to 80 billion over 20 years depending on how specific EU directives are interpreted. Poland will derive substantial environmental benefit from meeting certain EU standards quickly—especially for air quality—since this will reduce the burden of ill health and high mortality attributed to current conditions. Benefits in such areas are large relative to investment costs.

In other areas, however, such as water quality and wastewater treatment, direct benefits are smaller, less immediate, and difficult to measure. And the necessary investments are of such magnitude that early compliance (say, by 2002) may not be even technically possible. The key in this case is to develop a credible long-term strategy for compliance.

The development of Poland's human and institutional capacity—to adopt, implement, and enforce the terms of the acquis—could be one of the most rewarding investments but is also bound to be financially costly and politically difficult to sustain. EU aid in this area—if wisely used—can be helpful and nondistortionary. Improved institutional capacity will in fact be essential for effective and nondistortionary absorption of EU structural and cohesion aid. Large net transfers from these sources may not materialize, but if they do, without transparent, consistent, and objective cri...
teria to ensure "additionality" of investment, they may hamper growth—as experience in Greece has shown.

**CAPing the Agriculture**

In agriculture the economic costs of adopting high EU intervention prices before accession are too much for Poland's budget or consumers to bear. They could also hinder incentives to improve efficiency. Support to special groups, if decided by the government, needs to be based on better-targeted income support schemes, not price intervention. This is the trend of the EU's Common Agricultural Policy, which suggests that convergence in prices may be less of an issue by the time Poland accedes.

Poland's extensive agenda in agriculture needs to focus instead on the strengthening of market institutions (land and regional wholesale markets, rural credit, privatization), more transparent intervention in cereals (including privatization of storage and trading functions), with the aim to reduce its production and adoption of EU technological and quality standards.

Accession to the EU goes significantly beyond implementation of specific economic instruments or acts of European law. It is, first of all, a matter of creating the conditions under which Poland and the EU will be able to reap the benefits of integration. In this context, creating the conditions for fast and sustainable growth becomes the single most important "requirement" for EU accession.

*The author is Senior Economist at the World Bank.*

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**World Bank Supports Accession**

Leaders of the European Commission, the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD), and the World Bank decided during their end-March meeting in Brussels to join forces in supporting the EU accession of Central and Eastern European countries. The institutions will cofinance investment projects, as well as non-project-related work in the candidate countries, in accordance with the EU's preaccession policies, and will work together to foster the adoption of EU legislation, including the implementation of EU norms and standards in the public and private sectors. Representatives of the four institutions will meet regularly and staff cooperation will be strengthened, notably on the ground.

As a first concrete result of their enhanced cooperation, the European Commission, the EIB, the EBRD, and the World Bank have identified a preliminary list of projects amounting to about ECU 3.5 billion ($3.9 billion), that could qualify for cofinancing in 1998/99. The projects included in the indicative list range from small-scale projects, for example, environment projects in the Baltic States, to large-transport infrastructure projects in the context of the Trans-European Networks in countries such as Hungary and Poland. Some projects in private industrial sectors (such as food processing) have also been included.

Grant support of the European Commission's Phare program will continue to operate as an instrument for accession. Where appropriate, a combination of Phare grants, and loans from the EIB, the EBRD, the World Bank, and other international finance institutions will be sought.

The European Investment Bank (EIB), the EU's long-term financing institution, will work closely with the European Commission, by focusing on projects that facilitate the adoption of the *acquis communautaire* [laws and regulations, adopted by the member countries] in areas such as environmental protection, transport (particularly Trans-European Networks), telecommunication and energy links, enterprise and employment development, and regional development. The EIB has already approved a new Preaccession Facility aiming at financing projects in the candidate countries.

The EBRD stands ready to explore cofinancing opportunities in areas where substantial additional investment is needed to implement EU legislation, such as public and private infrastructure (municipal infrastructure, transport, energy), the environment, and the agribusiness industry, as well as modernization of the financial sector, restructuring of large industries, and support to small and medium-size enterprises.

The World Bank will play an important role in the preaccession preparation, through its analytical work and cofinancing of major infrastructures, in particular, in the transport, energy, and urban sectors and accompanying environmental support; helping policy reform and institutional reform (also at local and subnational levels), developing regulatory frameworks; and supporting the social sectors.

*Excerpts from the joint press release, dated March 30, issued following the March meeting in Brussels.*
Changing Landscapes in Europe’s Economic Structure

by Harilaos Mertzanis and George Petrakos

Across Europe a North-South divide that separates countries according to their level of development—measured by per capita GDP and by the share of agriculture, industry, and services in GDP—is being complemented by a deepening East-West divide (see table).

- The share of the agricultural sector in total GDP in the EU countries is very low, with the exception of Greece, and is decreasing. During 1990-95 it fell by 21.8 percent in the core eight countries of the EU (France, Germany, Italy, and the Benelux countries, United Kingdom, and Ireland), but dropped by only 8.8 percent in three Mediterranean states (Spain, Portugal, Greece). In transition economies the overall average share of the agricultural sector in GDP is about four times higher than the EU average. The agricultural sectors of Albania, Croatia, FYR Macedonia, Moldova, and Romania are growing both in absolute and relative terms. Agricultural production is gradually moving away from the northern part of Eastern Europe toward the southern part. (The Baltic states are gradually becoming less dependent on the agricultural sector, while the Balkan states grow more dependent.) The more a country’s industrial share in GDP shrinks, the higher the chance that the agricultural sector share will increase, as, in the absence of an absorbing service sector, many displaced workers return to the land.

- The share of industrial production in GDP is continuously shrinking in EU countries, with the exception of Luxembourg and Spain where it has increased slightly in the 1990s. The trend is similar in the Eastern European economies, where the share of industry in GDP, on average, has fallen considerably. But in many postsocialist countries this reflects more the deterioration of the industrial base than a positive process of industrial restructuring and faster-than-average development of the service industries. In many transition economies the share of industrial production in GDP exceeds the

### The Sectoral Distribution of GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Agriculture</th>
<th>Industry</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1990</strong></td>
<td><strong>1995</strong></td>
<td><strong>90/95</strong></td>
<td><strong>1990</strong></td>
</tr>
<tr>
<td><strong>EU15</strong></td>
<td>4.7</td>
<td>3.9</td>
<td>-15.5</td>
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<tr>
<td><strong>EU (core)</strong></td>
<td>2.8</td>
<td>2.2</td>
<td>-21.8</td>
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<tr>
<td><strong>Mediterran (3)</strong></td>
<td>9.1</td>
<td>8.3</td>
<td>-8.8</td>
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<td><strong>Austria</strong></td>
<td>3</td>
<td>2</td>
<td>-33.3</td>
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<td>2</td>
<td>1.6</td>
<td>-20</td>
</tr>
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<td>4.4</td>
<td>3.4</td>
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<td><strong>Finland</strong></td>
<td>6.4</td>
<td>5</td>
<td>-21.9</td>
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<td>3.4</td>
<td>3.2</td>
<td>-41.2</td>
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<td><strong>Germany</strong></td>
<td>1.5</td>
<td>1</td>
<td>-33.3</td>
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<td>17</td>
<td>16</td>
<td>-5.9</td>
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<td>8.2</td>
<td>7.9</td>
<td>-3.7</td>
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<td>3.2</td>
<td>2.9</td>
<td>-9.4</td>
</tr>
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<td><strong>Luxembourg</strong></td>
<td>1.6</td>
<td>1.3</td>
<td>-18.8</td>
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<td>4</td>
<td>3</td>
<td>-25</td>
</tr>
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<td><strong>Portugal</strong></td>
<td>5.8</td>
<td>6</td>
<td>3.4</td>
</tr>
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<td><strong>Spain</strong></td>
<td>4.6</td>
<td>3</td>
<td>-34.8</td>
</tr>
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<td><strong>Sweden</strong></td>
<td>2.9</td>
<td>2</td>
<td>-31</td>
</tr>
<tr>
<td><strong>United Kingdom</strong></td>
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<td>2</td>
<td>5.3</td>
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<td><strong>CEE</strong></td>
<td>16.8</td>
<td>15.7</td>
<td>-6.5</td>
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<td><strong>Balkan (5)</strong></td>
<td>19.4</td>
<td>24.2</td>
<td>24.7</td>
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<td><strong>Visegrad (5)</strong></td>
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<td>37</td>
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<td>8.9</td>
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<td>-18</td>
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<td>11.5</td>
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<td>7.4</td>
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<td>-24.3</td>
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<td><strong>Yugoslovia</strong></td>
<td>19.3</td>
<td>33.4</td>
<td>34.4</td>
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</table>

* The share of industrial production is continuously shrinking in EU countries, with the exception of Luxembourg and Spain where it has increased slightly in the 1990s. The trend is similar in the Eastern European economies, where the share of industry in GDP, on average, has fallen considerably. But in many postsocialist countries this reflects more the deterioration of the industrial base than a positive process of industrial restructuring and faster-than-average development of the service industries. In many transition economies the share of industrial production in GDP exceeds the

**Source:** World Bank
EU average, indicating that the process of industrial restructuring has not been completed yet.

- The share of the service sector in GDP in every EU country is relatively higher than both the agricultural and industrial sector shares, and has exhibited a steady increase during the 1990s. In some transition economies, including Bulgaria, Estonia, Lithuania, and Romania, the service industry increased by an average 80 percent in the first half of the 1990s having started from a very low level. Other countries—Albania, Latvia, Moldova, Romania, Slovenia, and Ukraine—have seen services fall and then rise considerably. Vigorous development of this sector is hampered by government policies that funnel significant resources to the industrial sector, to safeguard industries that serve the "national interest," and to prevent acceleration of unemployment. In Croatia, Estonia, Hungary, Lithuania, and Slovakia the service sector has already recorded relatively high shares in GDP, comparable to the EU average. But in the EU countries, banking, financial, and business services, as well as cultural, leisure, and other personal services, have a strong presence, while in many transition economies the service sector is dominated mostly by nontradable activities such as extensive retail trade and an overstuffed public sector.

Thus the structural composition of GDP across Europe reveals that:

- Homogenization in the EU countries has made significant progress, but disparities along Europe's North-South divide are still noticeable, with the Mediterranean countries differing significantly from the EU core countries.
- Within and between the transition countries, disparities are widening, with the Visegrad countries adjusting faster than the other Eastern European states. Most Balkan countries lag behind in reform actions compared with their counterparts in Central and Northeastern Europe.
- On the whole, the development gap between the EU countries and the CEE countries is still widening.

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Are the Acceding Countries Ready?

At a seminar organized by the Vienna Institute for Comparative Economic Studies in early 1998, George Kopits, Assistant Director of the IMF's Fiscal Affairs Department, discussed the requirements that countries acceding to the EU will have to meet and the policy issues that they face. Overall, it seemed clear that the five postcommunist countries invited by the European Commission in July 1997 to meet EU requirements—Czech Republic, Estonia, Hungary, Poland, and Slovenia—are, in many important respects, in a better position than Greece and the Iberian countries were when they acceded to the EU. The countries slated for accession will have to adhere to an exchange rate mechanism currently followed by most EU members before the euro is introduced in 1999. That means keeping their currencies at a parity to the euro with a 15 percent corridor in each direction for two years before adopting the euro.

The countries will also have to meet the various Maastricht criteria (including a budget deficit no larger than 3 percent of GDP). It is safe to assume that they will need to adhere to such institutional requirements as using market-based monetary instruments and maintaining central bank independence from political influences. Other tasks include eliminating all trade barriers with the other EU members; establishing the common external tariff; and implementing common procedures for consumer and environmental protection, public procurement, banking regulation, and tax harmonization. As a benefit, the five countries will have access to the Structural Funds (SF), the Cohesion Fund (CF), and perhaps to the Common Agricultural Policy (CAP). While the transfers potentially allocated to them could be enormous according
to current criteria, it seems likely that the amount available to them will be limited to 4 percent of GDP.

The five countries seem to be doing rather well in meeting those criteria. Inflation and long-term interest rates have come down, although they remain above the EU averages. There is progress on adopting market-based monetary tools and establishing central bank independence. Budget deficits in several countries already fulfill the Maastricht criteria, although there may be significant extrabudgetary and quasi-fiscal expenditures. Their external sectors are already liberalized, and there is progress on antimonopoly and consumer protection legislation. However, much remains to be done in the areas of environmental standards, banking regulation, harmonization of indirect taxation (especially rates of value added tax and payroll contributions), and procurement procedures.

It is unclear whether the countries acceding to the EU will be able to operate within the prescribed exchange rate corridor, given the myriad pressures on their exchange rates. There are factors that may lead to the appreciation of their currencies, including foreign direct investment and short-term capital inflows, and the productivity-driven adjustment of their prices to the levels of their EU neighbors. But there are also pressures for depreciation. Growth of wages tends to exceed that of labor productivity; budget deficits and rapid monetary growth persist; and speculative capital occasionally flows out.

Another issue is whether the countries can remain within the EU's fiscal guidelines while dealing with major structural challenges. Accession will bring some budgetary advantages, including transfers under the Structural Funds, Cohesion Fund, and CAP programs; the elimination of sectoral subsidies; reform of budgetary practices; and lower interest costs.

At the same time, accession will also pose budgetary challenges, such as the need to cofinance the transfer programs, make contributions to the EU budget, eliminate tariffs against imports from EU members, and adopt the common external tariff. The candidate countries will also have to provide for tax harmonization, which will force major reductions in VAT rates; adopt EU accounting practices; and incur restructuring costs, especially for investments in infrastructure.

Despite such challenges the accession should be a success. The process has been successful in Portugal and Spain, less so in Greece. The five postcommunist countries have many similarities with the three Mediterranean states at the time of their accession: low income levels, low productivity, a need for enterprise restructuring, and scope for infrastructure investment. At the same time, the five transition countries are more open to foreign trade and capital movements, especially as compared with Greece and Spain at their accession; have smaller macroeconomic imbalances; and, ironically, have less widespread state ownership following their privatization efforts. However, the enlarged EU will be different from the European Community of the 1980s, particularly since the community was a customs union only, not a single market, and did not have a common monetary policy.

In sum, the five countries seem better prepared for accession than many observers realize. There is more doubt about the viability of upcoming changes in the EU—especially the single currency and reform of the transfer programs—than about the ability of those candidate countries to adopt current procedures—George Kopits pointed out.

The article is based on a Radio Free Europe report by Michael Wyzan, an economist living in Austria.

**Reliable Predictions**

**OOPS...DIDN'T SEE THAT ONE COMING: NOW LET ME TELL YOU WHAT WE CAN EXPECT DOWN THE ROAD.**

From the World Press Review.
Underworld Bankers Lend to Small Businesses in Transition Economies
by Thomas Orszag-Land

Hungary in 1997 introduced landmark legislation to combat the thriving financial institutions of the criminal underworld. Changes to the 1996 Finance Act would make unlicensed financial services, provided for profit or interest payments, a criminal offense, punishable by five years' imprisonment. The aim is to outlaw money lending by the mafia and thus break organized crime's hold over thousands of small businesses. Heretofore, these businesses have been exploited with impunity, for money laundering operations.

Money lending is one of the most popular ways of making tainted cash grow, explains Laszlo Pelikan, chief of the economic crime investigation department at Pest County Police Headquarters. Bankers in the underworld have provided millions of dollars in loans at interest rates up to 30 percent—per week. Such loans usually lead to other serious offenses like blackmail and violence against person and property. The collateral required for such loans often includes the entire wealth of the borrower. A frequent ploy of lenders has been to manipulate the borrower, often by means of violence, in such a way that he cannot meet his obligations in order to secure control of his home and business. Complaints generated by the unofficial financial sector have numbered in the tens of thousands during the past couple of years. But authorities have had great difficulty investigating such offenses because money lending, even at exorbitant rates, has always belonged to the sphere of civil rather than criminal law. The change in the criminal code may thus lead to quick prosecution in many cases that in the past would have escaped sanction.

Sanctions can be effective only if the root cause of the underworld's involvement is eliminated. So far, the legitimate banks of the once communist-dominated countries of Europe have failed to meet small enterprises' needs for start-up loans. Economic reforms have led to a significant decline in bank lending over the past years, accompanied by high collateral requirements and extremely high interest rates, implying lack of competition. In the absence of adequate credit facilities, in the case of Hungary, organized crime is thought to have gained as much as a 25 percent share in the financing of small and medium-size businesses, effectively turning such enterprises into operations for laundering tainted cash. That proportion is probably much higher in other countries of the region.

“It is easier to rob a local bank than to persuade its manager to raise a loan for a new business,” observes Laszlo Arva, an adviser of the Hungarian Privatization Research Institute, in an essay published recently in the financial daily Vilaggazdasag (World Economy). Even when a legitimate bank loan is available, the requirement for high collateral places it beyond the reach of most entrepreneurs. By contrast, “organized crime demands a more easily insurable and more readily collectable deposit,” Arva notes. “It is the life of the borrower.”

The mafia has also learned to fill many other needs neglected by the fledgling democratic institutions of the region. Entrepreneurs are turning to organized crime for help in many areas—for example, collecting debts or protecting property—at a huge long-term cost to society. “It is possible for someone's house to be sold out from under him because of the shortcomings of the land registry system,” Arva explains. “And it may take years of legal wrangling before the overburdened judiciary system can sort out a property conflict. Is it surprising then that many aggrieved parties ignore the courts and look to the mafia for justice?”

Criminal lenders enjoy huge advantages over their legitimate counterparts, observes economist Douglas Keh in a recent study, Drug Money in the Changing World: Economic Reform and Criminal Finance, published by the United Nations' Vienna-based International Drug Control Program. These underworld bankers do not suffer the heavy cost of nonperforming loans that burden the legitimate banks. They have the freedom to discriminate among borrowers, extracting the maximum amount of profit yield that can be collected from each. They can also use violence to ensure compliance with the terms of the loan. In some countries of the region the proliferation of organized gangs is even eroding the difference between legitimate and criminal banks.

These problems are likely to prove temporary, observes the Organization for Economic Cooperation and Development (OECD) in its analysis of the Hungarian economy. Andrew Burns and Giancarlo Perasso, authors of the OECD analysis, maintain that the excessively high requirement for collateral set by the banks is attributable to the underdeveloped mortgage market and the poor maintenance of the national property registry (though the registry is rapidly improving). The analysis suggests that
bankers’ exaggerated prudence in lending is the result of their recent experience with bad loans and lack of expertise in evaluating promising new loan applications. Nonetheless, the banks are increasingly seeking to expand their lending activities, according to the OECD report. Recent legislation on mortgages may also improve individuals’ access to legitimate seed capital.

If Hungary succeeds in ridding itself of the root causes of illegal lending activities, and contains criminal banking, it could help the entire region in the fight against financial crime. That is why Hungary’s neighbors throughout Central and Eastern Europe—whose financial and judicial institutions are undergoing painful, radical reforms as the region adapts to West European standards—are watching with enormous interest. The mafia has profited during the transition process by assuming the role of the state, which has been reduced sharply in many key areas and replaced by the newly emerging institutions of democratic society. When these institutions mature and are able to fulfill their functions properly there will be no room left for organized crime—except in jail cells.

The author, a foreign correspondent stationed in Budapest, writes on global affairs, and contributes regularly to the Christian Science Monitor (Boston) and the Observer (London).

**Fighting Organized Crime and Public Corruption**

by Michael Gray

No economic plan or provision for democratic and legal reform, including regulatory controls and criminal statutes—no matter how comprehensive—can guarantee the creation of a market economy free from fraud and corruption. Although some crimes could be prevented by enacting laws that aim to eliminate the economic incentives of illegal activity, the law’s effectiveness will ultimately depend upon thorough investigation, prosecution, and enforcement. Corruption within the law enforcement community itself not only prevents an effective apprehension and prosecution of organized crime, it offers a haven for criminal activity within the state structure itself.

This is the case in many transition economies, where law enforcement agencies seem overwhelmed by the challenges posed by the explosion of organized crime and corruption. The region is awash with narcotics, smuggled weapons, and stolen automobiles. The ranks of organized crime often comprise government officials, members of the police, and even prosecutors. In testimony before a U.S. Congressional Subcommittee for Appropriations, U.S. investors complained of rampant corruption among government officials in Ukraine and apparent links between Ukrainian law enforcement officials—including the newly founded Tax Police—and Russian organized crime. They linked law enforcement officials’ failure to intervene in obvious corruption incidents to their acceptance of bribes from organized crime figures. And since early 1996 the complaints have increasingly mentioned the presence of Russian organized crime in Ukraine.

With privatization now under way in Ukraine, Western governments and multilateral assistance organizations are concerned that Russian organized crime groups, having developed their expertise during Russia’s privatization program, will flourish and expand in an environment robust for transnational crime activity and replete with corruption. Ukraine represents a significant challenge as well as opportunity for the United States and other countries to take the lessons learned thus far in Russia’s privatization process and play a more constructive role in helping the Ukrainian Government sever the links between public officialdom and illicit private gain.

In November 1996, in response to requests for assistance from several countries in the region, including Russia and Ukraine, and the growing threat to the United States posed by Eurasian organized crime, the U.S. Department of Justice and the FBI initiated an ambitious effort to provide anticrime and corruption assistance to countries of the newly independent states of Europe and Asia. These requests for assistance in many ways mirrored those addressed to the World Bank and other multilateral development institutions across the globe: institutions and practices were required to effectively confront organized crime and corruption, without creating a new bureaucratic structure that would deepen existing interagency rivalries. The challenge faced by the Justice Department and FBI officials from the beginning of this program was stark if not simple: What could Western agencies do to help provide a near-term solution to the problem of corruption, and specifically, corruption among law enforcement agencies?

The Justice Department found an effective weapon in its law enforcement arsenal: it concluded that the experi-
ences of its anticrime Strike Forces and anti-public corruption task forces could provide useful lessons to Russia and other newly independent states, where pervasive organized crime and public corruption practically merge. The Strike Forces are permanent units established in key cities around the United States, as semi-autonomous group of investigators and prosecutors. Their primary purpose is to combat organized crime whose tentacles reach into public and official life. They operate with enough independence to be able to effectively investigate and prosecute powerful public officials believed to be corrupt. Anti-corruption task forces, on the other hand, are temporary, and are typically set up to address a particular type of corruption.

In the past three decades the two forces, in combination, have played a key role in breaking the stranglehold of organized crime and corruption in major economic sectors of the United States. As the activities of organized crime and corrupt public officials typically cut across lines of perceived jurisdictions among law enforcement agencies, the creation of elite units composed of agents working closely together tends to significantly reduce the problem of interagency rivalries. Also, the institutional knowledge developed among a team of permanent investigators and prosecutors over a long period has proved an invaluable tool in improving investigative and prosecutorial techniques in the United States.

The U.S. Justice Department and the FBI conducted a series of workshops in Russia and Ukraine in the past two years promoting the establishment of closer interagency cooperation in combating crime and corruption. More than 300 investigators and prosecutors from the Ministries of Internal Affairs, Security Services (formerly the KGB), Customs Services, Boarder Guards, Tax Police, and General Procuracy participated in the workshops in Moscow, Kiev, and Uzhgorod, and in Washington, D.C. To stem the growth of public corruption and organized crime the following goals were drawn up:

- Western governments and multilateral organizations, including the World Bank, should establish clear links between their assistance, especially in support of privatization, and effective law enforcement.
- Policymakers and law enforcement officials in the former Communist countries should set up interagency organizations to fight crime and corruption—similar to the Strike Forces proposed in Ukraine—and, in particular, these organizations should combat corruption within the law enforcement community.
- The efforts of governments and enacted legislation should be directed toward reform of law enforcement and the judiciary, in order to help safeguard civil liberties and foster public participation in anticorruption initiatives.

The author is former director of the Program for Anti-Organized Crime Assistance to CEE and FSU countries, at the U.S. Department of Justice.

Developing the Private Sector in Kosovo—An Ongoing Research Project
by Muhamet Mustafa

In July 1997 the Pristina (Kosovo) based the Rilinve Research Institute conducted a survey to assess the major factors that impede the progress of the private sector; the survey sample was 300 enterprises (3 percent of Kosovo’s private companies). Major difficulties listed by the private companies included the following:

- About three-quarters of polled entrepreneurs complained about the uncertain political situation that deters investors and prevents cooperation with foreign partners. Elimination of Kosovo’s autonomy and the mass firing of Albanians from state-owned enterprises and public institutions, especially the firing of those in leading positions (more than 130,000 Albanians, almost 60 percent of whom worked in the governmental sector, were discharged from their jobs), created a degree of uncertainty that is nonconducive to business and hampers the pooling of resources. The majority of enterprises have only one founder-owner, and only 3.3 percent of polled enterprises operate as some kind of joint venture.
- The central authorities collect more and more in taxes and penalties. Companies are audited every second month, on average. In 60 percent of cases the auditors come up with an arbitrary penalty. The milking of legally established companies prompts them to go underground.
- Little or no financial support is available to private companies. A low 11.3 percent of polled enterprises have used short term credit for financing working capital, but no company has secured such credit for investment activities. Entrepreneurs have to use their own financial resources and cannot hope for any loans or guarantees. With the exception of the Economic Bank of Pristina, Belgrade banks have only rep-
representative offices in Kosovo, and these are authorized only to conduct foreign exchange transactions. And even the Economic Bank cannot provide long-term credits or establish relations with foreign banks.

As a consequence, old structures survive, the private sector stagnates, and reform is at a standstill. The number of registered private companies has ceased to grow. In the hostile environment, the survey confirmed, private companies showed weaknesses in three important areas:

- Most do not apply modern management concepts.
- Organization is outdated.
- Until recently the business community has been unable to coordinate and protect its interests.

**Weaknesses in Management**

Kosovo's private enterprises generally do not employ advanced management practices, marketing and promotion strategies, or information systems. Our investigation showed that most entrepreneurs and managers develop their business objectives and concepts without first designing a business plan or strategy. Feasibility studies are rare. Instead, businesses rely on intuition. More than 70 percent of private businesses are general-purpose commercial enterprises. Only 55 percent of registered enterprises are operating according to their original profile. Investments are largely improvised without a well-thought-out strategy, at least partly because of the overwhelming difficulty of daily operations and the lack of information.

On the positive side, entrepreneurs and managers have relatively high qualifications: about 68 percent have a university or college education; by training, 38 percent are economists and 25 percent are engineers. (Most have not upgraded their knowledge with time, however. Only 10 percent had participated in seminars or workshops organized to discuss legislative changes and other professional topics).

Companies still do not view marketing as a core activity. Only 8 percent of polled enterprises engage in regular promotion of their products or services. The target market is Kosovo, where 80 percent of goods and services are sold; only 15 percent is exported to Serbia and Montenegro and a mere 5 percent goes abroad. One reason for this is that much of Kosovo's production is not yet competitive on the world market.

Although many private companies have begun computerizing their business activities (66 percent of enterprises have one or more PCs), this hasn't been integrated yet with management methods. PCs are used mostly in accounting and for registration of inventory, and as word processors. Only 17 percent of private enterprises have access to local computer networks and just 3 percent to the Internet.

**Outdated Organizational Patterns**

Inadequate organizational patterns have hampered enterprises' ability to react promptly to outside impulses and make crucial decisions in a timely fashion. Important business information often does not reach the right persons. Staff hiring is flawed; and management is less motivated to initiate systematic employee education, or retraining through seminars and workshops. Bookkeeping and accounting suffer and lack accuracy.

**Fragmented Business Community**

Organizing the business community in Kosovo has long been neglected. But the recent establishment of Kosovo's Business Association is a change for the better: the association has pledged to act in the interests of its members, providing information about legislative changes, supporting their marketing efforts, and setting up links to research institutes and universities. It will establish relationships with similar organizations in other regions and countries. Members hope that through the association, international institutions and organizations will provide technical assistance.

The Riinvest Research Institute conducted this survey as part of an ongoing research project, "Economic Activities and Democratic Development of Kosovo." The project's aim is to analyze key issues confronting the private sector in Kosovo and, simultaneously, to learn more about the sector's structure, resources, management skills, and partnership potential. The project is supported by the Center for International Private Enterprises (CIPE), Washington; the Open Society's Branch Office, Pristina; and the Friedrich Ebert Stiftung, Bonn.

Based on this research and international experience, Riinvest will draft guidelines on changing the institutional environment, developing the small and medium-size enterprises, and introducing an effective business education program; in short: a transition strategy that will create in Kosovo an open, market-based economy.

*The author is President of the Board of Riinvest Institute for Development Research, Pristina, Kosovo, FR Yugoslavia. (Riinvest is a private research institute that was formed in May 1995.) Fax: 381-38-35718.*
Kosovo—Economic History in a Nutshell

Economic activity in Kosovo, before World War II, was organized along family lines, with patriarchal characteristics. The roles, duties, and responsibilities of family members were strictly defined, under the domination of the father. Some big families counted 20, 30, and, in some cases, even 50 or 60 members. Family business was concentrated in agriculture, cattle raising, and handicrafts. Traditional artisans and simple manufacturers dominated production. Although Kosovo has many natural resources—including lead, zinc, silver, nickel, ferronickel, and coal—it remained largely agricultural before World War II, untouched by technological progress. Education was at a low level, with a high proportion of the population illiterate, but the central government in Belgrade cared little about the situation.

After World War II the socialist system in the former Yugoslavia measured its success in terms of the state sector’s increasing share in production. The private sector was reduced to family farms, grocery stores, small restaurants, and handicraft shops. During the 1980s the authorities became more supportive of small and medium-size businesses, including private enterprises, yet the private sector’s share in GDP by the end of the decade was no higher than 20 percent, compared with a 40 percent share in the early 1950s. In Kosovo the private sector’s share in total investments during that period had fallen from an annual 28 percent to 16 percent. Most investment over this nearly 40-year period went to housing construction (75-80 percent) and agriculture (12-15 percent), with much less put into arts and crafts (3 percent) and almost no investment in infrastructure and industry.

Despite these weaknesses enterprises in the former Yugoslavia were more decentralized, more directly exposed to domestic and foreign market impulses, and more liberal in their foreign trade than other CEE countries. Yugoslavia’s 1989 Corporation Law mandated the establishment of private enterprises and joint ventures between private and public sector participants, and between domestic and foreign companies. That should have yielded a great advantage to the country as, during the early 1990s, private initiative took off. In Kosovo, too, the number of private companies increased by leaps and bounds between 1991 and 1995. Then the spectacular increase came to a halt as Yugoslavia became a battleground and eventually split into successor states. The present Federal Republic of Yugoslavia has been reduced to Serbia and Montenegro. Kosovo’s autonomy has been suspended. Economic activity in the region has declined, reform has been blocked, and private business expansion has slowed.

In recent years Kosovo’s private sector has developed more as a result of social pressure than of market impulses. It now contributes about 55 percent to the region’s GDP, similarly to Bulgaria, Croatia, FYR Macedonia, and Slovenia. This rate is higher than Serbia or Montenegro’s average (32.6 percent and 35.5 percent, respectively). Kosovo’s private sector has shown resilience and vigor, while public sector enterprises have lost ground. State (social) sector production in Kosovo declined by 25 percent both in 1992 and 1993, and stagnated in 1994. At the same time private sector production shrank by only 13 percent both in 1992 and 1993, and increased by 18 percent in 1994. Many jobs that were lost in the state sector—not least because the Belgrade authorities took state-owned companies under their direct control after 1990—were made up by job creation in private businesses. It is estimated that some 70,000 to 80,000 workers—about 20 percent of the labor force—are employed in private enterprises, including small businesses but excluding agricultural activities. Many individuals started their own ventures. Successful entrepreneurs are benefitting from Kosovo’s comparative advantages, including a young, relatively well educated population and rich natural endowments (principally its marketable agricultural products).

More than 70 percent of Kosovo Albanians are unemployed, and the figures are not much better for Serbs living in Kosovo. The social time bomb is ticking: out of 2.2 million citizens, more than 50 percent are under 19. Economic activity takes place mainly in grey areas of the economy. The level of foreign investment is insignificant. Largely replaced by Serbs in public jobs, most Kosovo Albanians are supported primarily by hard currency sent home by the roughly 600,000 to 700,000 Kosovo Albanians abroad. By 1994 per capita GDP had decreased by 60 percent, compared with 1989, to a level of about $350. Industrial production shrank by 70 percent over the same period.

The situation has continued to deteriorate. The Albanian boycott of the Serbian administrative system began in 1990 in protest over Belgrade’s move a year earlier to revoke Kosovo’s autonomous status. The Albanians have since set up their own education system for some 500,000 students and established an unofficial administration. They have also built up their own mechanisms to organize social and health services, information flows, and cultural and scientific activities.

Based on Professor Mustafa’s essay and news agency reports.
North Korea's Economy, Once Freed, Will Need Shock Therapy
by Junki Kim

The Democratic People's Republic of Korea, or DPRK, has experienced severe contraction in its economy in recent years. Industrial production has fallen precipitously over the past seven years and a food shortage has worsened economic problems. There are no signs that the country is abandoning its bureaucratic centralized economic planning structure or pursuit of its socialist goals. But debate among economists is heating up about the depth and scope of the reform needed to move North Korea toward a market-based economy. The experiences of Eastern Europe, countries of the FSU, and China can be useful in this respect.

China's dual-track approach—continuing state control and heavy subsidization of the state-owned enterprise (SOE) sector while allowing the private sector to develop—cannot be adopted in North Korea. The country's economic structure and social welfare system are quite different. Whereas in China 70 percent of the work force is engaged in agriculture, in the DPRK the figure is only 25 percent. When China's agricultural sector was liberalized, it had room for growth, largely unhindered by problems in the relatively small state sector. The rapidly expanding nonstate sector was able to employ the vast rural labor pool. North Korea's economic structure, in contrast, resembles the structures in Eastern Europe and the FSU, where the state plays a more extensive role.

Indeed, in comparison with the former socialist economies, the DPRK is by far the most heavily industrialized country: its state-owned manufacturing industries employ more than 56 percent of the work force, as against Russia's 46 and Poland's 37 percent in the late 1980s. Although the exact amount of government subsidies to SOEs and state farms in North Korea is not known, it is likely to be closer to Russia's 20 percent of GDP registered in 1992, than the 8 percent allocated in China in 1991. Tackling the state sector's difficulties will thus be crucial to economic transition.

Extensive social welfare programs in North Korea absorb about 14 percent of GNP, adding inefficiencies to the labor market. Universal social welfare coverage and an equitable income distribution system ensure that the income levels of the urban and rural populations are much closer than in China. Labor mobility is thus quite restricted. A Chinese-style agricultural reform, by itself, would not be sufficient to stimulate the flow of labor and capital into the more productive nonstate sector. The large, heavily subsidized state enterprise sector and the inefficient labor market, taken together, would make development of the private sector difficult. If reform is to succeed in the DPRK, the SOE sector must be reduced, subsidies cut, and social welfare programs kept to a minimum.

The half-hearted attempt in the 1980s to reform the state-owned sector—in which managerial incentives were improved and enterprises were "depoliticized"—not only failed, they backfired. To counter severe information asymmetry problems, the authorities decided to strengthen centralization of the information flow and resource allocation. Steps taken to grant greater autonomy to SOEs did not also credibly harden their budget constraints and only led to hoarding of material resources and labor. The authorities shied away from a real hardening of budget constraints, which would have required SOEs to undergo bankruptcy procedures and give up most of their state subsidies.

Unlike command economies that allowed private ownership on a selective basis and provided some material incentives for workers, the Democratic People's Republic of Korea has relied mainly on its SOE sector and nonpecuniary incentive schemes. The state's role in the economy is pervasive, as evidenced by the ratio of government expenditure to GNP, which reached 71.9 percent in 1990 compared with 34 percent in prereform China in 1979. The DPRK leadership's hard-line ideological stance against private ownership has all but decimated the private sector. When conditions allow for reform, the country's economy will require a comprehensive, radical structural adjustment, rather than applications of the tools of a gradual development, Chinese-style.

Evaluating the course that reform policy will take in North Korea is critical at this juncture. South Korean officials seem to favor a partial, gradual reform approach similar to that followed in China. When they look at the apparent success of the Chinese reform and compare it with the high, short-term costs of comprehensive reforms in Eastern Europe and countries of the FSU, which incorporated macrostabilization, liberalization, and privatization, these policymakers opt for a gradual reform strategy in the North. Such a policy choice is understandable, as South Korea traditionally has promoted economic development through state control over resource (credit) allocation and through
various industrial policies. Korea's Development Institute (KDI), a government think tank, takes the stance that "the shock therapy is to swift to be efficiently digested by a previously command economy." It argues further that the relative effectiveness of the two approaches is clear-cut "if the economic performance of East Asian transitional economies is compared with that in Eastern Europe."

This view ignores the experience of many East European and FSU countries that have pursued comprehensive reforms, achieved macroeconomic stability, and are on track for stable economic growth. Gradualists, on the other hand, have sometimes fared worse, suffering falls in production and living standards that have, in turn, intensified political difficulties, as seen in Bulgaria and Russia.

Although the Chinese reform is thought of as gradual, sectors that have pursued comprehensive reforms have in fact undergone a shock therapy: for instance, in the agricultural sector, farms were decollectivized and prices liberalized. Those sectors that moved quickly toward a market economy, have reaped the greater benefits. Analysts have found that the main sources of growth were the nonstate industries—small to medium-size firms in rural areas and private manufacturing firms and joint ventures in urban areas. North Korea should look to these lessons learned in China. But without a thorough reform of the SOE sector and fundamental changes in the role of the state, there is little chance that North Korea will recover from the current economic crisis.

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Statistical Blackouts in North Korea: Trade Figures Uncovered
by Nicholas Eberstadt

Since the early 1960s analysis of economic performance in the Democratic People's Republic of Korea (DPRK) has been severely limited by a prolonged and strictly administered statistical blackout. At this juncture no official data series on any aspect of the country's economic performance is being released regularly. Data about DPRK's international commerce are the only exceptions; but these are released from its trade partners—figures known as mirror statistics. Trade trends in three sectors—food, energy, and transport—are of major strategic significance to the entire DPRK economy.

The severe and continuing downturn that has gripped North Korea's economy since 1989 has intensified pressures on each of these critical sectors, most dramatically on the food sector, whose woes prompted Pyongyang in 1995 to issue its unprecedented international appeal for emergency humanitarian aid. Difficulties in any one of these sectors cannot be understood in isolation, however. The DPRK's current agricultural troubles, for example, have probably been compounded materially by energy shortages, on the one hand, and transport system problems on the other. The linkages between these three sectors suggest that problems in one area are unlikely to be resolved, and may not even be significantly relieved, without tangible progress in the other two.

Transport Purchases Bogged Down

During 1972-95 the DPRK imported transport equipment valued at an estimated $2 billion (in nominal dollars, at current official exchange rates). More than half of these imports originated in the former Soviet Bloc territories (48 percent in U.S.S.R./Russia, 7 percent in countries of Central Asia, as well as Central and Eastern Europe). Roughly 40 percent came from OECD countries (29 percent from Japan, 10 percent from Germany and other OECD members). The remainder—just 6 percent—was shipped from China or from developing countries. (Although inter-Korean trade officially began in the late 1980s and had achieved a cumulative turnover approaching $1 billion by 1995, Republic of Korea transport equipment exports to the DPRK during this period were negligible.) Between 1972 and 1995 the DPRK transport equipment sales identified through mirror statistics—adjusting for some obvious statistical errors—averaged a trivial $3.4 million per year. Evidently, the DPRK's hoped for "independent national economy" never really developed the capability to manufacture nonmilitary motor vehicles that could be sold abroad.

DPRK's imports of nonmilitary transport equipment appear to total roughly 41,500 automobiles, 46,500 trucks, 2,300 buses, some 115 locomotives, and an additional 5,500 tons of railway equipment between 1972 and 1995. Mirror statistics do not allow us to estimate the size of the country's road fleets; one U.S. government source, however, estimated that 264,000 vehicles were in use in the DPRK in 1990—military trucks and jeeps included. If this estimate is correct, the ratio of road vehicles to population in the DPRK in 1990 would have been among the lowest of any Communist state. In Eastern Europe, for example, the ratio of vehicles to population around 1989/90 would have been 10 times higher than in the DPRK. For the Soviet Union the
ratio would have been well over three times the DPRK's.

Between the early 1970s and the mid-1990s a revolution in transportation capabilities swept the world; to judge by mirror statistics, however, that revolution bypassed the DPRK. In fact, one may infer from the absolute decline in the nominal value of DPRK transportation imports in the early 1990s, and from recent reports of DPRK sales of scrap metal from motor vehicles, that the country's transportation system, for decades undermechanized and stretched thin, is now afflicted by positive decay.

**Food Exports Despite Shortages**

The DPRK imported about $2.7 billion in foodstuffs between 1972 and 1995, judged by mirror statistics. The nominal dollar value of DPRK food exports for those same years is close to that total, at $2.8 billion. This appears to be the only sector in which the DPRK's long-term exports and imports are in rough balance—and in which annual trade surpluses have been registered on a fairly regular basis.

DPRK food exports between 1972 and 1995 averaged about $115 million a year. Principal overseas purchaser were Japan (accounting for about 44 percent of the nominal total for the entire period); the U.S.S.R./Russia (26 percent); developing countries, in particular, Indonesia, Malaysia, and Singapore (16 percent); and China (11 percent). Between 1989 and 1995 the Republic of Korea's purchases of DPRK foodstuffs totaled roughly $70 million.

As was true for DPRK exports as a whole, the country's overseas food sales seem to have risen somewhat during the 1980s, and to have dropped since the final crisis of Soviet socialism. In the 1970s (1972-80) exports of cereals accounted for about 70 percent of DPRK foodstuff exports; by the 1990s (1991-95) cereal exports accounted for less than 1 percent. During the intervening years such items as seafood and mushrooms assumed a much more prominent place among the DPRK's limited foodstuffs available for sale overseas: “low cost” calorie foodstuffs were gradually being replaced by “high cost” calorie exports.

Food imports to the DPRK for 1972-95 averaged about $110 million a year (in current dollars, at official exchange rates). Roughly a third (34 percent) of food imports originated in the OECD, while China accounted for about 26 percent, and the U.S.S.R./Russia and the developing countries accounted for 23 percent and 17 percent, respectively. The regional composition of the DPRK's food import sources has shifted over time. In the 1970s OECD countries were the country's prime source of food imports, while since the early 1990s China has served its chief food supplier.

In the decade 1985-94, DPRK net imports of cereal products reportedly totaled about 6 million tons—an average of 600,000 tons per year. Net grain imports could have constituted a significant share of overall dietary energy for the country's population in the decade before Pyongyang's first emergency appeal for food aid. Several aspects of the DPRK's international cereal commerce, as reflected in mirror statistics, deserve special comment:

- The bulk of cereal imports in any given year is accounted for by a small number of transactions, typically exceeding 50,000 tons apiece. All other imports, in contrast, were purchased in a large number of small-volume sales (sometimes only a ton or two), generally for delicacies or such luxury items as “Bread or biscuits,” “Cakes or pastries,” and even “Diet infant cereal preparations.” Purchases of this kind would be consistent with a “two tier” food procurement system: food purchases for the general population and provisions for a small, but distinctly better-fed elite circle.

- The DPRK experienced an abrupt decline in cereal imports in 1994. In 1992 and 1993—immediately after the collapse of the U.S.S.R.—Chinese grain shipments to DPRK reportedly averaged nearly 800,000 tons; in 1994 they fell to less than 280,000 tons. The DPRK's “food crisis” (reports began to circulate in the international media in early 1995) followed closely China's cutback in grain shipments on “friendship” terms.

- Between 1972 and 1995 Pyongyang ran a deficit in its non food accounts averaging more than $450 million a year (in nominal dollars), equal to 40 percent of its nonfood exports for the period. Over the same period the country's overall trade in foods registered a slight cumulative nominal dollar surplus. A net food trade surplus was registered in the “precrisis” year, 1994, and even in 1995, which witnessed the DPRK's first international appeal for humanitarian aid! It seems that the country's food trade has been administered according to the principle of financial “self-sufficiency.” DPRK authorities may believe that solving “the food problem” through flows of humanitarian aid from abroad imposes no additional burdens on the foreign exchange account.

**Energy Imports Gathering Steam**

Between 1972 and 1995 the nominal value of reported energy product shipments into the DPRK amounted to about $6.3 billion, or about $260 million a year. More than 95 percent originated in the U.S.S.R./Russia and in China. The collapse of the Soviet state caused a massive disruption in DPRK energy supplies. Between 1982 and 1990 the country's estimated energy imports averaged almost $450 million a year. For 1991-95 it dropped to about $250 mil-
lion a year. Since the collapse of Soviet-DPRK trade, China has accounted for nearly 90 percent of the country's energy imports. The DPRK's reported energy exports for 1972-95 totaled $742 million: an average of about $30 million a year, of which roughly 60 percent went to China and 31 percent to Japan.

DPRK imports of crude oil and petroleum products in 1994 and 1995 averaged 1 million tons a year—less than half the 2.2 million tons a year reported in 1986 and 1987. Soviet/Russian shipments plummeted from 1 million tons in 1986 to a mere 19 thousand tons in 1995. China's reported oil and oil product exports to the DPRK also declined over that decade, albeit only gradually. Imports of coking coal (coke) appear to have fallen from about 330,000 tons in 1986 to less than 100,000 tons in 1995. With the dissolution of the U.S.S.R., coke shipments by Moscow to Pyongyang effectively ceased.

Cutting imports of oil products can restrain the use of gasoline-powered engines and cut production of petroleum-intensive agricultural inputs, such as fertilizer and pesticides. Limited availability of coke can create bottlenecks in the iron and steel industries, and thus for other sectors whose demand for iron and steel is high. If foreign observers are correct, the current troubles with the DPRK's coal supplies are chiefly the result of sharp drops in its own coal output. This might have been caused, in turn, by shortages of other energy sources; for example, if diesel fuel for mining equipment was in short supply.

Much of Pyongyang's effort to solve its fuel and power problems in recent years has focused on negotiations with foreign governments for concessional supplies of coal and oil. In the summer of 1996 Beijing agreed to provide the DPRK with annual shipments of 1.3 million tons of oil and 2.5 million tons of coal for the next five years—all gratis. Further, under the terms of the "Agreed Framework" it signed with Washington in October 1994, the DPRK has obtained a total of 650,000 tons of heavy crude oil free of charge, through the Korean Peninsula Energy Development Organization (KEDO). And under the terms of that accord Pyongyang stands to gain additional amounts of free oil—up to 500,000 tons a year—until the nuclear reactors now under construction by KEDO in the DPRK are operational. Yet all this will provide only a limited measure of relief to a badly battered economic system.

The current aid-oriented approach to the DPRK's food and fuel problems can be criticized as an application of mere tactical remedies for deep-seated structural problems—a substitute for a more thorough overhaul of the state's economic policies. From the vantage point of the DPRK leadership, this may be precisely the allure of the current approach.

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Letter to the Editor

Marching toward a Global Business Standard

The latest issue of Transition (February 1998, p. 1-13) featured a number of articles dealing with the effects and lessons of Asian development. Some personal reflections: While the crises in Thailand, the Republic of Korea, and Indonesia certainly have common elements—most notably the marked absence of Western-type standards of corporate governance, transparency, and business regulation—their stories are quite distinct. The Thai case exhibited a classic “mania” or “bubble”; Korea, the crash of a headlong export drive that too often ignored profitability; and Indonesia, widespread corruption that underscored profound political problems.

Why did the other East Asian countries (including Malaysia) do better than this afflicted trio? Largely, I think, because the institutional frameworks within which businesses operate are reasonably congruent with what I would call the “global business standard.” This includes the rule of law, disclosure requirements, conflict resolution, auditing, the treatment of minority shareholders, and so forth. Not since 1914 has trade been so free and capital so mobile. In gauging risks and rewards, investors pay great attention to the degree to which each country’s institutional environment approximates this global business standard. Expectations of boundless market expansion may lead investors for a while, and often for years, to do business where institutions clearly do not meet the global standard. But the crisis shows that idiosyncratic corporate governance brings with it serious risks, and that these risks are being perceived more clearly now, as other parts of the world—for example, Latin America—move closer to the global standard.

The record of economic and business performance shows that the global business standard is a powerful underpinning for job and wealth creation. I believe that the standard may become a twenty-first century analog to the gold standard of the nineteenth century. The increasingly prevalent standard may seem to be the hallmark of a ruthless system that penalizes the populations of countries whose governments choose not to conform. No doubt, pressures for more impersonal, more transparent rules of the game will be resisted. The Korean chaebols are likely to resist change every bit as forcefully as do some of the newly privatized former communist enterprises. And in China, resistance to the transformation of state enterprises is intense. But market pressures to meet global standards will not relent; indeed, they will intensify, and the winners will be companies and countries that move away from their idiosyncrasies. As this happens, not only will improved corporate governance increase prosperity: governance, in the broader, national sense, will benefit.

Meeting the global business standard need not demand political homogeneity. Indeed, the pressure to meet this standard will fuel political reactions. But while assertive nationalism is likely to continue to be part of everyday life in the next century, it might not preclude simultaneous progress toward better institutional business frameworks.

Three additional thoughts:

1. The current crisis is a painful but perhaps salutary wake-up call: it may shock Thailand, the Republic of Korea, Indonesia, and other countries into creating more impersonal, transparent, institutional frameworks.

2. Another possible benefit of the crisis is that it has put a dent in the notion that authoritarian and corrupt regimes should be acceptable when they “deliver the goods” in terms of economic growth. Transparency and authoritarianism seldom go together.

3. The global business standard will test not only the governments of developing countries but all governments that are wed to idiosyncratic institutional frameworks. The crisis sends a message to Japan and Europe as they struggle with their structural problems.

And now a “pop sociological” note about the role of lawyers in the coming century. Cultures exhibit different styles when dealing with economic and business issues, and thus leaders from different occupational streams are at the center of the decisionmaking process. In Germany these will be bankers; in France, graduates of grandes ecoles, usually with an engineering bent; in China and in Russia, engineers; in Japan, administrator graduates of Tokyo University; in Korea, perhaps the military. My point is that the global business standard approximates Anglo-Saxon best practice and in Anglo-Saxon countries, in the United States in particular, no important decision affecting business could conceivably be made without the central involvement of lawyers. Hence, my conclusion: as governments and corporations move closer to the global business standard during the next decades, lawyers are likely to play an ever more prominent role worldwide.

Guy Pfeffermann, Director of Economics Department, International Finance Corporation.
World Bank/IMF Agenda

The World Bank Supports Russia's Textbook Revolution....

The World Bank will loan Russia $71 million over the next four years to support the modernization of the country's flagging educational system. Over $45 million will support curricula reform and governance reform in universities. About $26 million will be provided for the general education where 22 million students participate in a given year. The program was planned in cooperation with the education ministry. World Bank official Mark Agranovitch explained: despite the relatively small size of the loan, the Bank hopes that it will help make big changes in the school textbook market. Over 150 new textbooks will be developed during 4 years.

The competition will be organized in 4 rounds, with 40 textbooks in each round. In the Soviet days there was only one textbook on each subject distributed throughout the entire country. "Our aim is to demonopolize the textbook market that is dominated by two major companies," he added. At least 10 publishers will participate in the project. Smaller textbook publishers are also encouraged to compete. Russian textbooks were last updated about seven years ago. Russian regions now are responsible for textbook procurement and the Bank will set up a $8 million fund to help them to purchase new textbooks.

....Supports Romania's Telecom Industry....

The World Bank on April 28 approved a $30 million loan to Romania to promote telecommunications development. Part of the loan will support privatization of the national telecommunications company (Rom Telecom). Up to 30 percent of the shares will be sold to private investors, up to 5 percent to Rom Telecom employees. Another component will assist to upgrade the General Inspectorate of Communications (GIC) into a full-fledged regulatory body for the telecom sector. The loan will be at the standard interest rate for LIBOR-based single currency loans in US dollars, repayable in 20 years, including a 5-year grace period. Since 1990 Bank commitments to Romania total $2.6 billion for 19 projects.

....Land and Real Estate Reform in Moldova....

On April 23 the World Bank approved a $15.9 million equivalent (SDR 11.5 million) credit for a First Cadastre Project to promote the privatization of land and the development of real estate markets in Moldova. The real estate registration system established under this project will provide property owners with the security of ownership rights and will enable commercial banks to give secured credit against real estate. The credit will be on standard IDA terms and will be repayable in 35 years, including a 10 year grace period. Since Moldova joined the World Bank in 1992, Bank/IDA commitments total $277.9 million for 11 projects.

....Economic Development in China

A $63 million World Bank loan and a $22 million Global Environment Facility grant approved on March 26 will support technical assistance and training for a project to increase energy efficiency and associated reductions in the growth of carbon dioxide emissions and other pollutants. A $250 million World Bank loan approved at the same time will help alleviate critical bottlenecks in power transmission infrastructure and increase electricity trade on a commercial basis in the East China region; A $150 million World Bank loan approved on March 31 will support enterprise reform within the state farm system.

IFC Plans to Invest in China Companies

The IFC plans to invest in six Chinese companies this year, marking the most ambitious year of expansion in China for the private-financing wing of the World Bank. Besides the recently announced investment in northeastern China's Orient Finance Co., the company was also about to conclude a $15 million investment in Minsheng Banking Co., China's first privately owned bank. That would give IFC 5 percent of Minsheng's equity, and help Minsheng learn the international standards of disclosure necessary to secure future loans overseas. IFC will also lend Minsheng $100 million, financed through bonds that will be syndicated internationally. By the end of June IFC plans to take a stake in New China Life Insurance and to help set up a joint-venture credit-rating agency with Chengxin, China's only credit-rating agency. During the second half of the year IFC plans further to buy into Xiamen International Bank, which is China's first joint-venture bank, and Shanghai City United Bank, the biggest of the city banks being set up across China, most resulting from mergers of credit cooperatives.

Stricter IMF Standard

The International Monetary Fund is to tighten its standards for member countries' economic data, now that France has dropped its opposition to a requirement for more information on foreign exchange reserves. The IMF's special data dissemination standard will require countries to publish information on their net foreign exchange reserve position, after also taking sales and purchases in the forward market into account.
Private Sector Advisory Council?

In a letter to the International Monetary Fund's policymaking Interim Committee, the Institute of International Finance (IIF) proposed that the fund create a Private Sector Advisory Council to facilitate closer cooperation and consultation between the public and private sectors. The global organization of commercial banks, major investment funds, and insurance companies says it's time the private sector was involved in some of the deliberations of international financial institutions.

Faster Growth in Transition Economies?

Economies in transition (countries of Central and Eastern Europe as well as the newly independent states of Central Asia) will record output growth of 3.4 percent this year, a significant improvement over 1997's average growth of 2.9 percent, the IMF forecasts in its semiannual World Economic Outlook report, published in April. Inflation for the region as a whole is forecast to average 17 percent a year during 1998. Spillovers from Asia were felt most in Russia, Ukraine, and Estonia. Albania and Bulgaria, after virtual collapses, implemented strong reforms in 1997 and, as a result, saw their imbalances narrow, inflation decline, and growth resume. By contrast, Romania not only delayed its reforms, which contributed to a drop in output last year, but also loosened its monetary policies, and that has led to a resurgence of inflation early this year. Net capital inflows, especially from the private sector, are forecast to grow to $35.4 billion this year, jumping to $39.2 billion next year in all the nations in transition. Net official flows, including IMF, other similar sources will account for less than 10 percent of the total capital inflow. By next year repayment of loans will increase to $4.4 billion more than new loan drawings. (Robert Lyle, Radio Free Europe)

Understanding Transition in Central Asia; The Winners Are—Results of the EDI Competition


Ukraine: Lending Depends On the Pace Of Reform

World Bank lending depends on the pace of reform, and the pace has nearly stopped in Ukraine— the head of the World Bank's resident office in Ukraine, Edilberto Segura and chief economist John Hansen told a group of international financial journalists visiting Kyiv. Most of the bank's lending programs are no longer active: a $300 million loan for rehabilitating the Ukrainian coal industry is undisbursed, another $300 million loan for agricultural rebuilding, and a $317 million loan for modernizing the electric power industry are undrawn. Of the $2.2 billion in loans the Bank has committed to Ukraine, Segura says only about $1 billion has actually been released to Kyiv. Foreign direct investment in 1997 still amounted to only $615.6 million. They expressed hopes, however, that Ukraine will get back on the reform track. (Robert Lyle, Radio Free Europe)

IMF Suspends Stand-by to Ukraine

The IMF suspended disbursement of a stand-by loan of $585 million to Ukraine after the country exceeded the deficit set in the budget for this year's first quarter, National Bank of Ukraine international relations head Oleg Rybachuk reported from Kiev. Rybachuk said the deficit had reached 1.4 billion hryvnia in the March quarter compared with the targeted 650 million, and that Ukraine could not return to the framework laid down in the budget in the two months remaining before the end of the stand-by program. Rather than carry on with the program, Ukraine and the IMF had decided to negotiate an Extended Fund Facility as IMF sources confirmed the EFF will be approximately $2.2 billion, but before the IMF Executive Board would consider the request, the government will have to take

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fiscal measures both on revenue and expenditure side—measures that will require parliamentary approval.

Scholars Evaluate IMF ESAF

A panel of independent experts has urged the IMF for sharper distinction between policies appropriate for stabilization and policies that are appropriate in an post-stabilization environment. In the later, the growth-oriented strategies should be accompanied by increased aid flows. They also urged the Fund to work with the World Bank to identify sectors likely to lose from proposed reforms and to make sure that sufficient social services remained in place to assist them. The report, commissioned by the IMF and released in April, was drafted by four university professors—Kwesi Botchwey of Harvard University, Paul Collier of Oxford University (who, in the meantime, became Director of the Development Research Group of the World Bank), Jan Willem Grunning of The Free University of Amsterdam, and Koichi Hamada of Yale University—who visited eight countries. Their mission was to assess the IMF's Enhanced Structural Adjustment Facility (ESAF), the mechanism by which the Fund makes low-interest loans to impoverished countries that agree to implement reforms. IMF executive directors said in a statement that they endorsed the fundamental view of the evaluators that while the ESAF was a valuable means of helping low-income countries with balance of payments difficulties, its operation could be improved.

Market Economy Training to North Korean Officials?

North Korea recently delivered its intent to the World Bank, to learn about capitalist economic operation. A group of European nations, including Sweden, Switzerland, and the Netherlands, have expressed an intention to provide economic aid of $1 million to $1.5 million to North Korea. The UN Development Program will act as fund manager for the education program. The World Bank's survey mission which recently visited North Korea at Pyongyang's request. If and when the financial aid is made in the next few months, the World Bank, along with the IMF, will visit Pyongyang officially to provide technical support concerning the country's economic restructuring. The World Bank cannot make any direct financial aid to North Korea, as the country is not one of its members.

Eastern Europe Faces Infrastructure Funding Gap

A conference in Amsterdam on April 1 drew together multilateral lending institutions, including the World Bank and the EBRD, to address infrastructure funding in Eastern Europe. According to World Bank vice president Johannes Linn the proportion of private finance in infrastructure for all developing countries is expected to fall because of the events in East Asia. Jan Kauffman, chairman of ABN Amro, warned the conference that eastern Europe faces the threat of an Asia-style currency crisis if it relies on the foreign private sector to fund big projects. Major lenders told the conference that a massive shortfall in infrastructure funding in emerging eastern Europe must be urgently addressed to help transform the region's economies. To overcome the problem of declining private finance for infrastructure, Johannes Linn said that European countries needed to reduce risk by establishing a reliable institutional and legal environment, a stable macroeconomic framework, and political trust.

Obliterating Cambodia's Forests

At current rates of cutting, Cambodia's forests will be depleted within five years, warned Ngozi Okonjo-Iweala of the World Bank. The Bank's recent study into logging in Cambodia has revealed that more than 20 percent of the country's protected forests are subject to intensive harvesting and about 95 percent of all logging activity is illegal. The authors of the study—the Bank-funded Development Alternatives International—said it had revealed that Cambodia's remaining forests faced a much greater crisis than previously believed, and that illegal logging had cost the government some $60 million in lost revenue over the past 12 months. Agriculture Minister Tao Seng Hour said he would freeze new concessions as a result of the study.

Extending Network of IPAnet

IPAnet—the Investment Promotion Network—was created three years ago by the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Website: http://isp.space.worldbank.org/cgi-bin/frameit.fcgi/http://www.ipanet.com. The registration-based service now has more than 6,000 registered users from more than 175 countries. Signing up gives them access to regional and sector-specific resources, news and events, specific investment opportunities, as well as an on-line directory of international investment organizations and professionals. Through IPAnet, companies can identify relevant investment and project development opportunities worldwide, including specific projects in key sectors such as tourism, hospitality, manufacturing, technology, and pharmaceuticals. Details of infrastructure projects in transportation, power, water, telecommunications, and related sectors are available. MIGA is working with other multilateral organizations on gathering information on specific investment projects in emerging economies. Users can also research legal, policy, and regulatory frameworks in specific countries. The World Bank's database of 49 competitiveness indicators can also be used to assess economic performance and the environment for competitive business development for a range of countries.
Bosnia Donors' Conference Redux

International donors met in Brussels on May 7-8 to discuss more aid for Bosnia, following pledges that post-war economic reforms will continue. Paving the way to the donors conference was a promise by Bosnia’s Moslem-Croat entity to submit legislation to overhaul its pension scheme to ensure that pension obligations will not wreck public finances. Other conditions were progress on economic reforms in the Serb entity of Republika Srpska, better inter-entity cooperation on public services, and agreement on a country-wide economic and financial program. Out of the $5.1 billion reconstruction program, donors had pledged nearly $3.14 billion as of last December 31. Most generous have been the EU, putting up $673.2 million, and the US with $523.8 million. Japan has pledged $266.7 million, the Netherlands $175 million, Britain $67.2 million, Germany $51.5 million, Spain $38.7 million, Canada $40 million, and France $19.4 million.

Conference Diary

For the Record

21st Annual Arden House Conference on American-Russian Relations: “Has Russia Finally Turned a Political and Economic Corner?”
March 27-29, Harriman, New York.

Organizers: Davis Center for Russian Studies at Harvard and the Harriman Institute of Columbia University.
Topics: After Yeltsin, Who?; NATO Expansion: What Next; The Economy: Is the Worst Behind Us?; Operating in Russia; Making Russia Safe for Investment; Prospecting for Oil in the Former USSR; Russia as an Emerging Market for Foreign Investors.
Information: Marshall Goldman, tel. 617-495-4485; fax 617-495-8319; Email goldman3@fas.harvard.edu; Internet: http://www.fas.harvard.edu/~davisrca/ardenhouse.html

Forthcoming

1998 Annual Meeting of the Canadian Association of Slavists
May 30-June 1, 1998, Ottawa, Canada

Organizer: University of Ottawa.
Information: Prof. Richard Sokoloski, CAS Program Committee, Department of Modern Languages and Literatures, 70 Laurier Street, Room 138, Arts Building, University of Ottawa, Ottawa, Ontario, Canada K1N 6N5, fax 1-613-562-5138, Email: rsokolos@aix1.uottawa.ca

June 15-17, 1998, Hammersmith, London, United Kingdom

Organizer: Hurstbourne Management Ltd. Booking of stands: $269 per square meter. Exhibitors may stage seminars at no additional cost.
Information: Hurstbourne Management Ltd., tel. 44-707-25-1027, Email: Hurstbourne.m@swipnet.se

Third Moscow International Conference: Comparative Analysis of Economic Transformation in Post-Socialist Countries: The Global Context
June 17-19, 1998, Moscow, Russia

Organizer: The Faculty of Economics of the Lomonosov, State University of Moscow.
Topics: Essence, stages and models of economic transformation.
Information: Professor Alexander Buzgalin, MGU, Economic Faculty, Vorobeyev Gori, Moscow 119 899, Russia

Opportunities of the Transition in Yugoslav Economy: Enable Market to Function Properly
June 24-26, 1998, Montenegro, Yugoslavia

Organizer: University of Bristol.
Language: English.
Topics: Employee ownership and the transition to a market economy; Employee participation in transnational corporations; The stakeholder economy: participation, trust and social inclusion. Call for papers: Submissions invited from all relevant fields including industrial economics, comparative economic systems, organisational studies, management studies, economic sociology, institutional economics, evolutionary
economics, development economics, and studies of economies in transition. Information: Dr. Will Bartlett, School for Policy Studies, University of Bristol, Rodney Lodge, Grange Road, BS8 4EA, United Kingdom, tel. 44-117-974-1117, fax 44-117-973-730, Email: W.Bartlett@bristol.ac.uk

14th Colloquium: Stretching the Boundaries of Organisation Studies into the Next Millennium
July 9-11, 1998, Maastricht, The Netherlands
Organizer: Maastricht University.
Call for papers: The organizers of the session "Sub-theme 5," Karoly Balaton and Ed Clark, welcome papers addressing the questions: What are the characteristics of the emerging organisational solutions in different transitional economies? Are they similar to those widely used in advanced market economies? Information: EGOS Colloquium Secretariat, Faculty of Economics, Maastricht University, P.O. Box 616, 6200 MD Maastricht, The Netherlands, tel. 31-43-3883656, fax 31-43-325-8495, Email: egos@mw.unimaas.nl

The 5th EACES Conference: Economies in Transition and the Varieties of Capitalisms: Features, Change, Convergence
September 10-12, 1998, Varna, Bulgaria
Organizer: Institute of Economics, Bulgarian Academy of Sciences, Sofia.
Topics: Distinctive general features of capitalisms; The change of different models/types of capitalism; The change of economic systems from transitional economies to capitalism; Cooperation and integration of capitalism and transitional economies. Registration fees: for EACES members: Senior members USD 80; students and East Europe scholars USD 40. For Non-EACES members: Senior members USD 100; students and East Europe scholars USD 50. Information: Wladimir Andreff, ROSES, University Paris I, 106-112 Boulevard de l'Hôpital, F-75647 PARIS Cedex 13, fax 33-(0)1-5543-4191, Email: richet@univ-mlv.fr; or Mitko Dimitrov, Institute of Economics, Bulgarian Academy of Sciences, Aksakov Street 3, BG-1000 Sofia, fax 359-2-882108.

Marketing Strategies for Central & Eastern Europe
December 2-4, 1998, Vienna, Austria
Organizers: Kellstadt Center for Marketing Analysis and Planning, DePaul University Chicago, University of Economics and Business Administration Vienna.
Call for papers: Deadline August 31, 1998. Information: Dr. Reiner Springer, Wirtschaftsuniversitaet Wien, Althanstr. 51 Vienna, Austria, tel 43-1-313-364371, fax 43-1-313-36751, Email: springer@isis.wu-wien.ac.at

3rd International Conference on Enterprise in Transition
May 27-29, 1999, Split, Croatia
Organizer: University of Split, Faculty of Economics.
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In developing and transition economies 60 to 80 percent of all passenger and freight transport moves by road—the main form of access for most rural communities. Yet most of the 11 million kilometers of roads in these economies are badly maintained and poorly managed. One of the most effective ways to promote sound policies for managing and financing road networks is commercialization. The paper discusses the emerging concept of bringing roads into the marketplace, putting them on a fee-for-service basis, and managing them like a business.

Other World Bank Publications


The manual explains the planning process, technical procedures, and standards used in Living Standards Measurement Study household surveys. Topics include the technical aspects of questionnaire formatting and testing, ways of implementing a sample design, budgeting, and what fieldwork and data management procedures have been successful. A brief section describes how to assess local statistical capacity.


Morbidity and mortality from chronic and infectious diseases have increased among women in Russia. Women's reproductive health has been compromised by an increase in the incidence of sexually transmitted diseases and lack of access to up-to-date, high-quality maternity and family planning services. As part of the World Bank's assistance to improve health care, field testing of revised protocols for the care of women and infants was carried out.


The 2nd edition of World Development Indicators (WDI), formerly the statistical appendix to the World Development Report has been enlarged to include more than 80 tables and 600 indicators for almost 150 countries. The WDI is organized in the following sections: World View, People, Environment, Economy, States and Markets, and Global Links. New additions include development goals, unemployment data, new data on relative prices and purchasing power parities (purchasing power parity), relative prices in PPP terms, military expenditures and arms trade, and new data on average tariffs. The volume is accompanied by a Windows-based CD-ROM. Its time-series now cover 1965–96 for most indicators, with some extending to 1997.


The 30th edition of the World Bank Atlas compliments WDI 1998, with maps for about 18 indicators and five tables covering key indicators for 210 countries. Two new sections, Global Links and World View, have been added. The Global Links section, with table, maps, and charts, is drawn from WDI's counterpart section. World View's cartograms and charts graphically present the development goals of the 21st century. Available for the first time are new estimates of purchasing power parities (PPP) and data on relative prices for countries that participated in the most recent round of the International Comparison Program.


Global Development Finance 1998 presents a comprehensive review of the developing countries' external debt and financial flows, with special emphasis
on the causes and implications of the East Asian financial crisis. The principal volume, Analysis and Summary Tables, examines recent developments in flows from international capital markets to developing countries and comments on trends in net official finance and aid allocation, efforts to assist the heavily indebted developing countries, and the increasing volume and scope of guarantee activities. Appendixes cover debt burden indicators, country classification, official and commercial debt restructuring, privatization activity, and external financing and debt of the geographic regions. The companion volume, Country Tables, provides statistical data for the 138 countries that report public and publicly guaranteed debt under the World Bank Debt Reporting System. The country tables cover total external debt stocks and flows, major economic aggregates, and key debt ratios. Data are provided on debt service paid, average terms of new commitments, currency composition of long-term debt, debt restructuring, and scheduled debt service projections. Regional and income group tables are also included in this volume. Global

Pictures of a Region in Transition

By one measure the size of the economies of Central and Eastern Europe and Central Asia, figured per person, is $2,200 per year, or only 8.5 percent of the per capita figure in the richest nations. But that is a traditional measure, calculated at official exchange rates, which the World Bank says does not accurately reflect the situation of real people. The Bank works out a figure it calls Purchasing Power Parity (PPP), which, using real local wages and prices in local currency, converts these to dollars to more accurately reflect true purchasing power. The Bank's PPP figures show that the per capita economy among the nations in transition is really twice the official figure—an annual $4,310—or nearly 20 percent that of the high-income countries. That puts the region just below the center of middle-income countries around the globe. Of course, the figures vary widely within the region—Uzbekistan stands at half the regional average, even using the PPP figures, while for the Czech Republic the figure is 60 percent higher than the average. But the World Bank says this is yet another example of how different facts and statistics can paint more complete pictures of nations around the globe. The facts and figures are assembled in the Bank's annual World Development Indicators report.

In the broad sweep the figures show that the number of people in the region living on one dollar a day or less—the Bank's definition of abject poverty—was 14.5 million in 1993, or 3.5 percent of the population. To reduce that poverty by half by 2015, the Bank says the region must have annual growth rates in real consumption of at least 0.8 percent every year from 1997 to 2000. This should not pose a problem, according to the Bank. The region's actual real consumption growth rate from 1997 to 2000 is projected to exceed 2.4 percent per year. Overall economic output growth is projected to hit 3 percent for the region this year, and 4 percent next year, and will exceed 5 percent by 2000.

But the region's financial depth and efficiency are still low, with domestic credit provided by the banking sector at a weak 31.9 percent of GDP, the lowest figure for any region in the world. At the same time, integration with the global economy, as measured by such things as trade and gross foreign direct investment, puts the region solidly among the middle-income nations. Employment in the region is still heavy in agriculture and industry—23 percent of the male workforce and 22 percent of the female workforce were still employed on farms in 1994, while 43 percent of male workers and 30 percent of female workers were in industry that year, compared with levels 10 to 15 percent lower in the advanced economies. Still, the Bank says the employment trend in the region is shifting to service companies, which provide the vast bulk of employment, like the rest of the world.

In health care the region spent an average of 5.4 percent of GDP—or around $315 per person a year (PPP)—in the first half of this decade, slightly above the share of health expenditure in most other middle-income countries and a little more than half as much as in the richest nations. Life expectancy in the region was 64 for men and 73 for women in 1996, about average for middle-income nations as a whole but significantly below the figures for high-income countries—74 years for men and 81 for women.

The region has moved into the information age. In 1996 in the region there were 6 mobile phones for each 1,000 people, 1.2 fax machines, 17.4 personal computers, and 350 television sets. These figures are on a par with the average for middle-income countries, but well below figures for the high-income nations. In the rich countries, for example, there were 131 mobile phones per 1,000 people in 1996, 47.5 fax machines, 224 personal computers, and 611 television sets.

Robert Lyle, Radio Free Europe correspondent
Development Finance 1998 will also be available on diskette and as a Windows-based CD-ROM.


The 1997 conference on development economics focused on four themes: corruption, incentives and performance in public organizations, the transferability of high-growth experience, and poverty and the environment. This volume contains the following studies: “An Agenda for Development in the Twenty-First Century,” by Joseph E. Stiglitz; “Corruption and Development,” by Susan Rose-Ackerman; “Incentives, Efficiency, and Government Provision of Public Services,” by Sherwin Rosen and Bruce A. Weinberg; “What Can Developing Countries Learn from East Asian Economic Growth?”, by Takatoshi Ito; and “Environment, Poverty, and Economic Growth,” by Karl-Göran Mäler.


IMF Publications


An essential step in reducing a country's vulnerability to external shocks is to reform the institutional arrangement governing debt policy, so as to promote a transparent, publicly accountable, and professional debt agency with a degree of autonomy from political influence. Reserves management would also benefit from public scrutiny that holds the central bank accountable for its investment decisions and performance. To reconcile its investment objectives with its liquidity constraints, the central bank can split its reserves into separate liquidity and investment portfolios. Benchmarks for both portfolios should be established and publicly disclosed.


Regional trade agreements with the European Union have helped improve the Baltics' trade performance and provided a basic framework for their trade and economic relations, pending their membership in the World Trade Organization. Despite similar agreements, the Baltic countries' trade and FDI performances have differed. Estonia, which has the most liberal trade regime, also has the best trade performance, the most FDI, and the most vigorous private sector.


By end-1996 Russia's central bank had developed a broad range of monetary instruments. These included credit auction, collateralized with government securities; deposit auction; dealings in foreign exchange; and reserve requirements. The most developed instruments injected liquidity into the market. Instruments for taking liquidity out of the system were less well developed. The deposit auction was of limited impact because its rate was set too low to attract sizable amounts. Changes in reserve requirements were occasionally used for monetary purposes. The central bank has been a key player in the development of a market for treasury bills (although it is not yet very actively used to implement monetary policy through outright sales and purchases).

Four formerly Soviet states, around the Caspian Sea and in Central Asia—Azerbaijan, Kazakhstan, Turkmenistan, and Uzbekistan—enjoy substantial endowments of oil and gas. Their natural wealth makes these countries vulnerable to what is often dubbed “Dutch disease”—the potentially negative effects of an inadequately managed natural resource boom. (In the 1970s, following the discovery of the North Sea oil and gas fields, Holland launched a massive sale of natural resources. The consequent huge exports surplus lifted the currency, the competitiveness and production of non-hydrocarbon industries declined, as a result, and recession ensued.)

Certain risks are associated with large-scale use of large natural resources in a transition economy, but the right policy strategy can deal with these risks. The standard Dutch disease theories could have the following consequences in Azerbaijan:

- Short-term macroeconomic adjustment problems related mainly to large, oil-related foreign exchange inflows.
- Unbalanced growth, that is, the “crowding out” of the non-oil manufacturing sectors.
- Squandering of oil wealth through unproductive public expenditures.

In transition economies these risks are experienced alongside some specific conditions:

- The currency is generally undervalued, which may permit a real appreciation for some time without endangering the competitiveness of the non-oil traded goods sector.
- Strong capital inflows can be expected in successfully transforming economies, even without a resource boom. These factors are likely to accelerate real appreciation of the currency.
- Underdeveloped financial systems will likely mean a shortage of capital for the non-oil manufacturing sectors, regardless of the oil boom. Slow development of the non-oil manufacturing sectors thus may be due more to structural and institutional rigidities than to real appreciation of the currency.

Azerbaijan’s medium-term policy, which could serve as a blueprint for countries dealing with the dual challenges of transition and oil boom, relies on promoting savings and open trade. At the same time, structural policies need to strengthen the supply side, with particular attention paid to the capacity for financial intermediation in the banking sector.


“In even greater discipline and confidence than simply pegging the exchange rate. Of course, a currency board can be abandoned just as a pegged exchange rate can. Institutional arrangements, however, make the abolition of a currency board considerably more difficult. Compared with other pegged regimes, currency boards are more constraining on credit policy and on the ability of the authorities to alter the exchange rate parity. A somewhat different cost is the reduced ability of the central bank to act as a lender of last resort in the face of systemwide liquidity crunches. Ancillary reforms, such as measures to enhance labor market and wage flexibility, the buildup of excess coverage to allow limited purchases of domestic assets in times of liquidity crunches, and permitting foreign branch banking, can help address these issues.

On average, inflation under currency board arrangements was about 4 percent lower than under other pegged exchange rate regimes. This was achieved by a discipline effect (having lower money growth rates), and by a confidence effect (whereby for a given money growth rate, higher money demand results in lower inflation). Countries with currency boards grew faster than the average of all countries with pegged exchange rate regimes. The currency board countries ran an average fiscal deficit of 2.8 percent, compared with 4.2 percent under other pegged exchange rate regimes and 4.4 percent under floating exchange rate regimes.

William Davidson Institute Working Papers

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Enterprise managers in Russia’s emerging market economy lobby for high depreciation rates in order to write off as quickly as possible the obsolete capital stock they inherited. Policymakers, seeking to maintain or expand tax revenues to finance the transition, resist pressure to allow market forces to value capital and continue to set depreciation rates similar to those in the former Soviet economy. Surveys indicate that in both 1992 and 1995, state-owned firms reported significantly higher average depreciation rates—and thus faced a lower tax burden, other things being equal—than joint ventures, leased firms, joint stock companies, and privately owned firms, the “engines of transition.”


### Principal Characteristics of Presently Operating Currency Boards

<table>
<thead>
<tr>
<th>Country</th>
<th>Years in operation</th>
<th>Peg currency</th>
<th>Permissible reserve assets</th>
<th>Minimum cover</th>
<th>Latest actual cover</th>
<th>Public access to exchange at central bank</th>
<th>Power of CB to change the arrangement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bosnia</td>
<td>3 months</td>
<td>Deutschmark</td>
<td>With the exception of 50 percent of central bank capital, only DM assets</td>
<td>100 percent of monetary liabilities of the central bank</td>
<td>100 percent of monetary liabilities of the central bank</td>
<td>No</td>
<td>None</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>5 months</td>
<td>Deutschmark</td>
<td>Foreign assets and gold MO plus some desired excess coverage</td>
<td>134 percent of M0, 40.5 percent of M2</td>
<td>Yes</td>
<td>None</td>
<td></td>
</tr>
<tr>
<td>Estonia</td>
<td>5.5 years</td>
<td>Deutschmark</td>
<td>Foreign assets and gold</td>
<td>100 percent of M0, (excluding central bank certificates)</td>
<td>118 percent of M0, 14.7 percent of M2</td>
<td>Initially yes, later abandoned</td>
<td>N.A.</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>14 years</td>
<td>U.S. dollar</td>
<td>Foreign assets and gold</td>
<td>105 percent of notes and coins</td>
<td>408 percent of M0, 22.4 percent of M2</td>
<td>No</td>
<td>Some</td>
</tr>
<tr>
<td>Lithuania</td>
<td>3.5 years</td>
<td>U.S. dollar</td>
<td>Foreign assets and gold</td>
<td>100 percent of M0 plus liquid central bank liabilities</td>
<td>91.8 percent of M0, 41.1 percent of M2</td>
<td>No</td>
<td>Central bank can appreciate the rate</td>
</tr>
</tbody>
</table>

*Source:* MAE, Balino, Enoch, Ize, Santiprabhob and Stella (1997), and authors’ calculations.

a. M0 equals reserve money, that is, the sum of currency in circulation plus nongovernment demand liabilities.

b. To be covered initially by gross reserves, with the aim of building up further cover in terms of net reserves.
Peter Huber and Andreas Wörgötter, Local Labor Market Dynamics in the Czech and Slovak Republics, WP 121, November 1997, 38 p.


Analyzing data on investment behavior of medium-size and large industrial firms in the Czech Republic in 1992-95, the authors find that foreign-owned companies invest the most and cooperatives the least. The hypothesis that private firms invest more than state-owned ones has not been supported by the data set. Only cooperatives and the smaller (but not the very small) private firms display a significant positive link between investment and lagged profit. The imperfectly functioning legal system permits firms to disregard earlier commitments to their partners, and this phenomenon affects investment.

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Other Publications


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This book is about change in Central and Eastern Europe. In contrast to the dominant "transition framework" that examines organizational forms in Eastern Europe according to the degree to which they conform to, or depart from, the blueprints of already existing capitalist systems, the book examines the innovative character, born of necessity, in which actors in the postsocialist setting are redefining and recombining resources. Instead of thinking of these recombinations as accidental aberrations, the volume explores their evolutionary potentials. The starting premise is that the actual unit of entrepreneurship is not the isolated individual personality but the social network that links firms and the actors within them. Drawing insight from evolutionary economics and from the new methods of network analysis, several leading sociologists, economists, and political scientists report on changes in organizational forms in Hungary, Poland, Eastern Germany, Russia, and the Czech Republic.


The ownership structure of Russia’s Lukoil would indicate that “state capitalism” is unlikely to take root in the oil industry. Important controlling influences are being exerted by the emerging banks and financial institutions, and a strong top management is in place, inherited from the previous Soviet oil industry. The federal government can hardly resist demands from local governments for a greater share in the economic rents earned by the dominant oil companies. To order: Suzanne Marsh, Publications Secretary, Judge Institute of Management Studies, Trumpington Street, Cambridge, CB2 1AG, United Kingdom, tel. 01223-339-636, fax 01223-339-581, Email: sjm56@eng.cam.ac.uk.


Governments in Central and Eastern Europe have been replaced frequently since 1989, whether in the wake of general elections, or as a result of a new balance between political parties during the course of a given parliament. Such changes present a dual challenge: the new government has to move to implement its policies as soon as possible, but there also has to be continuity in the affairs of state despite governmental change. Canadian and French examples are instructive in this respect:

- Both countries have a career civil service, with public servants surviving changes in the party in power.
- Both countries have a body—the Privy Council Office in Canada (PCO), the Secretariat-General of the Government in France (SGG)—that plays an essential role “passing the baton” of public affairs from the old to the new government. To order: SIGMA-OECD, 2, rue André-Pascal, 75775 Paris, Cedex 16, France, tel. 331-4524-7900, fax 331-4524-1300, Email: sigma.contact@oecd.org, Internet: http://www.oecd.org/puma/sigmaweb.


A number of economic measures can influence a potential belligerent to avoid violence:

- Sanctions. These signal international concern to the offending state, punish bad behavior, and serve as a precursor to stronger actions—if necessary, the use of force.
- Inducements. Political or economic benefits may be granted in exchange for specific policy adjustments, including such incentives as favorable trade terms, tariff reductions, direct purchases, subsidies for exports or imports, economic and military aid, favorable taxation, and access to advanced technology.
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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, if only Russian farms were as efficient as Finnish ones. Under the Soviet system farms produced 35 percent less grain per hectare than Canadian farms and 60 percent less than Finnish family farms. And Russia’s 26,000 giant agricultural enterprises, still collectives in all but name, produce even less today. 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 reregistered as joint stock companies and in 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 also still suffer from the inefficiencies of collective agriculture. At present, 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 equal only to the amount of 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 land owners—especially pensioners, who generally own around 40 percent of land shares. (While Russian peasant farmers are paying 11-15 percent of total yield in rent and large enterprises are paying 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 land owners about their rights and options. At present, most of them continue to lease back to the old enterprises (it seems least risky and avoid offending old leaders who might cut their pensions). But this is merely a continuation of collective farming.

The government should make sure land owners know what they are legally allowed to do with their property and set rules that make their rights clear. A major impediment to peasant farmers is the unavailability of machinery. (Excerpted from a report by Robert Lyle for RFE/RFL).

To order: Elina Erlendsson, Russian Far East Advisory Group LLC, P.O. Box 22126, Seattle, Washington 98122, United States, tel. 206-447-2668, fax 206-628-0979.


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