http://www.worldbank.org/transitionnewsletter

24606

Nominated for President's Award for excellence 2002

THE NEWSLETTER ABOUT REFORMING ECONOMIES

TRANSITION NEWSLETTER

Vol. 13, No. 3 THE WORLD BANK *in collaboration with:* May-June 2002

STOCKHOLM SCHOOL OF ECONOMICS and THE WILLIAM DAVIDSON INSTITUTE

Transition—With Chinese Characteristics

China needs to learn from the experience of various transition economies. That was the main consideration of the China Institute for Reform and Development (CIRD), the Haikou (Hainan)-based think tank, when in mid-June it hosted an international symposium on this topic. Prominent economists from across China attended, together with foreign experts, including Stanford professor and international trade guru Masahiko Aoki; Poland's former finance minister and leading transitologist Grzegorz Kolodko; as well as Professor Richard Rose, expert in mass behavior in new democracies and inventor of the New Russia Barometer. During the three-day meeting the hosts, led by Executive Director Chi Fulin, elicited lively discussion on the topic. The following two articles are based on presentations during this conference.

Progress in Ownership Changes and Hidden Risks in China's Transition

By Fan Gang

An important aspect of the reform process is how the growth of the nonstate sector has changed the conditions for reform of state-owned enterprises (SOEs) in particular, and of the state sector (SOEs, the state banking system, and the government) in general, and why the SOEs must be reformed if the nonstate sector and the economy as a whole are to continue growing. Clarifying these issues is crucial to understanding China's current situation and the future of its economic transition and development. Other questions can also be raised: Can China's gradual reform succeed? Will the SOEs' difficulties drag the whole economy down? Will China's economic growth become unsustainable because of the state sector's problem?

The key characteristic of China's gradual approach to transition is not that it is slow, but that it develops elements of the new system, such as the private sector and market pricing, while keeping the old system, such as SOEs and state banks, in place for a while. In comparison, radical reform of the type undertaken in Russia, for example, started with reform of the old system, with the new elements growing on the ruins of the old structures. This comparison is not intended as a value judgment, but simply to point out that approaches to transition differ under different circumstances.

Nevertheless, one way or another both approaches require structural changes in the economy. The fundamental structure of an economy is its ownership structure, and the transition from a planned economy to a market economy requires the prevalence of private ownership, compared with the domination of the state-owned sector as under the old system. This in turn means that no matter how big the state sector was at the start of transition, as long as the nonstate sector can grow, the transition will eventually succeed. Thus the foremost issue of the entire process is to allow the nonstate sector to expand.

Theoretically transition could take place without any reform of the state sector. A gradual approach could launch the transition without reforming the state sector, at least for a while. SOEs could operate and state employees could continue to receive their wages as before until they all retired. Thus during the course of one generation the state sector could disappear and the transition might be complete. This seems like the least painful process and an ideal approach.

What's Inside

Naturally such a course of action is unrealistic, but it underscores the key elements of economic transition: developing the private sector and limiting expansion of the state sector. No matter how large the state sector is and how significant its difficulties, the focus should always be the growth of the private sector, with relatively little attention and resources devoted to reform of the state sector.

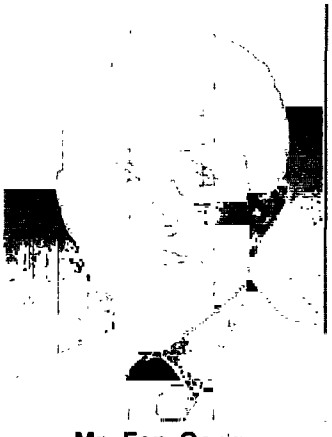
China's transition started with the growth of the nonstate sector, the most important outcome of China's economic transition during the past 20 years. Reform of the state sector, however, did not commence until recently. During the 20 years of transition the state sector's problems became severe, such as the low profitability, the increase in the number of loss-making enterprises, and the accumulation of huge nonperforming loans owed to the state banks. While the difficulties in the economy are related to the state sector's problems, the economy continues to grow and financial and social stability are present because the state sector's role is diminishing. Currently it accounts for only about 30 percent of national income.

However, influential interest groups in the state sector are not eager to succumb. They are doing their best to protect themselves and are using their political and monopolistic powers to acquire more resources and roll back the advances of the private sector. Thus the nonreform approach is feasible only in theory, not in a real-life political economy.

Despite the apparent contradiction, the conditions for reforming SOEs are improving in line with the growth of the nonstate sector. The reasons for this are as follows:

- Increased competition from the nonstate-sectors eliminates the monopoly position of SOEs and reduces their monopolistic profits. Their worsening financial situation is the ultimate driving force for undertaking their reform.
- Expansion of the nonstate provides more job opportunities for laid-off state employees. In addition, given the private sector's contribution to the overall growth of the economy, the government will have more resources to provide increased unemployment benefits to laid-off workers.
- Growth of private financial assets enables the capital restructuring and privatization of SOEs through market mechanisms.
- Increased entrepreneurial capability on the part of the private sector can allow private enterprises to take over sound assets of SOEs for more productive and efficient uses.

As nonstate businesses are still generally small, they compete mainly against small SOEs, which explains why small SOEs have been the first to reform and to be taken over by private entrepreneurs. Some preliminary data from the provinces indicate that in some regions more than 70 percent of small SOEs have already been privatized or restructured. Thus once the nonstate sector has grown and private counterparts to the larger SOEs have emerged, the conditions will be ripe for reforming the bigger SOEs.



Mr. Fan Gang

In many cases the progress of reform depends on the government's political will, but one could argue that such will is determined by economic conditions. Much depends on the perceived gains or losses accruing as a consequence of reform. All the major breakthroughs in policies toward SOE reform were adopted following a major development in the economy or change in the performance of different sectors. For example, the year after output (value added) in the nonstate sector surpassed that of the SOEs for the first time in 1992, the Communist Party's Central Committee decided to restructure property rights. Similarly, following developments in 1996-97, when SOEs registered an accumulated net loss, the 15th Party Congress declared that the legal status of the nonstate sector would henceforth be equivalent to that of SOEs, and also decided that small SOEs should be fully exposed to market competition, even if that meant privatizing them. In many coastal regions the government's reform policy changed sharply when the private sector surpassed the state sector as the main source of local fiscal revenues. Nothing occurs by chance.

The more than 100 million state employees used to benefit from lifetime employment and various privileges extended by the government. Even though the SOEs were 20 to 30 percent overstaffed, even according to official government estimates, layoffs, particularly mass layoffs of millions of workers each year, would have been unthinkable even five years ago; however, since 1995 more than 15 million state employees have been laid off at an accelerating rate. The practice has become so widespread that almost every SOE has laid off employees.

The question here is why state employees—perhaps the most powerful interest group in China—refused to accept layoffs for a long time, but now accept the severance packages. The answer is simple. In recent years the government has shored up the social security system and increased unemployment benefits, plus getting a job in the nonstate sector has became more attractive.

So far we have painted a relatively rosy picture of the economic transition: as long as the nonstate sector continues to grow, the conditions for reforming the state sector will improve and institutional change will be achieved gradually, no matter how large the state sector was and how long the transition process lasts. In reality, however, reforms face tremendous difficulties, and the possibility is always present that reforms are discontinued, the transition process is reversed, and as a result economic growth halts. The main problem is that the state sector may use its power to control income redistribution and resource allocation, and consequently delay the necessary structural changes.

Growth may be lower in the state sector, but it can still rely on the government's power to control distribution and resource allocation in order to subsidize the SOEs. In China the government not only has taxation power, but it has also maintained the monopoly of state banks and state financial institutions. Resource redistribution and subsidies take various forms as follows:

- Budgetary subsidies, which became less important in the mid-1980s, but have been on the rise recently, because the government has been encouraging state banks to engage in debt-for-equity swaps with indebted SOEs.
- Nonperforming loans extended to SOEs by state banks, which can be viewed as quasi-government debts.
- Nonperforming foreign debts owed by the SOEs directly, by state financial institutions, or by government agencies that borrowed on the international capital market on behalf of the state sector.
- Funds raised on the stock markets by SOEs whose performance has not improved is a form of subsidy to SOEs received from the public via the securities markets.

These subsidies must come from somewhere, and they come from the nonstate sector. If the nonstate sector had equal access to bank loans or foreign loans and could have an equally high nonperforming loan ratio, or if the nonstate sector could equally go to the stock market to raise funds proportional to its contribution to GDP, there would be no real subsidy. But "equally" is nonexistent, at least in China. The most serious distortion in

The Private Sector Catches On In Transition Countries

Percentage of GDP generated by the private sector in the 1990s, including privatized businesses and startups

COUNTRY	1990	1994	1999
Czech Republic	12%	50%	68%
Estonia	10%	55%	75
Hungary	18%	55%	80
Romania	17%	40%	60
Central/Southeast Europe/ Baltics*	11%	50%	68
Russia	5%	50%	70
Armenia	12%	40%	60
Belarus	5%	15%	20
Commonwealth of Independent States	10%	20%	50

*Albania, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, Slovenia

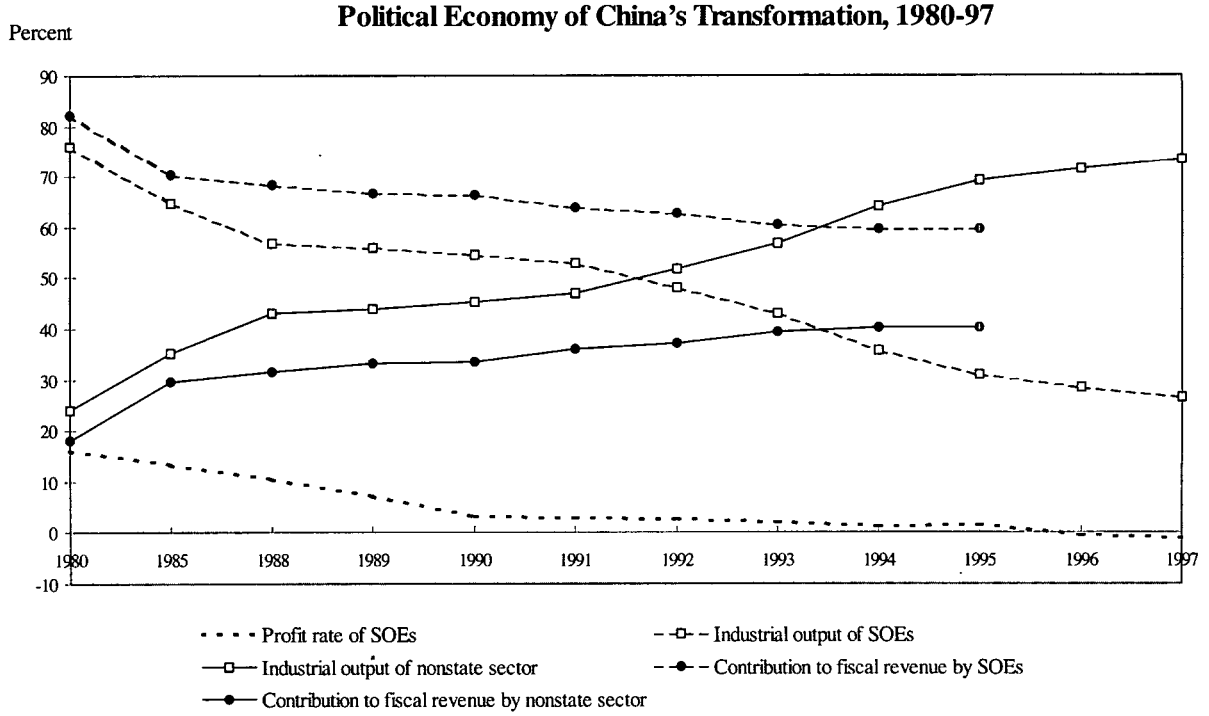
Source: EBRD/World Bank

relation to resource allocation is that the nonstate sector, which contributes more than 70 percent of output, accounts for less than 30 percent of bank credits. And the most serious policy mistake in the past 20 years of reform has been the lack of development of nonstate financial institutions that could adequately provide for the growth of the nonstate sector. The private sector is barred from the securities markets, while the state-owned banks are too large to work with small private enterprises. In sum, the private sector is deprived of proper financing channels. This serious distortion of resource allocation is risking a reversal of the transition process.

Given the extent of taxes levied on the nonstate sector and the subsidies provided to the state sector, the state sector must be reformed to prevent such resource transfers from becoming excessive. If the old sector could pass away naturally because of its lesser efficiency, transition would be much less painful, and only patience would be required. However, those who have a vested interest in the old system may use their political influence to resist such a process by drawing resources away from the nonstate sector and delaying, or even reversing, the transition process. Therefore the "old sector" has to be reformed.

The crucial issue is the extent of resource transfers from the state sector to the nonstate sector. If this transfer or "tax" is excessively high, it risks a crisis and the reversal of the transition process. Expansion of the private sector could be halted if its accumulated

Political Economy of China's Transformation, 1980-97



Source: Author.

resources are drained too vehemently, and the aim of the reform policy should be to prevent this from happening. The magnitude of this resource transfer is determined by two factors. The first is the size of the state sector in relation to the nonstate sector throughout the transition. The bigger the state sector, the bigger the resource transfer is likely to be. Second, the less efficient and less profitable the state sector as a whole is, the bigger the likely resource transfer. Experience shows that the longer the state sector exists, the worse its financial situation and the lower its profitability.

In Russia the state sector's virtually complete domination of the economy and 70 years of a planned economy left no other choice but to undertake mass privatization at the beginning of the transition, otherwise the private sector would not have been able to grow, because any extra resources it might have been able to accumulate would have been immediately taxed away, at the very least by inflation. In China, however, the relatively small size of state industries (in terms of employment) at the initial stage of transition made it possible to postpone the reform of SOEs for some time. In addition, the SOEs' relatively better financial situation because of their shorter history made the resource transfer relatively small, and even enabled the government to reduce nonstate companies' taxes during their early stage of growth. A similar argument may also be applicable to some Eastern European economies

How can we measure the extent of the transfer in China? Nonperforming loans represented roughly 25 percent of total bank lending at the end of 1998, equivalent to about 27 percent of GDP. If we add government debt (about 9 percent of GDP) and foreign debt (about 14 percent), the comprehensive public sector liability, as the resource transfer may be referred to, equaled about 50 percent of GDP Compared with similar indicators for other economies, China's overall financial situation does not seem to be as bad as the volume of nonperforming loans indicates. Recent trends in structural change are also encouraging: the role of the nonstate sector as a major contributor to national output is increasing steadily. This indicates that the process of transformation is continuing and, at least for now, is not threatened with a reversal. Nevertheless, the financial sector urgently needs reform.

This article is based on the author's presentation at the recent International Symposium on Transition hosted by the CIRD, Haiku/Hainan, China. Fan Gang is a professor of economics at Peking University and director of the National Economic Research Institute of the China Reform Foundation in Beijing. His email address is fangang@neri.org.cn.

China's Experience with Transition: What Is Behind Its Stunning Economic Success?

By Richard Hirschler

China's great Prime Minister Chou En-Lai was once asked what he thought about the French revolution. "It is too early to tell," he responded. One could say the same about the transition process, the long, arduous road from central planning to a market economy that is still ongoing. However, it is never too early to make some assessments. Countries can learn from the mistakes of others and adopt best practices from elsewhere.

Explaining China's Success

Despite all the odds, since Deng Xiaoping launched his reform policy 25 years ago China has made huge strides. During this period its GDP increased from $300 billion to more than $1 trillion. A steady growth rate of 9 percent, during much of this time, elevated this country of 1.3 billion people out of poverty. China is heading toward becoming one of the world's most powerful economies (see table 1). How can one explain these developments in China compared with the situation in the countries of the former Soviet Union, primarily Russia? Three complementary schools of thought attempt to do so.

- ***Initial conditions matter.*** The leading proponent of this explanation is Jeffrey Sachs, who points out that China started its reforms in the late 1970s as a developing, agricultural country, while the Soviet Union was overindustrialized, overcentralized, and overbureaucratized, and was dominated by obsolete heavy industry. Reflecting Chairman Mao's belief in community-based self-reliance, even before the reform period China was much more

decentralized than countries in the Soviet economic sphere. China's dense network of horizontally linked, smaller economic units at the local level provided much more flexibility than the Soviet Union's huge, specialized industrial complexes, the favorite "pets" of Moscow's central planners. Thus in China development and transition went hand in hand. The space for maneuvering was wide, and with the household responsibility system in place in agriculture, the economy expanded in leaps and bounds. Meanwhile in the "new" countries of the collapsed Soviet Union, their old political, economic, and social structures had been dismantled (including the trade organization of the socialist countries), without the emergence of efficient new institutions.

Table 1. China's Key Economic Indicators, 2001-03

Indicator	*2001*[a]	*2002*[b]	*2003*[b]
Real GDP growth (percent)	7.3	7.4	7.7
Private consumption (percent)	5.6	5.7	6.5
Gross fixed investment (percent)	11.4	13.5	12.5
Consumer price inflation (percent)[c]	0.7	0.6	2.0
Commercial bank prime rate (percent)[c]	5.9	5.3	6.5
GDP ($ billions)	1,180.0	1,286.0	1,412.0
GDP per capita ($)	930.0	1,000.0	1,100.0
Trade balance ($ billions)	31.4	24.0	14.0
Current account balance ($ billions)	20.3	8.3	2.7
Exchange rate RMB:$1[c]	8.3	8.3	8.3
Exchange rate RMB:¥100[c]	6.8	6.2	6.4

a. Estimated.
b. Forecast.
c. Annual average.
Source: Economic Intelligence Unit data.

• ***Reform strategies matter.*** A prominent representative of this other school of thought is Nobel laureate Joseph Stiglitz, who focuses on the significance of different reform strategies. Russia considered privatization more important than competition. Its government rushed ahead with mass privatizations that—given the lack of appropriate institutions—propelled most "privatized" firms into the hands of insiders, primarily *nomenklatura* managers. Later, through the loans for shares scams, the richest state enterprises were sold at bargain basement prices to the chosen few, the infamous oligarchs. The authorities blocked the entry of new enterprises in many ways, especially local governments that did not want to endanger existing businesses under their protection.

China, by contrast, succeeded in creating a favorable atmosphere for establishing "nonstate" businesses, namely, township and village enterprises, and in creating special economic zones, which are islands of foreign private enterprises. Russia took the advice of neoliberal economists, who suggested macroeconomic stabilization, liberalization, and privatization, too seriously, hoping that such measures would create the proper conditions for a market economy. However, price liberalization—again undertaken without assuring proper competition—drove prices up and pushed half the country into poverty. Similarly, liberalizing foreign exchange without creating a business-friendly atmosphere resulted in capital flight. Meanwhile China went ahead by experimenting with new ideas in local areas, only expanding them once they had proven successful. Russia believed, mistakenly, that a few masterful restructuring programs could create miracles.

• ***Institutions matter.*** Early on China's decisionmakers were ready to create "semi-perfect" institutions that conformed to the "semi-perfect" market conditions—or maybe they just pragmatically adapted to changing circumstances. The household responsibility system was already the result of such a compromise: peasants can only lease the land long term but cannot sell it. Twenty-five years ago though, it created a completely new situation in agriculture.

The dual-track approach enabled gradual price liberalization, the two-tier currency rate provided a grace period until the country could afford a single yuan rate. The relationship between the central government and local governments gradually developed from the prereform "eating from one bowl" principle to the concept of "cooking in separate kitchens." This in turn motivated local governments to generate more revenues so they could retain more funds and spend more locally. Later, in the 1990s, fiscal federalism was the guiding principle shaping the general rules of revenue sharing between the federal and local governments.

The backbone of economic expansion in the 1980s and early 1990s was the township and village enterprises, which were owned by local governments. These unique nonstate businesses created new jobs, provided valuable products for consumers, and contributed to regional development. By the late 1990s they had accomplished their objectives, and thus most are now being privatized. In the financial sector the authorities encouraged cash transfers (tolerating the anonymity of bank deposits),

and thus the money-printing business (seigniorage) brought extra revenues to the state. The state was also benefiting from keeping deposit interest rates at an artificially low level, underpinned by the monopoly of the state banks, and prohibiting capital transfers. In 2000 the authorities eliminated anonymity for new deposits, but retained it for earlier ones.

Further Challenges

These successes notwithstanding, some serious unresolved issues can stymie further development in China.

Challenge 1: Dealing with Loss-Making State-Owned Enterprises

The importance of state-owned enterprises (SOEs) to the economy is clearly diminishing as the private sector is becoming the driving engine of progress. Industrial SOEs produced $0.81 in profit for every dollar they invested in 1985. By 1997 this profit had fallen to $0.09, despite two decades of incremental reform. In 2000 SOEs accounted for less than a quarter of industrial output and just over a third of urban formal employment (see table 2). Yet according to conservative estimates three-quarters of all bank lending ended up in the SOEs' coffers. In comparison, private enterprises received just under 1 percent of all bank loans in 2000. The SOEs' poor financial performance is responsible for the problems in the banking sector. The rating agency Standard & Poor's believes that fully half of all loans on the books—an amount equal to two-thirds of GDP—are nonperforming. In the late 1990s more than a third of SOEs were in the red.

Services (wholesale commerce, transportation, communications, and banking) are still dominated by state firms, and their privatization could lead to major increases in efficiency. The consolidation of state-owned commercial banks has started, and their bad loans are being transferred to asset management companies in exchange for government bonds. Recently, however, these banks have again been extending questionable loans to SOEs, so their portfolios have not improved much. Time is short. By 2006 foreign banks will be able to collect renminbi savings and compete with China's banks on an equal footing.

Corporate governance in SOEs is complicated because the party controls the selection and dismissal of managers. According to the Chinese press, at some large, corporatized SOEs the "three old committees" (the party committee, the employee representative committee, and the workers union) have been challenged by the "three new meetings" (the meeting of shareholders, the meeting of the board of directors, and the meeting of the supervisory committee). Chinese economists therefore propose putting the state, institutional investors, and individual investors on an equal footing and letting boards select the most capable chief executive officers without any political intervention. Eventually, except for a few enterprises in which the state intends to retain 100 percent ownership, all other enterprises should become joint stock companies with multiple owners, including domestic and foreign investors.

The National Bureau of Statistics has estimated that as a result of drastic retrenchment by SOEs, urban unemployment, which has reached about 10 percent, is likely to rise to 15 percent, or 30 million people. Meanwhile unemployment in rural areas now amounts to 35 percent of the total rural work force, or 170 million people. China will have to create between 100 million (World Bank estimate) and 300 million (Chinese Academy of Social Sciences estimate) new jobs over the coming decade to maintain the status quo in the labor market. Economists predict that WTO accession will not have a long-term impact on the overall level of employment, but will result in sectoral shifts as workers move between industries. The silver lining of China's unemployment cloud is that it has significant room for job creation in the service sector.

The unemployment situation could accelerate the implementation of the government's long-stalled project to fund a basic social security and public welfare scheme by selling off government-held shares in listed state-owned companies. These account for almost 70 percent of currently issued "A" shares, or about $350 billion at current

Table 2. The State Sector's Diminishing Role: SOEs' Share in Selected Indexes *(percent)*

Year	*Industrial output*	*Urban formal employment*	*Government revenue*	*Bank lending*
1978	78.0	78.3	87.0	96.8
1988	57.0	70.3	71.6	90.0
1995	34.0	64.9	71.1	81.0
2000	23.5	38.1	n.a.	77.5

n.a. Not available.

Sources: China Statistical Yearbook; Edward Steinfeld, *Forging Reform in China* (Cambridge, U.K. Cambridge University Press, 1998).

Table 3. Household Consumption, 1994 and 2000

Item	*1994 (percentage of total)*	*2000 (percentage of total)*	*1994-2000 (percentage change in value)*
Medicines and health care	2.4	5.0	+174.7
Housing	5.6	9.7	+130.2
Education and entertainment	7.5	10.9	+110.5
Transport and communication	4.2	6.1	+91.0
Household durables	6.9	7.8	+50.6
Services	4.1	4.6	+48.6
Food	53.1	43.9	+9.6
Clothing and footwear	16.1	11.1	-8.3
Total per capita consumer expenditure	100.0	100.0	+32.7

Source: Urban and Rural Socioeconomic Survey Organization, National Bureau of Statistics.

market prices. Additional cash could be raised as new state companies are listed or by issuing government bonds.

Challenge 2: Reforming Pensions, Health Care, and Housing

Chinese policymakers have recognized the need to create a social safety net funded by workers and employers to replace the socialist cradle-to-grave welfare system that was sucking SOEs dry. Two decades of reform have seen a massive transfer of risk from SOEs to individual workers, and health care and housing are by far the fastest-growing segments of household budgets. These costs continue to rise rapidly, even as the cost of food, clothing and many other household goods declines (table 3).

In absolute terms, Chinese consumers pay nearly three times as much for health care as they did in 1994 and more than double for housing and education. According to the National Bureau of Statistics, in 1994 $0.70 of every dollar Chinese households spent went for food or clothing. By 2000 that figure had slipped to $0.55. During the same period expenditure on housing and health care leapt from $0.08 per dollar to nearly $0.15.

Five years ago the government started pilot health care programs in 59 cities to experiment with locally administered health insurance schemes funded by contributions from employers and deductions from employees' wages. The intent was to relieve SOEs of the burden of running their own hospitals and give a break to individuals, whose out-of-pocket medical payments had risen from 20 percent of national medical spending in 1978 to around 50 percent in 2000.

Local insurance schemes cover 50 million people, and insurance provided through the work place covers another 50 million. Some 600 million workers, or 85 percent of the labor force, have no insurance at all. The aim is for basic medical expenses to be covered by individual insurance accounts funded by employer and employee contributions. "Major," as yet undefined, expenses will be covered by a social fund financed by employers and municipal governments, and individuals' entitlements from this fund will be capped. Catastrophic illnesses, such as cancer or AIDS, are supposed to be covered by commercial health insurers, but currently China does not have any commercial health insurers.

The availability and quality of housing have increased, but the cost is often beyond the average person's reach and adequate mortgage lending to fill the gap has not yet developed. Per capita urban living space increased from 5.2 square meters in 1985 to 9.6 square meters in 2000, and on average, Chinese city dwellers now enjoy more living space than their counterparts in Hong Kong.

State enterprises have been selling off houses to workers at low insider prices. By 1995, seven years after state units began selling housing to its occupants, 29 percent of urbanites lived in apartments they had purchased by means of this mechanism and another 11 percent owned housing they had built themselves or had inherited. However, homeowners who bought housing from their work units do not own their apartments outright, as they are not entirely free to sell them. Work places must still approve any sale and often have the right to buy the apartment back. If the unit is sold to a third party, the work place claims the lion's share of the profit on the sale.

In addition, the apartment sales have not ended the system of allocated housing. While workers who have been employed for a number of years have been busy

buying subsidized apartments from their employers, newly hired workers still line up for assigned housing. The result is that people who can buy at low insider prices have no incentive to sell, and those who are not allowed to buy at such prices simply can not afford the purchase. The private rental market for ordinary housing is virtually nonexistent, and the purchase price of an apartment on the open market ranges from 10 to 20 times the average annual income. In the late 1990s SOEs still owned about two-thirds of all urban housing.

As concerns the pension system, retirees used to receive payments from their work units based on the number of years of service and their final wages. The funds came from the work unit's coffers, rather than from any sort of fund or savings account, making it a pay as you go system. Workers who retired before the mid-1990s continue to be paid under this system, with payments indexed to the one-year bank deposit rate, now 1.98 percent. Currently China has about eight workers for every retiree, but by 2050 this figure will fall to three.

Worried by this trend, since the mid-1990s China has tried to switch to a fully funded system, whereby employers and employees contribute to funds that the same employees will draw on when they retire. In 1997 the State Council introduced the following framework: a mandatory amount of 11 percent of payroll goes to individual retirement accounts, of which employees contribute 8 percent and enterprises contribute 3 percent. Local governments impose a further "social responsibility" tax on enterprises, often around 17 percent of payroll. Thus under this framework individuals contribute 8 percent and enterprises contribute a total of 20 percent of payroll.

In theory, there would be three separate funds: a social fund to provide retirees with a basic pension of 24 percent of the average local wage, a mandatory individual retirement account to bring the benefit close to 50 percent of the average local wage, and an extra individual account for workers at profitable enterprises. This would bring retirement benefits to levels equivalent to current pension levels, but represents a huge relative decrease from past pensions: a person who retired in 1978 received a pension worth 97 percent of his or her final wage. The new system has several other problems, of which the most significant is that contributions to the first two funds are collected by local governments, which then use the cash for other purposes, often to pay the pensions of current retirees By the end of 2001 more than RMB 200 billion ($24 billion) had been looted from pension funds, and the figure is growing.

Challenge 3: Keeping Government and Business at Arms' Length

A market economy can be endangered by crony capitalism. If state bureaucrats favor special groups or individuals or state capture by business enterprises is prevalent, this could thwart the development of a level playing field, prevent fair competition, and feed corruption. In addition, China must strengthen the rule of law and nurture a free press that is ready and able to report unlawful abuses. Communication channels between the government and the public have to be kept open business deals must be transparent. In addition, the public at large should be able to express its views. As World Bank President James Wolfensohn noted during his recent visit to China: "That comes with maturity in the market, but it certainly requires leadership at the top. If there is not that sort of leadership and integrity at the top, you will not get rid of crony capitalism. If you have it at the top, then you can have a really good shot at keeping it to a minimum." As many reformers within the Chinese Communist Party have stated, the Communist Party should be able to manage the difficult transformation from central planing to a market economy without directly interfering in the process

By joining the WTO China is becoming more integrated into the global economy. Flows of foreign direct investment to China in 2002-06 are estimated to average more than $60 billion per year, and are likely to reach $72 billion by 2006. By the end of 2002 China will already have more than $440 billion in foreign direct investment stock. The circumstances are right for surging ahead with economic, social, and political reforms, remembering that history never lacks surprises. Twenty years ago few had predicted the huge success of China's economic transformation in the subsequent two decades, and China is continuing full tilt on its remaining journey toward a modern market economy.

This article is based on the author's presentation at the recent international conference on Transition hosted by the CIRD in Haikou/Hainan, China. Reports and analyses by The Economist Intelligence Unit and Oxford Analytica were valuable resources for drafting this article.

Stiglitz-Rogoff Debate on *"Globalization and Its Discontents"*

Joseph Stiglitz, winner of the 2001 Nobel Prize in Economics and former World Bank chief economist, and Kenneth Rogoff, economic counselor and director of the Research Department at the IMF, held an exciting debate on development issues at the end of June, hosted by the World Bank. We highlight parts of the discussion that focused on Stiglitz's recently published book *Globalization and Its Discontents.* As background we also provide a slightly shortened version of a recent speech on the same topic by Thomas C. Dawson, director of the IMF's External Relations Department. Finally, we also quote some excerpts from this book that generated so much emotion.

Stiglitz: IMF Imposed Excessive Restrictions

"The book deals with important aspects of globalization of which the World Bank and IMF are only parts, but important parts. I will outline the general perspective of the book and highlight six important and related issues.

The general perspective is based on the following:

- **Globalization has benefited several countries**, especially those in Southeast Asia. Those that have benefited the most were taking control of globalization for their own purposes. The development success of China and some other East Asian nations was based on their exports growth, which would not have been possible had they not participated in globalization; however, they were unwilling to go along with other recommended actions, such as capital market liberalization, and have still not opened up their markets with respect to capital flows. Their case has shown very vividly that countries can get large amount of foreign direct investment without opening up their capital markets. Thus those countries that have been the most successful did not succumb to market fundamentalism.
- **Globalization has been run by rules more or less set by the advanced industrial countries,** especially by special interest groups within these countries, to their own benefit. To the extent the rules were not dominated by special interest groups, they were heavily influenced by free market ideology.
- **The industrial countries were enormously hypocritical**, demanding trade liberalization and the elimination of subsidies while maintaining trade barriers and subsidies for their own products. As a result, the terms of trade worked to the disadvantage of the developing countries.
- **Western advisers, especially those of international financial institutions, failed to adopt an appropriate posture toward the transition countries.** The role of their economists should be to present the available economic policy alternatives and let the political process choose from among these. This is particularly true if the consequences of different policies are uncertain. In the book I detailed the crisis in transition economies and argued that the failures were enormous. One of the hardest question for an economist is what would have happened in the absence of a certain action. We cannot be sure, but we have some evidence about what other countries have tried, and I suggest in the book that had these alternatives been followed, the outcomes would have been better.

Mr. Joseph Stiglitz

And now for the six related issues:

- **Capital market liberalization.** This was a risk without rewards. Malaysia, for example, was widely criticized for introducing capital control. In retrospect, however, this control resulted in a shorter downturn and a lesser legacy of debt than in the other countries affected by the 1997 Asian crisis. During the East Asian crisis the IMF argued that contagion needed an appropriate response and rapid intervention to halt the spread of the crisis from one country to another, but it did not address the underlying problem. Contagion is an externality, while capital liberalization is a cause of volatility of the exchange rate and of the current account. Thus we ought to do something about the underlying disease. Recently the IMF has changed its position, realizing that capital liberalization is not as advantageous as it had previously thought.

• **Transparency, accountability, and conditionality.** In the past the IMF's conditionality requirements were excessive, but the Fund is moving in the right direction. Nevertheless, a number of conditions are still extremely inappropriate. As to transparency, freedom of information should be the guiding principle, and I would like to see the IMF move in that direction. Conditionality tied to a loan should not be used as a means of micromanagement, but should be regarded as a broad framework. In East Asia, and particularly in South Korea, most conditions that the IMF imposed had nothing to do with the crisis. Conditionality clearly went overboard. The Fund is now recognizing that it was using conditionality excessively.

• **Excessive fiscal contraction policies.** The IMF recognized that it had pushed for excessively restrictive fiscal policy in East Asia, but in Latin America and some other countries it still seems to be continuing its excessively contractionary policies.

• **Bankruptcy and bailouts.** During the East Asian crisis bailouts [Editor's Note: rescue packages offering billions of dollars to countries that accepted certain monetary, fiscal, and other economic conditions] were extensively criticized. My view was that they were ineffective, leaving countries in debt, with their workers and domestic businesses suffering the most and the benefits going largely to the creditors. The IMF is now moving away from bailouts toward bankruptcy procedures.

• **Monetary policy.** The IMF has not yet made any concessions in relation to monetary policy. I argue in the book that raising interest rates during the East Asian crisis exacerbated that crisis, leading to more bankruptcies that in turn led to weaker economies. Capital left the countries rather than flowing into the countries. The IMF argued that if interest rates were not higher, the exchange rate would fall and that would cause bankruptcies. I argued that there was no tradeoff, that high interest rates did not support the exchange rate, but that even if they did, there was a moral hazard issue: should we bail out those who were speculating against a currency at the expense of domestic businesses?

• **Political and social context of intervention by the international financial institutions.** Insufficient attention has been paid to this issue."

Rogoff: Your Medicine is Dubious

"Let me make the following three substantive points:

• First, there are many ideas and lessons in your book with which we at the Fund would generally agree. For example, we completely agree that a dramatic change is needed in how we handle situations where countries go bankrupt.

• Second, in the book you set out a blueprint for how you believe the IMF can radically improve its advice on macroeconomic policy. Your ideas are at best highly controversial, at worst snake oil.

• Third, and most important, in your role as chief economist at the World Bank you decided to become what you see as a heroic whistle-blower, speaking out against macroeconomic policies adopted during the 1990s Asian crisis that you believed to be misguided. You were 100 percent sure that your policies were absolutely the right ones.

Mr. Kenneth Rogoff

Let's look at Stiglitzian prescriptions for helping a distressed emerging market debtor, the ideas you put forth as superior to existing practice. Governments typically come to the IMF for financial assistance when they are having trouble finding buyers for their debt and when the value of their money is falling. The Stiglitzian prescription is to raise the profile of fiscal deficits, that is, to issue more debt and to print more money. You seem to believe that if a distressed government issues more currency, its citizens will suddenly think it more valuable. You seem to believe that when investors are no longer willing to hold a government's debt, all that needs to be done is to increase the supply and it will sell like hot cakes. We at the IMF have considerable experience suggesting otherwise. We have found that when a country in fiscal distress tries to escape by printing more money, inflation rises, often uncontrollably. Uncontrolled inflation strangles growth, hurting the entire populace, but especially the indigent. When an almost bankrupt government fails to credibly constrain its fiscal deficits, things generally get worse instead of better.

I would cloak your theories in the mantle of Arthur Laffer and other extreme expositors of 1980s Reagan-style supply-side economics. Laffer believed that if the government would only cut tax rates, people would work harder, and total government revenues would rise. The Stiglitz-Laffer theory of crisis management holds that countries need not worry about expanding deficits, as in so doing they will increase their debt service capacity more than proportionately.

I do not have time here to do justice to some of your other offbeat policy prescriptions, but let me say this about the transition countries. You accuse the IMF of having "lost Russia." Your analysis of the transition in Russia reads like a paper in which a theorist abstracts from all the major problems and focuses only on the couple he or she can handle. You entirely neglect the fact that when the IMF entered Russia the country was not only in the middle of an economic crisis, it was in the middle of a social and political crisis as well.

Throughout your book you betray an unrelenting belief in the pervasiveness of market failures and a staunch conviction that governments can and will make things better. You call us "market fundamentalists." We do not believe that markets are always perfect, as you accuse us of doing, but we do believe there are many instances of government failure as well and that, on the whole, government failure is a far bigger problem than market failure in the developing world. Your alternative medicines, involving ever more government intervention, are highly dubious in many real-world settings."

Stiglitz, the IMF, and Globalization

By Thomas C. Dawson

Stiglitz accuses the IMF of being driven by a belief in the perfection of markets and the imperfection of governments. The accusation is simply wrong. IMF staff are well aware that they owe their jobs to the imperfections of markets.

What is probably true is that the staff of the IMF (and the World Bank) have, over time, become more confident about the ability to use markets to serve the public interest. What caused this shift? Quite simply, the evidence. Through the 1980s central planning represented an important alternative to markets as a way of organizing economies. The collapse of the Soviet Union and the fall of the Berlin Wall suggested to many that markets, whatever their faults, were a more durable way of organizing a country's economy. This feeling was reinforced by the good economic performance of the United Kingdom and the United States, both of which had moved to more market-oriented systems during the 1980s.

I take strong exception to the portrayal of IMF staff as uncaring bureaucrats serving the narrow interests of the Western financial community. Stiglitz implies that IMF staff see the unemployed "as just a statistic ... the unintended casualties in the fight against inflation or to ensure that Western banks get repaid." He suggests that IMF staffers, like the pilots of "modern high-tech warfare" who drop "bombs from 50,000 feet" have no feelings for the people whose lives are affected by their policies. The IMF's staff is drawn from nearly 150 countries. Many are acutely aware of the pain and suffering of the people of developing countries and want the situation in these countries to get better. Stiglitz has not cornered the market on morality and caring.

Let me acknowledge the validity of some of Stiglitz's criticisms of the IMF. One criticism is that the U.S. Treasury and the IMF showed excessive zeal in encouraging countries to open up to short-term foreign capital in the mid-1990s. The critics say that the entry, and often the subsequent hasty exodus, of foreign capital into economies that are too small or whose financial sectors are ill-equipped to regulate and absorb the capital can be devastating. There is no denying that the vision of the world the IMF was promoting in the mid-1990s was different: at the 1997 IMF-World Bank meetings the proposal on the table was to make eventual deregulation of international capital flows obligatory for IMF members.

Nevertheless, while Stiglitz's characterization of a greater push toward capital account liberalization is broadly correct, it is inaccurate in many important details. The IMF and the U.S. Treasury did not encourage countries to liberalize short-term flows through the banking sector, which is what turned out to be the Achilles heel during the Asian crisis. In addition, many countries liberalize for their own reasons rather than as a consequence of external prodding—Thailand, for instance, was keen to have Bangkok emerge as an international financial sector like Singapore. However, as a result of the criticism by Stiglitz and others, the IMF is more vocal in pointing out the risks of rapid capital account liberalization.

Other aspects of our handling of the financial crisis in Asia have also come in for criticism from Stiglitz and others. We have acknowledged that we made mistakes in our initial response to the crisis. We were surprised by the speed and virulence with which the crisis spread to many countries in the region. The experience revealed that the IMF had not kept up with the rapid developments in international capital markets, a deficiency it

has tried to rectify through a number of steps taken over the last couple of years.

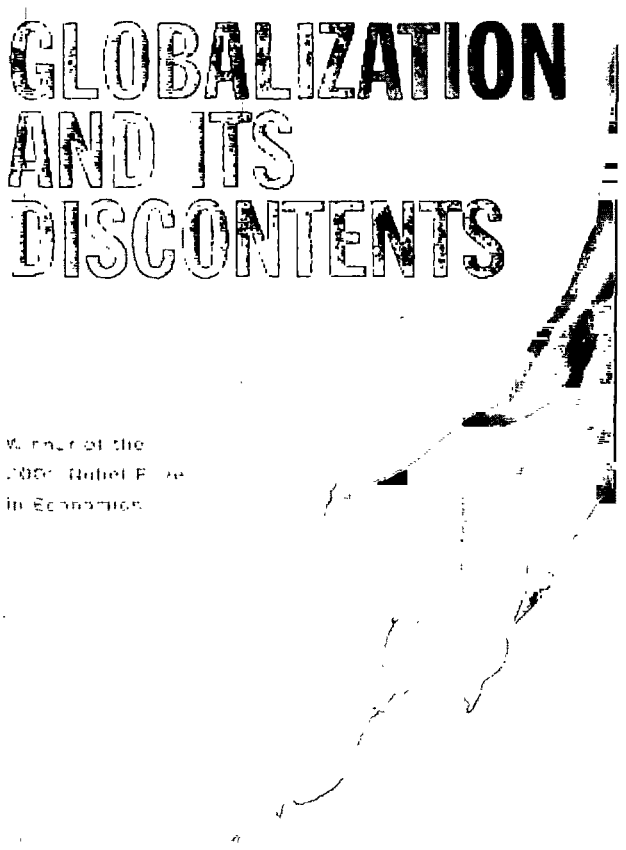
Our most glaring error, according to many observers, was to recommend excessive belt-tightening to Thailand at the start of the crisis. Recall that in July 1997 Thailand was still growing rapidly, had a huge and growing current account deficit (more than 8 percent of GDP), and faced large, though as yet unrecognized, fiscal liabilities to recapitalize the financial system. It was against this background that the IMF recommended a roughly unchanged fiscal position. However, once the scope of the crisis became evident, we quickly changed course. Indeed, IMF-supported programs in Thailand and other crisis countries were soon marked by large budget deficits, in part because of increases in spending on social safety net programs. This is exactly the kind of easing of fiscal policy Stiglitz advocates.

There is another, more technical, debate about which there is still no meeting of the minds between Stiglitz and others. This debate concerns the appropriateness of the IMF's advice on monetary policy during the Asian crisis. The IMF and many others continue to disagree with Stiglitz's assertion that it is obvious that monetary policy must also be eased at the onset of a financial crisis. As Larry Summers noted recently, "When a country's exchange rate is declining rapidly because capital is trying to leave the country, and the country's financial institutions are in real trouble, there is a fundamental conflict between restoring external confidence by raising interest rates and providing for financial repair through increased liquidity. It's a classic problem of a single instrument and multiple targets. Confidence is widely recognized as essential in combating financial crises." Others have taken similar positions. MIT Professor Rudiger Dornbusch, for instance, says that "investors will take confidence and bring money back when they see fiscal conservatism and high interest rates. Do that for a few months and you are on the right track." So the point is that professional consensus on this topic is lacking. What is needed is honest debate and a closer look at the evidence, not polemics.

The experience of more recent financial crises, such as the one in Argentina, suggest that our existing mechanisms to resolve crises in a rapid and orderly fashion do not work smoothly. One problem is that governments do not deal with their sovereign debt problems promptly; they often allow the situation to fester until a crisis is precipitated. Our current deputy head, Anne Krueger, has suggested creating a statutory mechanism to secure a more orderly and timely restructuring of unsustainable sovereign debts. For those of you who may have been following this issue, the mechanism being proposed is to empower a super-majority of creditors to take key decisions in the restructuring process in negotiation with the debtor. Stiglitz has been quite supportive of the general idea of having a sovereign debt restructuring mechanism.

With respect to our other main task, poverty alleviation, Stiglitz notes that the IMF and the World Bank have recently launched a new approach. This is a more participatory approach, one that involves a country's government and its civil society at an early stage in measuring the size of the poverty problem and in devising development strategies to reduce poverty. We get a rare compliment when Stiglitz says that even though participatory assessments are not yet being perfectly implemented "they are a step in the right direction." He also notes correctly that if the gap between the rhetoric and the reality of the new poverty strategy "persists for too long or remains too great, there will be a sense of disillusionment."

Thomas Dawson's talk was presented to the MIT Club of Washington on July 2, 2002.



Excerpts from *Globalization and Its Discontents*

By Joseph Stiglitz

On Russia's 1998 Crisis

The country was deeply in debt, and the higher interest rates that the East Asia crisis had provoked created an enormous additional strain. This rickety tower collapsed when oil prices fell. Oil is both a major export commodity and a source of government tax revenue for Russia, and the drop in prices had a predictably devastating effect. Given the exchange rate at the time, Russia's oil industry could cease being profitable. A devaluation would then be inevitable. It was clear that the ruble was overvalued. Russia was flooded with imports, and domestic producers were having a hard time competing. The switch to a market economy and away from the military was supposed to allow a redeployment of resources to produce more consumer goods, or more machines to produce consumer goods. But investment had halted, and the country was not producing consumer goods. The overvalued exchange rate, combined with the other macroeconomic policies foisted on the country by the IMF, had crushed the economy, and while the official unemployment rate remained subdued, there was massive disguised unemployment.

The managers of many firms were reluctant to fire workers, given the absence of an adequate safety net. Though unemployment was disguised, it was no less traumatic: while the workers only pretended to work, the firms only pretended to pay. Wage payments fell into massive arrears, and when workers were paid, it was often with bartered goods rather than rubles. If for these people, and for the country as a whole, the overvalued exchange rate was a disaster, for the new class of businessmen the overvalued exchange rate was a boon. They needed fewer rubles to buy their Mercedes, their Chanel handbags, and imported Italian gourmet foods. For the oligarchs trying to get their money out of the country, too, the overvalued exchange rate was a boon—it meant that they could get more dollars for their rubles, as they squirreled away their profits in foreign bank accounts. Despite this suffering on the part of the majority of Russians, the reformers and their advisers in the IMF feared a devaluation, believing that it would set off another round of hyperinflation. They strongly resisted any change in the exchange rate and were willing to pour billions of dollars into the country to avoid it. By May, and certainly by June of 1998, it was clear Russia would need outside assistance to maintain its exchange rate. Confidence in the currency had eroded. In the belief that a devaluation was inevitable, domestic interest rates soared and more money left the country as people converted their rubles for dollars.

Because of this fear of holding rubles, and the lack of confidence in the government's ability to repay its debt, by June 1998 the government had to pay almost 60 percent interest rates on its ruble loans (GKOs, the Russian equivalent of U.S. Treasury bills). That figure soared to 150 percent in a matter of weeks. Even when the government promised to pay back in dollars, it faced high interest rates. (Yields on dollar-denominated debt issued by the Russian government rose from slightly over 10% to almost 50%, 45 percentage points higher than the interest rate the U.S. government had to pay on its Treasury bills at the time.) The market thought there was a high probability of default, and the market was right. The IMF came to the rescue with $4.8 billion in July 1998.

When the crisis hit, the IMF led the rescue efforts, but it wanted the World Bank to provide $6 billion of the rescue package. The total rescue package was for $22.6 billion. The IMF would provide $11.2 billion of this total, the World Bank would lend $6 billion, and the rest would be provided by the Japanese government. This was hotly debated inside the World Bank. There were many of us who had been questioning lending to Russia all along. We questioned whether the benefits to possible future growth were large enough to justify loans that would leave a legacy of debt. Many thought that the IMF was making it easier for the government to put off meaningful reforms, such as collecting taxes from the oil companies. The evidence of corruption in Russia was clear.

Apart from these moral issues, there were straightforward economic issues. The IMF's bailout money was supposed to be used to support the exchange rate. However, ...[o]ur calculations showed that Russia's exchange rate was overvalued, so providing money to maintain that exchange rate was simply bad economic policy. Moreover, calculations at the World Bank before the loan was made, based on estimates of government revenues and

expenditures over time, strongly suggested that the July 1998 loan would not work. Unless a miracle brought interest rates down drastically, by the time autumn rolled around, Russia would be back in crisis.

There was another route by which I reached the conclusion that a further loan to Russia would be a great mistake. Russia was a naturally resource-rich country. If it got its act together, it didn't need money from the outside; and if it didn't get its act together, it wasn't clear that any money from the outside would make much difference. Under either scenario, the case against giving money seemed compelling. In spite of strong opposition from its own staff, the Bank was under enormous political pressure from the Clinton administration to lend money to Russia. The Bank managed a compromise, publicly announcing a very large loan, but providing the loan in tranches installments. A decision was taken to make $300 million available immediately, with the rest available only later, as we saw how Russia's reforms progressed. Most of us thought that the program would fail long before the additional money had to be forthcoming. Our predictions proved correct.

Three weeks after the loan was made, Russia announced a unilateral suspension of payments and a devaluation of the ruble. The ruble crashed. By January 1999, the ruble had declined in real effective terms by more than 45 percent from its July 1998 level. The August 17 announcement precipitated a global financial crisis. Interest rates to emerging markets soared higher than they had been at the peak of the East Asian crisis. The surprise about the collapse was not the collapse itself, but the fact that it really did take some of the IMF officials—including some of the most senior ones—by surprise. They had genuinely believed that their program would work.

Our own forecast proved only partially correct: we thought that the money might sustain the exchange rate for three months; it lasted three weeks. We felt that it would take days or even weeks for the oligarchs to bleed the money out of the country; it took merely hours and days.

By lending Russia money for a doomed cause, IMF policies led Russia into deeper debt, with nothing to show for it. The cost of the mistake was not borne by the IMF officials who gave the loan, or America who had pushed for it, or the Western bankers and the oligarchs who benefited from the loan, but by the Russian taxpayer. There was one positive aspect of the crisis: The devaluation spurred Russia's import competing sectors—goods actually produced in Russia finally took a growing share of the home market. This "unintended consequence" ultimately led to the long-awaited growth in Russia's real (as opposed to black) economy.

On the Bolshevik Approach to Market Reform

Had the radical reformers looked beyond their narrow focus on economics, they would have found that history shows that most of the experiments in radical reform were beset by problems. This is true from the French Revolution in 1789, to the Paris Commune of 1871, to the Bolshevik Revolution in Russia in 1917, and to China's Cultural Revolution of the 1960s and 1970s. It is easy to understand the forces giving rise to each of these revolutions, but each produced its own Robespierre, its own political leaders who were either corrupted by the revolution or took it to extremes. By contrast, the successful American "Revolution" was not a true revolution in society; it was a *revolutionary* change in political structures, but it represented an *evolutionary* change in the structure of society.

The radical reformers in Russia were trying simultaneously for a revolution in the economic regime and in the structure of society. The saddest commentary is that, in the end, they failed in both: a market economy in which many old party apparatchiks had simply been vested with enhanced powers to run and profit from the enterprises they formerly managed, in which former KGB officials still held the levers of power. There was one new dimension: a few new oligarchs, able and willing to exert immense political and economic power.

In effect, the radical reformers employed Bolshevik strategies though they were reading from different texts. The Bolsheviks tried to impose communism on a reluctant country in the years following 1917. They argued that the way to build socialism was for an elite cadre to "lead" (often a euphemism for "force") the masses into the correct path, which was not necessarily the path the masses wanted or thought best. In the "new" post-Communist

revolution in Russia, an elite, spearheaded by international bureaucrats, similarly attempted to force rapid change on a reluctant population.

Those who advocated the Bolshevik approach not only seemed to ignore the history of such radical reforms but also postulated that political processes would work in ways for which history provided no evidence. For instance, economists such as Andrei Shleifer, who recognized the importance of the institutional infrastructure for a market economy, believed that privatization, no matter how implemented, would lead to a political demand for the institutions that govern private property.

Shleifer's argument can be thought of as an (unwarranted) extension of Coase's theorem. The economist Ronald H. Coase, who was awarded a Nobel Prize for his work, argued that in order to achieve efficiency, well-defined property rights are essential. Even if one distributed assets to someone who did not know how to manage them well, in a society with well-defined property rights that person would have an incentive to sell to someone who could manage the assets efficiently. That is why, advocates of rapid privatization argued, one didn't really need to pay close attention to how privatization was accomplished. It is now recognized that the conditions under which Coase's conjecture is valid are highly restrictive—and certainly weren't satisfied in Russia as it embarked on its transition.

Shleifer and company, however, took Coase's ideas further than Coase himself would have done. They believed that political processes were governed in the same way as economic processes. If a group with vested interests in property could be created, it would demand the establishment of an institutional infrastructure necessary to make a market economy work, and its demands would be reflected in the political process. Unfortunately, the long history of political reforms suggests that the distribution of income does matter. It has been the middle class that has demanded the reforms that are often referred to as "the rule of law." Today, in Russia, we do not see demands for strong competition policy forthcoming from the oligarchs, the new monopolists. Demands for the rule of law have come from these oligarchs, who obtained their wealth through behind-the-scenes special deals within the Kremlin, only as they have seen their special influence on Russia's rulers wane.

On Changing the Global Financial Architecture

The reforms of the international financial system have only just begun. In my mind, among the key reforms required are the following:

- **Acceptance of the dangers of capital market liberalization,** and that short-term capital flows ("hot money") impose huge externalities, costs borne by those not directly party to the transaction (the lenders and borrowers). Whenever there are such large externalities, interventions—including those done through the banking and tax systems—are desirable. Rather than resisting these interventions, the international financial institutions should be directing their efforts to making them work better.
- **Bankruptcy reforms and standstills [Editor's Note: suspension of payment by the government].** The appropriate way of addressing problems when private borrowers cannot repay creditors, whether domestic or foreign, is through bankruptcy, not through an IMF-financed bailout of creditors. What is required is bankruptcy reform that recognizes the special nature of bankruptcies that arise out of macroeconomic disturbances; what is needed is a super-Chapter 11, a bankruptcy provision that expedites restructuring and gives greater presumption for the continuation of existing management. Such a reform will have the further advantage of inducing more due diligence on the part of creditors, rather than encouraging the kind of reckless lending that has been so common in the past.
- **Less reliance on bailouts**. With increased use of bankruptcies and standstills, there will be less need for the big bailouts, which failed so frequently, with the money either going to ensure that Western creditors got paid back more than they otherwise would, or that exchange rates were maintained at overvalued levels longer than they otherwise would have been (allowing the rich inside the country to get more of their money out at more favorable terms, but leaving the country more indebted).
- **Improved banking regulation**—both design and implementation—in the developed and the less developed countries alike. Weak bank regulation in developed countries can lead to bad lending practices, an export of instability. While there may be some debate whether the design of the risk-based capital adequacy standards adds to the

stability of the financial systems in the developed countries, there is little doubt that it has contributed to global instability, by encouraging short-term lending. [Editor's Note: An international standard which recommends minimum capital adequacy ratios has been developed to ensure that banks can absorb a reasonable level of losses before becoming insolvent. Thus banks have to lock up certain percentage of their total capital, depending on their risk-weighted credit exposure.] Financial sector deregulation and the excessive reliance on capital adequacy standards has been misguided and destabilizing; what is required is a broader, less ideological approach to regulation, adapted to the capacities and circumstances of each country. Thailand was right to have restricted speculative real estate lending in the 1980s. It was wrong to encourage the Thais to eliminate these restrictions. There are a number of other restrictions such as speed limits (restrictions on the rate of increase of banks' assets) which are likely to enhance stability. Yet the reforms cannot, at the same time, lose sight of the broader goals: a safe and sound banking system is important, but it must also be one that supplies capital to finance enterprises and job creation.

- **Improved risk management**. Today, countries around the world face enormous risk from the volatility of exchange rates. While the problem is clear, the solution is not. Experts—including those at the IMF—have vacillated in the kinds of exchange-rate systems that they have advocated. They encouraged Argentina to peg its currency to the dollar. After the East Asia crisis, they argued that countries should either have a freely floating exchange rate or a fixed peg. With the disaster in Argentina, this advice is likely to change again. No matter what reforms occur to the exchange rate mechanism, countries will still face enormous risks. Fixing their exchange rate to one currency will not resolve the problems; it can actually exacerbate fluctuations with respect to other currencies. But there are other dimensions to risk. The Latin American debt crisis in the 1980s was brought about by the huge increase in interest rates, a result of Federal Reserve Chairman Paul Volcker's tight money policy in the United States. Developing countries have to learn to manage these risks, probably by buying insurance against these fluctuations in the international capital markets.
- **Improved safety nets.** Most developing countries have weak safety nets, including a lack of unemployment insurance programs. Even in more developed countries, safety nets are weak and inadequate in the two sectors that predominate in developing countries, agriculture and small businesses, so international assistance will be essential if the developing countries are to make substantial strides in improving their safety nets.
- **Improved response to crises.** We have seen the failure of the crisis responses in the 1997-98 crisis. The assistance given was badly designed and poorly implemented. The programs did not take sufficiently into account the lack of safety nets, that maintaining credit flows was of vital importance, and that collapse in trade between countries would spread the crisis. The policies were based not only on bad forecasts but on a failure to recognize that it is easier to destroy firms than to recreate them, that the damage caused by high interest rates will not be reversed when they are lowered. There needs to be a restoration of balance: the concerns of workers and small businesses have to be balanced with the concerns of creditors; the impacts of policies on domestic capital flight have to balance the seemingly excessive attention currently paid to outside investors. Responses to future financial crises will have to be placed within a social and political context. Apart from the devastation of the riots that happen when crises are mismanaged, capital will not be attracted to countries facing social and political turmoil, and no government, except the most repressive, can control such turmoil, especially when policies are perceived to have been imposed from the outside.

Most important, there needs to be a return to basic economic principles; rather than focusing on ephemeral investor psychology, on the unpredictability of confidence, the IMF needs to return to its original mandate of providing funds to restore aggregate demand in countries facing an economic recession. As the United States went into a recession in 2001, the debate was not whether there should be a stimulus package, but its design. By now, the lessons of Argentina and East Asia should be clear: confidence will never be restored to economies that remain mired in deep recessions.

Part of the reason I remain hopeful about the possibility of reforming the international economic institutions is that I have seen change occur at the World Bank. It has not been easy. Nor has it gone as far as I would have liked. But the changes have been significant. By the time I arrived, the new president, James Wolfensohn, was well on his way to trying to make the Bank responsive to the concerns of the developing countries. Though the new direction was not always clear, the intellectual foundations not always firm, support within the Bank far from universal, the Bank had begun seriously to address the fundamental criticisms levied at it. Reforms involved changes in three areas: development, aid in general and the Bank's aid in particular; and the relationship between the Bank and the developing countries.

How Free from Fear Are Citizens in Transition Societies?

By Richard Rose

Freedom from fear is the first freedom. If people live in fear of their lives, any advantage gained through education or a higher income can be wiped out by a single violent act. If the state cannot ensure individual security, it is failing in its primary obligation to maintain order. The collapse of the old regimes in transition countries has not only brought greater freedom for ordinary people, but also for criminals. While the collective security figures represent anxieties about what *might* happen, the individual security index reflects what has *actually* happened to individuals, their families, or their friends.

When the All-Russian Center on Research of Public Opinion asks whether Russians value order or democracy more, most people consistently put order first. Russians do not want a return to Soviet-style repression, but they do want freedom from fear. Security and fear are states of mind. For that reason, we need data about individual attitudes rather than official statistics that notoriously under-report crimes. For the past decade, the Centre for the Study of Public Policy has been collecting evidence of individual and collective insecurity in its nationally representative barometer surveys of the public in postcommunist countries in transition (see http://www.cspp.strath.ac.uk).

Measuring Individual Insecurity

Paradoxically, security can be defined by its opposite, a sense of insecurity. In the past year in 11 Central and Eastern European countries 7 percent of adults have been robbed while on the street, 9 percent have had a family member attacked, and 12 percent have had a friend attacked. Safety on the streets is highest in Slovenia, where only 14 percent of survey respondents have been close to street crime, and is lowest in Slovakia, where 44 percent of survey respondents have good grounds to feel insecure (table 1).

House break-ins are widespread. One in 12 households has been robbed and 1 in 6 adults have had a friend whose house has been burgled. The extent of burglary is highest in Lithuania, where 39 percent of survey respondents have been victimized or know someone whose house has been broken into, and Russia, where more than a third of survey respondents live in unsafe areas. Poles and Slovenes have the least to fear, as fewer than one-sixth have been affected by burglaries.

Altogether, 40 percent of citizens have immediate grounds for insecurity because they, a family member, or a friend have been mugged on the street or had their house broken into (see the figure). In Lithuania 57 percent of citizens have been touched by crime, and in Slovakia, 53 percent have been affected. Even in the safest country in the region, Slovenia, 24 percent have been too close for comfort to street crime or having their house burgled.

Even among people who have not been victimized or known a victim of crime, high crime rates encourage a

Table 1. Experience of Violent Crime, Selected Transition Countries
(percentage of respondents)

Survey questions: In the past year have you or anyone in your family or your friends been attacked or had something stolen when on the street? In the past year have you or any friends had their house broken into and something stolen? The total number of respondents was 13,010.

	Attacked on the street				*Theft from house*		
Country	*Self*	*Family*	*Friend*	*None*	*Own*	*Friend*	*None*
Slovenia	3	6	5	86	4	11	85
Latvia	7	6	7	79	7	11	82
Hungary	7	8	6	78	8	14	77
Poland	5	9	9	77	4	9	87
Estonia	3	8	14	75	6	22	71
Romania	9	5	13	73	6	11	83
Bulgaria	10	8	14	69	14	16	69
Czech Republic	8	9	14	68	6	20	73
Russia	7	8	20	67	8	29	64
Lithuania	11	14	15	61	19	19	61
Slovakia	11	14	19	56	9	22	68

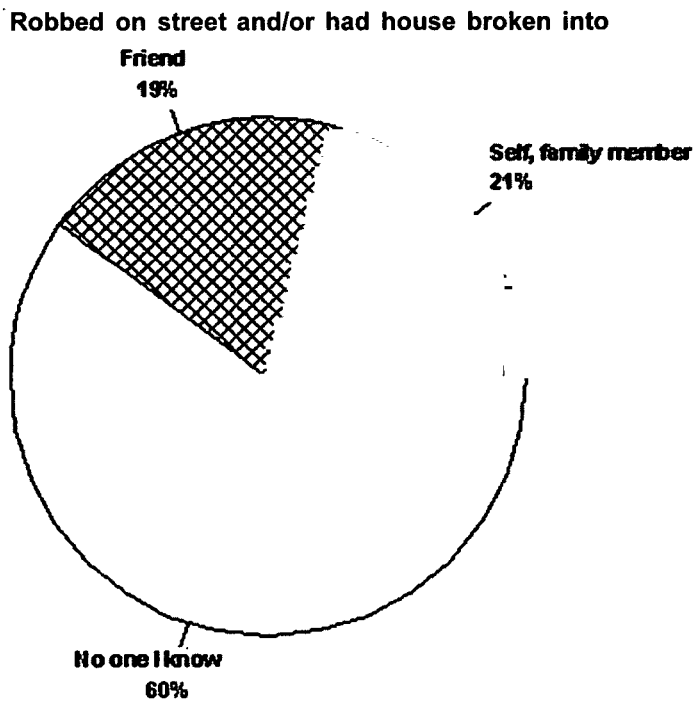
Source: Centre for the Study of Public Policy, *New Europe Barometer 1* (Glasgow, 2001) and *New Russia Barometer X* (Glasgow, 2001).

feeling of insecurity. For example, among Russians who have not been affected by crime in the past year, more than half feel unsafe on the streets and two-fifths feel unsafe at home. Altogether, 70 percent of Russians feel vulnerable to attack on the streets.

Measuring Collective Insecurity

Individual and collective security differ in the directness of their impact. Collective insecurity is a sense of vulnerability to what might happen. Whereas street crime and burglary are everyday occurrences, collective threats to security are contingent risks. In the 11 countries surveyed here, the great majority of citizens have not lived in a war zone or been caught up in domestic ethnic conflict. The extent to which people see such conflicts as threatening their own security will vary with national circumstances (table 2). Peoples from the Baltic countries are doubly insecure. In Estonia, Latvia, and Lithuania more than two-thirds see some threat from the Russian Federation and more than two-thirds see ethnic conflict within Estonia and Latvia as a possibility. While the small percentage of Russians in Lithuania substantially reduces anxieties about ethnic conflict there, Lithuanians are almost as insecure as their Baltic neighbors in worrying about the Russian state.

Figure 1. Grounds for Insecurity, Selected Transition Countries



Source: Combined answers to questions reported in table 1.

In all three Baltic states the majority feels much more insecure than the Russian minority. Among Estonian nationals, 96 percent see the Russian minority as a potential threat to peace; among Latvians, 80 percent see Russian residents as a potential threat, and this is also true of 60 percent of Lithuanians. By contrast, 67 percent of Russians in Estonia see ethnic problems as a potential cause of trouble and only 27 percent see them as more than a little threat. Among the Russian minority in Latvia, 56 percent see ethnic problems as threatening, and in Lithuania the figure is 48 percent. A measure of fear of the Russian state affects almost all Estonians and Latvians and five-sixths of Lithuanians. In the minority population, few see the Russian state as posing a big or some threat, but less than half dismiss it as giving no cause for concern. The largest Russian ethnic group sees the Russian state as having at least a little potential to threaten the security of the Baltic states.

In countries where ethnic minorities are only a small percentage of the population, from two-thirds to nine-tenths of the population do not see them as a big or some threat to peace. By contrast, in Russia, where an internal war is raging in Chechnya, more than two-thirds of the population see minority ethnic groups as posing at least a small threat to domestic security, and in Slovakia, where nationalists have sought to make political capital by propagating anti-Hungarian sentiments, concern about ethnic problems is even higher.

Even countries that are ethnically homogeneous today, such as Poland, have neighbors with whom they have been at war in the past. While substantial fears of their neighbors are only evident in the Baltic states, in 9 of the 11 countries surveyed the median citizen expresses at least a little anxiety about nearby threats to peace and security.

Two Indexes Not One

Simple indexes are popular in policy debate, because they can be condensed into a headline based on league tables that show which country is doing best and which worst. In policy analysis, however, adding up incommensurables hides information rather than highlighting it. Individual and collective security differ fundamentally in their cause and

in the problems they present to governments. Crime waves require honest and effective policing and social policies to reduce the causes of crime. By contrast, threats from neighboring states require military force and threats from ethnic minorities require patient negotiation, and even exceptional legislation, to reduce friction with the majority.

While individual and collective security differ, a country could be doing well on both counts. This is the case in Poland and Slovenia, where crime against individuals is relatively low and threats from ethnic minorities and neighboring states are also low. Hungarians are also relatively secure. Bulgaria, the Czech Republic, and Romania are close to the regional average for both experience of crime and a sense of collective security. However, crimes take many forms. Whereas only a sixth of Romanians report being affected by crimes of violence, the *New Europe Barometer* shows that 88 percent think that corruption is rife in government.

By contrast, in Lithuania and Slovakia individual insecurity is high because of violent crimes, and collective insecurity is relatively high too. Estonia and Russia are doing relatively badly, because while individual insecurity is about average for the region, collective insecurity is worse than average. In Latvia, the above average perception of freedom from violent crime is offset by above average anxiety about collective security.

In percentage terms, the difference between quantitative indicators of individual and collective security is limited. An average of 40 percent of survey respondents have been affected by crime, 29 percent see some or a big threat from ethnic conflict within their society, and 26 percent see a threat from neighboring countries. However, there is a fundamental difference between the measures. While the collective security figures represent anxieties about what *might* happen, the individual security index reflects what has *actually* happened to individuals, their families, or their friends. Adjusting crime figures to take into account popular fears of being a victim of crime substantially increases individual insecurity. Whereas two-thirds of Russians report that they do not know people who have been directly affected by crime in the street, only 15 percent say they definitely feel safe when they go out on the street.

Collective security issues addressed in arguments about expanding NATO to include more transition countries reflect real military concerns, but discussions about ballistic missiles are, literally and figuratively, over the heads of the great majority of people in the region. Insecurity is chiefly the fear of being hit on the head while out on the street or having one's home burgled while out or while in it. If transition states are to demonstrate their effectiveness, they must do more to reduce the violent crime that generates widespread insecurity here and now.

Richard Rose is director of the Centre for the Study of Public Policy, University of Strathclyde, Glasgow, and convenor of the Global Barometer Survey Network, which covers Africa, East Asia, and Latin America as well as postcommunist countries. His latest book is Elections without Order: Russia's Challenge to Vladimir Putin (Cambridge, U.K.: Cambridge University Press, 2002), with Neil Munro. For more details see http://www.cspp.strath.ac.uk.

Table 2. Ethnic Minorities and Perceptions of Neighboring Countries as Threats, Selected Transition Countries
(percentage of respondents)

Survey questions: Do you think ethnic relations pose a threat to peace and security in this society? Do you think neighboring countries pose a threat to the peace and security of this country? The total number of respondents was 12,718.

	Threats from ethnic groups			*Threats from neighboring countries*		
Country	*Some*	*Little*	*None*	*Some*	*Little*	*None*
Slovenia	10	28	62	11	37	51
Hungary	19	31	50	23	42	35
Poland	18	36	46	20	37	43
Bulgaria	29	30	41	19	31	50
Lithuania	22	37	41	33	40	27
Romania	32	29	38	27	26	46
Czech Republic	24	42	33	8	50	41
Russia	44	25	30	34	30	36
Latvia	37	33	30	49	27	23
Slovakia	43	32	24	30	38	33
Estonia	43	42	15	51	29	20

Note: "Some threat" includes a small percentage of respondents who see the issue as a big threat.

Sources: *Centre for the Study of Public Policy,* New Russia Barometer X *(Glasgow: 2001),* New Baltic Barometer IV *(Glasgow: 2000),* New Democracies Barometer V *(Glasgow: 1998).*

Undertaking a Difficult Transition in Yugoslavia

By Aleksandra Brankovic and Aleksa Nenadovic

Transition in the Federal Republic (FR) of Yugoslavia had initially begun in the 1990s, alongside similar endeavors in other formerly communist countries. Soon FR Yugoslavia split into five independent countries. Except in Slovenia war, the suspension of business and trade relationships among the new states, and the movement of large number of refugees made the transition extremely painful. In Serbia and Montenegro these trends were further aggravated by their international economic and political isolation (with UN sanctions lasting from 1992 to 1995), by their extremely high inflation, by NATO bombardment in 1999, and by economic mismanagement and disinvestment. Economic and political changes were initially delayed, and later completely halted.

Expectations and Disappointments

The political changes in 2000 raised expectations that the country would step away from its recent past and move toward economic and social recovery and growth, even though the situation at the end of 2000, when the new leadership took over, was not encouraging. As in other transition economies, output has fallen significantly since 1989, the beginning of transition, but in Yugoslavia it has not yet recovered. At the end of the 1990s GDP shrank to less than half of its 1989 level, and monthly industrial production was less than one-third of that in 1989. During the period of international isolation the shadow economy accounted for a large proportion of GDP, and unemployment also rose significantly.

Before the recent political changes the fiscal system was complex and was characterized by a lack of transparency. Approximately 40 percent of public expenditures were financed outside the budget and special tax concessions were granted to "privileged" taxpayers.

Even though FR Yugoslavia had already had serious problems with unemployment before, in the 1990s the situation deteriorated further and the number of unemployed reached a quarter of the labor force (this figure does not take the agricultural labor force into account). Large numbers of those who were officially employed were in reality on forced leave and received only the minimum wage. At one point in 1993 their number was estimated as at least 800,000.

Inflation was generally high throughout the 1990s even though the state controlled the prices of and fees for various products and services. By October 2000 the average monthly wage equaled about $40, and the middle class had virtually disappeared .

Changes after October 2000

In October 2000 dramatic changes began:

- Prices were liberalized, and so most price distortions disappeared. As a result, year-on-year inflation increased, but in 2001 cumulative inflation was reduced to 40.7 percent from 112 percent in 2000. Inflation did not fall more because of higher electricity tariffs and fees for public utility services, which alone contributed two-thirds of the 40.7 percent inflation rate (see the table on the next page).
- Once the new democratic government took power, this was soon followed by the renewal of Serbia's membership in various international economic institutions, including the IMF, the World Bank, and the European Bank for Reconstruction and Development. Serbia signed an agreement with the Paris Club that enables Serbia to undertake a phased, 66 percent write-off of debt totaling $4.5 billion, which represents about 40 percent of the country's total external debt. About half of the debt write-off will come into effect as soon as a three-year agreement with the IMF has been signed, and the rest will be written off following successful completion of the IMF agreement. This write-off is critically important if Serbia wants to go ahead with economic reconstruction and reforms.
- Major progress was also achieved in liberalizing the foreign trade regime. Bureaucratic obstacles were abolished, customs duties were lowered, and customs tariffs and procedures were simplified.
- In December 2000 the country adopted a managed float exchange rate. The exchange rate has been stable ever since, which in turn has significantly lowered inflationary expectations and strengthened confidence in the domestic currency. Last year the value of foreign exchange reserves doubled.
- The National Bank of Yugoslavia has become a largely independent institution, and has pursued a monetary policy based on fully covering the money supply with foreign currency reserves. It stopped its earlier practice of directly lending to enterprises, and also reduced its loans to the government. The steady increase in the monthly growth rate of the money supply through 2001 reflected the gradual remonetization of the Serbian

Basic Economic Indicators, Serbia, 1998-2002

Indicator	*1998*	*1999*	*2000*	*2001*	*2002*
Real GDP growth ($)	2.3	-18.3	5.7	6.2	4.0
Growth in industrial production (%)	4	-26	12	0	3
Growth in the real net wage index (%)	2	-16	6	17	4
Open unemployment rate (%)	22.8	25.5	25.6	26.8	27.9
Trade balance ($ millions)	-1,673	-1,512	-1,773	-2,493	-2,624
Exports of commodities ($ millions)	2,685	1,369	1,557	1,708	1,947
Percentage change in commodities' exports	8.8	-49.0	13.7	9.7	14.0
Imports of commodities ($ millions)	4,358	2,881	3,330	4,201	4,571
Percentage change in commodities' imports	0.7	-33.9	-15.6	26.2	8.8
Real M1, end of period (DM millions)	1,280	744	988	2,161	2,874
Foreign currency reserves of the National Bank of Yugoslavia, year end ($ millions)	n.a.	297	524	1,169	1,319
Discount rate, average of monthly rates (%)	n.a.	2.13	2.00	1.47	n.a.
Market interest rate, average of monthly rates (%)	7.0	4.3	5.8	4.8	n.a.
Consumer price inflation, year-on-year (%)	29.9	43.5	112	40.7	n.a.
Exchange rate, yearly average (YUN/$)	11.2	23.2	54.9	66.4	n.a.

n.a. Not available.

Source: Based on projections by the G17 Institute, the Serbian and Yugoslav governments, and the IMF.

economy and did not risk acceleration of the inflation rate.

- Restructuring the banking sector proved to be more difficult than had been foreseen. Four major banks representing 15 percent of the country's banking sector were shut down because they had incurred losses of about $35 million in the first 11 months of 2001. However, some other banks that had been shut down because of illegal operations are now back in operation following a decision by the Supreme Court, which is still under the influence of Slobodan Miloševic's cronies.
- A new fiscal system was introduced, affirming the integration of the budget and pooling all fiscal revenues and fiscal expenses. In 2001 the fiscal deficit was lower than expected, namely (1.2 percent of GDP instead of 6 percent as projected, because of efficient collection of fiscal revenues and lower public expenditure.
- The number of people employed in state-owned enterprises has gradually shrunk, while the number of those employed by the private sector has been rising. In December 2001 the new Labor Law was passed that made it easier for employers to hire and fire employees.
- With the enactment of the Privatization Law in 2001 Serbia adopted the necessary legal and institutional framework to start privatization, which will be carried out through public tenders and public auctions. Employees may acquire shares free of charge up to 15 percent of an enterprise's capital, and another 15 percent will be distributed for free to adult citizens. Three cement plants have already been sold for about $150 million through public tenders. State-owned enterprises still control 80 percent of the capital stock and employ almost 75 percent of the labor force, but generate not more than 50 percent of total profits.

Future Challenges

The prices of electricity and public utilities should be liberalized in the coming years. This must be done gradually so as not to further jeopardize people's livelihoods and to induce individual savings. [Editor's note: According to a recent article from the *Washington Post*, official estimates put unemployment at 35 percent. Laid-off workers receive a year and a half of benefits and are then on their own. One-third of Serbs subsist on the equivalent of a dollar a day; another third live on twice that. The country is experiencing a typical post-Berlin Wall hangover of unfulfilled expectations.]

Even though public debt was lower in 2001 than expected, it could increase in the coming years for several reasons: increasing public investment; restructuring of the economy, which is likely to cost more than foreseen; and servicing external debt. Options to help improve fiscal performance include adopting a public procurement law, establishing a treasury system, and introducing a value added tax.

The deep-seated industrial decline could be turned around with a large amount of foreign direct investment that brought new equipment and new technology into the country. As for energy, the security of the energy supply could be an issue in the future. Serbia has already borrowed several loans to rebuild its energy production and distribution network, but until private investment starts to flow in, the situation will remain problematic.

Unfortunately, high interest rates discourage investment. Rates are high not because money is unavailable, but as a leftover from 2001, when investing was extremely risky. Inflows of foreign direct investment have not been significant so far. Foreign investors are waiting for macroeconomic stabilization and for a more favorable institutional environment. They are still deterred by the risks of social unrest and political conflicts, the federation's uncertain future, the complicated bureaucratic procedures, the inefficient judicial system, and the still undeveloped financial markets. Some of these issues have been addressed, and as soon as improvements are visible in other fields, the level of foreign investment should gradually increase.

Auctions and sales of small and medium enterprises (SMEs) began in 2002, and 150 large state-owned enterprises are to be privatized over the next four years. The restructuring of large, insolvent enterprises—which employ more than 200,000 people, or 9.5 percent of the labor force—will also start in 2002 with the objective of preparing them for privatization in the future. Public enterprises will be restructured in the short and medium term. In the short term restructuring will be based on decentralizing, or even separating, various units of enterprises. Eventually business activities will be exposed to market forces and hard budget constraints will be imposed, while protecting public interests. Speeding up the development of SMEs is important, because the expectation is that SMEs will absorb much of the labor made redundant as a result of the restructuring of large state-owned enterprises.

The G17 Institute: Belgrade's Catalyst for Reform

The G17 Institute was established in response to the radical economic and political changes that took place in Serbia and Montenegro following the victory of opposition candidate Vojislav Kostunica in the September 24, 2000, presidential elections. The institute grew out of the original Group 17 (G17), an organization that brought together economists and experts in other social sciences with the aim of promoting and implementing the ideas of a modern market economy, an open and democratic society, and the rule of law through its programs, projects, and public activities. Over the last 10 years economic issues have been completely marginalized by politicians who favored irrational and populist policies and failed to recognize that without adequate solutions to economic problems there would be no progress in other areas.

In June 2001 G17 became the G17 Institute, a research institute devoted to the study of economic processes and the application of contemporary achievements in economics, with the objective of promoting economic and social advances in Serbia. Research activities include both macroeconomic and microeconomic policy issues, as well as more specialized areas, such as business economics, current economic trends and policies, methods of economic analysis, human resources development, spatial and regional economics, international economics and technological development, and investment project planning. Another important part of the institute's work involves education and dissemination. Since 1998 G17 has conducted highly successful three- to four-week economic policy summer schools. A number of talented young researchers excelled during the schools and some of them are currently working as researchers in the institute. The institute has continued this activity and plans to increase the number and frequency of such courses. The ultimate objective is to create a small graduate school for economics.

The institute's goal is to increase academic understanding of the transition to a market economy in the country, but also to provide expertise and economic advice to domestic and foreign policymakers and international organizations. The institute places great emphasis on promoting cooperation with similar institutes abroad through regular exchanges of visitors and through research scholarships. The institute currently employs 15 full- and part-time researchers, and is divided into four departments that deal with social policy, macroeconomics, institutional reforms, and European integration. Its research findings are disseminated by means of monthly publications, press conferences, special publications, public debates, roundtables, and frequent appearances in the media by its staff. In September 2001 the institute initiated a series of working papers.

Strengthening bilateral and multilateral economic relations with other countries and international institutions is also a priority. FR Yugoslavia has applied for WTO membership and is negotiating a stabilization and association agreement with the EU. FR Yugoslavia might become a WTO member in the next four or five years, but probably would not be able to join the EU before the next decade. By the end of 2002 it will have signed agreements on free trade with all the Southeast European countries, and a free trade area will be subsequently formed. This might help the country improve its external position by reducing its high trade deficit. Lagging export performance to date has mainly been an outcome of neglecting to improve product quality and maintaining inefficient production systems and management at the enterprise level. For years enterprises were oriented towards rent-seeking and tax evasion, and little investment took place. Thus export recovery requires radical restructuring and technological upgrading.

Uncertainty surrounding Serbia's and Montenegro's future relations could also slow down the reform process and postpone the inflow of foreign investment. A three-year "probation" period as agreed to by the two republics is not a stable framework for a long-term strategy. Kosovo's provisional status is another source of uncertainty. Finally, Serbia is still a fragile democracy, with complicated relationships within the ruling coalition, and nationalistic sentiments are still strong. These factors make foreign investors cautious. Thus the policymakers in Belgrade face a daunting task in sustaining the reforms needed for economic recovery.

The authors are junior researchers at the G17 Institute, Belgrade, Knez Mihailova 10, 11000 Belgrade, Yugoslavia, email: office@g17institute.com, URL: http://www.g17institute.com/.

International Training Program for Entrepreneurs in Mekong Countries

By John McKenzie

Vietnamese entrepreneurs, emerging from the economic shadow of the state sector, eagerly responded to the recent publication of a "Teach Yourself Business Management" series. Demand has been so strong that it has generated impetus for the creation of a new, multifaceted, flexible training program in business to reach out to small and medium enterprises throughout Cambodia, Laos, and Vietnam.

A major effort of the Mekong Project Development Facility (MPDF)—an international program managed by the International Finance Corporation that supports private, domestic small and medium enterprises (SMEs) in Cambodia, Laos, and Vietnam (see the box)—is to boost the market for management training services. A special project team has been set up in Ho Chi Minh City dedicated to producing international standard learning material adapted to the local market. Partners of capacity building delivery include publishers, training centers and management consultants; and branding and marketing its learning products.

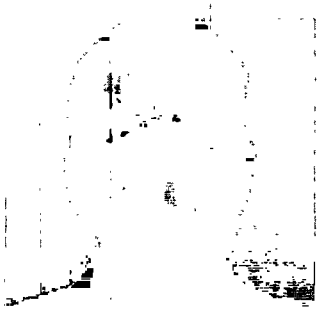
In 1997, the first year of the MDPF's operations, it became clear that there was a chronic lack not only of appropriate learning materials, but also of instructors who could train SME owners and managers. At that time business management training courses in Vietnam were inappropriate for domestic firms, as they were aimed at the executives of joint ventures and large state-owned corporations. Few courses were available, those that were offered were expensive, and course content was largely taken from Western business schools.

MPDF thus engaged in curriculum development; brought in overseas subject specialists; and, in partnership with three local business schools, developed 36-hour courses in accounting, marketing, human resource management, and operations management. The management training program was well adapted to local conditions both in terms of quality and price. As a result, it has snowballed having now been adopted by 21 new partner schools and business colleges, all of which were provided with the full curriculum and training of trainers course material and adult teaching methodology. 71 such courses conducted last year were delivered on a commercial basis and more than 1,600 SME managers participated.

Yet the impact of the training programs are still limited in meeting the specific market needs of SMEs in the Mekong region. Vietnam has more than 70,000 registered private companies plus 2 million household

enterprises, thus to date the training program has only so far scratched the surface. In addition, many SME owners and managers simply do not have the time for scheduled seminars or classroom attendance. Thus the challenge is to move beyond the classroom, and the aim of the Flexible Learning Unit—launched on April 1, 2002, grown out of the MPDF's original business management program—is to get the training content into people's hands by other means.

The "Teach Yourself" series was launched in May 2001 and soon after the books became bestsellers. By December the entire first print run of 24,000 titles in Vietnamese and 5,000 in Khmer had been sold. Sales of the English language version in Cambodia and Vietnam were less brisk, but still impressive. The series is published through a partnership with the Youth Publishing House in Vietnam and the Angkor Book Store in Cambodia. Both publishers print and distribute the books throughout Cambodia and Vietnam on a commercial basis. The current cover price is $1.80 per title (slightly more expensive than a photocopy).



Mr. John McKenzie

The series focuses on the practical needs of SME owners and managers. Examples of existing "Teach Yourself" titles include: *Recruiting, Job Search, and Selection; Wage and Salary Systems; About Customers: Gathering Information; Promotion and Advertising;* and *Pricing and Pricing Strategy.* The Canadian Open Learning Agency of British Colombia designed the series and Mark Nielsen, director of the agency's product development and research group, is now heading the Flexible Learning Unit on a 12-month assignment. Another 20 titles are being adapted for the local market and translated this year, moving beyond human resources and marketing to such topics as finance and accounting, general and operations management, and personal productivity skills.

The new publications will feature improvements, particularly in the choice of words and structure, to make them even more locally relevant and easy to use. Few training materials address the needs of SMEs employing 10 to 300 people that may have started out as family businesses. Many such companies have grown and suddenly find themselves needing a structure rather than operating on an informal basis. The idea is for the individual training programs to be provided in any way the client or client group wishes. This can range from in-house workshops, industry association seminars, home study, and interactive media links to more conventional classroom situations. For classroom and other facilitated training, the Flexible Learning Unit will work with a number of local partners including publishers, training centers, television producers, CD-Rom publishers and internet sites to establish a variety of channels through which to distribute content.

The idea is to design modules to meet such market demand, starting from the bottom up. The first step is to develop a content library, and the Flexible Learning Unit has already begun to procure suitable content from a variety of global outlets. The unit is recruiting local staff with formal training as instructional designers and content specialists, mainly from universities or from foreign companies with direct experience of on-the-job training. Once the unit has developed the learning modules and adapted them to various media forms, its next task will be to customize and market them.

Mekong Project Development Facility

The Mekong Project Development Facility (MPDF) was established in 1997 to support the development of private, domestically-owned small and medium enterprises in Cambodia, Laos, and Vietnam. Its headquarters are in Hanoi, with regional offices in Hanoi, Ho Chi Minh City, Vientiane, and Phnom Penh. The MPDF is managed by the International Finance Corporation and is financed by a number of donor countries and institutions, including the Asian Development Bank, the International Finance Corporation, Australia, Canada, Finland, Japan, Norway, Sweden, Switzerland, and the United Kingdom. It provides specialized assistance to two main target groups, namely:

- To private sector managers with plans for business expansion via the Company Advisory Assistance Program
- To organizations providing business services to private companies, such as joint stock banks and training institutions, via the Business Support Services Development Program.

The goal of the Flexible Learning Unit is to become a self-sustaining, independent entity in designing a variety of business management training programs for clients throughout Cambodia, Laos, and Vietnam, in accordance with the MPDF's guideline that all activities must be self-sustaining i.e. "marketable" and paid for by the customer.

Accordingly, once learning material have been transferred to partner training centers and others, they are then offered to SME users for a fee on a for-profit basis.

MPDF is confident that, step by step, it can build up its business training program in the three Mekong countries. Through the Flexible Learning Unit MPDF is now building the capacity to generate training content. Ultimately it seeks to deliver learning to anyone, anytime, anywhere on any business training subject by developing the product and its distribution channels. After that, the market will take over.

The author is the manager of the MPDF's Business Support Services branch, which has been responsible for setting up the Flexible Learning Unit.

Vietnam Focuses on Education

In downtown Ho Chi Minh City stands a colonial-era villa with Moorish windows and a turret where a multinational oil company's executives, and later a senior Communist Party official, once lodged. As Ami Kazmin of the *Financial Times* reported, today the mansion houses Vietnam's hope for the future: an independent campus of Australia's Royal Melbourne Institute of Technology (RMIT), Vietnam's first wholly foreign-owned university, where around 400 students are studying language and technical skills to help them thrive in the global marketplace.

Knowledge at this small but idyllic satellite of Australia's "working man's college" does not come cheap. Tuition fees range from $1,200 for a 10-week, 200-hour English course to $8,460 for a software engineering degree course, not an insignificant amount in a city where annual per capital GDP is estimated at just $1,400 a year. Yet the hefty tuition is not expected to constrain the institution's growth. Within two years RMIT Vietnam—with the backing of the Asian Development Bank and the World Bank's International Finance Corporation—plans to open a brand new university campus with initial capacity for 5,000 full-time students and room for further growth.

Currently an estimated 1.5 million high school graduates compete in grueling national entrance exams for fewer than 250,000 places at state-run universities. Those selected for admission are rewarded with dilapidated, overcrowded facilities; poorly paid professors; and outdated curricula that bear little relevance to modern workplace skills. While Hanoi—which aspires to a "knowledge-based economy"—is boosting its education spending, the funds are largely directed toward primary and lower secondary education in rural areas rather than to higher education.

Both Hanoi and Ho Chi Minh City are already flush with private language schools that offer evening and weekend classes of varying quality and costs to such learners as small shopkeepers, police officers, taxi drivers, and the children of well-placed government officials.

On the technical end, Indian software companies NIIT and APTECH, which specialize in training computer programmers, have set up centers to generate manpower for the country's fledgling programming industry. Saigon Tech, an institute started by a local economics professor and an overseas Vietnamese software developer with the backing of the Houston Community College, opened its doors last year and now has 180 students studying its five-semester course at a cost of $4,000 each.

To woo more foreigners to set up universities, the government offers generous incentives, taxing foreign education ventures at just 10 percent, compared with rates of 30 to 40 percent for other sectors. Now, however, Hanoi faces a new challenge: upgrading its ability to regulate the growing private education sector to ensure that students get a decent education in exchange for their hefty fees.

Since 1995 Vietnam has received the equivalent of $483.8 million in total official development assistance for the education sector. Of this amount, loans account for 52 percent or $252.2 million and grants total $231.6 million. The foreign loans are included in total state budget spending on the education sector, which stands at 15.6 percent of total budget spending this year, while grants are not included. Vietnam has to pay interest rates of 0.45 to 1 percent per year for the foreign loans.

Ongoing education projects using foreign loans in Vietnam include the following:

• The **Primary Education Project** (1995-2002), with total capital of $70 million provided by the World Bank, aims to improve the capacity of the state-run Education Publishing House, the country's sole textbook publisher; update textbooks; upgrade schools; and train local management cadres.

• The **Junior Secondary Education Project** (1998-2004) uses a $50 million Asian Development Bank loan to reform curricula and textbooks, retrain teachers, upgrade teacher training colleges, and upgrade classrooms in 234 schools in 10 provinces.

• The **Junior Secondary Teacher Training Project** (from August 2000) is funded by a $25 million Asian Development Bank loan.

• The **Primary Teacher Training Project** (2002-05) has received a World Bank loan of $20 million.

• The **Tertiary Education Project** (1998-2006) obtained a World Bank loan of $80 million.

• The **Combustible Engine Laboratory Upgrade Project** for the Hanoi University of Technology (1999-2004) uses a $9 million loan provided by the Austrian government.

According to the Deputy Education Minister Le Vu Hung, altogether Vietnam will receive loans of $550 million from the World Bank and the Asian Development Bank for five major education and training development projects between 2003 and 2007.

The World Bank/IMF Agenda

World Bank Lends to Russia's Treasury System and ...

On June 6 the World Bank approved a $231 million loan to Russia to support its Treasury Development Project. The Treasury system will help Russia use more effective tools for budget execution and financial management, thereby improving the efficiency and transparency of resource allocation. Strengthening public administration management is a top priority. The project will also help the government translate its anticorruption strategy into specific programs. The Treasury Development Project will be repayable in 17 years, including a 5-year grace period. The Russian Federation joined the World Bank in 1992. Since then commitments to the country have totaled $12.5 billion for 52 operations.

...Decides on Lending $600 Million Annually

On June 6 the World Bank's Board of Executive Directors discussed the World Bank Group's Country Assistance Strategy (CAS) for the Russian Federation for fiscal years 2003-05. The CAS envisages an IBRD program of lending and guarantees of up to $600 million per fiscal year over the CAS period, supported by an extensive program of analytical work in support of the reform agenda. At the same time the directors voiced concern that despite Russia's strong economic performance since 1999, which has been accompanied by considerable progress in the legislative agenda, formidable challenges remain. At least 40 million Russians still live in poverty, with children particularly at risk. Access to high-quality education and health care is restricted, and the risks of an HIV epidemic are growing. Growth has been uneven, with poor regions and segments of the population falling further behind. Exports are largely based on commodities and investment remains overconcentrated in the same sectors. Small and medium enterprise growth has been anemic. Institutional capacity remains weak, and governance and corruption are still serious issues.

Despite Russia's current strong fiscal position, this CAS argues for a continued strong World Bank Group presence during fiscal years 2003-05 to help the government consolidate and implement its formidable development agenda. A strong World Bank presence is also the wish of the government. The CAS is organized around three central themes as follows:

• **Improving the business environment by**

–Creating the conditions for diversification of the economy to reduce over-reliance on the natural resource sectors.

–Promoting a level playing field among businesses.

–Increasing effective financial intermediation and opportunities for entry.

–Developing and delivering modern and flexible education and training services.

Continued on page 49

The World Bank in cooperation with SITE and WDI
28

Articles provided by:

Local Government and Public Service Reform Initiative

Open Society Institute

Education, Ethnicity, and Single Motherhood:

The Determinants of Poverty in Postcommunist Countries

By Ivan Szelényi

Our recent survey on poverty was conducted in six postcommunist European countries: Bulgaria, Hungary, Poland, Romania, Russia, and Slovakia. The survey used random samples of the adult population (in three of the countries the Roma population was oversampled). The survey asked people to recall how they had lived in 1988 compared with 2000 and to assess whether their situation had improved or deteriorated as a result of transition.

In every country people see the transition as a period of sacrifice. Between 55 and 85 percent of those surveyed believed that they lived "worse" or "much worse" in 2000 than in 1988. The respondents also reported a higher level of extreme poverty in 2000 than 12 years earlier. Five to 15 percent said they had experienced extreme poverty in 2000, while only 1 to 5 percent said the same for 1988. Thus a reasonable conclusion is that the proportion of the population that lives below the poverty line has increased from two to five times during the 12 years of the postcommunist era (depending, of course, on how one defines the poverty line). Moreover, dramatic differences in poverty levels exist across the countries surveyed.

A similar survey in 1993 compared 1988 with 1993 and asked similar questions in some of the same countries, but the results were different. Then the proportion of those who reported a worsening living standard was almost identical in all the countries surveyed. The 2000 survey tells a different story: some countries exhibit signs of consolidation and even modest improvement in living standards and less poverty. For example, in Hungary in 1993, 62 percent of the population reported a deterioration in their living standards, while only 57 percent did so in 2000. By contrast, in Bulgaria in 1993, 69 percent of the respondents claimed that their living standards had deteriorated, but 84 percent did so in 2000.

The 2000 survey indicated that the level of poverty is strikingly different from country to country. In Hungary 8 percent of the population lived below the poverty line set by the World Bank ($4.30 per day per "equivalent adult"). In Bulgaria this figure was 36 percent. We tried to assess poverty by asking people whether they had suffered from hunger in 2000. When asked, "Did you go to bed hungry last week because you could not afford to buy food?", 6 percent of Hungarians and 16 percent of Bulgarians responded in the affirmative.

Thus the extent of poverty has increased substantially compared with late state socialism, where extreme poverty was relatively rare; mainly because of full employment. But did the character of poverty also change? Did postcommunism create a "new poverty"? Many commentators suggest that it did. Earlier research indicates that poverty under state socialism was mainly a life cycle and demographic phenomenon. The single most important predictor of poverty was the number of children in a family. Families with many children tended to be relatively poor, but as children entered the labor market they moved out of poverty. By contrast, the important predictors of the new poverty appear to be education and labor market performance. Achievement rather than ascription (ascribed status is a person's social position that is given at birth) indicates who falls below the poverty line.

Thus poverty is a structural phenomenon that will not necessarily disappear with changes in the life cycle. People who are inadequately educated, and thus perform poorly in the labor market, are likely to continue to do so throughout their lives. Our data offer qualified support to the hypothesis that with the transition to a market economy, the determination of poverty may have shifted from ascription to achievement, because the

quality of education is now the most important indicator of poverty. Households with low levels of education are four to five times more likely to be below the World Bank poverty line than households with higher levels of education. Labor market performance in itself is not that important. Those households where the head of household is unemployed or is out of the labor force are more likely to be poor than other households; however, this effect is not nearly as strong as the education effect.

Nevertheless, even though education is the strongest factor determining poverty, ethnicity and gender also play important determining roles in postcommunist Europe. Even after accounting for education, Roma are twice as likely to be poor than non-Roma. Similarly, households headed by single mothers are also about twice as likely to be poor than other households. Clearly improving educational opportunities for Roma would be an important vehicle for reducing poverty among Roma, though education alone will be insufficient, because substantial inequalities between Roma and non-Roma will persist in other spheres, in particular, unequal employment opportunities.

When considering the three determinants of poverty—education, ethnicity, and single motherhood—an additional unique feature of postcommunist societies is relevant. While a link between ethnicity and single motherhood can be expected in the United States, this is not the case in Central and Eastern Europe given the strength of extended Roma families. Unwed Roma mothers are much more likely to live with the fathers of their children, and if their partners abandon them they are likely to live with other kin. Hence the Roma are not as exposed to the risks of poverty attributable only to single motherhood.

Another important question the survey asked was: "How do people cope with poverty? To what extent can they rely on welfare institutions, and to what extent do they survive by self-support?" Thus our study looked both at access to transfer payments and self-support, two complementary coping mechanisms. Surprisingly, the structure of both was similar across countries. The major transfer payment, excluding pensions, is a child allowance, which 25 to 40 percent of the households surveyed receive. Social assistance and unemployment benefits are available to approximately another 10 percent.

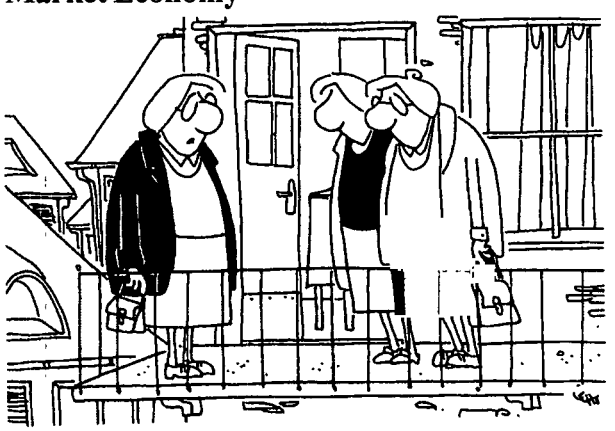
The welfare system is rather uniform across countries, and typically is selective and targeted. The structure of self-support is also similar, roughly half the households surveyed rely on self-support when it comes to food. Roma, however, are much more likely to receive transfer payments than non-Roma: almost twice as many Roma families receive child allowances compared with non-Roma households, and Roma receive two to three times more transfers in the forms of social assistance and unemployment benefits than non-Roma families. In self-support the opposite is true: Roma are half as likely to be able to provide for themselves compared with non-Roma.

Postcommunism led to a massive increase in poverty, but the extent and persistence of this poverty varies a great deal across regimes. Neoliberal regimes show lower levels of poverty than neopatrimonial systems. While poverty has moderated somewhat during the last five years in the neoliberal countries, poverty increased in the neopatrimonial countries.

The most important finding of our study was that there are three determinants of poverty under postcommunist capitalism. The effects of ethnicity and single motherhood complement the effects of education. Education is twice as important as ethnicity and single motherhood, but after controlling for education, both Roma and single mothers are still about twice as likely to be poor than other groups. Thus while market transition criteria based on achievement may have gained ground, ethnicity and gender remained strong predictors of poverty.

The author is professor and chair of sociology at Yale University, and can be reached by email at ivan.szelenyi@yale.edu. *This article is a shorter version of "Poverty Strikes Back," published in the summer 2002 edition of LGI's Local Government Brief.*

Market Economy



"Earlier, only a change in the weather gave me a headache, now it is the stock exchange."
From the Hungarian magazine *Hócipő*

Corruption and Poverty in Postcommunist Europe

By William L. Miller

Moral crusaders condemn the use of contacts, gifts, and bribes as intrinsically immoral or illegal, a sin or a crime. Lawyers condemn it as being illegal. But economists and political scientists have been more ambivalent. As long as corruption had a positive effect on economic efficiency and political stability, economists and political scientists did not rush to condemn it. In particular, many observers of the Soviet Union felt that the system was unworkable unless fraud and deception were allowed on a vast scale. Even in postcommunist Russia commentators have argued that bribery is an indispensable part of life, that it softens the edges of an authoritarian society and enables citizens to circumvent a ponderous state bureaucracy.

However, the weight of opinion among economists and political scientists has changed, with the most recent studies suggesting that corruption is both economically inefficient and politically destabilizing. Economists now argue that corruption distorts economic activity. It is not merely a tax, but an arbitrary tax that damages economic development more than its sister activity, taxation. It is a cause of poverty, but worse than that it increases inequality and hits the poorest hardest.

Inequalities of wealth provide the means to pay bribes, while inequalities of power provide the means to extort them. Far from softening the hard edges of society, economists now argue that a state with endemic corruption can be especially brutal to the very poor, who have no resources to compete with those willing to pay bribes. Hence bribery is a sell-out to the rich and makes political systems less democratic. State contracts for unnecessary projects go to inefficient and uncompetitive firms, and state benefits and services go to citizens who are neither those most entitled to them nor the most needy. The state is cheated out of revenue by those who bribe officials, and consequently has to impose greater (eventually unbearable) tax burdens on those who cannot avoid payment by bribing officials and/or let public services, on which the poor in particular depend, collapse.

Corruption is only one aspect of the relationship between citizens and officials in postcommunist Europe. Our findings show that corruption in itself is neither the most frequently annoying nor the most intensely annoying aspect of encounters between citizens and street-level bureaucrats in any of the countries (Bulgaria, the Czech Republic, Slovakia, and Ukraine) that we studied, though it is nonetheless a significant source of annoyance in some of them. Even an incorruptible bureaucracy can be inefficient, insensitive, unresponsive, arbitrary, capricious, or unfair, and these are the things that ultimately affect citizens. However, a corrupt bureaucracy is likely to be more inefficient, more arbitrary, and more capricious than an incorruptible one. While a corrupt bureaucracy may be more sensitive, responsive, and fair to those citizens who pay bribes for the privilege, it can be so only at the cost of being less sensitive, less responsive, and less fair to the poor, who cannot pay, or pay enough, to buy privilege.

We measured poverty not by low income itself, but by its inadequacy. We asked respondents whether, after "taking into account the number of people in your family," they rated their family income as "not really enough to survive on "(33 percent overall), "only just enough to survive on" (43 percent), "enough for a fair standard of living" (20 percent), or "enough for a good standard of living" (4 percent). Those whose incomes are "not enough to survive on" are certainly "poor," and those with enough for a "fair" or "good" standard of living can be described as "well-off."

Poverty correlates with low education, with being a pensioner, and with being unemployed. The poor were less likely to have to deal with customs, passport, or court officials; with the police; or with officials that handled contracts or regulatory documents. Conversely, the poor were more likely to deal with pension, unemployment, and health service officials. Thus the poor might avoid the notoriously corrupt traffic police or customs officials, but they were forced into relatively frequent contact with health service staff whose corruption is equally notorious, and their lack of education meant that they could not easily use information or negotiate the use of gifts and bribes that they could ill-afford.

The poor ranged from 12 percent in the Czech Republic and 14 percent in Slovakia to 45 percent in Bulgaria and 53 percent in Ukraine. This complicated the analysis enormously, because it confused the impact of poverty with the impact of Bulgarian and Ukrainian circumstances or culture. The poor are disproportionately located in Ukraine, and the well-off are disproportionately located in the Czech Republic. It may not be entirely a coincidence that Ukraine is both the poorest and the most corrupt of the

four countries, but the poor in other countries do not think and behave exactly like those who live in Ukraine.

When we asked about the actual strategies they had used recently in their own dealings with officials, the poor in the Czech Republic and Slovakia were as likely as the well-off to admit to using "contacts," "small gifts," and "bribes" (money or an expensive gift), while in Bulgaria and Ukraine the poor were somewhat less likely than average to admit to using contacts, gifts, or bribes. Perhaps the poor were especially poor and unable to pay in these countries. However, the poor were scarcely any more willing than average to condemn the practice of using contacts, gifts, and bribes to influence officials, and "if asked, and if they could afford to pay it" the poor were just as willing as others to give a bribe "to solve an important problem." Indeed, if we neglect to consider cross-national differences, the poor appear significantly more willing to pay bribes because the poor tend to be Ukrainians, who generally would pay, while the well-off tend to be Czechs, who generally do not.

What distinguished the poor, however, was that in every country they were about 20 percent less likely than the well-off to feel that they "knew their rights" when dealing with officials. In every country the poor were more dissatisfied in their dealings with officials, less likely to report that they had been treated with respect "as equals," less likely to report that they had been treated "fairly," and less likely to report that they had enjoyed "especially favorable" treatment. Good government requires especially favorable treatment for those with the greatest needs, but in the countries surveyed exactly the wrong people seem to get the favors, especially in Bulgaria and Ukraine.

Our research produced at least some evidence that paying bribes in Bulgaria and Ukraine helped the poor more than the well-off to get special favors. In these countries the oor who paid bribes received favorable treatment as often as the well-off who paid bribes, but the poor who did not pay bribes got favors less often than the well-off who did not pay bribes. If this is indeed the case, it would underline the reality that the poor generally lack other resources of education, information, and negotiating skills—even prestige and influence—that the well-off can use as substitutes for crude bribes. This finding echoes the old, and now largely discredited, argument that corruption gives the poor access that they would not otherwise have. But that is perhaps the wrong way to look at the situation. Rather, it is particularly in those places where the poor receive favors far less frequently than the well-off that the poor who do not or cannot pay bribes are the ones who suffer the most. Instead of emphasizing the ability of poor bribe-payers to buy what they should get for free, we need to emphasize that the burden of corruption falls hardest on those of the poor who are so honest—or more likely so very poor—that they do not pay.

The author is a professor of politics at the University of Glasgow. Together with Ase Grodeland, and Tatyana Koshechkina, he conducted several surveys on corruption involving thousands of respondents in postcommunist countries. His email address is w.l.miller@socsci.gla.ac.uk.
This article was originally published in the summer 2002 edition of LGI's Local Government Brief.

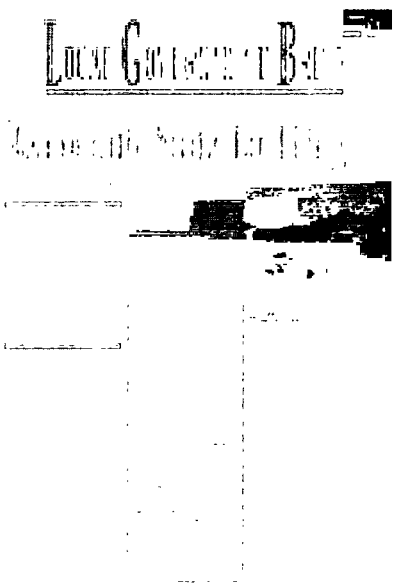
Education to Facilitate the Way Out of Poverty

By Lucinia Bal

Before the fall of the Iron Curtain, the communist states had some of the highest literacy rates in the world. The 1994-95 international adult literacy survey defined literacy as the information-processing skills that adults need to perform tasks encountered at work, at home, and in the community, and included Poland in the research. Although the percentage of young Polish adults who completed secondary education was higher than in some OECD countries, the overall literacy rate was significantly lower. The more recent OECD Program for International Student Assessment study assessed the ability of 15-year-olds to use their knowledge and skills in real-life situations. The surveyed transition countries—the Czech Republic, Hungary, Latvia, Poland, and Russia—ranked average in scientific literacy, but scored well below the OECD mean in reading literacy. These and other studies suggest that the postcommunist education systems have failed to develop the skills and dispositions needed to meet today 's challenges.

The traditional teacher-centered approach to education does not encourage the development of problem solving techniques or of independent decisionmaking. Yet it is precisely this method that dominates most postcommunist school systems. New teaching methods spread slowly, especially because of inadequate

preservice and in-service teacher training programs. Curricula are often outdated. Teaching materials are in most cases inadequate, and sometimes prohibitively expensive. With few exceptions vocational education has not yet started to create the practical skills and professional flexibility the new economies need. National examination systems reward old methods of teaching and penalize new ones. Assessment systems rarely encourage critical thinking and initiative, but rather reward the reproduction of previously delivered content. In many countries secondary and higher education is infected by corruption. Hasty decentralization to create democratic education systems did not automatically empower schools. Communities and local governments have not been assisted to identify and adapt to their new roles with respect to schools. Perhaps above all, quality assurance mechanisms to help democratic education systems are not yet in place.



Life-long learning is currently a major feature of the EU's social and economic policy, yet most transition countries lack systemwide forms of adult education and have almost no concept of the meaning or importance of life-long learning at the policy level. The economic sector and the education system fail to interact to support adults in need of professional retraining and skills to cope with the new situations they encounter. If children leave school with low attainment, they have few opportunities to go back to school or to retrain as adults.

Is there equal access for all to quality education? The postcommunist countries have legislation that calls for at least eight years of obligatory education and their governments have committed themselves to equity of educational access. Yet records indicate that not all children 7 to 10 years old are enrolled in school, and that a significant percentage of students drop out before the end of the obligatory cycle.

Children from rural areas are greatly disadvantaged. Decreasing numbers of qualified teachers work in villages, where the living conditions are worse than elsewhere and the possibility of supplementary earnings is reduced. Commuting is becoming difficult, because parents are impoverished and roads are often in bad condition, and urban accommodation remains unaffordable. The high percentage of rural inhabitants in these countries, sometimes more than 40 percent, aggravates this problem.

The current education systems are extremely limited in including children with special needs in mainstream education. Worse, the special needs groups often include children without such needs who have been diagnosed as such for social, and even political, reasons, for instance, the Roma. "Special" schools are often inadequate because of a lack of funding, marginalization, and antiquated teaching methods and materials. Obsolete vocational training compounds the problem.

Education budgets in many transition countries are low. Teachers' salaries are often derisory, many times below the subsistence rate. Expecting good results from unmotivated and tired teachers is unrealistic. Access to quality education becomes available only through private tuition and private schools, which are, of course, inaccessible to the poor.

Capacity building is necessary in the following two areas if countries want to develop their education systems successfully:

- **Develop technical and professional competence.** This includes teacher training in contemporary teaching methodologies, curriculum development, and assessment and evaluation methodologies.
- **Enable governments to formulate and implement effective education policies.** Evaluation mechanisms must be deeply integrated into reform strategies. At the national level new management approaches should involve local governments and schools in supporting quality education. At the local level school management training is recommended. The creation of a favorable environment for participation and dialogue is likely to support and sustain educational change.

The author has worked for the Open Society Institute for nine years, specializing in educational development. Her email address is Ibal@osi.hu. This article is a shorter version of "Education: The Way Out?", published in the summer 2002 edition of LGI's Local Government Brief.

Articles provided by:
SITE
Stockholm Institute of Transition Economics
STOCKHOLM SCHOOL OF ECONOMICS

Russian Industry and WTO Accession: Death Knell or New Beginning?

By Ksenia Yudaeva, Evgenia Bessonova, and Konstantin Kozlov

While WTO accession is anticipated to improve the position of the exporting sectors in international trade, more specifically, to reduce the number of antidumping cases initiated against Russian companies, it is also expected to increase the exposure of Russian manufacturing firms to foreign competition. The government and the public worry that WTO accession might lead to a further decline in industrial production, especially in manufacturing.

Currently fuel and metal production industries account for 34 percent of Russian industrial production and employ some 15 percent of those working in industry. Given the relatively low geographical mobility of labor in Russia, a continued decline in the manufacturing sector may result in substantial social costs. The government is interested in evaluating such costs, both in the short run and in the long run, and under different accession scenarios. The government is particularly interested in assessments that take cross-industry effects into account as follows:

• **International trade.** Russia is an open economy. Exports constitute about 46 percent of GDP (1999 data), and 40 percent of budget revenues are revenues from international trade (tariffs, excise duties, and customs fees). Officially reported imports are equal to about 28 percent of GDP, but these might be under-reported by about 20 percent. Even when official statistics are used, import penetration appears to be quite high in some industries, for example, 56 percent in heavy industry. Therefore even before accession to the WTO, Russian firms confront significant competition from imported goods.

• **Tariffs.** Since the mid-1990s Russia has not had quantitative barriers to trade in place and tariffs are the only trade barriers. Tariffs are imposed on both imports and exports. The level of import tariffs throughout the second half of the 1990s was less than 30 percent for most goods. The tariff rates structure was extremely complicated until early 2002, when Russia undertook a major effort to unify tariffs. Currently commodities are divided into four subgroups with marginal tariff rates of 5, 10, 15, and 20 percent, respectively. Major exemptions are spirits (100 percent), cigarettes (30 percent), sugar (30 percent), and automobiles (25 percent). However, collection has been poor, and in 1999 the amount actually collected was about half of what should have been amassed. Note, however, that the customs service has made substantial efforts to improve tariff collection rates in recent years.

• **Nontariff barriers: licensing and certification, customs valuation procedures.** Measures aimed at improving tariff collection rates include not only the unification of tariff rates, but also certification and licensing requirements for imports of goods with low tariff rates and regulation of minimal customs values of imported goods; however, because of corruption among customs officials such measures have not proven effective and only add to the bureaucracy and create more opportunities for corruption. Survey evidence shows that the complexity of customs procedures has become one of the most serious barriers to foreign direct investment. We plan to study the differences between Russian customs regulations and WTO rules to assess the effects of changing customs procedures on the volume and structure of foreign trade.

What level of protection will be maintained after WTO accession is as yet unclear. Russia's previous tariff offer envisaged an increase in tariff levels at the time of accession and a decrease to the current level during a grace period of five to seven years; however, thinking that the other negotiating parties will accept such an offer is unrealistic. The government recently decided to change its tariff offer and make it more

liberal. We predict that accession will be followed by a slight decrease in tariff protection in most sectors with the exception of those that have strong lobbying groups, such as automobile production or agriculture. However, if WTO accession improves the efficiency of the customs authorities, a decrease in nominal tariffs may actually mean an increase in tariff protection in practice. In any case, simplifying customs procedures and enhancing transparency may have positive effects on imports organized directly by foreign companies.

Output and Employment Trends

The government is keen to ascertain the likely short- and long-run effects of WTO accession on production and employment. Long-run effects can be estimated by constructing a model as done by David Tarr of the World Bank, and we plan to use some of his predictions in our future work. However, adjustments to the long-run equilibrium in Russia can take a fairly long time, thus partial equilibrium results can be useful for deriving estimates of the short-run effects. By estimating Tarr's equation, which directly connects imports and production or employment for 1993-96, we can report some preliminary results. (Note that we must use the equation because the available information on the prices of imports and domestic counterparts is inadequate.)

Many Russian economists and business people are convinced that trade openness was the major factor behind the output decline of the mid-1990s. Consequently they fear that accession will result in another serious output decline and increase in unemployment (see Centre for Financial and Economic Research and Club 2015, "Russia in the WTO: Myths and Reality," *Transition*, September 2001, p. 39). Testing the hypothesis that output declined in 1993-96 as a result of trade liberalization and limiting our attention to the effect of increased imports on manufacturing, our results are as follows:

- Trade liberalization was an important reason for the output decline. Those industries whose share of imports in consumption was high in 1994 experienced the largest decline in the early transition years. This result can be attributed to these industries' low level of competitiveness.
- The decline in complex industries could have taken place because of their poor ability to withstand foreign competition and not because of their disorganization. Another possibility is the reversed causality explanation, that is, the share of imports in complex industries was high because supply fell short of demand because of their disorganization.
- Monopolies fared much better than other firms.
- Firms that received subsidies from the federal budget experienced smaller output declines than firms that did not, while subsidies from regional governments had positive effects only on firms in the food industry.
- Surprisingly, the effect of small-scale privatization was negative and significant in some branches of machine building, as well as in construction, light industry, and chemical industries. Possibly in some cases enterprise managers found that it was more profitable to rent out offices in their buildings instead of continuing with production.

Some of our results contradict the theory that reform progress is beneficial for growth, and even provide evidence for the counterargument that reforms initially have a destructive effect on growth. The literature on growth in transition economies has not yet provided an answer as to which of these two effects is dominant. Our results suggest that at the initial stages of transition reforms could have had a destructive effect on large and medium firms; however, reforms can lead to faster restructuring of those firms more eager to introduce reforms during the early stages of transition.

Our results have a number of implications for the WTO accession debate. While the trade liberalization of the 1990s seems to have had a negative effect across sectors, disorganization was a more important factor in some of the machine building industries and in light industry, so the overall decline cannot be attributed to the opening up of the economy. The important issue is the extent to which Russian industry has restructured since that time, and therefore how big the WTO accession shock is likely to be.

Our results demonstrate that employment in firms that competed with imports in 1996 experienced the smallest decline among all industries during 1996-2000. Thus the completely uncompetitive industries had apparently already disappeared following the 1990s trade liberalization, and thus WTO accession will not have a detrimental effect on the remaining industries. On the contrary, as WTO accession makes lobbying for protection a less rewarding activity than restructuring, we also expect WTO accession to have a substantive positive effect on restructuring. As mentioned earlier, we leave the evaluation of differences in short-run effects for future work.

Mixed Effects on Productivity

One of the most important effects that WTO accession can have will be its effects on the productivity of domestic

firms in the medium term, but economic theory does not allow us to give clear predictions about the direction and size of the effects. Advocates of the infant industry argument claim that competition with imported goods can prevent a country from developing an industry where learning by doing and economy of scale effects are important. This argument is often used by various lobbying groups in Russia, whose members claim that for domestic industry to develop, it must be protected for a sufficiently long period of time. However, trade openness is likely to have a positive influence on the total factor productivity (TFP) of Russian firms, admittedly with some time lag, for a number of reasons, namely:

- Increasing trade flows imply an increase in competition, which in turn can force Russian firms to restructure faster.
- Increasing imports involves increasing information about foreign goods and technologies, which can have positive spillover effects on domestic firms, as predicted by modern economic growth theory and confirmed by empirical papers on developing countries.
- Increasing imports of foreign inputs can have an indirect effect on the TFP of domestic firms. The experience of some other countries has shown that the positive effects of trade policy reforms often dominate in the medium and long run.

Our estimates show that TFP started to grow in almost all industries in the late 1990s. Moreover, the growth was more pronounced in large and medium firms than in small enterprises. The percentage of firms with positive TFP growth increased from around 20 percent to more than 50 percent in the last two years of the sample. We conducted a rough test of the effects of import competition on the productivity, output, labor, and capital of Russian firms in 1996-2000, and some of the results are as follows:

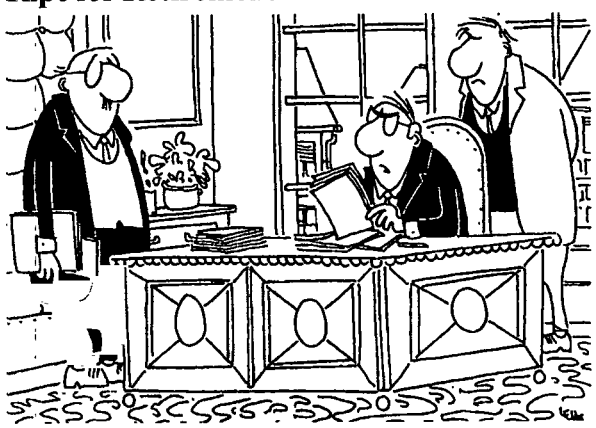
- Firms in industries with high levels of imports showed the highest TFP increase during the period under consideration, and this is the only group of firms for which overall TFP growth was positive.
- Export industries experienced a pronounced decline in TFP during this period despite the substantial increase in output in the previous couple of years. This was a surprising finding.
- TFP stagnated in nontraded goods industries and in industries with lower shares of imports in total demand.
- In 1999-2000 all industries experienced increases in output, employment, and investment.

For the years prior to 1997 we were able to conduct a more rigorous test of the effects of foreign trade on the TFP of domestic firms. We concluded that increased import penetration either has no immediate significant effect on productivity, or if it does, then it is negative in line with the effect on output. Trade liberalization initially resulted in a decline in TFP, but perhaps the positive effects of import penetration on productivity occur only with a delay. Firms need time to adjust their production methods and to introduce new, more competitive products. We also concluded that the larger a company's market share, the less productivity increases as a result of trade liberalization. This result was expected, because it confirms the hypothesis that monopolistic firms have weaker incentives to restructure.

As far as WTO accession is concerned, our results suggest that it could boost restructuring by Russian firms. With increased international competition and better access to imported components and foreign consumer markets, Russian firms will become more productive and efficient.

Ksenia Yudaeva is the Acting Academic Director at the Centre for Financial and Economic Research (CEFIR) and is a Centre for Economic Policy Research affiliate. Evgenia Bessonova and Konstantin Kozlov are researchers at CEFIR. This article presents some results of the authors' study of the effects of the trade reform of the 1990s on domestic firms, along with some implications of WTO accession for Russian industry. This project, funded by the Swedish International Development Cooperation Agency, started in late 2001. It has two main goals: to take stock of current research and policy advice work in relation to Russia's accession to the WTO and to analyze the potential effects of accession on Russian industry.

Ripe for Retirement



"It seems to me that you are unable to adapt to the modern age, your precise and impeccable bookkeeping is disgusting."

From the Hungarian magazine *Hócipõ*

The William Davidson Institute
The World Bank
in cooperation with
SITE and WDI

THE WILLIAM DAVIDSON INSTITUTE
AT THE UNIVERSITY OF MICHIGAN BUSINESS SCHOOL

A Symposium on Outstanding Issues of Transition Economics

The winter 2002 issue of the Journal of Economic Perspectives (vol. 16, no. 1) featured five articles by research fellows of the William Davidson Institute (WDI) that summarized their evaluation of the main outstanding issues in the economic transformation that is now more than 10 years old. The papers are summarized below and are all available in the WDI working paper series.

Transition Economies: Performances and Challenges

By Jan Svejnar

This paper assesses the strategies and outcomes of the first 12 years of the transition from plan to market and outlines the principle challenges the transition economies face. It compares the performance of five Central European countries—the Czech Republic, Hungary, Poland, Slovakia, and Slovenia—with that of Russia during the same period. For comparison it also refers to three other groups: the Baltic countries of Estonia, Latvia, and Lithuania; the Balkan or Southeast European countries of Albania, Bulgaria, and Romania; and Ukraine as the second largest economy of the former Soviet Union. The overall assessment is that the countries' performance during the first 12 years of the transition has been poor. While important structural transformations have taken place, the relative gap in per capita income between these countries and the advanced economies has widened. A major problem was clearly the initial recession that set these countries back relative to the advanced economies.

Transition countries further east have, on average, performed worse than their more western counterparts, which suggests that geography-related initial conditions have been important in the transition process. The Central European countries, the most western of the transition economies, have historically shared the same alphabet and religions, had similar educational and bureaucratic systems, and intensively traded and otherwise interacted with countries in Western Europe. Together with the Balkan countries they were under the Soviet system for only four decades, compared with five decades for the Baltic countries and seven decades for the CIS countries. Finally, the countries of Central Europe were the first to aspire to and be encouraged to prepare for entry to the EU. Their physical proximity to and historical association with Europe seems to have given the western transition economies an important advantage in moving from the Soviet-style system to a democratic and market-oriented system. However, given that the western-most transition economy, the Czech Republic, has performed worse than others since the mid-1990s indicates that geography does not provide a complete explanation and that policies do matter.

Policymakers in the former Soviet bloc formulated transition strategies that focused on macroeconomic stabilization and microeconomic restructuring, along with institutional and political reforms. The implementation of these strategies varied across countries in terms of speed and specifics. A major debate took place about the merits of fast or "big bang" reform versus gradual reform, but as it turned out, almost all the transition governments plunged ahead in rapid big bang style with what the paper defines as Type I reforms. However, significant policy differences ensued in what the paper refers to as Type II reforms, which only some governments carried out.

Type I reforms include undertaking macroeconomic stabilization; liberalizing prices; reducing direct subsidies; breaking up trusts, state-owned enterprises, and the monobank system; removing barriers to the creation of

new firms; carrying out small-scale privatization; and introducing social safety nets. All these reforms were, for the most part, carried out quickly by all the transition countries. Type II reforms, by contrast, were implemented differently by the various transition countries. These reforms include engaging in large-scale privatization; pursing further, in-depth development of a commercial banking sector and an effective tax system; putting in place labor market regulations and institutions related to the social safety net; and establishing and enforcing a market-oriented legal system and accompanying institutions.

A natural question to ask is when transition is likely to be completed. The answer depends on how one defines the terminal point. A number of analysts are on record on this issue and their definitions differ considerably. The perspective of this paper suggests that most citizens of the transition countries do not feel that they have accomplished the transition. The paper suggests that this is because most have been implicitly equating the transition with a process that will make them partners with the relatively advanced countries in general, and with Western Europe in particular. Taking this into account, the end of transition is defined as a state when these economies replace central planning with a functioning market system, and when they generate rapid and sustainable rates of economic growth that enable them to interact with the more advanced market economies without major forms of protection. The Czech Republic, Estonia, Hungary, Poland, Slovenia, and possibly Slovakia will probably reach this stage in a few years when they enter the EU. Others have a much longer way to go.

Jan Svejnar is WDI's executive director and Everett E. Berg is a professor of business administration and of economics at the University of Michigan. The article on which this summary is based first appeared as WDI Working Paper no. 415.

The Political Economy of Transition

By Gérard Roland

The theory of the political economy of transition is part of a recent trend in economic research that attempts to integrate the political process into the analysis of economic problems. Political economy issues are being introduced and analyzed in all areas of economics: trade, macroeconomic policy, regulation, public finances, financial economics, labor, and others. The tools of game theory developed in recent decades now allow research to integrate the analysis of economic and political processes using unified tools of analysis. The overriding importance of political constraints in the transition process has led to developments in the theory of the political economy of reform. What are the main insights from that theory? How does it reflect the transition reality? What have we learned and what do we still need to learn? This article attempts to answer these questions.

Political economy arguments have been at the heart of debates and controversies about strategies of transition from socialism to capitalism. For example, advocates of a big bang approach to transition argued for a fast and comprehensive implementation of all major reforms. Speed was of the essence, they argued, because there was a "window of opportunity" (or a "honeymoon period" or a "period of exceptional politics") created by the establishment of democracy. During this period, they maintained, governments should adopt reforms as fast as possible and attempt to make them irreversible.

On the other side, those who opposed the big bang approach often advocated a gradualist strategy that emphasized the need for a precise sequencing of reforms. The political economy argument in favor of gradualism was that an appropriate sequencing of reforms would provide demonstrated successes to build upon, thereby creating constituencies for further reforms. In China the success of decollectivization built support for later reforms. Similarly, the thinking in Central and Eastern Europe was that successful entry of small and medium enterprises could build support for later reforms in the state sector.

Political economy arguments, in addition to shedding light on the pace and sequencing of reforms, have also been extensively used to explain or justify many aspects of the transition process. For example, mass privatization involving the giveaway of state assets to citizens (as in the Czech Republic) or to workers (as in Russia) was designed to overcome political constraints to transition. To take another example, China implemented so-called dual-track liberalization, under which plan contracts between enterprises are maintained, but frozen at a pre-existing level, and price liberalization is

implemented "at the margin" for any production beyond the planned contract. The political economy argument for dual-track liberalization is that it was a way to liberalize prices without eliminating the pre-existing rents of economic agents.

Political economy arguments have also been used to explain the striking difference in economic performance across transition countries. While all transition economies experienced a fall in output at the start of the process, most countries in Central and Eastern Europe recovered after a few years, while Russia and most former Soviet Union countries (apart from the Baltic states of Estonia, Latvia, and Lithuania) saw little or no recovery of growth through most of the 1990s. One political economy argument often made is that the extent of state capture and rent-seeking was much more important in the former Soviet Union countries than in Central Europe and that this difference goes a long way in explaining differences in output performance. Another political economy argument suggests that Central European countries expected to access the EU, which enhanced their incentives to change the systems of law enforcement, law compliance, and protection of property rights, while in former Soviet Union countries, where prospects of accession to the EU were virtually nil, no such incentives existed.

Policymakers often refer to the transition economies of the former Soviet Union and Central and Eastern Europe, but for these countries far more than the economy is involved in transition. They are also creating institutions of democracy and governance, including the executive, legislative, and judiciary branches of government; a free press; new social norms and values; an openness to private organizations and to entrepreneurship; a network of regulators; and a new network of contractual relationships, both domestically and abroad. The economic transition is intimately related with these institutional transformations.

In this setting economists have often gone astray in their analysis of transition economies by examining only economic factors and ignoring these deep institutional transformations. Successful institutions of capitalism are already present in advanced economies and we tend to take them for granted when analyzing economies in transition or developing economies where such institutions are absent. The transition experience has therefore reinforced the institutionalist perspective in economics and engendered a shift in emphasis in economic thinking, from the analysis of markets and price theory to that of contracting and to the legal, social, and political environment of contracting. Moreover, transition has also forced us to think about institutions not in a static way, but in a dynamic way: how momentum for reform is created and how institutions can evolve, but also how momentum can be lost and how one can get stuck with inefficient institutions. These questions, addressed by the political economy perspective, have become central in understanding how successful capitalism can emerge. The transition countries started this process of change from specific initial conditions, but the questions addressed by transition go far beyond the transition process itself.

Gérard Roland is a professor of economics at the University of California at Berkeley, codirector of the Transition Economies Program of the Center for Economic Policy Research, and a WDI research fellow. This article is a summary of the author's study first published as WDI Working Paper no. 413.

Institutional Determinants of Labor Reallocation in Transition Countries

By Tito Boeri and Katherine Terrell

The transition process from planned economies to market-oriented economies involves a substantial reallocation of labor. In the planned economies employment was typically concentrated in heavy industry, away from consumers' preferences. A strong small business sector was lacking, and private initiative had been tolerated almost exclusively in agriculture. Patterns of foreign trade were determined by economic planners within the framework of the Council for Mutual Economic Assistance. In the process of transition, employment had to flow out of such sectors as state-owned heavy industry into the new private, mostly small-scale, business sector. The success of transition in a given country can be assessed in part by how well it has addressed the problem of reallocating labor.

One of the reasons why studying the experience of transition economies is so interesting is their wide range of experience with the reallocation of labor. Comparing adjustment trajectories across countries and time provides

several useful insights, from which two key patterns can be discerned. On the one hand, the countries created from former republics of the Soviet Union typically display L-shaped patterns of GDP since the beginning of transition—that is, a sharp decline and then a leveling out at the lower level—although some recent signs of a possible upturn are apparent. They have also seen relatively little decline in employment, marked declines in labor productivity and real wages, relatively large turnover of the unemployment pool, and relatively small reallocations of jobs between the old and the new sectors. On the other hand, most economies of Central and Eastern Europe saw more U-shaped patterns of GDP, with employment falling substantially at the initial stages of the transition process, with consequently lower declines in labor productivity.

The recovery started earlier in the Central and Eastern European countries and was more pronounced than in the former Soviet Union. However, along with a fairly rapid degree of structural change, these countries have also experienced desperately stagnant unemployment. Between these two polar adjustment trajectories, there are some intermediate cases, such as the Czech Republic and Estonia. The former, unique among the Central and Eastern European countries, experienced a long period of low unemployment. The latter, unlike other former Soviet Republics, displayed significant labor reallocation from the beginning of the transition process.

How can such differences in adjustment trajectories be explained? Can they be attributed to different macroeconomic policies or are they a by product of institutional asymmetries between the countries of Central and Eastern Europe and of the former Soviet Union? Unlike previous literature, which focused mainly on the timing of liberalization and privatization, along with the so-called "optimal speed of transition literature," this paper primarily explores institutional determinants of these asymmetric patterns of GDP, employment, and labor reallocation. From this perspective the paper offers tentative answers to four questions.

Why was labor market adjustment so different in the countries of Central and Eastern Europe and of the former Soviet Union? One main explanation involves the different models of social policy that these two groups of countries adopted. [Editor's Note: The replacement model the countries of Central and Eastern Europe followed assigned a much greater role to unemployment benefits than the model the former Soviet Union countries followed.] The higher level of nonemployment benefits implied floors to wage distributions and prevented a further decline of wages. Thus wages adjusted more in the countries of the former Soviet Union and employment quantities adjusted more in Central and Eastern Europe. Given the need to have labor move to a new sector, the wage adjustment strategy was less successful that the adjustment in employment levels. While we do not rule out the possibility that other institutions may also have played an important role in the wage-employment tradeoff—information and research on institutional effects is sketchy at this time—cross-country differences in the design and generosity of nonemployment benefits are consistent with this explanation of the different adjustment trajectories.

Why was the model of social policy and labor market adjustment used in Central and Eastern Europe more conducive to structural change than the model used in the countries of the former Soviet Union? The wage floor imposed by nonemployment benefits in the countries of Central and Eastern Europe meant that old and inefficient firms were forced to shed their least productive labor rather than being allowed to adjust wages downwards, or even to accumulate wage arrears, as occurred in Russia. Nonemployment benefits also imposed a wage floor in the private sector, which made jobs in the new gap-filling, retail service sector more attractive, but at the same time more difficult for the least skilled workers to obtain, and hence created more unemployment among this group. However, nonemployment benefits also operated as a subsidy to job creation in the new sector, as the self-employed and the new small business sector were allowed to combine benefits and earnings from work, thereby obtaining explicit or hidden seed capital for the start-up of new entrepreneurial activities. Overall, nonemployment benefits contributed to more quantity adjustment, as opposed to price adjustment, in the countries of Central and Eastern Europe. This quantity adjustment implied faster structural change, which in turn allowed for stronger growth sooner than in the countries of the former Soviet Union.

Why were these two different social policy models adopted by countries starting from similar initial conditions and having the opportunity to introduce nonemployment benefits from scratch? Further work taking a political economy perspective will have to address this issue. At least at first sight, it is difficult to attribute the cross-country variation in the size and composition of social spending to differences in the degree of aversion to inequality, because the countries' historical and cultural roots were similar, as were their past records of income inequality. Differences in the degree of economic development or access to international capital markets that made it more difficult for the former Soviet Union to sustain large social policy outlays cannot entirely explain the

differences in the policy mix. The budget of the Russian Federal Employment Service, which was responsible for paying unemployment benefits, was in surplus until the mid-1990s. Rather than accumulating surpluses, such funds could have been used to improve the level of benefits or the number of people covered.

People who quit their jobs voluntarily, as opposed to being laid-off, were the dominant component of separations from state enterprises both in the former Soviet Union and in Central and Eastern Europe. Hence the greater importance attributed to unemployment benefits in countries like the former Czechoslovakia, Hungary, and Poland than in Russia cannot be attributed to political pressures coming from workers laid off at the outset of transition. The most convincing explanation for these differences in policy models may be that the countries of Central and Eastern Europe were more culturally and politically drawn to the EU social policy model than were the countries of the former Soviet Union. Central and Eastern European countries were also faster than the former Soviet Union in developing broadly based electoral systems. This is likely to have reduced the degree of freedom of governments in allowing for huge and persistent wage declines.

Which of the two main models of labor market adjustment is preferable? A higher level of nonemployment benefits helped to encourage structural change and to reduce income inequality, but it also generated more unemployment—and more long-term unemployment—in the countries of Central and Eastern Europe than in the countries of the former Soviet Union. The overall balance would seem to be in favor of the labor market adjustment approach used in Central and Eastern Europe. In countries that have weak wage bargaining institutions and little ability to enforce minimum wage laws, unemployment benefits put a floor under wage setting. Contrary to conventional wisdom, constraining from below wage flexibility may foster, rather than hinder, structural change. But a warning is in order here: this does not mean that in the transition to a market economy it is always advisable to have institutions containing the growth of wage inequality. The former East Germany, for example, imported centralized wage bargaining institutions from West Germany that raised and compressed the whole earning structure, which hindered restructuring and employment gains.

Tito Boeri is a professor of economics at Innocenzo Gasparini Institute for Economic Research-Bocconi, a research fellow of the Center for Economic Policy Research, and a WDI research fellow. He is also director of the Rodolfo Debenedetti Foundation. Katherine Terrell is a professor of economics at the University of Michigan, with a joint appointment at the Business School and the Ford School of Public Policy, and a WDI director for labor and human resources. She is also an associate fellow at the Center for Economic Policy Research. This article is a summary of the authors' study first published as WDI Working Paper no. 384.

Competition and Corporate Governance in Transition Countries

By Saul Estrin

Improved enterprise performance must be at the heart of any successful transition from a command to a market-oriented economy. The standard pattern in the transition economies has been to seek to improve companies by heightening competition and enhancing corporate governance in various ways: by privatizing state-owned firms; by allowing and encouraging new firms and competition between existing firms; and by withdrawing government subsidies so that firms must face their own profits and losses, or what the literature refers to as a hard budget constraint. However, this pattern has had mixed success. The ability of these reforms to improve corporate performance appears highly sensitive to the institutional environment and initial conditions in which the policies were introduced, along with the specific nature of the policies enacted.

This paper explores the elements of institutional development critical to the enhancement of company performance in transition economies. These include the initial conditions; the forms of privatization; the institutional and legal framework, especially the corporate governance structure; the relationship between the private sector and the state; and the competitiveness of product markets, including the impact of international trade.

Policies and Enterprise Reform: Empirical Findings

A substantial literature is now available on the determinants of enterprise restructuring in transition economies. The main results outlined in this literature are as follows:

- The impact of privatization on the performance of firms in transition economies has, for the most part, been positive; however, the privatization effect is significantly stronger in Central Europe than in Russia and the CIS countries. In most cases,the impact is around twice the size.
- The empirical evidence confirms the expectation that the identity of the eventual owner affects the outcome of privatization. Privatization to investment funds is five times as productive as privatization to insiders, and privatization to foreigners or blockholders is three times as productive as privatization to insiders. On average, banks and blockholders improve company performance about as much as foreign owners. One interpretation of these findings is that the concentration of ownership is crucial, because blockholders, funds, foreigners, and banks all have concentrated holdings.
- The impact of differences in corporate governance on enterprise performance is hard to test; however, studies that have focused on managerial turnover suggest that new managers lead to higher productivity: by 6.2 percent in the Czech Republic and 7.3 percent in Central Europe. Similarly, managerial bonus schemes appear to raise total factor productivity: doubling managers' bonuses increases total factor productivity growth by 7.4 percent.
- The studies suggest that both domestic and import competition play a significant role in improving company performance, thus product market competition has proved to be another important factor in raising companies' productivity. However, once again the effects are more robust for Central Europe.
- The hardness of budget constraints is also an important factor in stimulating enterprise restructuring. Early studies of Poland found that restructuring occurred in state-owned firms prior to privatization if budget constraints were hard. Ten papers have explored the issue econometrically, and they confirm the positive impact of hard budget constraints on total factor productivity, productivity, or sales growth. Again, the effect is highly significant in the studies of the non-CIS countries, but less consistent for Russia and the CIS states. It is harder to measure the impact of indirect soft budget constraints; however, policies that sever the links between important economic institutions and the state, like privatizing utilities or the banking sector, probably enhance enterprise performance. Hence the private sector's share of GDP may itself be an important influence on the impact of privatization.

Conclusions

The transition countries began with very different initial conditions and have since employed a variety of policies with respect to privatization, price and trade liberalization, competition, and enterprise support. A few conclusions emerge from this survey of the determinants of enterprise performance.

Initial conditions, in the sense of the degree of central planning or the extent of structural macroeconomic imbalances, do not appear to have been a fundamental determinant of either the reform path chosen or of subsequent economic performance. Those economies that were relatively more reformed before the transition—like Hungary, Poland, and Slovenia—along with relatively less reformed ones—like the Czech Republic and some countries that were formerly part of the Soviet Union like Estonia, and Latvia—are all current leaders among the transition economies. However, none of the initially advanced countries have fallen seriously behind.

There does appear to be a sharp distinction in terms of the policies followed and their impact between Central Europe on the one hand, and Russia and the CIS countries on the other. The reasons for these divergences are complex, and may stem from fundamentally different political attitudes toward reform. The economies of Central Europe were led by legitimate governments elected on platforms of reform, while the reformers in Russia and many of the CIS countries represented a small but powerful political group that was advising the president, but was opposed by much of the parliamentary and civil service structure. Moreover, governments in Russia and other CIS countries had to make compromises in introducing policies to build internal political support for reform, perhaps because they faced more deeply entrenched managerial interests. This pattern resulted in reforms that were less conducive to improved enterprise performance and restructuring, notably with respect to privatization methods, corporate governance, competition, and subsidies. Moreover, many Central European countries wanted to join the EU, which provided their governments with additional legitimacy when adopting Western European laws and institutions. Taken together, these factors imply inferior performance in economic restructuring in Russia and the CIS.

Finally, transition policies underlying enterprise restructuring must be regarded as complements to each other, not substitutes. Privatization alone will be insufficient. Enterprise reform will also require effective corporate governance and hard budget constraints.

Saul Estrin is deputy dean and professor of economics at the London Business School and a WDI research fellow. This article is a summary of the author's study first published as WDI Working Paper no. 431.

Research Data from Transition Economies

By Randall K. Filer and Jan Hanousek

More than 10 years into the transition from communism in the countries of the former Soviet Union and Central and Eastern Europe, a cursory search of the EconLit database turns up hundreds of empirical studies published in refereed journals that deal with various issues in transition economies. Even so, we suspect that many economists are prevented from making full use of the possibilities offered by the transition because of the difficulties of obtaining and interpreting data from the region. The purpose of this brief essay is to suggest possible sources for data that can be used for economic analysis, as well as some general cautions regarding the use of these data.

Many transition countries of the former Soviet Union and Central and Eastern Europe have been rapidly reforming and increasing the capabilities of their statistical offices, and there are now few difficulties involved in obtaining macroeconomic data from throughout the region. Problems with respect to macroeconomic data occur not in obtaining these data, but in using them intelligently. The sources, coverage, and quality of macroeconomic data in the transition economies have varied dramatically over the past decade. Many researchers have used data from the region as if their coverage and quality were consistent over the past decade, despite the massive evidence to the contrary. These differences and changes over time in the data call into question almost all cross-country comparisons based on official aggregate data. Given the wide availability and questionable nature of aggregate macroeconomic data, this essay focuses primarily on the microeconomic datasets that are increasingly becoming available across the region.

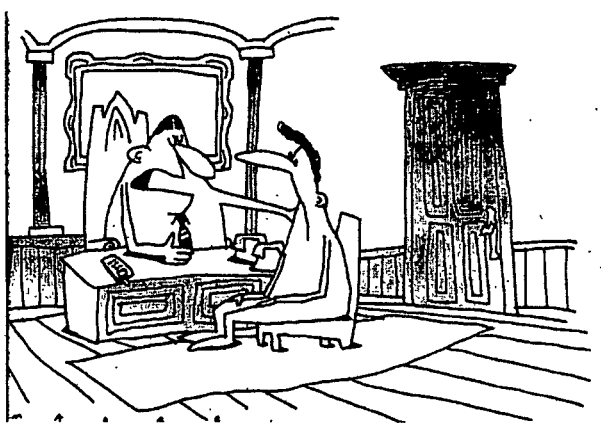
Access to microeconomic data on individuals and firms from the transition economies is difficult. The concept of free—or marginal cost—access for scholars to publicly collected data is only slowly penetrating the region. Many government statistical offices, constantly strapped for cash, see presumably rich Western academics as a source of budget enhancement. Rather than establishing price lists for access to various datasets, offices appear to be acting as sophisticated price discriminators, negotiating widely variable prices based on presumed willingness to pay. Nonetheless, researchers willing to make the effort can obtain a wealth of data. Furthermore, conventional market research survey firms have been established throughout the region. These firms provide another opportunity for scholars, who often find it highly cost-effective to add study-specific questions to ongoing random population surveys. Similarly, original surveys are feasible with modest support in even the least developed transition economies.

Scholars who ignore the unique problems of data in the transition countries run a serious risk of findings that are at best meaningless, and at worst totally inaccurate. The paper provides a sample of some common problems researchers might encounter while using data from these sources. The bottom line is that when working with data from the transition countries, paying careful attention to the details of how the data were collected and the exact wording of questions and sample design is even more important than usual.

These cautions are intended to flag the need to pay special attention to the idiosyncrasies and anomalies of data from the transition economies. They are not meant to deny the fact that the wealth of data available in the region presents innumerable new opportunities for empirical economics.

Randall K. Filer is a professor of economics at Hunter College; the Graduate Center, City University of New York; and The Center for Economic Research and Graduate Education (CERGE-EI), Prague, and a WDI associate fellow. Jan Hanousek is an associate professor of economics, CERGE-EI, Prague, and a WDI research fellow. This article is a summary of the authors' study published as WDI Working Paper no. 416.

Selection Criteria



"I need intelligent, independently thinking colleagues who know when I need applause, enthusiasiam, or cheers and praise during my speech."

From the Hungarian Daily *Népszabadság*

Articles provided by:

The Urban Institute
A NONPARTISAN ECONOMIC AND SOCIAL POLICY RESEARCH ORGANIZATION

Poor Decentralization Policy Burdens Poland's Social Services

By Janelle Kerlin

Poland's mid-level decentralization reform in 1999 was an immense undertaking that included administrative, political, and fiscal decentralization, as well as territorial re-division of the state. The goals of the reform were to bring government closer to the people, improve public services, and further "decommunize" the public bureaucracy. However, a closer look at the level of social services provision reveals many unfulfilled promises and unintended consequences of decentralization.

New family assistance centers set up in the counties were assigned many tasks without sufficient funds for full implementation. Funding for services varied depending on whether they were provided in urban or more rural areas. Given their limited fiscal autonomy, county and provincial governments were unable to direct services according to the preferences of their respective regions. Many of these outcomes can be traced to the politics of decentralization that created poor decentralization policy.

In mid-2000 the impact of decentralization on social service delivery was examined using a nationwide representative survey of managers in 200 public social service offices. While the survey was also conducted in provincial and municipal social service offices, it focused mainly on services administered by the newly established county family assistance centers. Their responsibilities included referral services to residential nursing homes, crisis intervention (domestic violence), counseling services, services for the disabled, foster care, and community integration services for youth.

The purpose of the survey was to determine the degree to which the overall goals of decentralization had been achieved in the area of social services. Survey questions asked about the degree of implementation of reform, the level of funding, the influence of civil society and societal oversight, and the influence of county elections. The survey also asked about changes in accessibility, flow of information between levels of government, and professional versus political criteria used in the selection of new directors of the county family assistance centers.

The results showed that unsatisfactory outcomes in many of these areas were due to poor decentralization policy, including policy that did not address the goals of the reform; policy that addressed reform goals in one area, but worked at cross-purposes with goals in other areas; and policy that was written without sufficient foresight or knowledge. About three-quarters of decentralization policy that affected social services was found to have these shortcomings.

The study turned to the development of the reform to learn why decentralization policy was so off base. Poor decentralization policy that did not address goals of the reform was found mainly in the area of reform finance. Regulations addressing the finances of the reform had been written by a small group of officials in the Ministry of Finance who had purposely excluded other stakeholders from participation, such as representatives of local government organizations, members of Parliament, government officials, and even staff of other departments within the Finance Ministry. The result was that no one would agree to the legislation when it came time for it to be passed, because their concerns had not been taken into consideration. With no time left, Parliament had to pass "temporary" legislation that, rather than decentralizing finances to the authority of new subnational governments, kept finance authority at the central level as it had been previously. Thus policy on reform finance did not meet a reform goal for fiscal decentralization and subsequent fiscal autonomy for new subnational governments. In addition, policymakers who had deliberately isolated themselves manipulated the substitute reform to their own ends, resulting in other deviant policy that underfunded central transfers for decentralized services.

Poor decentralization policy was also found where policy addressed reform goals in one area, but worked

The World Bank in cooperation with SIPE and WBI
The Urban Institute

at cross-purposes with goals in other areas. For example, two of the main goals of the reform were to bring government closer to the people and improve the efficiency of public service administration. However, to achieve support for decentralization that would bring government closer to the people, reformers felt that they had to compromise with citizen groups that demanded an inefficiently large number of counties. The result was that even though the first goal of bringing government closer to the people was achieved, the second, improving administrative efficiency, was not.

Also at times policymakers did not foresee how broader reform could negatively affect policy for a given sector. For example, even though many programs and services were decentralized to newly-restored, self-governing counties, central government field offices remained at the provincial level. When the number of provinces was reduced from 49 to 16 to harmonize Poland's provincial structure with that in Western Europe, these provincial offices were, in effect, centralized in relation to municipal social service offices. As a result, social service workers at the municipal level had a much more difficult time communicating with provincial offices when difficulties arose with centrally-funded benefits and programs.

This analysis shows that increasing citizen involvement and improving public services at the subnational level through national-level democracy can be elusive. While scholars of decentralization may prescribe the specific factors needed to achieve expected outcomes, the politics of reform can prevent these factors from coming together simultaneously, or even from materializing at all.

Janelle Kerlin is a visiting dissertation fellow at the Urban Institute. This article is based on her dissertation, "The Political Means and Social Service Ends of Decentralization in Poland." For more information contact the author at jkerlin@ui.urban.org.

Measuring and Evaluating Transition: The Blessing and Curse of Indicators

By Iván Tosics

During the first half of the 1990s the countries of Central and Eastern Europe (CEE) took many fundamental decisions influenced mainly by political considerations, including changing property ownership structures, price structures, and social subsidies. The speed and depth of changes was unprecedented. In some CEE countries, for example, the privatization of the entire stock of public rental housing happened as a result of a political decision from one day to the next. Under such circumstances ongoing, comprehensive analysis of the changes and their consequences was impossible. Moreover, domestic political forces, usually planning only for the short term, were not interested in such analysis.

In 1993 the World Bank contracted the Metropolitan Research Institute (among institutions in three different countries) to work on developing a system of intensive housing indicators. As an outcome of the first promising results, at the end of 1994 the World Bank decided that CEE countries would apply the housing and urban indicators in their preparatory work for the Habitat II project. This project, sponsored by the U.S. Agency for International Development with additional help from UNCHS/Habitat and the Economic Commission of Europe, was carried out between 1994 and 1996 and covered 12 CEE countries.

In contrast to many observers' assessments that before the transition the Eastern European housing sector was in crisis because of severe quantitative and qualitative shortages of housing and required massive investment akin to wartime reconstruction to solve its problems, we found little evidence of the validity of this view. (Related research, that is, theoretical work was conducted together with Jozsef Heqedus and Steve Mayo.) Notwithstanding clear problems related to the maintenance and upkeep of the housing stock throughout much of the region, the stock is generally of better quality and better served with infrastructure than the housing stock of most other countries with similar economic resources. Instead, if there was a crisis it was one of disequilibrium: between preferences, ability to pay, and outcomes; between institutional structures, incentive systems, and the requirements of a well-functioning housing sector capable of meeting the needs of all citizens. During the years of the transition the inadequacies of the Eastern

European housing model have become clear, and a major process of restructuring the sector has begun.

In the framework of the intensive indicators project not only were the 11 key housing indicators calculated for 250 cities worldwide, but also new indicators were developed that described the special features of housing systems in Central and Eastern Europe. One of these, the indicator to measure the level of ongoing housing expenditures, was the rent to income ratio. This had a traditionally low value in the socialist countries compared with the Western world, and by the mid-1990s it was still at around 5 percent of incomes. However, concluding that transition did not result in any change regarding people's expenditures on housing would have been a mistake. In reality it did, because payments for utilities—energy, water, sewage—increased dramatically from 2 to 3 percent of incomes to around 20 percent.

As a result, the level of combined housing expenditures—rent plus utilities—in the postsocialist cities reached that of Western cities, where rents were high, but utility payments were low compared with incomes. One of the important policy consequences was that the rapid increase in utility prices to world market levels in the postsocialist cities was crowding out the possibilities for increasing rents and maintenance expenditures. This led to further deferrals of the maintenance of multifamily housing. Another consequence was a rapid increase in arrears. The mass privatization policy chosen by many countries in the region did not solve the problem, as low-income families could not deal with the problems, whether as renters or as owners.

The analysis of housing indicators showed that during the transition period, the deterioration of the multifamily housing stock and decreasing affordability were serious problems. Hence the housing policy proposals of that period, which dealt almost exclusively with the problem of housing shortages and directed all subsidies to new construction, were questionable.

In the years following the publication of the indicator results, many experts in the field accepted that—contrary to common perceptions—the housing sector of the Central and Eastern European countries was not in bad shape at the beginning of the transition when compared with the housing situation of countries with similar levels of economic development. The focus of the debates changed from housing shortages to the other problems discovered in the comparative analysis, for example, the future of the privatized multifamily housing stock, the affordability problem, and the financial sector's inefficiency and unwillingness to participate in finding a solution to the housing problems.

Although the conclusions drawn from the indicator analysis were generally well accepted, critics noted that the analysis of the achievements and problems of the housing sector in the CEE countries was based on one-sided initial assumptions, and therefore that the results of the comparisons could not be regarded as the only starting point for devising new policies in these countries. To understand the essence of this criticism and to assess its validity, let us look at the theoretical and methodological aspects of indicators.

Indicators: Statistics with a Policy Aim

Indicators differ from raw data, and also from data processed into statistics, insofar as indicators are statistics directed specifically toward policy concerns that point toward successful policy outcomes. They are usually highly aggregated and have easily recognizable purposes. Indexes are found at an even higher level of the information pyramid, for example, the consumer price index or human development index. These combine different indicators into a single number useful for comparisons over time and space.

According to this definition, the crucial difference between data and indicators is that indicators are valueled from the beginning. Experts who are given the responsibility of developing indicators in a given country at a given moment usually do so for a preselected policy aim, and the indicators they develop are tailored to measure success in achieving this aim. Thus indicators go hand in hand with policies, and are usually developed as part of the policy development cycle.

Included in the World Bank's indicator set was the time needed to obtain a building permit. The assumption was that the shorter the time, the more efficient the housing/urban planning system. The results clearly showed that this assumption was erroneous. While the waiting period is 1 month in Thailand and 12 months in the Netherlands, one cannot conclude that the urban planning system is more efficient in Thailand. To make a correct judgment about the efficiency of the urban planning system would only be possible on the basis of a more detailed theory of efficiency, including the analysis of other circumstances, for example, what factors are examined and taken into consideration when making a decision on building permits (environmental factors, the density

of housing in the area, the level of urban sprawl and/or concentration, the potential external effects, and so on) and what procedures are followed.

Leading housing analysts in the United Kingdom have raised this type of criticism against the World Bank-initiated housing indicators system in more general terms. In many Western European countries, especially in the United Kingdom, the generally market-oriented housing policy has a long tradition of rent control and a huge social rental sector, and policies are increasingly concerned with rehabilitation. These aspects of housing are missing from the housing indicators system.

In 1993 D. Maclennan and K. Gibb, in their study "Political Economy, Applied Welfare Economics and Housing in the UK" wrote: "The Bank's indicator set reflects both an ethical view, namely what housing policies ought to be, as well as a technical view of a housing market's function. The Bank takes the standpoint that housing policy should be concerned with measures to enable housing, land and finance markets to operate competitively and to allow consumers to determine housing choices. The removal of regulatory and monopolistic distortions (and indices of their extent and consequences) and the replacement of tied subsidies with income-targeted housing allowances then come to the centre stage of policy analysis."

According to this view, the World Bank's indicator system measures how a given country is performing from its own standpoint, for example, how open the land market is, how efficiently the administration is working to enable market actors in the development process, how clear competition procedures are. As a result, countries with the best indicator results can proudly state that they are the countries with the best enabling policies helping the development of a free market in housing and urban development. However, it does not follow that these countries have the best housing or urban development policy in general. Other policies may exist in relation to housing based on such principles as social justice or environmental considerations. To measure the effectiveness of such policies would require different indicators.

Why the Housing Indicator Program Collapsed

One can distinguish between more general, top-down developed indicators, usually devised for comparative purposes, and locally relevant, less general indicators developed using broadly based consultative processes. Because of the sharp contrast between these two approaches turning directly from one approach to the other is impossible. This was one reason for the 1996 collapse of the CEE housing indicators program. The promising collaborative work of the experts stopped suddenly after the Habitat II Conference, when the international donors terminated their sponsorship. In this situation the CEE countries themselves should have continued this project; however, this did not happen. It did not occur not because of the economic situation of these countries, but because the project had been almost exclusively organized in a top-down perspective based on outside sponsorship. As a consequence, no local, or even national, entities were interested in continuing the program.

Before the Habitat II + 5 Conference, held in New York in June 2001, the indicators again appeared on Habitat's agenda. A new approach to the indicators program had been elaborated that emphasized the indicators' policy orientation, and that gave preference to a broadly based consultative approach for selecting city indicators instead of highlighting the importance of universal key indicators. The approach also reflected the view that the system could be built using a bottom-up approach instead of a top-down one.

The current new approach of UNCHS/Habitat to the indicators increases the chances that the CEE countries will continue with this exercise. However, to achieve a new commitment from these countries the new methodological approach by itself will not be enough. A new policy framework should also be developed. The indicators should contribute to comparability, with the emphasis on measuring the countries' progress with democratization, economic efficiency, poverty reduction, and other issues. A new system of European urban indicators should also be developed, taking into account the current interest in European urban policy, the process of EU enlargement, and so on. Developing new urban indicators at subnational levels, linking indicators to regional and local issues, is also essential.

Well-established and well-measured indicators could contribute a great deal to the development of economic and social analysis. Preventing misinterpretation of these indicators is up to the researchers, scientists, and advisors.

The author is a researcher and the director of the Metropolitan Research Institute in Budapest. He can be reached at tosics@mri.hu.

Articles provided by:
Bank of Finland
Institute for Economies in Transition

The Importance of Nominal Convergence for EU Candidate Countries

By Marketta Järvinen

The conventional wisdom in EU circles is that candidate countries should focus on real convergence rather than on nominal convergence criteria. While politicians and academics generally agree on this, they differ on how real convergence is best achieved. In candidate countries, by contrast, the discussion tends to center on exchange rate strategies and nominal convergence during the run-up to the European Monetary Union (EMU). Indeed, the discussions between the EU and the candidate countries on the EMU appear to suffer from a certain deafness on both sides. The EU seems to be ignoring the candidate countries' intention to adopt the euro as soon as possible, while the candidate countries have failed to address real convergence issues.

To their credit, the candidate countries have political reality on their side. EU membership will be a political decision, while EMU entry demands the application of economic criteria that do not include real convergence. To ensure that EMU decisions do not become political, as well as the smooth functioning of the enlarged euro area, the relevant EU authorities (finance ministries, the European Central Bank, and EU central banks) need to be prepared to discuss nominal criteria, that is, inflation, interest rates, exchange rates, and public finances, focusing on their sustainable fulfillment. To date, exchange rate regimes have generated the most discussion by far. Inflation has ceased to be a major macroeconomic problem in most countries, and the soundness and sustainability of public finances is gaining more attention through pre-accession economic programs submitted by candidate countries.

The Fiscal Theory of the Price Level

The fiscal theory of the price level appears appropriate for providing a framework for analyzing the interaction between the variables of nominal convergence. It combines monetary and fiscal policies and provides a holistic approach to macroeconomic analysis. Fiscal policy can be either Ricardian (monetary dominant), where primary surpluses, that is, surplus before debt servicing costs, adjust to guarantee fiscal solvency for any sequence of prices, or non-Ricardian (fiscal dominant), where a government's intertemporal budget constraint is satisfied for some, but not all, price paths. An example of an "irresponsible" (non-Ricardian) policy is setting the primary surplus at a fixed level. The Maastricht criteria on deficit and debt force countries into a Ricardian regime. A similar reasoning underlies the Stability and Growth Pact, whereby member states commit to respect the medium-term budgetary objective of positions close to balance or in surplus.

Fiscal Policy and Exchange Rate Regimes

Applying the fiscal theory of the price level in different exchange rate regimes shows that no exchange rate regime in itself can impose fiscal responsibility. Irresponsible fiscal policy affects the price level in all exchange rate regimes. If fiscal policy is responsible, the price level is determined in the traditional way by monetary policy and the fiscal variables have no effect. In a monetary union, irresponsible fiscal policy by one member country raises the price level of the entire union. In the EU context, responsible fiscal policies are essential for the functioning of the EMU, which is probably why the EU has agreed on the Stability and Growth Pact. If the exchange rate is to be credibly fixed within the new exchange rate mechanism (ERM II), the candidate country must conduct responsible fiscal policy or exit the peg.

[Editor's note: The countries not participating in the euro area will still be using their national currencies. To prepare these currencies for later participation in the euro area while helping to ensure exchange rate discipline throughout the EU, the ERM II was introduced on January 1, 1999. Its main feature is that the currencies

of the participating countries will have a central rate against the euro. The standard fluctuation margins will be of +/- 15 percent, although the determination of narrower margins is possible. Intervention support from the European Central Bank to any currency of a participating country is, in principle, automatic.] The accession countries will probably join the ERM II before adopting the euro.

The requirement for responsible policies is naturally strengthened by the Maastricht criteria (fiscal responsibility and price and exchange rate stability).

For the pre-ERM II period, countries with irresponsible fiscal policies are probably better off sticking to flexible regimes that can absorb the effects of irresponsible policies. A forced exit from the ERM II would certainly not impress the EU and would likely prove costly in economic terms. By contrast, the credibility of responsible policies may be enhanced by a commitment to a fixed exchange rate regime. Thus the dialogue between the EU and the candidate countries on the topic of nominal convergence needs to deepen, and to do so soon. Such dialogue would support the conduct of responsible policies that extend beyond the point of acceptance into the monetary union. Rapid changes in fiscal stance are possible as witnessed in the deterioration in Poland in 2001 and the amelioration in Lithuania in 2000, which, coincidentally, can be seen as confirming the foregoing results: irresponsible fiscal policy is possible with a floating regime, while a currency board supports the conduct of responsible policies.

The author is an economist at Finland's Ministry of Finance. This article was published in the May issue of the Baltic Economies—Bimonthly Review and is available at www.bof.fi/bofit.

Finnish Firms See More Business in Russia—and Reform Needs

By Mirja Azeem

To gain a better understanding of the Russian economic situation, earlier this year the Finnish-Russian Chamber of Commerce commissioned the first of what will be an ongoing series of semi-annual surveys of business leaders in the chamber's member companies. The results of the March survey represent the views of more than 300 business managers working in industry (over 40 percent), services (almost 30 percent), and trade (20 percent). Some 75 percent of the companies represented operate in Russia, more than 40 percent export directly, and 8 percent have production facilities in Russia. Almost 45 percent of the exporting companies reported that their exports to Russia had increased during the past six months, while the share of firms with stagnant exports was the same. Well over 60 percent of the companies with business in Russia noted that their business had grown, and about 30 percent faced unchanged business volumes. Expectations for the next six months were positive, with 70 percent of both groups anticipating growth in exports or of business on the spot. Although few anticipated rapid growth of the Russian economy, three-quarters of all those surveyed expected "some growth" in the short term. These expectations are good indicators of possible trends in demand. Demand could feed imports rather than domestic production. While domestic demand in Russia increased almost 10 percent in 2001, domestic production grew only 5 percent and imports expanded some 20 percent. Some long-term projections incorporate the notion that rising incomes in Russia will sustain growth in consumption and imports at a higher rate than production, and that this could be sustained for several years because of Russia's large external surpluses.

The survey, which asked respondents to name and rank up to five of their largest problems in their Russian operations, revealed numerous issues faced by firms in the field. Russian legislation and regulations and the functioning of Russian authorities topped the list of business managers' worries. Customs was regarded as the foremost problem area, while legislation, bureaucracy, the authorities, and taxation also figured high. The outcome should encourage Russia to continue to pursue reforms. It confirms that customs reform, which has been designed, but not yet approved, is definitely necessary and will bring clear gains to the economy.

The survey results further suggest that the antibureaucracy laws, adopted last year to protect firms from the excesses of officials, should be implemented along with wider public sector reform. Notably, perceptions of Russia's taxation may have already improved, partly because of

Russia's recently enacted profit tax legislation. As another area in need of reform, the banking and payments system also appeared higher in the survey than more standard issues such as business culture, prices, clients, and competition. Instability of the economy and the currency appeared low on the list of concerns. This should underscore the need for Russia to retain stable macroeconomic policy alongside the reforms.

The author is chief executive officer of the Finnish-Russian Chamber of Commerce (www.finruscc.fi). This article was published in the June issue of The Russian Economy—The Month in Review and is available at www.bof.fi/bofit.

The World Bank/IMF Agenda *(continued)*

Continued from page 27

- **Strengthening public sector management by**
  - –Enhancing accountability mechanisms and information flows within and across different levels of government
  - –Improving fiscal management at the national and subnational levels
  - –Improving the efficiency and quality of public service delivery
- **Mitigating social and environmental risks by**
  - –Reducing poverty and mitigating the negative consequences of income insecurity
  - –Improving the quality of selected health and education services
  - –Improving the design, targeting, administrative capacity, and financing of social protection programs
  - –Addressing environmental hazards and improving environmental management.

Peter Woicke, Head of IFC, Visits Russia

To reaffirm the International Finance Corporation's (IFC's) continued commitment to private sector development in Russia, Peter Woicke, head of IFC and a managing director of the World Bank Group, paid a two-day visit to Russia on May 30-31 and met with government and business leaders. IFC, the private sector development arm of the World Bank Group, has worked actively to support the development of a strong private sector in Russia since it became a member in 1993. IFC has invested more than $136 million in equity and provided loans totaling $448 million to the private sector in Russia, as well as mobilizing $110 million from other sources of financing.

Key IFC priorities in Russia include developing and strengthening financial institutions, attracting foreign investment and technology, working with local partners to improve transparency and corporate governance, and expanding efforts to improve the business environment, particularly for small and medium enterprises. IFC helped set up several private equity funds and credit lines to finance small and medium enterprises.

World Bank to Lend China More Than $1.3 Billion Annually

The World Bank's future lending to China will be in the range of $1.3 billion to $1.5 billion each year, said President James Wolfensohn during his late May visit to China, as the Bank refocuses its poverty relief efforts in the world's most populous country. Wolfensohn said that the Bank's projects in China will focus on aiding poor rural areas, assisting economic reforms, boosting the role of the private sector, and cleaning up the environment.

Since 1992 the Bank's lending to China has averaged more than $2 billion annually, peaking at $3.1 billion in 1993. It has lent about $35 billion in total to China since its first project in 1981. However, lending has fallen since 2000, when China's growing wealth made it ineligible for the Bank's cheapest (International Development Association or IDA) financing, which is reserved for the poorest countries (IDA credits are interest free and usually have a maturity of 30 years with a 10-year grace period). Wolfensohn praised the country's economic policy record, which, he said, had lifted 250 million people out of poverty over the past 20 years. Speaking at the end of eight days in China, he suggested several areas where China could make further progress to consolidate its great achievements, namely:

- **Focusing on poorer areas**. Income disparities and lack of opportunity are marginalizing millions of people, mainly in the remote western regions. More concerted efforts will mean not just greater investment in rural development, health, education, and basic infrastructure, but also finding ways to provide financial assistance, perhaps through microcredit schemes, to small businesses and farmers.

• **Continuing the transition to a more open, market-driven economy.** The nonperforming loans held by state banks, the loss-making state-owned enterprises, the unfunded pension systems, the inadequate property markets, and the relatively weak domestic financial system are among the obstacles China must continue to deal with as it prepares for full compliance with WTO requirements in 2007. A better investment climate presumes progress in improving transparency and accountability in businesses, reducing corruption, and upgrading the legal and judicial systems. A free press and a strong civil society could play an useful watchdog role in all this.

• **Stepping up efforts to restore and protect the natural environment.** The environment has suffered badly through inadequate planning, protection, and enforcement in both urban and rural areas.

World Bank Credit to the Yugoslav Economy

On May 23 the World Bank approved a $85 million Private and Financial Sector Structural Adjustment Credit for FR Yugoslavia. The credit will support the resolution of nonperforming loans held by banks and the privatization of indebted enterprises. "We are pleased to be able to support the privatization program adopted by the government of Serbia, which should be a good basis for restarting the growth of the real sector. The credit equally supports government policy designed to remove regulatory barriers to the entry and growth of small and medium enterprises," said Itzhak Goldberg, the World Bank's private sector team leader. The credit will be disbursed on International Development Association terms and will repayable in 20 years, including a 10-year grace period. It will be disbursed in one tranche.

GEF Council Approves 20 Projects Worth $610.9 Million

In mid-May the governing Council of the Global Environment Facility (GEF) approved $113.7 million for 20 environmental projects with a total value of—including cofinancing—$610.9 million. Many of the 20 new projects provide opportunities for the private sector to participate by supplying technology or making investments.

The 20 projects approved includes a regional project involving the Czech Republic, Slovakia, and the Baltic countries, for which the GEF is providing $11.25 million to help reduce greenhouse gas emissions and increase energy efficiency. The expected reduction of the region's greenhouse gas emissions is 7.4 million metric tons of carbon dioxide over 10 years at the low cost of $0.67 per metric ton. This amount is equivalent to the emissions of about 1.1 million U.S. citizens over one year, and the cost is well below prices being paid for carbon reduction worldwide.

Another large regional GEF project involves 15 countries at or near the Danube River, the GEF Strategic Partnership on the Danube/Black Sea Basin, whose long-term objective is to reduce nutrient levels and other hazardous substances until the Black Sea/Danube ecosystems return to the favorable conditions of the 1960s. Now a second tranche can be drawn from the Nutrition Reduction Fund, managed jointly by the GEF and the World Bank. In addition Croatia will receive financing for a renewable energy resources project, Poland for an energy efficiency automobile program, and Cuba for shoring up its protected areas.

The GEF was established in 1991 to channel multilateral funds to projects that result in local and global environmental benefits. It aims to conserve biodiversity, reduce greenhouse gas emissions, protect the ozone layer, clean up international waters, stop land degradation, and eliminate persistent organic pollutants. Since 1991 the GEF has allocated $4.2 billion in grants, supplemented by more than $11 billion in additional financing, for more than 1,000 projects in 160 developing and transition countries. For more information go to the GEF web site: www.gefweb.org.

World Bank Credit to Assist Access to Safe Blood in Vietnam

In late May the World Bank and Vietnam signed a $38.2 million credit for the Regional Blood Transfusion Centers Project, which will support efforts to establish blood transfusion centers across the country. "The project will benefit a population of 30 million people in 21 provinces served by 180 hospitals," pointed out Le Duc Thuy, governor of the State Bank of Vietnam. As World Bank Vice President and Chief Economist Nicholas Stern noted, several problems in the current blood supply system need to be addressed, including estimates that only about 10 to 14 percent of blood needs are being met and that available supplies are of uncertain quality, meaning that transfusions tend to be risky. Compliance with existing national standards for testing, screening, and storing of blood by the many underfunded hospital blood laboratories is highly uneven. The World Bank's support will change this situation, he added.

Bulgaria: Country Assistance Strategy Offers $750 Million

In early May the World Bank's Board of Directors discussed the Country Assistance Strategy (CAS) for Bulgaria. Under the most likely scenario, the World Bank's assistance program over the next three years is expected to entail a lending program of up to $750 million, and the CAS will serve as the road map for this program. The World Bank Group's program in Bulgaria over the coming three years will focus on reducing poverty, raising living standards, and helping with the country's EU accession process. The Bank Group will support Bulgaria through a combination of research work, policy advice, and selected lending operations. The International Finance Corporation will continue to invest in the private sector by providing postprivatization support and catalyzing business development, shifting the focus to areas where Bulgaria has a comparative advantage, including such export-oriented sectors as wood, clothing, pharmaceuticals, shipyards, tourism, and agribusiness.

In pursuing its assistance strategy the World Bank Group will help Bulgaria to:

- **Promote private sector-led growth**. The main goal is to improve the business environment through accelerated privatization, better regulations for businesses, and development of financial institutions.
- **Strengthen public administration and anticorruption initiatives**. The Bank will promote the development of an effective, transparent, and accountable public sector. In addition, programs for improving the efficiency of the court system would be supported.
- **Mitigate the social impact of restructuring and delivering social services more effectively**. The Bank's strategy will focus on alleviating poverty further, promoting human capital development, modernizing the education and health sectors, improving the targeting of social safety net programs, and monitoring policy impacts on living standards and welfare.

Conference Diary

For the Record

Building Competitive Advantage in Nations: Increasing Transparency, Combating Corruption, and Improving Corporate Governance
March 26-28, 2002, Budapest, Hungary

"We see corruption and weak corporate governance as twin enemies of country competitiveness—these are two sides of the same coin of no accountability," said a high-ranking U.S. Agency for International Development (USAID) official of the topic of a recent conference held in Budapest and organized by the USAID and the Center for International Private Enterprise (CIPE), together with J. E. Austin Associates. The conference explored the links between building effective market-oriented policies and promoting better ethics in both the public and private sectors. About 150 participants from 18 countries discussed how to improve the general investment climate through greater transparency and accountability. Slovak Deputy Prime Minister for the Economy Ivan Miklos discussed his government's efforts to forge an effective public-private partnership to combat corruption. Speakers warned that corruption is impeding investment and growth, increasing transaction costs, and wasting management time.

Information: CIPE's web site: http://www.cipe.org/events/budaconf. A copy of the conference CD-ROM is also available.

SITE Conference Announcements

Centre for Economic Policy Research/The Williamson Davidson Institute (CEPR/WDI) Seventh Annual International Conference on Transition Economics
June 20-22, 2002, Riga, Latvia

Hosts: The Stockholm Institute for Transition Economics (SITE) and the Baltic International Centre for Economic Policy Studies (BICEPS) at the Stockholm School of Economics (SSE) in Riga.

Organizers: Erik Berglöf of SITE, SSE, and CEPR; Gerard Roland of CEPR and the University of California at Berkeley; and Jan Svejnar of WDI and the University of Michigan.

This conference will provide a forum for leading economists and other social scientists working on transition and development issues to meet, present new research, develop collaborative relationships, and complete ongoing research. The conference will also bring together key policymakers in the region with these researchers to facilitate discussion and the exchange of ideas. A special feature of this conference will be a panel that will explore similarities and differences between issues and methods in transition and development economics. A provisional program may be viewed on the BICEPS web site: http://www.biceps.org. In parallel, economists originally from the Baltic states but now studying or working around the

world will meet to discuss issues of particular interest to their native countries.

Centre for Financial and Economic Research (CEFIR) International Conference: Negotiating Russia's WTO Accession—Lessons from Multilateral Trade Liberalization and Club Enlargement
June 24-25, 2002, Moscow

This international conference will bring together prominent academics and policymakers to examine the theoretical and policy issues of Russia's accession into the WTO. Its aims are to increase awareness among Russian economists of international trade theory as an important area of economics, to inform academic and policy circles in Russia on cutting-edge research in the areas of multilateral trade liberalization and trade negotiations, and to give Western economists working on trade theory and policy an opportunity to discuss the policy-relevant implications of recent research in the context of Russia's accession negotiations.

CEFIR is honored to welcome an eminent group of economists to Moscow for the meeting, including Bill Ethier of the University of Pennsylvania, Gene Grossman of Princeton University, James Markussen of the University of Colorado, Keith Maskus of the World Bank, Ray Riezman of the University of Iowa, Robert Stern of the University of Michigan, and others.

Some major themes that will be addressed are:
- Consequences of WTO accession for Russia's economy and for the world economy in general
- Sector-specific aspects of Russia's accession negotiations (services, agriculture, investments, intellectual property)
- Political economy of trade reforms and reciprocal trade liberalization in the context of Russia's WTO accession
- Lessons and consequences of China's accession negotiations for Russia's accession
- The WTO legal system and the credibility of domestic reforms in Russia on the eve of accession
- Institutional design and the principles of the General Agreement on Tariffs and Trade and the WTO
- Reciprocity, nondiscrimination, and renegotiation in trade policy cooperation
- Gradualism in reciprocal trade liberalization.

Information: SITE, Stockholm Institute of Transition Economics and East European Economies, Box 6501, SE-113 83 Stockholm, Sweden, Sveavägen 65, 9th Fl.; tel: 468-736-9670, fax: 468-316-422, email: SITE@hhs.se, URL: http://www.hhs.se/site.

Forthcoming

VII North—Western Banking Conference
July 17-20, 2002, Saint Petersburg, Russia

Organizers: Association of Russian Banks, St. Petersburg Department of the Central Bank of Russia, Promsvyazbank, and the St. Petersburg Union of Manufacturers and Owners (Employers).

A major topic, "Clients and Banks—from Cooperation to Partnership," will include discussion of interaction between the banking and industrial sectors, banks' participation in enterprise restructuring, completion of regional projects, assisting industrial growth through trade and project finance instruments, and attracting foreign capital. A parallel session on "Legal Regulation of Banking Activities" will deal with such issues as currency regulation, currency control, and loan security.

Information: Conference@psbank.spb.ru.

Unofficial Activities in Transition Countries: 10 Years of Experience
October 18-19, 2002, Zagreb, Croatia

This international conference will analyze the size, scope, causes, consequences, and policy implications of unofficial (illegal, unrecorded, unreported, informal, underground, hidden, shadow, parallel) activities in transition countries during the past decade. The conference aims to answer such questions as:

- Why have unofficial activities been so widespread in some transition countries and less important in others?
- How did this develop? What have the consequences been?
- Is some pattern or sequencing apparent in the development of unofficial activities connected with transition and reforms?
- If so, can we derive any policy recommendations from the experience of more advanced transition countries that could usefully be offered to those that have not gone as far along this road?

Prospective contributors are invited to submit an application, abstract, and curriculum vitae before May 31 and a final paper before September 30. Travel and accommodation expenses will be paid for the authors of papers selected for presentation depending on available funds.

Papers and abstracts should include key words, full name and affiliation, address, email, and fax and phone numbers of the author. We strongly support email submissions. All papers must conform to standard journal style formats. Please follow instructions provided on http://www.aeaweb.org/aer/styleguide.html. Selected papers will be published in a special issue of the journal *Financijska teorija i praksa* and possibly in a conference volume.

Information: Katarina Ott, Institute of Public Finance, Katanciceva 5, 10000 Zagreb, Croatia; tel.: 385-1-4819363, fax: 385-1-4819365, email: kott@ijf.hr, URL: http://www.ijf.hr.

Call for Papers: Does Globalization Lead to Changes in Social Institutions That Enhance or Decrease "Trust" in Managerial Behavior?

The conference will focus on identifiable trust exhibited in managerial behavior, including corporate governance, employer-employee relationships, and firm-to-firm behavior (with competitor firms, with suppliers, and with customer firms). We welcome theoretical and empirical research that focuses on the relationship between these target dependent variables and social institutions, and the relationship between global competition and economic integration and social institutions. In particular, we are interested in how globalization changes the target dependent variables via changing social institutions. We are especially interested in research results that can influence practitioners in business and in public policies, and that can be integrated into classroom discussions and business school curricula.

Here is a set of possible research questions:

- Descriptions of instances of international business dealings that have affected the historical development of social institutions in different countries and cultures, and therefore led to changes in managerial behavior and the trust it reflects.
- Explorations of how openness to the global economy relates to contemporary institutional changes associated with change in trust in managerial behavior. Does the change have a positive or negative effect on economic efficiency? On individual's welfare? Are the effects uniform or individual and firm specific?
- Analysis of examples, either successful or unsuccessful, of how economic openness has led to the transplanting from one country to another of the social institutions associated with fostering trust in managerial behavior.
- Analysis of which sorts of social institutions are necessary or sufficient to enhance levels of general trust in managerial behavior, and of whether or not these institutions can be successfully transplanted.
- Is a convergence of social institutions necessary to achieve the levels of trust in managerial behavior needed to sustain economic functioning, or can different institutional arrangements foster equally well the required levels of trust to encourage investor confidence in governance and disclosure, labor confidence in fair treatment and business-to-business partners' confidence in their contractual arrangements? In other words, are there "functional equivalents" to the norms, laws, and regulations that are intended to sustain the necessary standard of managerial behavior in industrial countries?
- In-depth studies categorizing how international business interactions influence social institutional development (for better or for worse).
- Studies pertinent to developing, emerging, and transition economies are especially welcome.

Submission instructions: Send an abstract (four pages maximum) or completed paper that describes the research question, the theoretical argument, the empirical method, and the anticipated results to Svetlana Corr, William Davidson Institute Program Coordinator, at corrs@umich.edu by Monday, July 22, 2002. For more information contact Bernard Yeung, New York University, Stern School of Business, at Byeung@stern.nyu.edu or 212-998-0425.

The complete call for papers is available at http://www.wdi.bus.umich.edu/research/call/Trust.doc.

The conference is sponsored by the Aspen Institute's Initiative for Social Innovation through Business and The William Davidson Institute at the University of Michigan Business School.

Deadline for submission of a three- to four-page abstract: Monday, July 22, 2002.
Notification of acceptance: September 6, 2002.
Preliminary conference: Ann Arbor, Michigan, November 15-17, 2002.
Final conference: Aspen, Colorado, March 14-16, 2003

Marketing and Business Strategies for Central and Eastern Europe

December 5-7, 2002, Arcotel Hotel Wimberger, Vienna, Austria

This will be the 10th joint annual conference of the Kellstadt Center for Marketing Analysis and Planning; DePaul University, Chicago; and the Department of

International Business, University of Economics and Business Administration, Vienna.

Empirical research, case studies, or discussion sessions are sought that address such topics as comparative analysis of conditions of market entry in Central and Eastern European (CEE) countries, market entry through exports versus market entry via capital investment, acquisitions as opposed to joint ventures in CEE, marketing strategies to reach CEE consumers, marketing mix decisions for markets in CEE, financial strategies for opening CEE markets, and case studies of CEE experiences by Western firms.

Abstracts of the papers, in English, should be received by September 15, 2002. The final papers must be ready by November 1, 2002. For more information or to send abstracts contact either of the conference sponsors.

Information: Prof. Dr. Reiner Springer, Wirtschaftsuniversität Wien, Althanstr. 51, 1090 Vienna, Austria; tel.: 43-1-313 36/4371, fax: 43-1-313 36/751, email: Reiner. Springer @wu-wien.ac.at, or Prof. Dr. Petr Chadraba, Kellstadt Center for Marketing Analysis and Planning, DePaul University, 1 East Jackson Boulevard, Chicago, Illinois 60604; tel.: 312-362-6889, fax: 312-362-5647, email: pchadrab@depaul.edu.

International Health Summit on Public-Private Partnerships
December 8-11, 2002, Sheraton Bal Harbour, Miami Beach, Florida, U.S.A.

Hosts expect eminent health sector leaders, including policymakers; physicians; and executives of health plans, hospitals, and pharmaceutical and technology firms to attend.

Information: Registrar Office: Bay Area, California, United States; tel.: 925-680-1862, fax: 925-676-5785, email: eidetics@conferencemanagement.com; European Office: 24 Milson Road, London W14OLJ, U.K.; email: pgarside@ihsummit.com, URL http://www.ihsummit.com/.

New Books and Working Papers

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

World Bank Publications

To receive ordering and price information for World Bank publications contact the World Bank, P.O. Box 960, Herndon, VA 20172, United States; tel.: 703-661-1580, fax.: 703-661-1501, email: books@worldbank.org, URL: http://www.worldbank.org/publications, or visit the World Bank InfoShop at 701 18th Street, N.W., Washington, D.C., tel.: 202-458-5454.

Working Papers
http://econ.worldbank.org/

Stijn Claessens and Leora F. Klapper, **Bankruptcy around the World: Explanations of its Relative Use,** WPS 2865, July 2002, 35 pp.

Recent financial crises have highlighted the importance of insolvency systems for resolving corporate sector financial distress. The literature and the crises have emphasized the complex role of creditors' rights, which affect not only the efficiency of resolution of distressed corporations, but also influence risk-taking incentives and the degree of entrepreneurship in an economy more generally. The authors document how often bankruptcy is actually being used in 35 countries, including the Czech Republic, Hungary, Poland, and Russia. They then investigate various insolvency regimes in relation to the quality of the countries' overall judicial systems.

Bankruptcies are higher in common-law countries (where the "unwritten" law is based on historical legal precedents, shaped by judges, as opposed to civil law systems that require all laws to be codified) and in market-oriented financial systems. Greater judicial efficiency is associated with more use of bankruptcy, but the combination of stronger creditor rights with greater judicial efficiency leads to less use. Countries with more efficient and speedy procedures for opening new businesses have greater bankruptcy use. The presence of more small and medium firms is associated with less use of bankruptcy, which may reflect the costs of using formal bankruptcy procedures, deterring their use by smaller firms. These findings suggest that proper insolvency systems combined with an effective judiciary system encourage less risky behavior and more out-of-court settlements.

The authors may be contacted at stijn@fee.uva.nl or lklapper@worldbank.org.

Sunita Kikeri and John Nellis, **Privatization in Competitive Sectors: The Record to Date,** WPS 2860, June 2002, 52 pp.

Privatization improves firms' financial and operating performance, yields positive fiscal and macroeconomic benefits (proceeds are saved rather than spent, transfers decline, and governments start collecting taxes from privatized firms), and improves overall welfare. The popular view that privatization always leads to layoffs is unfounded. While highly protected firms have seen significant declines in net employment, competitive firms have generally experienced only slight declines, if any. The effects of privatization on wealth and income distribution have only recently been receiving the attention of analysts, and research is just getting under way.

Successful privatization requires strong political commitment, combined with wider public understanding of and support for the process; creation of competitive markets through the removal of entry and exit barriers, financial sector reforms that create commercially-oriented banking systems, and effective regulatory frameworks that reinforce the benefits of private ownership; and transparency in the privatization process.

The authors may be contacted at skikeri@worldbank.org or jnellis@starpower.net.

Olivier Fremond and Mierta Capaul, **The State of Corporate Governance: Experience from Country Assessments,** WPS 2858, June 2002, 30 pp.

Corporate governance deals with the ways in which the rights of shareholders are protected and in which they receive a fair return. Good practices reduce the risk of expropriation of outsiders by insiders, and thus reduce the costs of the enterprise raising capital on the market. The authors summarize experience with corporate governance in 15 countries, including Bulgaria, Cambodia, China, Croatia, the Czech Republic, Laos, Ukraine, and Vietnam.

The authors may be contacted at ofremond@worldbank.org or mcapaul@worldbank.org.

Gerard Caprio, Jr., and Patrick Honohan, **Banking Policy and Macroeconomic Stability: An Exploration,** WPS 2856, June 2002

The authors may be contacted at gcaprio@worldbank.org or phonohan@worldbank.org.

Luc Laeven, Daniela Klingebiel, and Randy Kroszner, **Financial Crises, Financial Dependence, and Industry Growth,** WPS 2855, June 2002

Donald Cox, **Private Interhousehold Transfers in Vietnam in the Early and Late 1990s,** WPS 2853, June 2002

David A. Grigorian and Vlad Manole, **Determinants of Commercial Bank Performance in Transition: An Application of Data Envelopment Analysis,** WPS 2850, June 6, 2002

Jacques Morisset and Olivier Lumenga Neso, **Administrative Barriers to Foreign Investment in Developing Countries,** WPS 2848, May 16, 2002

International experience has shown that excessively complex administrative procedures required to establish and operate a business discourage inflows of foreign direct investment. The authors present a new database on the administrative costs private investors in 32 developing countries face. The database is more comprehensive than existing sources, as it contains not only information about general entry procedures, such as business and tax registration, but also captures regulations on land access, site development, import procedures, and inspections. The data include measures on the number of procedures, direct monetary costs, and time.

The costs of administrative procedures vary significantly across countries. The most important barriers appear to be the delays associated with securing land access and obtaining building permits, which in several countries take more than two years. Countries that impose excessive administrative costs on entry tend to be equally intrusive in firm operations, thereby weakening the argument that barriers to entry are a substitute for the government's unwillingness or inability to regulate enterprise operations. The level of administrative costs is positively correlated with the incidence of corruption and negatively correlated with the quality of governance, degree of openness, and public wages. These correlations suggest that administrative reforms need to be incorporated into the broader agenda for reform, such as trade and financial liberalization, anticorruption activities, and public sector administration.

Gregorio Impavido, Alberto R. Musalem, and Dimitri Vittas, **Contractual Savings in Countries with a Small Financial Sector,** WPS 2841, May 7, 2002

Andrew Sunil Rajkumar and Vinaya Swaroop, **Public Spending and Outcomes: Does Governance Matter?** WPS 2840, May 7, 2002

Other World Bank Publications

William Battaile, **2001 Annual Review of Development Effectiveness: Making Choices,** Operations Evaluation Studies, 2002, 108 pp

The bottom line for the World Bank is its development effectiveness. The independent Operations Evaluation Department tracks the Bank's development performance, analyzing the effectiveness of Bank projects, programs, and processes; draws lessons from its operational experience; and provides advice to the Board based on evaluations at the project, country, sector, and thematic levels. The latest project evaluation data confirm a significant improvement in the outcomes of the Bank's lending performance, especially for projects that had been completed by June 2001. The upward trend continues into fiscal year 2001, with solid improvements in sustainability and institutional development impact. Lending is, however, only one dimension of the Bank's broader assistance tool kit, which includes both financial and nonfinancial instruments. Selecting the right combination and proper sequencing of activities can make the difference between success and failure.

Csaba Csaki, John Nash, Vera Matusevich, and Holger Kray, **Food and Agricultural Policy in Russia: Progress to Date and the Road Forward,** World Bank Technical Paper 523, 2002, 168 pp.

Russia's agriculture sector has considerable untapped productive potential. Given this potential, agriculture could provide a solid foundation for growth and poverty alleviation, particularly in rural areas. The objectives of this book are to facilitate the debate of issues key to agricultural policy, to contribute to a greater understanding of the Russian agriculture sector, and to identify a framework for further collaboration between the Russian government and the World Bank in the rural sector.

Boris Pleskovic and Nicholas Stern, editors, **Annual World Bank Conference on Development Economics 2001/2002,** April 2002, 274 pp.

The Annual World Bank Conference on Development Economics is a global gathering of the world's leading scholars and development practitioners. Among the attendees were participants from developing countries, universities, think tanks, nongovernmental organizations, and international financial institutions. The 13th annual conference, held in May 2001, concentrated on the current thinking in development policy and the implications for the global economy, with a particular focus on the two important and controversial themes of globalization and health. This book is a collection of conference papers from this forum, published together with the Oxford University Press.

The World Bank Atlas, 2002, June 2002, 64 pp.

Special Package Set. World Bank Atlas 2002 and The Little Data Book 2002, June 2002

Institute of Public Finance, Zagreb/Croatia Occasional Paper Series

To order: Institute of Public Finance, Katanciceva 5, 10000, Zagreb, Croatia; tel.: 385-1-481-9363, fax.: 385-1-481-9365, URL: http://www.ijf.hr, email: office@ijf.hr.

Vedran Sosic, **Dollarization and the Underground Economy: Accidental Partners?** OP no. 15, April 2002, 22 pp.

Aleksandar Stulhofer and Ivan Rimac, **Opportunism, Institutions, and Moral Costs: The Socio-Cultural Dimension of the Underground Economy in Croatia 1995-1999,** OP no. 14, April 2002, 13 pp.

How much, if at all, should Croatia be concerned about the underground economy? In the postcommunist transitional setting the underground economy reflects the failure of institutions. It is negatively correlated with economic openness and the volume of investment; tax revenue, the development of the banking system, and the capital market; the rule of law; the quality of the political establishment; and civil society. It is positively correlated with corruption and the degree of economic regulation. The underground economy has a destructive effect on social development and diminishes social trust. In Croatia the underground economy reached about 25 percent of "official" GDP in the early 1990s. Since 1995, however, its role has been declining.

Sanja Madzarevic-Sujster, **An Estimate of Tax Evasion in Croatia,** OP no. 13, April 2002, 23 pp.

In the midst of adjustment of the taxation system to the market economy, the broadening of the tax base, the introduction of new and the abolition of old taxes, and the changes in tax rates, making reliable calculations about the extent of tax evasion is difficult. Through a separate analysis of the evasion of some direct and indirect taxes for 1994-2000 two estimates have been obtained: the lower estimate puts tax evasion at the equivalent of 5.5 percent of GDP and the upper estimate ranges from 7.5 to 11 percent of GDP.

BOFIT Discussion Papers

Axel Brüggemann and Thomas Linne, **Are the Central and Eastern European Transition Countries Still Vulnerable to a Financial Crisis? Results from the Signals Approach**

The aim of the paper is to analyze the vulnerability of the Central and Eastern European accession countries to the EU, as well as of Russia and Turkey, to a financial crisis. Our methodology is an extension of the signals approach. We develop a composite indicator to measure the evolution of the risk potential in each country. Our findings show that crises in Central and Eastern Europe are caused by much the usual suspects as in other emerging markets, in particular, an overvalued exchange rate. Weak exports and dwindling currency reserves have good predictive power for assessing crisis vulnerabilities.

Balázs Égert, **Investigating the Balassa-Samuelson Hypothesis in Transition: Do We Understand What We See?** BOFIT DP no. 6/2002

This paper studies the Balassa-Samuelson effect in the Czech Republic, Hungary, Poland, Slovakia, and Slovenia. Time series and panel co-integration techniques are used to show that the Balassa-Samuelson effect worked reasonably well in these transition economies from the first quarter of 1991 to the second quarter of 2001. However, productivity growth did not fully translate into price increases because of the structure of consumer price indexes. We thus argue that productivity growth will not hinder the ability of the five EU accession candidates to meet the Maastricht criterion on inflation in the medium term.

LGI/OSI Publications

Gerard Marcou, editor, **Regionalization for Development and Accession to the European Union: A Comparative Perspective,** Local Government and Public Reform Initiative, Budapest, LGI Studies Series, 2002, 208. pp.

In some Central and Eastern European countries, unlike in EU member states, regionalization has occurred via institutional changes, even if the socioeconomic dimension is still in its infancy. These institutional changes anticipate policies that are being contemplated with a view to gaining EU membership and obtaining structural funds for regional development. To date regionalization in Central and Eastern European countries has been a regionalization of institutions. The five countries under review in this book—Hungary, Lithuania, Poland, and Slovakia—have introduced new regional levels of government.

Katalin Tausz, editor, **Impact of Decentralization on Social Policy,** Local Government and Public Reform Initiative, Budapest, LGI Studies Series, 2002, 236 pp.

Decentralization is defined, interpreted, and made a political issue in several, sometimes contradictory, ways. Sometimes it is considered a term, sometimes a concept, a process, a theory, a methodology, a policy, or even a trend. In the states of the former Soviet bloc systemic changes provided the opportunity for breaking down the heavily centralized structures. A combined team of Hungarian, Latvian, and Ukrainian experts on social policy and public administration carried out this research project in their own countries.

Gábor Péteri, editor, **Mastering Decentralization and Public Administration Reforms in Central and Eastern Europe,** Local Government and Public Reform Initiative, Budapest, LGI Studies Series, 2002, 119 pp.

Decentralization and the formulation of democratic local government system are parts of broader reforms. First, they essentially change the political setup by shifting citizens' workplace and job-related dependency toward territorial, residence-based political structures. Local governments become critical elements of the new political system. Second, the establishment of local governments also transforms the structure and procedures of public administration. Traditional mechanisms of dual subordination, when local administrations had to report both to local councils and to sectoral ministries, is changing to a new relationship between central and local governments by separating functions, developing audit and control mechanisms, and increasing the influence of elected councils and mayors over local administrations.

William Davidson Institute Working Papers

Papers can be downloaded at no charge from www.wdi.bus.umich.edu

Evzen Kocenda and Jan Svejnar, **The Effects of Ownership Forms and Concentration on Firm Performance after Large-Scale Privatization**, WP 471, May 2002

Nauro F. Campos and Fabrizio Coricelli, **Growth in Transition: What We Know, What We Don't, and What We Should**, WP 470, February 2002

Susan J. Linz, **Barriers to Investment by Russian Firms: Property Protection or Credit, Constraints?** WP 469, May 2002

Susan J. Linz, **Job Satisfaction among Russian Workers**, WP 468, May 2002

Viliam Druska, Byeong Ju Jeong, Michal Kejak, and Viatcheslav Vinogradov, **Assessing the Problem of Human Capital Mismatch in Transition Economies**, WP 467, March 2002

Susan J. Linz, **Motivating Russian Workers: Analysis of Age and Gender Differences**, WP 466, February 2002

Gary Krueger and Susan J. Linz, **Virtual Reality: Barter and Restructuring in Russian Industry**, WP 465, April 2001

Michael Berlemann, Kalin Hristov, and Nikolay Nenovsky, **Lending of Last Resort, Moral Hazard and Twin Crises: Lessons from the Bulgarian Financial Crisis 1996/1997**, WP 464, May 2002

Tomasz Mickiewicz and Anna Zalewska, **Deindustrialization—Lessons from the Structural Outcomes of Post-Communist Transition,** WP 463, January 2002

Albert Park and Minggao Shen, **Joint Liability Lending and the Rise and Fall of China's Township and Village Enterprises**, WP 462, July 2001

Albert Park and Minggao Shen, **A Refinancing Model of Decentralization with Empirical Evidence from China**, WP 461, April 2002

Margaret Maurer-Fazio and James Hughes, **The Effects of Market Liberalization on the Relative Earnings of Chinese Women**, WP 460, March 2002

Margaret Maurer-Fazio, **The Role of Education in Determining Labor Market Outcomes in Urban China's Transitional Labor Markets**, WP 459, April 2002

Josef C. Brada, Ali M. Kutan, and Su Zhou, **Real and Monetary Convergence within the European Union and between the European Union and Candidate Countries: A Rolling Co-Integration Approach**, WP 458, April 2002

Arnoud W. A. Boot and Todd T. Milbourn, **Credit Ratings as Coordination Mechanisms**, WP 457, March 2002

Josef C. Brada, and Ali M. Kutan, **Balkan and Mediterranean Candidates for European Union Membership: The Convergence of Their Monetary Policy with that of the European Central Bank**, WP 456, April 2002

David M. Kemme, **Russian Financial Transition: The Development of Institutions and Markets for Growth**, WP 455, October 2002

Xiaogang Wu and Yu Xie, **Does the Market Pay Off? Earnings Inequality and Returns to Education in Urban China**, WP 454, April 2002

Bat Batjargal and Mannie M. Liu, **Entrepreneurs' Access to Private Equity in China: The Role of Social Capital**, WP 453, April 2002

Alan A. Bevan, Saul Estrin, Boris Kuznetsov, Mark E. Schaffer, Manuela Angelucci, Julian Fennema, and Giovanni Mangiarotti, **The Determinants of Privatized Enterprise Performance in Russia**, WP 452, June 2001

Lubomir Lízal, **Determinants of Financial Distress: What Drives Bankruptcy in a Transition Economy? The Czech Republic Case**, WP 451, January 2002

Other Publications

Brigitte Granville and Peter Oppenheimer, editors, **Russia's Post-Communist Economy,** Oxford University Press, Oxford, United Kingdom, 2001, 551 pp.
To order: Oxford University Press, Great Clarendon Street, Oxford OX2 6DP, United Kingdom, tel. 01-865-556-767.

K. Malfliet and L. Verpoest, editors, **Russia and Europe in a Changing International Environment,** Leuven University Press, Leuven, Belgium, 2002, 180 pp.
To order: Leuven University Press, Europahuis, Blijde-Inkomststraat 5, 3000 Leuven, Belgium, tel.: 32-16-32-5345, fax.: 32-16-32-5352, URL: http://www.lup.be, email: university.press@upers.kuleuven.ac.be.

Bibliography of Selected Articles

The web site addresses are for information only. Given the frequent changes in their content, we cannot take responsibility for their accuracy.

Postsocialist Economies

A. M. Al-Obaidan, **Efficiency Effect of Privatization in the Developing Countries,** *Applied Economics* (United Kingdom) 34(1):111-17, January 10, 2002

S. P. Das, **Foreign Direct Investment and the Relative Wage in a Developing Economy,** *Journal of Development Economics* (Netherlands) 67(1): 55-77, February 2002. http://www.elsevier.com/homepage/sae/econworld/econbase/devec/frame.htm

Y. Eilat and C. Zinnes, **The Shadow Economy in Transition Countries: Friend or Foe? A Policy Perspective,** *World Development* (United Kingdom) 30(7): 1233-54, July 2002

O. N. Toulan, **A Resource Perspective on Internationalization Responses to Market Liberalization,** *Emerging Markets Review* (Netherlands) 3(1): 51-68, March 2002. http://www.elsevier.com/inca/publications/store/3/8/6/index.htt

Central and Eastern Europe

G. Bakacsi and others, **Eastern Europe Cluster: Tradition and Transition**, *Journal of World Business* (United States) 37(1): 69-80, Spring 2002

M. Bisogno and A. Chong, **Poverty and Inequality in Bosnia and Herzegovina after the Civil War,** *World Development* (United Kingdom) 30(1): 61-75, January, 2002

Investing in Central and Eastern Europe: Financial Times Survey, *Financial Times* (United Kingdom), Suppl.: I-VI, May 17, 2002. http://news.ft.com/home/us/

Financial Times (United Kingdom), **Poland: Financial Times Survey** Suppl.: I-VI, June 17, 2002. http://news.ft.com/home/us/

C. Jensen, **Foreign Direct Investment, Industrial Restructuring, and the Upgrading of Polish Exports.** *Applied Economics* (United Kingdom) 34(2): 207-17, January 20, 2002

Jaxques Rupnik, **New Nationalism in Central Europe**, *East European Constitutional Review,* (United States/Hungary) 11(1/2): 68-70 Winter/Spring 2002. http://www.law.nyu.edu/eecr/vol11num1_2/index.html

CIS

Simon Commander, Irina Dolinskaya, and Christian Mumssen, **Determinants of Barter in Russia: An Empirical Analysis**, *Journal of Development Economics* (Netherlands) 67(2): 275-307, April 2002. http://www.elsevier.com/homepage/sae/econworld/econbase/devec/frame.htm

Financial Times (United Kingdom), **Russia: Financial Times Survey** Suppl.: I-X, April 15, 2002. http://news.ft.com/home/us/

Mikhail Krasnov, **Reforming Russia's Courts—Is the Concept of Judicial Reform Timely?** *East European Constitutional Review* (United States/Hungary) 11(1/2): 92-95, Winter/Spring 2002. http://www.law.nyu.edu/eecr/vol11num1_2/index.html

Asia

Ben Dolven, **Shanghai's Capital Drought,** *Far Eastern Economic Review* (Singapore) 165(27): 30-34, July 11, 2002. http://www.feer.com/articles/2002/0207_11/p030china.html

P. B. Duong and Y. Izumida, **Rural Development Finance in Vietnam: Microeconometric Analysis of Household Surveys,** *World Development* (United Kingdom) 30(2): 319-35, February 2002. http://www.elsevier.com/inca/publications/store/3/8/6/index.http

M. Godfrey, C. Sophal, T. Kato, L. Vou Piseth, P. Dorina, T. Saravy, T. Savora, and S. Sovannarith, **Technical Assistance and Capacity Development in an Aid-Dependent Economy: The Experience of Cambodia**, *World Development* (United Kingdom) 30(3): 355-73, March 2002

John Pomfret, **For China's Local Bigwigs, New Money Means Power**, *Washington Post* (United States), July 7, 2002. http://www.washingtonpost.com/

Subscribe to *Transition* (English Version)

For a free subscription to the English language version of *Transition*, write to:

Jennifer Vito
The World Bank
1818 H Street, N.W.,
Mail Stop MC3-302
Washington, D.C. 20433, USA
tel.: 202-473-7466, fax.: 202-522-1152
Email: jvito@worldbank.org

Or if you would like to receive the *Transition* Newsletter electronically, please notify Jennifer Vito at the above email address.

(Russian Version)

For a free subscription to the Russian language version of *Transition*, write to:

International Centre for Policy Studies
8/5, Voloska St.
Kyiv, Ukraine 254070
tel.: 380-444636337, fax.: 380-444635970,
Email: marketing@icps.kiev.ua,
Website: http://www.icps.kiev.ua

(Chinese Version)

For a free subscription to the Chinese language version of *Transition*, write to:

China Institute for Reform and Development (CIRD),
57 Renmin Rd., Haikou City,
Hainan, China

We appreciate the continuing support of:

Bank of Finland

Institute for Economies in Transition

P.O. Box 160, FIN-0010 Helsinki
tel: 3589-183-2268,
fax: 3589-183-2294
email: bofit@bof.fi
Website: http://www.bof.fi/bofit

LGI/OSI

Local Government and Public Service Reform Initiative (LGI) and the Open Society Institute (OSI)

P.O. Box 519
H-1397 Budapest, Hungary
tel: (36-1) 327-3104
fax: (36-1) 327-3105
E-mail: lgprog@osilhu
Website: http://www.osi.hu/lgi

The Urban Institute

A Nonpartisan Economic and Social Policy Research Organization

2100 M Street, N.W.
Washington, DC 20037
tel: (202) 833-7200
Website: http://www.urban.org

We look forward to establishing similar agreements with other sponsors—whether individuals or companies. Please contact the editor for more details.

For Distribution Use Only

Transition is a publication of the World Bank, and is produced by the Development Economics Research Advisory Staff. The opinions expressed are those of the authors and should not be attributed in any manner to the World Bank, to its Board of Executive Directors, or to the countries they represent.

Transition

Managing Director: Boris Plescovic
Senior Editor: Richard Hirschler
Room MC3-374
Telephone: 202-473-6982
Fax: 202-522-1152
Email: rhirschler@worldbank.org

Production Manager: Jennifer Vito
Telephone: 202-473-7466
Fax: 202-522-1152
Email: jvito@worldbank.org

Editor: Alice S. Faintich
The Word Doctor
10509 Brevity Drive
Great Falls, VA 22066, U.S.A.
tel. and fax: 703-759-6434
email: Asfaintich@aol.com
http://hometown.aol.com/asfaintich/TheWordDoctor/info.htm

The World Bank
1818 H Street, N.W.
Washington D.C. 20433
Telephone: 202-477-1234
Fax: 202-477-6391
http://www.worldbank.org/

In collaboration with:

SITE
Stockholm Institute of Transition Economics and East European Economies
STOCKHOLM SCHOOL OF ECONOMICS
Box 6501, SE-113 83 Stockholm, Sweden, Sveavägen 65, 9th Fl.
tel: 468-736-9670, fax: 468-316-422
email: SITE@hhs.se
Internet: http://www.hhs.se/site
Editor: Jody Lanfrey
Email: Jody.Lanfrey@hhs.se

and

The William Davidson Institute
724 East University
Wyly Hall 1st floor
Ann Arbor, MI 48109-1234, U.S.A.
tel. 734-763-5020
fax 734-763-5850
http://www.wdi.bus.umich.edu

Editor: Anna Meyendorff
Email: Ameyen@umich.edu
Associate Editor: Deborah Jahn
Email: Djahn@umich.edu

Volume 13, Number 3,
May-June 2002

Printed on recycled paper