"Economic Neoliberalism Became Almost Irrelevant..."
Poland's Grzegorz W. Kolodko on New Trends in Development Strategies

New development policies are emerging after 10 years of experience with the transition process. Both theoreticians and policymakers are revising earlier theories about the market-state relationship, scrutinizing privatization processes, tackling deregulation arrangements with a fresh attitude, and attempting to deal with the far-reaching consequences of globalization. The World Bank is at the forefront of this revision process. Grzegorz W. Kolodko, Poland's first vice prime minister and finance minister between 1994 and 1997, is a visiting fellow in the Bank's Development Research Group. Having gained both theoretical underpinning from years of studies on transition issues while a professor at the Warsaw School of Economics and Yale University, and practical experience as a policymaker, he is currently working on a study titled "Transition to a Market and Sustained Growth: Implications for the Post-Washington Consensus." Revision of the Washington Consensus was a major topic of the following interview with Transition editor Richard Hirschler.

Q. There are more and more signs that we have entered the era of post-Washington Consensus. It would help to clarify what the Washington Consensus meant in the first place.

A. The transition strategies in Eastern Europe and in the states of the former Soviet Union have been based, and in some countries still are largely based, on the so-called Washington Consensus. Originally the Consensus was a response to Latin America's structural crisis in the 1980s, a kind of policy advice agreed in Washington between important organizations such as the International Monetary Fund (IMF), the World Bank, and the U.S. Treasury. It had the following message: "Liberalize as much as you can, privatize as fast as you can, and be tough in fiscal and monetary matters!" This policy advice has been applied—mainly through the IMF and the World Bank—to the transition economies. Unfortunately, little attention has been paid to their distinguishing characteristics.

Western experts assumed that these postsocialist economies simply were affected by financial disequilibria, nonperforming debt, and high inflation similar to the distorted economies of Latin America. But these countries had system-specific defects: these were shortage-ridden economies (in some cases 100 percent owned by the state), economies without any type of market organizations or institutions. Western advisers also preferred to believe that market institutions—even if they were unsophisticated, underdeveloped, or in any embryonic state—were present in these economies. It's by no means a coincidence that the few countries that had some earlier experience with markets—Hungary, Poland, and Slovenia (Yugoslavia) included—were able to overcome their transition pains much faster than the others. For the other economies...
the erroneous advice of international institutions cost dearly in loss of national wealth, economic mismanagement, wasted resources, and social misery. It became obvious that without proper institutional arrangements, liberalization and privatization can produce problems—as is now the case in Russia and Ukraine, for example.

Q. So what should be the major features of a hopefully “gentler and kinder” post-Washington Consensus?

A. Primarily, the government's role has to be put in its proper place. The international institutions realized that the real question is not whether a government is big or small, but whether a government is able to provide leadership, introduce right policies, or is unable to do so. Thus the state must remain active in shaping a country’s political-economic policy, not as an owner of assets or an administrator of state companies, but as an architect of institutional arrangements, as a guard of financial fundamentals, as an investor in the human capital, as a financier for infrastructure development, and as a manager of global integration. I would like to highlight three areas that need to be addressed:

- **Taking care of financial and economic fundamentals.** Here I do not differ from IMF orthodoxy or a classical mainstream liberal approach. Fiscal balance has to be restored, current account has to be sustainable, inflation has to be brought down, liberalization has to proceed vis-à-vis prices and trade, and privatization has to be completed.
- **Creating and maintaining institutions, such as antitrust agencies and laws, commercial and investment banking, social safety nets, securities exchange commissions, and re-regulation of capital markets.** The negligence of institutional arrangements has been a grave miscalculation of the orthodox approach, for example, in Russia. If the governments are unable to set up institutions that can facilitate market economies, a “neither plan nor market” situation can arise—a systemic vacuum that will be filled in by informal arrangements. It can be run by organized crime or fraudulent financial intermediaries, such as the managers of Albania’s financial pyramids. Russia’s seven tycoons—heads of the country’s seven industrial-financial-media empires—function as a “shadow government,” combining their enormous economic power with wide-scale political influence. The price is paid by the majority of the society. It also demonstrates that there is a link between the lack of proper institutional arrangements, on the one hand, and widening inequality and growing poverty, on the other hand.
- **Investing in human capital.** To assume that the market per se takes care of its education needs is wrong. Postsocialist economies have no organizations, no networks, and most important, not enough private resources for that. Many parents cannot afford to send their children to high schools, vocational schools, or universities or even to retrain and redeploy themselves if necessary, therefore, the government has to take over these tasks.

Thus the role of government, especially in the postsocialist transition economies, seems to be on the rise. It contradicts the intentions of the neoliberal approach that didn’t have much to say to the government, except that it should “liberalize everything, privatize everything, and then pull back.” However, governments can fail or succeed, but they cannot afford to pull back. What should pull back instead is neoliberalism as an economic theory and, especially, as an economic policy.

Q. Would you say then that neoliberalism, as an economic ideology and policy, has become irrelevant?

A. Almost. Not completely yet, but hopefully soon. There is good reason to expect such an outcome after the harm that this train of economic thought and policy has caused in the final decade of the twentieth century. And not only by mishandling transition issues in postsocialist economies, but also by economic mismanagement in the aftermath of the East Asia crisis.

Q. Thus the revised, enlarged role of governments is an important feature of the post-Washington arrangement. But wouldn’t the East Asia crisis warrant doubts about the soundness of governments’ judgement?

A. I don’t think so. The message is clear: the market has failed more so than the state. I wouldn’t claim that governments in Indonesia, Malaysia, Thailand, or the Republic of Korea didn’t make mistakes. They have to learn the hard way that certain policies don’t work. But much of the blame for the contagion of the Asia crisis can be put on the panicking markets. The problem is the lack of proper regulation of capital flow that should be re-regulated instead of being even more deregulated.

Q. Consequently, should the effects of globalization also be included in the post-Washington Consensus?

A. Absolutely. This is the most sensitive element of the post-Washington Consensus. Whether we want it or not, hardly any major decision or policy can be executed in the world—be it in Moscow or Bangkok, Budapest or Jakarta—without international backing, primarily from Washington, D.C., the location of the World Bank, the IMF, the U.S. Treasury, Congress, and other influential organizations and think tanks. Globalization reached a point where governments are
Q. You claim that as Poland’s deputy prime minister and finance minister between 1994 and 1997, you were able to achieve a “therapy without shock,” contrary to the “shock therapy” that characterized Poland’s economic policy in the early 1990s. What were the major differences between your policy approach and your predecessor’s?

A. During 1994–97 Poland’s GDP grew by more than 28 percent, inflation fell by two-thirds, unemployment dropped from 3 million to 2 million, the accumulated inflow of foreign capital exceeded 16 billion dollars, and—as the Wall Street Journal put it—Poland had to face a new challenge: managing success. Contrary to the opinion of many observers, what really mattered was the efficiency of the policy and not the dose of radicalism or gradualism. Although it is true that, under our stewardship, lots of measures, including deregulation, destatization, and de-nationalization of the economy, gradually mitigated the negative social effects of these changes. We have been extremely radical if justified and quite gradual when it was necessary, depending on the challenge. Also, and that is a crucial institutional difference, we strongly opposed the approach that claimed that the best industrial policy is not having one at all. We in the government have actively and deliberately supported the restructuring of Polish enterprises. I am pleased that the succeeding Solidarity-led government has not abandoned industrial policy—for example, the restructuring of the steel and coal industries—even if they have to coordinate it with the European Union.

We have also paid great attention to institutional arrangements. Those were intro-

Changes of Gini coefficient in transition economies, between 1987/88 and 1993/95

Source: The author, based on data provided by B. Milanovic (1998)
Note: The *Gini coefficient is a measure of income inequality. The higher the coefficient, the larger the inequality.
duced simultaneously with further privatization and liberalization, to facilitate the emerging private capital, assist in capital formation, and help to improve efficiency without an a priori assumption that the market will do the job. A Polish joke illustrates the point well: How many experts were needed under a centrally planned economy to replace a light bulb? Three. One worked on the plan, another replaced the bulb, and the third drafted a report. How many experts do we need under the market regime? None. The market will do the job (my predecessors also believed that). I said we still needed somebody to replace the bulb. That makes a huge difference. That is what distinguishes our program, known as Strategy for Poland, implemented in 1994–97, as “therapy without shock” from the “shock therapy,” exercised in Poland at the onset of the 1990s.1

Q. Do you think that this reassessment of the Washington Consensus will change the attitude and approach of international finance institutions, including the World Bank?

Beyond the Washington Consensus

Senior vice president and chief economist of the World Bank Joseph E. Stiglitz earlier this year delivered the 1998 United Nations University, World Institute for Development Research (UNU/WIDER) Annual Lecture titled “More Instruments and Broader Goals: Moving toward the Post-Washington Consensus,” in Helsinki. We have excerpted some major ideas from the presentation, which is available in full on the following website: http://www.wider.unu.edu/stiglitz.htm

The policies advanced by the Washington Consensus are not complete, and they are sometimes misguided. Making markets work requires more than just low inflation, it requires sound financial regulation, competition policy, and policies to facilitate the transfer of technology and encourage transparency. These are some of the fundamental issues neglected by the Washington Consensus. Our understanding of the instruments needed to promote well-functioning markets has improved, and we have broadened the objectives of development to include other goals, such as sustainable, egalitarian, and democratic development.

The success of the Washington Consensus as an intellectual doctrine rests on its simplicity. Its policy recommendations could be administered by economists using little more than simple accounting frameworks. A few economic indicators— inflation, money supply growth, interest rates, and budget and trade deficits—could serve as the basis for creating a set of policy recommendations. Indeed, in some cases economists would visit a country, look at and attempt to verify these data, and make macroeconomic recommendations for policy reforms all within a couple of weeks.

Probably the most important policy prescription of the stabilization packages promoted by the Washington Consensus was controlling inflation. The evidence, however, has shown only that high inflation is costly. Recent research suggests that low levels of inflation may even improve economic performance relative to what it would have been with zero inflation.

A second component of macroeconomic stability has been reducing the budget deficit and the current account deficit. There is, however, no simple formula for determining the optimum level of the budget deficit or the current account deficit. For instance, the case for maintaining budget surpluses in the East Asian countries in the face of an economic downturn, where the rate of private saving is high and the public debt-GDP ratios are relatively low, is less compelling.

Macroeconomic stability—as conceived by the Washington Consensus—downplays the stabilization of output or unemployment. Minimizing or avoiding major economic contractions should be one of the most important goals of policy. In the short run large-scale involuntary unemployment is clearly inefficient—in purely economic terms it represents idle resources that could be used more productively. The social and economic costs of these downturns can be devastating: lives and families are disrupted, poverty increases, living standards decline, and, in the worst cases, social and economic costs translate into political and social turmoil.

The importance of building robust financial systems goes beyond simply averting economic crises. The financial system can be likened to the “brain” of the economy. It plays an important role in collecting and aggregating savings from agents who have excess resources today. These resources are allocated to others—such as entrepreneurs and home builders—who can make productive use of them. The financial system must continue to monitor the use of funds, ensuring that they continue to be used productively. In the process financial markets serve a number of other functions, including reducing risk, increasing liquidity, and conveying information.

Left to themselves, financial systems will not do a very good job of performing these functions. There is a growing recognition of the importance of sound legal framework, sound institutions, and good information for the effective functioning of markets. But the agenda for creating sound financial markets should not confuse means with ends; redesigning the regulatory system, not financial liberalization, should be the issue.
A. Following the temper and tone of discussions in Washington, which included the Bretton Woods organizations, I am convinced that the priorities and the emphasis have been shifted. For example, a recent IMF conference on economic policy and equity, organized by Vito Tanzi and Stanley Fischer, was attended not only by distinguished experts of the IMF, the U.S. Treasury, the World Bank, and scholars from Harvard and Oxford Universities, but also by trade union representatives and archbishops, including a secretary of the Vatican Council for Justice and Peace. I said that if the Fund was going to take care of equity and the Vatican, efficiency, I preferred to keep it in the old way...

But seriously, it is clear that the Fund is paying more attention to equity, not only because it now believes that the fruits of the growing economy should be shared more fairly, but also because if they are distributed more equally it works on behalf of sustained growth. The World Bank now focuses more on how to sustain growth, with the broadest possible

The fundamental theorems of welfare economics, the results that establish the efficiency of a market economy, assume that both private property and competitive markets exist in the economy. Many countries—especially developing and transition economies—lack both. Until recently, however, emphasis was placed almost exclusively on creating private property and liberalizing trade—trade liberalization being confused with establishing competitive markets. Trade liberalization and privatization are important, but we are unlikely to realize their full benefits without anti-trust laws and enforcement and other policies to increase competition.

Chinese policymakers not only eschewed a strategy of outright privatization, they also failed to incorporate numerous other elements of the Washington Consensus. Yet China's recent experience is one of the greatest economic success stories in history. One of the important lessons of the contrast between China and Russia is for the political economy of privatization and competition.

It has proved difficult to prevent corruption and other problems in privatizing monopolies. The huge rents created by privatization will encourage entrepreneurs to try to secure privatized enterprises rather than invest in creating their own firms. In contrast, competition policy often undermines rents and creates incentives for wealth creation. The sequencing of privatization and regulation is also very important. Privatizing a monopoly can create a powerful entrenched interest that undermines the possibility of regulation or competition in the future.

The Washington Consensus policies were based on a rejection of the state's activist role and the promotion of a minimalist, noninterventionist state. The unspoken premise is that governments are worse than markets. Therefore, the smaller the state the better the state. It is true that states are often involved in too many things, in an unfocused manner. Trying to get government better focused on the fundamentals—economic policies, basic education, health, roads, law and order, environmental protection—is a vital step. But states can also improve their capabilities by reinvigorating their institutions. This means not only building administrative or technical capacity but instituting rules and norms that provide officials with incentives to act in the collective interest while restraining arbitrary action and corruption. Perhaps some of the most promising and least explored ways to improve the function of government is to use markets and market-like mechanisms.

The Washington Consensus advocated the use of a small set of instruments (including macroeconomic stability, liberalized trade, and privatization) to achieve a relatively narrow goal: economic growth. The post-Washington Consensus recognizes that a broader set of instruments is necessary and that our goals are also much broader. We seek increases in living standards—including improved health and education—not just increases in measured GDP. We seek sustainable development, which includes preserving natural resources and maintaining a healthy environment. We seek equitable development, which ensures that all groups in society, not just those at the top, enjoy the fruits of development. And we seek democratic development, in which citizens participate in a variety of ways in making the decisions that affect their lives.

Whatever the new consensus is, it cannot be based on Washington. If policies are to be sustainable, developing (and transition) countries must claim ownership of them. A second principle of the emerging consensus is that a greater degree of humility is called for, acknowledgement of the fact that we do not have all the answers. Continued research and discussion, not just between the World Bank and the International Monetary Fund, but throughout the world, is essential if we are to better understand how to achieve our many goals.

Hard copies of the paper (WIDER Annual Lectures 2) are available free at UNU/WIDER Publications, Katajanokanlaituri 6 B 00160 Helsinki, Finland. tel. 358-9-615-9911, fax 358-9-615-9933, Email: wider@wider.unu.edu.
participation of social groups, and has been working out new, more productive relationships with the governments as well. World Bank President James Wolfensohn envisions the Bank as an organization that disseminates knowledge worldwide, that functions as a teaching and learning institution. Senior Vice President and Chief Economist Joseph Stiglitz has provided a detailed analysis of this new policy design [see box on previous page].

Q. In your studies you often refer to the big mistake of confusing policy goals with policy means.

### Decivilization? A Historic Approach to State Retrenchment by Zsuzsa Ferge

The functions of the state in past centuries seem to form the shape of a bell curve. The ascending line promised a "virtuous circle" forcing the state to complete its self-serving and coercive functions with more responsibility for the common good, including health, education, and welfare services. The descending side, on the other hand, may lead to a vicious circle, allowing free course to a process of decivilization.

Rethinking and reshaping the role of the state—which, among other things, involves the far-reaching reform of social policies—is on the agenda worldwide. The World Bank's *World Development Report 1997: The State in a Changing World* reflects, to some extent, on the post-Washington Consensus, noting a new approach of the Bank to the relationship between state and market. One would have expected that the Bank's policy toward the transition and developing economies would change and that the Bank would become more responsive to the social consequences of its actions. However, the arguments, pro and con, remain rather ideological and less embedded in history than might be desirable.

In the early period of state formation the military function dominated. The protection of the lives and property of the subjects (policing) became almost as important as during the earliest times. On the other hand, the handling of the poor was the duty of the smallest available helping unit—the family, the landowner, the parish, the guild, the local community.

The evolving market economy changed the face of poverty. With increasing social density and mobility, the poor and their

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### Recession and growth in transition economies, 1990-97

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Source: National statistics, international organizations and author's own calculations.

Note from page 4: "See also The Polish Alternative—Old Myths, Hard Facts, and New Strategies in the Successful Transformation of the Polish Economy, by G. W. Kolodko and D. M. Nuti, UNU/WIDER, Research for Action No. 33, 1997)."
miserable conditions became more visible in the fast-growing cities. The poor have also become more dangerous to the safety, property, morality, and—because of epidemics—even the health of the nonpoor. The state was forced to take over both the policing of the poor and the alleviation of some of their sufferings.

New mores, new skills, and new types of relationships and communications emerged initially at the top of society, but then slowly permeated into the other layers of society. Civilizing agents promoted adjustment to the rapidly changing conditions, offered new skills, new norms of behavior and communication, and new "survival kits." The early agents—from church to factory—fulfilled this need only partially. The state was forced to step in to enforce school attendance and literacy, the use of "modern" ways of coexistence.

The compulsory institutions of health, education, and income savings have initially affected mainly the "lower" social groups—workers, peasants, and other poor people. The coercive aspects then weakened as the institutions became increasingly collective. The history of the welfare state after World War II is not only the history of the expansion of those all-encompassing compulsory institutions, but also of their gradual improvement.

This process was never smooth. Spells of "de-civilization" bursted upon humanity during wars or during various forms of totalitarian dictatorships. These cataclysms were often followed—at least in the past century—by an increase in the civilizing and welfare functions of the state.

A new pattern is emerging in our days. The contraction of the state has been on the agenda both in Western and Eastern Europe. The civilizing and welfare functions of the state—those that were added at later stages—are under attack. Cutting back on these functions is envisaged even if it would entail increasing funding in other realms, particularly in the administrative and policing functions of the state. The dangers of social polarization, increased resentment, violence and desperation, the spread of lawlessness, and the retreat of "civilization" are in the offing. If the society wants to maintain peace, policing forces have to be strengthened. With this switch the state increasingly serves those who have the most to lose and to fear, and less those who are in the most desperate situation.

In Eastern and Central Europe the re-trenchment of whatever civilizing and welfare functions the state had is also on the agenda. The intensity of these endeavors seems to be even greater than in Western Europe. The countries are poorer. Those late-arrival state functions have been less well rooted and their quality is less worth defending. Civil society has also been much weaker. Hence the above dangers are more visible in Eastern than in Western Europe.

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Consolation

"It is still better than 4000 years from now working for $2 an hour in a hamburger factory."

From the Hungarian magazine Hőcipő
Russia’s Stabilization Program—Will It Work?

Prime Minister Sergei Kirienko warned State Duma deputies on July 1 that failure of swift approval of the government’s stabilization program, unveiled on June 22 and renamed from the more dramatic “anti-crisis” program—a package of more than 20 draft laws, could have dire consequences for the Russian economy. The proposal includes 26 measures (see next page) aimed mostly at cutting budget expenditures and improving tax collection, bringing down interest rates, and reviving economic growth. Some of the measures have already been adopted, while others may need to be approved by the State Duma (lower chamber of parliament).

Tense Situation

- **Economic decline again.** The Russian economy grew by a modest 0.8 percent last year, its first sign of growth in almost a decade. But it has declined 0.2 percent in the first five months of this year.

- **Foreign investors are fleeing.** The Russian stock market has lost 60 percent of its value this year. Heavy selling of government treasury bonds continues. It had prompted the central bank by end-June to raise key interest rates sharply to 80 percent from 60 percent. The government has to redeem $5 billion in Treasury bills (GKO) every month; over a third of the budget now goes on servicing debt. The central bank said gross reserves fell by $1 billion in the third week of June and stood at $14.7 billion on June 19. The bank said reserves were depleted by foreign debt service and support for the ruble. In late June Russia floated a $2.5 billion Eurobond at an interest rate of 12.75 percent, more than seven percentage points above a comparable bond sold by the United States. Russia has issued four Eurobonds during the past four months, the latest was a five-year, $1.25 billion Eurobond.

- **The budget situation is worsening.** The price of oil that, together with natural gas, is Russia’s main earner of foreign currency, is down by more than 40 percent this year. Export revenues from oil, oil products, and gas were almost 20 percent down year-on-year in the first quarter. The current account is expected to go into deficit. A vast accumulation of unpaid taxes and unpaid wages has pushed half of Russia’s economic transactions into barter, thus starving the treasury of tax revenue. In the first five months of this year, tax collections fell around 25 percent short of targets. The government has been collecting a monthly $3.4 billion in revenues each month but needed $4 billion to make ends meet. Only 5 million out of 150 million citizens fill out income tax declarations. Companies regularly stash income overseas, and industrial groups, favored by the government, have ignored their taxes with impunity.

- **The living standard drops further.** According to Russian officials, real income has plummeted 40 percent since the Soviet Union collapsed in 1991. A quarter of all Russians are living below the subsistence level. Nearly one-third live below the poverty level. Three-quarters barely survive on an average income of $100 per month. The Red Cross calls conditions in Russia “a silent disaster,” reporting “We saw babies who were being fed powdered animal fodder because of lack of baby food.” The average life expectancy for men has declined by seven years, to 59, since 1990. One-quarter of Russia’s labor force receives its wages late, in kind, or not at all. The current mid-level salary (after tax) at the Academy of Sciences Institutes is 330 rubles/month or 11 rubles a day (less than $2). A loaf of bread costs 3 rubles and a liter of milk between 3.7 and 6 rubles. The current minimum pension (used for the calculation of all other social benefits) as well as the minimum wage (used as the base for all other public sector salaries and wages) are below the subsistence minimum—that is, less than the amount necessary to purchase sufficient caloric content to maintain physical survival. Child welfare payments, legally mandated until the age of 18, are currently about $9 per month—so low that only the desperately poor actually go to collect them. At the end of last year the federal government declared that it would provide funds for children only up to three years of age, suggesting that the regions cover older children. But no additional federal funding has been provided.

Devaluation Fears

The ruble’s fate is in the balance. To shore up the value of the ruble, Russia is seeking a new loan of at least $10-15 billion from the International Monetary Fund. Both the IMF and the government agree that any aid must be accompanied by financial reforms. Despite the release of $670 million of stalled IMF aid (Russia has so far received $5.8 billion of the existing $9.2 billion loan), many fear that without a speedy infusion of funds the government will not be able to restore balance to its markets. As long as the ruble remains at around 6.1 to the dollar, external debt-servicing costs will be around 1.3 percent of GDP this year (assuming a GDP of 2900-2950 billion rubles). Interest rates on Russian external debt are around 10 percent. Recent downgrading of sovereign-dollar-denominated debt by credit ratings agencies may increase foreign borrowing costs somewhat, but the external debt is not the immediate problem.

The major concern is the “domestic” ruble debt, around 25 percent of which has been held recently by non-residents and which has grown rapidly. The end-year stock of treasury bills and state loan obligations—which make up most of the domestic debt and are overwhelmingly short-term—was equivalent to 4.5 percent...
What Are the Twenty-Six Measures?

- Reduce interest rates to 25–30 percent by the fall, then to 20–25 percent from the current level of 60 percent.
- Adopt new tax and budget legislation (The government wants to cut spending by 42 billion rubles—$6.8 billion—that is 8% of the budget—and increase revenues by 20 billion rubles, mainly through increasing the authorities' powers against tax dodgers. There will be lawsuits against tax evaders, bankruptcies, and property seizures. Tax liabilities of legal entities in the first quarter of the current year rose by 16 percent, and on April 1, 1998, constituted about 110 billion rubles. There will be a shift of taxes away from producers and on to consumers. Sales taxes are easier to collect than taxes on industrial enterprises, which often conduct much of their business in barter transactions rather than cash. Critics warn against increasing taxes on consumption).
- Introduce more uniform income tax scale, with lower rates for all forms of income, including credits and insurance policies (Russia has a moderately progressive income tax that starts at 10 percent and climbs to 35 percent on incomes of $8,000).
- Move toward value-added taxes (VAT) and excise taxes as means of extracting revenues from sales at time of delivery.
- Adopt a single VAT rate of 20 percent, abolishing the lower rate currently levied on a range of goods.
- Eliminate exemptions from VAT and from profit tax.
- Introduce tax on barter deals.
- Introduce tax on promissory note issues (0.8 percent of nominal value).
- Give regions the right to introduce 5–10 percent sales tax. (The government wants 40 percent of income tax revenues—which now go entirely to regional authorities—to go to the federal budget, and the sales tax could help regional and local governments compensate for lost income tax revenues. The Duma rejected this proposal.)
- Tighten state control over the alcohol market, introducing stiffer penalties for illegal output and trade.
- Raise land tax and payment for unproductive use of land.
- Cut number of employees and agencies funded from budget (The number of civil servants would be reduced by a fifth).
- Cut subsidies from federal budget (Social support, as a universal right would be eliminated. The plan includes freezing the indexing of pensions as well as social and child-welfare payments).
- Lower transport tariffs for oil and coal (the pipeline tariff for oil exporters decreased to $.50 per ton as of July 1. The rate had already been reduced from $3/ton to $1.50/ton on April 1. Russian oil producers are currently claiming $70/ton production cost against an export price of $68).
- Lower wholesale prices for gas and electricity provided payments are made in cash. (Those who pay for public services—electricity, gas and so on—in cash will be offered a discount.)
- Cut hard currency part of crude oil transport tariffs.
- Cut import tariffs on equipment and spare parts not produced in Russia.
- Move to international accounting standards.
- Strengthen independent auditing and state financial controls.
- Guarantee the rights of minority shareholders.
- Develop institutional base for private ownership of land and property.
- Reduce salary and pension arrears. (Wage arrears in 10 major economic sectors rose 6.7 percent in May and now total 66.89 billion rubles ($10.8 billion); money owed by the state accounted for 16.5 percent of the wage debts.)
- Introduce faster, streamlined bankruptcy procedures.
- Increase revenues from privatization.
- Institute more effective use of state property.
- Develop mortgage market in Russia.
- Develop precious metals market in Russia.
- Improve production-sharing legislation.
- Raise import tariffs.

of 1995 GDP, 10.8 percent of 1996 GDP, and 14.8 percent of 1997 GDP. The end-April stock was around 18 percent of GDP (based on annual first-quarter figures).

The wide spread between yields on this ruble-denominated debt and on Russian sovereign foreign paper points to the market's main fear: a forced devaluation. GKO yields in early July rose to 100 percent. GKO yields have to be rolled over throughout this year. At ruble yields of 25 percent over the year, and with no forced devaluation, this would have cost around $14 billion in interest, or about 3 percent of GDP.

Some market operators take the view that yields of 50 percent would already put the budget under such strain that current debt-financing methods would fail, control over the money supply would be relaxed, inflation would rise and a forced devaluation would be likely.

Winners and Losers

A forced devaluation, to a rate below the floor of the present exchange rate band (7.015 to the dollar) would benefit Russian exporters and make ruble-denominated assets cheaper for foreign investors. How-
Don’t Devalue the Ruble

By Anders Aslund

Devaluation is not necessary because the ruble is not overvalued. Last year Russia had a huge trade surplus of $20 billion, and it has had similar trade surpluses for years. Falling oil and commodity prices have diminished the trade surplus, but it is still large. Russia’s position is excellent in comparison with other transition countries. Virtually all have large trade and current account deficits, and a few have current account deficits exceeding 20 percent of GDP.

Russia’s most immediate problem is that it has too large a short-term government debt in comparison with international reserves. The critical issue is that about $25 billion of treasury bills are held by Russian commercial banks and foreign investors, while the international reserves hover at around $15 billion.

First, the government needed to stop all new borrowing through treasury bills, and it has been doing so since the beginning of 1998. Next, the government had to get the budget deficit under control, and it has done so as well. The budget deficit was 8 percent of GDP last year, but it will be less than 5 percent of GDP this year. This is exactly what the International Monetary Fund (IMF) requires. For next year the IMF and the Russian government seem to agree that a budget deficit of 2.5 percent of GDP should be alright. After having stopped the fiscal bleeding, the Russian government now needs to restructure its debt, reducing those interest rates to 20-25 percent a year.

There are three possible sources of financing for the next month: the IMF, the World Bank, and Eurobonds. The release of proposed supplementary reserve facility (SRF), of $10 billion-$15 billion from the IMF does not look very likely. This is because the SRF is supposed to last a maximum of three years and Russia needs medium-term financing. Moreover, the IMF is short of funds.

A more realistic and sensible package would consist of a mixed strategy. First, the IMF could extend its current extended fund facility (EFF) up to $5 billion. Second, the World Bank could provide an additional $5 billion in so-called adjustment loans that are paid to the government on condition that they implement certain structural reforms. Finally, Russia could raise a few billion dollars in Eurobonds.

Such a package would be sufficient to reinforce Russia’s international reserves and salvage the ruble exchange rate. It is entirely possible to conclude such an agreement and even make a first IMF disbursement within a month. With such a package in place, and after the immediate financial crisis is over, Russia could raise a lot of private investments within the next six months. The current crisis is a good reason to speed up remaining privatization projects—quite a few have been prepared.

A large number of foreign investments could be forthcoming in boom industries such as food processing and car manufacturing. Russia received foreign direct investments of $6 billion in 1997, and that was only the beginning.

At present, Russian stock prices have fallen by 75 percent from their peak last October. On the one hand, it shows how deep the crisis is. On the other, it indicates that Russia possesses very attractive assets that are available on a functioning market. In a recovery Russia’s equity market could easily attract $20 billion within a year.

Based on RFE/RL correspondents’ and newswire reports.
In order to get any kind of significant foreign investment, however, Russia must undertake a number of fundamental reforms:

- First, a tax reform leading to a comprehensible tax system and reasonable and stable tax rates must be adopted. Tax reform is needed to impede capital flight and promote enterprise restructuring.

- Second, property rights must be secured. In particular, the aggressive theft of the property of minority owners, which has become the norm in both large and small Russian enterprises, must be stopped and the culpable parties must be penalized.

- Third, the government must show that it favors a level playing field by doing away with all privileges for the biggest companies. This means permanently abolishing tax offsets and forcing large enterprises, such as Gazprom, to pay their taxes.

What would the effects of devaluation be? Two years ago Bulgaria provided a striking parallel. Too large a budget deficit and too little international financing forced it to devalue. Panic struck. People sold their leva for dollars. The exchange rate plummeted by around 98 percent within a year. Similarly, a Russian devaluation would undermine what little remaining confidence there was in the ruble, and the exchange rate would drop by 80 to 90 percent.

The leva devaluation made the foreign debt service more expensive, and the velocity of money rose, causing Bulgarian inflation to skyrocket to 600 percent. Most banks went bankrupt, and the money economy was devastated. GDP fell by around 10 percent in 1997, and the impoverished people took to the streets in the tens of thousands, forcing early elections, which ousted the ruling party.

One difference from Russia is that Bulgaria was ruled by old communists. In Russia the reformers in government would probably be blamed, and the spectre of populism and nationalism could rise up. Whoever rules during a devaluation is bound to lose power. And the crisis would not stop in Russia. Ukraine and Kazakhstan, at least, would be forced to devalue, facing the same economic devastation, followed by changes in political regimes.

Anders Aslund is a senior associate at the Carnegie Endowment for International Peace. He contributed this comment to The Moscow Times on July 7, 1998.

An Opposing View...

Who Believes the Ruble Will Not Be Devalued?

by Evan Scott

Now that everybody says that the ruble should not be devalued, and international experts have equated the strength of the ruble with the survival of Russian reform, stability, and ultimately peace with the nuclear superpower, who really believes it?

International financial institutions, the governments of the U.S. and Russia, numerous commentators, economists, financiers, sociologists, and other heavy thinkers, all seem to agree that the ruble must be propped up. But the fact is that Russian oil export declined by a third since last year. The world price of oil has fallen. Thus there are two choices: allow the ruble to devalue, in line with the reduced oil income of Russia, or continue to declare that Russia will fall apart if the ruble is devalued, and make the currency an even more juicy target for foreign speculators.

How many times have we seen this mistake made in the past? Why have officials of international institutions and government western governments tied the future of reform in Russia to an overvalued exchange rate? Russia is a large country that produces most of its own goods. The inflationary impact of an adjustment of the ruble would be minimal if the government did not give in to demands for compensatory wage increases. If Russia moved to a flexible exchange rate policy and indeed it turned out that the ruble has not been overvalued, then any initial depreciation overshoot could be quickly reversed.

Compare this with the increasingly desperate measures to defend the current ruble exchange rate. The country’s income has fallen and no one is predicting an increase in oil-exports income anytime soon. The exports surplus, until now, has been used in effect to pay for failure to collect taxes and the resulting explosion of government debts. Trying to maintain an artificially high exchange rate will only deplete the country’s remaining foreign reserves, use up its lines of credit to international financial institutions, and force it to stifle recovery with an exorbitant interest rate, which has now reached 80 to 100 percent.

This a folly on an immense scale. Who dares say that the emperor has no clothes?

The author is international economist, based in Washington, D.C.
How to Turn the Asian Crisis to China’s Advantage
by Gao Shangquan

The extent, duration, and impact of Asia’s recent financial crisis caught everyone by surprise. This crisis will inevitably negatively affect China in many areas, including exports, foreign capital inflow, the cost of financing on the international markets, and tourism. While we should not underestimate this negative impact, we will be able to turn some disadvantages into advantages if we learn our lessons and take appropriate measures. Therefore, this crisis is not only a severe challenge but also an opportunity for implementing much needed reforms in China.

The Asian financial crisis erupted as globalization and financial liberalization accelerated and unrest on financial markets intensified. It was triggered by international speculation. The fundamental and deep-rooted causes were, however, the pervasive defects in the economic foundations and financial systems of the East Asia countries, including:

- The untimely economic adjustment after overexpansion.
- Banks burdened with large amounts of bad loans.
- The overdependence on foreign capital.
- Condonation of the irrational structure of foreign investment and ineffective supervision of capital inflow.
- The accumulation of large current account deficits and overdependence on capital influx to equalize the balance of payments.
- The increasing difficulty to readjust exchange rates as currencies became overvalued.

These miscalculations and policy failures, combined, led to the current crisis.

For China, the financial crisis in Asia is a vivid, invaluable, and free lesson. The key issue now facing China is to learn from the losses of other countries in order to offset the negative consequences of the Asian crisis and effectively maintain its economic development.

New Relationships

- In a government-dominated market economy relationships between the government, banks, and enterprises should be correctly handled. At the initial stage of their economic development countries like the Republic of Korea used administrative means to allocate resources and promote rapid economic growth. However, if the government overzealously intervenes in enterprise operations, then these enterprises, confident that the government and banks are behind them, will blindly expand, neglect cost and profitability, and fearlessly continue their loss-making operations. Enterprises and banks are bound together not by common interest but through government intervention. The result is soft budget constraints. Consequently, enterprises have low efficiency and banks are overburdened with bad debts. Then once the debt-credit chain between enterprises and banks deteriorates, a financial crisis will be a real possibility. To prevent that, both banks and enterprises should be free to choose each other, based on their individual circumstances.

- Large enterprise groups should operate in accordance with the market mechanism and not by administrative means. In some key industries, establishing large enterprise groups can promote efficiency and competitiveness. (However, attention should also be paid to small and medium-size enterprises.) Three important lessons can be learned from the Asian financial crisis:

1. Enterprises should be regarded as main players in establishing and developing enterprise groups.

2. The transformation of existing enterprise groups to stockholding companies should be accelerated, thereby substantially reducing government intervention in operations and management.

3. The government should adopt less patronizing financial policies toward large enterprise groups. Those groups should be encouraged to expand their financing channels through the capital market.

- Bad credits that state-owned commercial banks accumulated over time should be rapidly reduced and the efficiency of the financial sector improved. The enormous debt-credit chain between enterprises and banks was an important factor that led to the Asian financial crisis. In China bad loans that had accumulated over past years should be separated from the assets of state-owned commercial banks. Freed from the heavy debt burden, state-owned enterprises and banks could speed up the restructuring process. This is a key link in guarding against financial risks.
Structural readjustment should be accelerated to prevent a bubble economy. In the past few years some banks in Southeast Asian countries have relaxed their requirements for obtaining real estate loans. Consequently, many of these loans became bad due to the oversupply of real properties. Thailand and the Philippines thereafter decided to limit the proportion of real estate loans to 20 percent of the total banking business and also to restrict borrowing for real estate investments: the loan amount should not exceed 60 percent of total funding requirements. China should consider these regulations. In drafting industrial policies, China should emphasize technological advancement, the upgrading of the industrial structure, and productivity improvement so as to strengthen the export-competitiveness of Chinese products.

Controlling Capital Flow

A rational structure of foreign investment should be pursued. In order to achieve rapid economic growth, developing countries need foreign investment, but in a reasonable structure. In Thailand 70 percent of foreign capital is invested in securities. In Korea, out of a total of $245 billion in foreign capital investment, $180 billion is short-term capital. This has aggravated the current financial crisis. Therefore, within the total capital inflow, the ratio of direct to long- and medium-term investment should be increased, while short-term foreign capital and securities investment should be kept within reasonable limits.

Financial supervision should be strengthened and the financial system should be protected against possible financial speculation. During the Asian financial crisis countries like Singapore didn’t suffer too much because of their policy of strict financial supervision. China should establish a financial supervisory system and strengthen their surveillance of derivative financial instruments and overseas financial operations in order to resist the impact of foreign investment capital.

Peoples’ awareness of financial risks should be heightened in order to foster confidence. Not long ago Thailand’s vice premier admitted that, “When we publicized some data, the public thought that the real situation might have been much worse.” Lack of confidence and unawareness of financial risks add fuel to the fire of the financial crisis. People should be prepared for national crises and their psychological capacity to bear risks should be strengthened. At the same time, the government should supply more information about developments on the financial market in order to maintain the general public’s trust.

Reviving Economic Growth

Right now exports and foreign investments, the main driving forces behind China’s economic growth, show signs of weakening. Domestic demand also keeps slowing down. In order to return to rapid economic growth in the coming years, a series of measures are necessary to stimulate domestic demand (both consumption and investment), bolster exports, and attract foreign direct investment.

Nonstate economic actors should be able to invest in infrastructure, such as power production, power network, large water conservation projects, irrigation, and highways. Demand will be extremely high in future years for investment in infrastructure. These investments will become an increasingly important driving force behind economic growth.

The transformation of public utilities to shareholding companies should be accelerated in order to eliminate government control and industrial monopoly and improve returns on investment in the public utilities sector.

Reform of the housing system and real estate development should be accelerated in order to add more dynamism to economic growth.

Market-oriented reform in the service sectors should be accelerated. This would entail improving service quality and satisfying consumer demand for various types of services, such as education, culture, electronic information, medical care, and travel and hospitality.

A consumer credit system should boost domestic consumption. Expanding consumption credit, extending the maturity of mortgage loans, and reducing interest rates could stimulate consumption.

Various types of export-promoting financial instruments should be applied, such as export credit, export credit guarantees, and export credit insurance.

To attract foreign investment, a variety of methods should be adopted in order to exploit the comparative advantages of China. Though international capital still takes a wait-and-see attitude toward Asia, China is still an attractive destination. We can persuade investors to move in with a variety of methods, such as promoting foreign investment in Chinese stocks, initiating Buy, Operate, and Transfer arrangements, supporting a listing of Chinese companies at overseas stock exchanges, and utilizing the potential of Hong Kong as an international financial center.

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Vietnam's Renovation—A Unique Growth Path
by David Dollar and Jennie Litvack

In the late 1990s Vietnam's economic status was very similar to that of other low-income countries, many of which have carried out macroeconomic policy reform supported by the IMF and the World Bank, but without Vietnam's spectacular results.

Vietnam's program of doi moi (renovation) began in the agricultural sector. Collectives were dismantled in 1988 and land was distributed among peasant households. Initially, the property rights to land were left vague. But in 1993 a new land law clarified that peasants had the right to use the land distributed to them for 20 years and that this right could be renewed. Further, peasants could sell or mortgage the right to use their land. Just as important as the reform of property rights was the reform of prices introduced in early 1989. Controlled prices for most goods and services were abolished. For several years the country was functioning with a system of dual pricing, in which most output (both agricultural and industrial) had to be sold to the state at official prices; the balance could be sold at market prices. The abolition of these controlled prices and the system of state procurement in 1989 strengthened the incentive to produce.

Reforms in agriculture were particularly important because it was the largest sector of the economy, accounting for 40 percent of GDP at market prices in 1989. But there were analogous reforms in other sectors as well. For years private production of goods and services had been tightly restricted. Official policy changed in the late 1980s to increasingly tolerate and even encourage the private sector. Price liberalization in 1989 gave major impetus to this trend. In 1989 overall GDP growth accelerated to 8 percent. There was rapid growth in agriculture, services, and construction, all areas in which the private sector was able to respond quickly to strengthened incentives. On the other hand, industry, which remained largely under state control, showed negative growth for the year.

At the same time that the government was introducing these structural reforms, it was trying to cope with serious macroeconomic problems, including high inflation and the impending cutoff of Soviet aid. The fundamental problem was that the government and state enterprises were spending too much and this excess was being financed by Soviet aid and central bank credit. Strong measures to deal with this situation were introduced in 1989. Production and consumption subsidies were eliminated from the budget. At the same time, interest rates on loans to state firms were raised above the level of inflation (that is, to 9 percent a month in spring 1989, when inflation was about 7 percent a month).

In 1990–92 the government took additional steps to control the growth of credit and hence inflation. By 1991 credit was no longer used to finance the budget. Loans to state enterprises were also controlled more carefully and priced appropriately. This tightening of the budget constraint led to a major restructuring of the sector. Between 1988 and 1992 about 800,000 workers—one-third of the 1988 state-enterprise labor force—left the sector and the number of firms declined from 12,000 to 7,000. These policies gradually brought the expansion of credit under control. The restrained monetary policy succeeded in bringing inflation down to about 10 percent a year during 1993–95. The disinflation program required that discipline be imposed on state enterprises and on the budget.

Once stabilization was achieved, growth accelerated, averaging 9 percent for 1992–95. Because of this high growth and initial reforms of the tax system, government revenue increased rapidly after 1991, and the government was able to restore the investment and social expenditures that were cut during the austerity period. Thus government expenditures as a share of GDP were higher in 1994 than in 1989, at the beginning of the fiscal adjustment. Furthermore, because per capita GDP had increased substantially during this period, real per capita government expenditures were nearly twice as high in 1994 as in 1989.

Three aspects of Vietnam's reform strategy may help explain the country's outstanding results:

1. Large agricultural and private sectors at the outset. Stabilization is normally a shock to the economy because interest rates are raised, government sub-
sidies are cut, and devaluation makes imported inputs more expensive. Vietnam's stabilization had the predictable effect on the state sector of the economy, which showed negative growth in 1989. What distinguished Vietnam from most transition economies was that, alongside the state sector, the agricultural as well as the private service and manufacturing sectors were producing a total of about 60 percent of GDP and employing 85 percent of the labor force. These producers were receiving neither credit from the formal sector nor subsidies from the government. Thus, for them, 1989 was a year in which inflation fell and prices were liberalized, creating a good environment for expansion. The fact that interest rates were much higher and subsidies were lower did not matter to agricultural households and small private firms, since they were not getting any of the formal credit or budget subsidies to begin with.

2. Thorough opening to international markets. Opening itself to international markets included the unification of the country's multiple exchange rates in 1989. At the same time the official rate was devalued from 900 dong to the dollar to 5,000 dong to the dollar, the prevailing black market rate. The central bank has subsequently kept the official rate very close to the parallel rate. This bold devaluation in 1989 greatly strengthened incentives to export. At the same time administrative controls on exports and imports were relaxed. As a result exports have been a leading growth sector throughout the reform period, with real export growth averaging more than 25 percent a year. (For rice, oil, rubber, cashews, coffee, shoes, textiles, and tourism services.)

By 1995 imports plus exports relative to GNP had reached 79 percent in Vietnam, a high figure for a populous country. The comparable figure for Thailand—well known as an open economy—was 70 percent; Egypt, a large, closed economy, had trade totaling 32 percent of GNP. Vietnam's export surge was important not only because it spurred production but because it financed the economy's growing import demand.

3. Proper timing of reform-supporting foreign assistance. Another key way in which Vietnam differed from other low-income reformers was that it did not have access to official finance. Soviet aid declined rapidly after 1988 and was not replaced by funding from other sources. The collapse of funding did not require any cutbacks in imports, however, because Vietnam's export growth was sufficient to ensure that imports could grow throughout this adjustment period. The current account deficit declined from more than 10 percent of GDP in 1988 to around zero in 1992.

Investment increased sharply between 1988 and 1992, while foreign aid was drying up. In response to stabilization, strengthened property rights, and a greater openness to foreign trade, domestic savings increased by 20 percent of GDP, from negative levels in the mid-1980s, to 16 percent of GDP in 1992. Foreign financial assistance was not offered to Vietnam until the country had an established track record of successful macroeconomic and trade reform. Financing from the World Bank and the IMF resumed in 1993. While the delay was largely political, it perhaps offers a useful lesson: too much financing in the early stages of reform may delay adjustment rather than support it. In Vietnam's case foreign aid came after good policies were in place.

4. Quick benefit for a large number of households. The underlying distribution of assets in Vietnam was quite equitable. Vietnam has very little capital stock, its main assets are land and human capital. The distribution of land among households is relatively equitable and basic education and literacy are widespread. The vast majority of households were thus able to benefit quickly from market reforms and the opening of the economy to international trade.

Looking to the future, one important issue is whether the reform program will continue to generate robust growth. The state sector is still large and significant impediments to foreign trade and investment remain. It would be more difficult to promote private investment or to reduce protection of inefficient industries, if a large number of state-owned enterprises remained intact. Progress with structural reforms is thus one of the factors that will influence the country's growth. Divesting state enterprises, improving the environment for private investment, and lowering trade barriers are all structural reforms that will help sustain the growth of recent years. It will be easier for the government if it moves on all these policy fronts at once.

Vietnam: Economic Rethinking Amid Slowdown

Prime Minister Phan Van Khai told international donors during a one-day conference on June 15 that Vietnam was struggling to overcome its lack of competitiveness and efficiency in the face of the regional economic crisis. The weakness of the economy itself is the biggest bottleneck, the prime minister pointed out, adding, "growth during the first five months of the year had slowed to 6.8 percent (from 8.8 percent growth recorded in the same period last year). Vietnam's financial and monetary systems have many shortcomings, the government's management apparatus has not improved and is engaged in corrupt activities. Useful lessons must be drawn from the regional crisis. These include the need to create a level playing field and the encouragement of the entrepreneurial spirit and the promotion of competitive Vietnamese goods."

Donors' Alert

The meeting in the central Vietnamese city of Hue was the first of its kind that brought together Vietnam-based representatives of the members of the Consultative Group on Vietnam, which meets annually to coordinate the international community's aid pledges. The major donors include the World Bank, the International Monetary Fund (IMF), the Asian Development Bank, the United Nations Development Program, Australia, France, Japan, and Sweden. The group's last meeting in Tokyo resulted in aid pledges of $2.4 billion for 1998. The mid-year meeting reflected the donors' concern both over the pace of reform and over the impact of the regional economic crisis. They reiterated support for accelerated reforms in the financial sector, rationalization of state-owned enterprises, trade liberalization, and the reinvigoration of rural development. Rural development assumes both transferable land tenure and the deregulation of economic activities in rural areas. Donors also acknowledged that Vietnam faces a dilemma over economic reform, particularly the social costs of embarking on initiatives such as restructuring state-owned firms.

Donors felt that fiscal transparency, specifically the publication of the state budget and other data, was critical to a continued high level of foreign assistance and important for Vietnamese citizens and the private sector. With technical assistance available from the IMF and the World Bank, donors expressed hope that the budget will be published before the next meeting, which will be held in Paris, December 7-8, 1998.

Macro Worries

The impact of the East Asia crisis on the economy is reflected in the slower growth of industrial output, exports, as well as declining investment.

- **Industrial output** rose by 12.6 percent for the first six months of the year to $5.55 billion, down from 13.6 percent in the same period last year, according to preliminary official statistics released on June 25. State-owned enterprises, which accounted for 47 percent of industrial output, saw a rise in production of just 9 percent. Foreign-invested enterprises accounted for 31 percent of industrial output and registered a 21.8 percent increase in output. (More than 80 percent of foreign-invested projects are done in collaboration with state-owned enterprises.)

- **Exports** grew by only 10 percent during the first six months, its lowest figure in many years, and less than half the 25 percent growth for all of last year, reflecting slower East Asian demand and a loss of price competitiveness owing to the relative strength of the dong. Consumer goods exports—shoes and textiles and garments—have been worst hit, as demand from Japan and the Republic of Korea has fallen sharply. Imports grew by just 1.8 percent in the first five months of this year.

- **Foreign investment** has fallen 15.3 percent year-on-year in the first five months of 1998, and more and more foreign investors have scaled back or closed down altogether over frustration with rampant corruption, excessive bureaucracy, and opaque laws. For East Asian investors, who account for 64 percent of foreign direct investment inflows recorded to date, the cost of investing has increased as business transactions are increasingly conducted in U.S. dollars. EU and U.S. investors are also adopting a more cautious approach, despite the fact that this is a market of 75 million people, nearly 50 percent of whom are under the age of 25.

- **Both domestic and foreign companies are laying off workers** in growing numbers. Before the Asia crisis nearly 5 million people were jobless and the unemployment rate was estimated at 12.3 percent. It is estimated that up to 30 percent of state-owned enterprises (SOE) employees, or 600,000 people, are excess labor.

- **The agricultural sector** has been hit by drought and serious damage has been done to key crops. In the first five months of this year agriculture—which accounts for 28 percent of annual GDP—grew by just 2 percent, while annual agricultural growth rates over the past few years came to an average of 4.5 percent.

In mid-February the Central Bank of Vietnam lowered the interbank foreign currency rate by 5.3 percent to 11,800 dong to the dollar, but many foreign bankers...
and economists say the dong is still overvalued. They predict increased pressure against the dong because of the considerable decline in new foreign investment, a slump in export growth, and general concern about the deterioration of the Vietnamese economy. The competitiveness of shoes and garments—Vietnam’s chief manufacturing exports, which account for about 25 percent of export earnings—is especially vulnerable since the main competitors, Indonesia and Thailand, have seen their currencies depreciate between 50 and 70 percent. But Vietnam has been reluctant to undertake another major currency adjustment, it is concerned about the instability that a major devaluation might cause. Instead, it is offering new incentives to investing foreign companies and exporters. These include further tax reductions and lower land rents.

New Slogan: Equitize!

In mid-June Communist Party General-Secretary Le Kha Phieu called on SOEs to press ahead with the government’s program of partial “equitization” (privatization) of state-owned enterprises. Establishing vibrant, “equitized” companies is seen as a good way to create employment. Equitization is also regarded as necessary if plans to launch a stock market within one to two years are to be realized. As a first step the government plans to establish a Stock Exchange Centre, scheduled to be in place by September this year. The original program was launched in 1992, and its revitalization has taken on new momentum since Prime Minister Phan Van Khai came to office last year.

The government has indicated its intention to equitize 60 percent of the country’s 6,000 SOEs. To date, 26 small, mostly local SOEs have been equitized and a further 200 have registered for partial privatization. Of these, around 100 firms are believed to be financially sound. There are plans to equitize 150 firms by the end of the year, followed by a further 250 in 1999, and 600 in 2000. If any SOEs have been loss-makers for several years, bankruptcy proceedings are to take effect.

Strategic companies in such sectors as energy, telecommunications, and aviation, however, are excluded from the equitization process. Firms that are highly profitable, or the sale of which would involve large redundancies, will not be equitized either. Shares in equitized firms have hitherto been sold to companies’ existing management and workforce. Outside investors are scrutinized closely to ensure their suitability. Foreign investors are currently limited to holding 30 percent of a company’s equity. The pace of the equitization process is likely to be constrained by several other factors, including the following:

- Job losses have become increasingly politically sensitive. Firms are unlikely to receive government approval for laying off large numbers of workers.
- Due to concerns about rising layoffs and the loss of privileges that accrue to SOE managers, companies have been slow to volunteer for inclusion in the equitization process. Some firms are also concerned that evidence of mismanagement or corruption will come to light.
- Several banks are refusing to lend to newly equitized companies on the grounds that their profitability is not yet assured.
- SOEs enjoy relative autonomy in terms of day-to-day decisionmaking. Within each firm there is a complex set of relationships involving the controlling institution (usually a ministry or local government), the company director and the board of management, as well as the Communist Party and labor units. The various interests of these groups will have to be reconciled if equitization is to proceed.
- Before an enterprise can equitize, it must be audited and its assets valued, a process that has proven to be extremely complicated.
from family members or private money-lenders who charge very high rates of interest.

Various initiatives are currently under way to strengthen the banking system. A number of local banks have broadened their loan portfolios to include private, small, and medium-size enterprises, and even small market traders. A program of bank mergers has been designed to strengthen the sector.

**The World Bank's New Strategy**

The World Bank will announce later this year a shift in its Vietnam strategy away from big infrastructure projects and toward poverty eradication and rural development. Country Director Andrew Steer announced recently. World Bank economists are now working with the Vietnamese authorities on a Rural Development Strategy Report, which will be published in August and will serve as the basis for discussion by Vietnam's major donors during their forthcoming December meetings, where they will decide on their 1999 aid packages.

The new emphasis is in line with the World Bank's policies around the world and is also a response to conditions in Vietnam. At stake is the future of the country's peasants, who make up nearly 80 percent of Vietnam's population. Agricultural productivity has risen, but jobs off the farm are not being created fast enough, the World Bank believes.

The latest project of the Bank already reflects this new approach. A $67 million IDA credit, approved on June 25, will help small farmers diversify their agricultural production into rubber, livestock, and crops in order to reduce rural poverty and maintain growth in rural incomes. A $70 million annual rubber output would create 25,000 full-time jobs and increase farm income for some 100,000 families. For the next two years the Bank is hoping to add 5 to 10 more local economists to its staff of 25 people and release another $600 million in loans, in addition to the $1.6 billion concessional loan and grant assistance already pledged. Since 1994 the World Bank has disbursed about $475 million to Vietnam.

### Milestones of Transition

**The European Bank for Reconstruction and Development (EBRD) forecasts 2.5 percent growth for Eastern Europe and the countries of the former Soviet Union in 1998.** The EBRD released its forecast at its annual meeting held May 11-12 in Kiev. GDP growth of 3.9 percent is seen for Eastern Europe and the Baltics this year. The Commonwealth of Independent States (CIS) region should have GDP growth of 1.5 percent. Of individual countries, Estonia should experience GDP growth of 5.5 percent (the 1997 estimate was 10 percent), Latvia 6.0 percent (6.5 percent in 1997), Lithuania 5.5 percent (5.7 percent in 1997) and Russia 1.5 percent (0.4 percent in 1997). The mounting current account deficits require fiscal policy measures. As a lesson from the Asian crisis financial sector reform is needed. Last year the EBRD provided $2.6 billion in financing for 108 new projects. The EBRD presently has outstanding disbursements of more than $5 billion, about $1.5 billion more than in 1996. The largest debtors are Hungary, Poland, Romania, and Russia.

**Foreign direct investment (FDI) in transition economies was up a third in 1997.** A recent Financial Times survey found that FDI in transition economies rose from $13 billion in 1996 to $17 billion in 1997. The growth in FDI from 1996 was nearly 20 percent in Central and Eastern Europe and 54 percent in CIS countries. FDI to Russia in 1997 was $3.9 billion (up 90 percent), Estonia $131 million (up 18 percent), Latvia $415 million (up 10 percent) and Lithuania $327 million (up 115 percent).

**Leaders and laggards in the CIS economies.** Official data for the 11 CIS economies in the first quarter of the year show some successes, but most of the economies have still not shaken off their economic depression. (CIS Goskomstat bulletin, May 21). The Kyrgyz Republic and Georgia led the pack with reported GDP growth of 11 percent, followed by Azerbaijan with 8 percent. Armenia reported 6 percent growth, Belarus 13 percent, Tajikistan 1 percent, and Uzbekistan 3 percent growth rate. In the first quarter Moldova and Russia registered zero GDP growth, while Ukraine and Turkmenistan experienced a drop. Even though industrial output has stabilized in countries such as Kazakhstan and Moldova, agricultural output continues to fall there: meat output was 40–50 percent down from the 1997 level in those countries. This was also the case in Ukraine and Russia.

**EU Expands University Exchange to Central and Eastern Europe.** The European Union for the first time is extending its university exchange program, Erasmus, to five countries in Central and Eastern Europe. This year’s budget is more than $125 million. On May 25 the EU Commission approved the participation of 149 Central and Eastern European institutions of higher learning in the 1998/1999 academic year. More than 8,000 students and teachers from the Czech Republic, Hungary, Poland, Romania, and Slovakia will be spending study periods of up to one year at universities in EU countries. Their studies will cover languages, science, social studies, economics, and other areas. By the next academic year the Baltic repub-

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Continued on page 22
Can Ukraine Avert a Financial Meltdown?

Cash-strapped Ukraine had drifted to the brink of an economic crisis by mid-June. While the budget deficit swelled, the wage and pension arrears further accumulated, provoking an angry strike action from miners. The country’s payment obligation to foreign investors surged to a dangerous level. The legislative process has been paralyzed for months following the March election, as the parliament (Verkhovna Rada), dominated by leftists and centrist opposition, was unable to elect the speaker who is extremely powerful politically in Ukraine. Finally, in early July a prominent figure of the opposition, Oleksandr Tkachenko received the necessary votes. That makes him a likely candidate to contest the presidential elections in the summer of 1999.

Some major highlights of the present economic situation are as follows:

- **The government’s already large debt is expanding as a consequence of sizable budget deficits.** In the first four months of 1998 budgetary revenues amounted to 4.1 billion hryvnias (against a full-year target of 21.1 billion hryvnias), while debt servicing and repayment costs were 4.7 billion hryvnias. The revenue-collection shortfall so far this year as a result of tax evasion and delayed privatization initiatives is estimated at more than 5 billion hryvnias. Prime Minister Valery Pustovoitenko acknowledged that privatization receipts from January to May were 214 million hryvnias, against a full-year target of more than 1 billion hryvnias.

- **The short-term obligations of the government are fast increasing.** The budget deficit has been financed primarily through the selling of treasury bills (T-bills). In 1996 investors held T-bills with a total value of about $1.9 billion. In 1997 the government’s obligation increased to $5.6 billion and in April 1998, to $6.5 billion. The government has to redeem about $4.5 billion hryvnias worth of bonds within nine months; and $500 million worth of T-bills matured in June. Also, the interest rate is high and yields on treasury bills of various maturities are currently at 60 percent.

- **Foreign investors—who held half of Ukraine’s treasury bills last year—are increasingly selling their holdings.** They have been purchasing only 10 to 25 percent of the securities in recent months. Their exodus from the T-bill market has already forced the National Bank to spend $1 billion to prevent the hryvnia from falling. The money comes from borrowing on the overseas capital markets. After borrowing more than $1 billion recently, the government is now planning to raise another $2.5 billion to pay off mature T-bills and foreign debt in the next three months. Ukraine’s foreign debt has reached $12 billion, compared to $450 million in 1994.

- **The government’s huge financing needs crowd out the “real economy’s” capital needs.** There is an acute shortage of credit. In 1997 commercial banks provided less long-term loans to enterprises than in 1994, when inflation was still rampant. (At least inflation has been constrained; in 1998 it lingers below 10 percent.) The maturity of most long-term loans is limited to one year and the loan recipients are usually forced to put up collateral worth 20 percent more than what they borrow. About 30 percent of bank profits come from nonlending activities—mostly trading—and the rest mostly come from short-term loans to favored customers.

- **In 1997 Ukraine’s GDP fell by 3.2 percent—the GDP has fallen by 60 percent since 1991.** Finally, in the first five months of 1998 it showed a 0.1 percent growth, compared to the same period last year. The GDP now stands at 35.7 billion hryvnias. While 12 percent of industrial units were officially recognized as unprofitable in 1995, the figure rose to 30 percent in 1996 and 45 percent in 1997. In January–May 1998 the number of loss-making companies grew to 51 percent of the total.

- **The omnipresence of corruption has been criticized recently by Professor James Mace, consultant to the Kyiv-based Deni (Day) newspaper. “Lawmakers openly sell their votes. The Interior Ministry has not solved a single big case like a political or big-business murder. Humanitarian aid is openly sold in almost every bazaar. The secret police agent spying on you can actually come up, introduce himself, and complain about how poorly he is paid. And nothing whatsoever can be done about it given the poverty that breeds corruption,” he lamented. According to an IFC survey small business owners receive a visit from a Ukraine government inspector once every four days. Given that the loss of any of the 36 licenses and permits needed to run a business would spell closure, most Ukrainians take these official “courtesy calls” very carefully.”**
seriously. The state-sponsored meddling could be one reason why most of Ukraine’s economy is run off the books and out of sight.

- The shadow economy has reached 60 percent of GDP, Ukraine’s tax chief acknowledged in mid-June. Mykola Azarov, head of the State Tax Service, estimated the size of the shadow economy at between $13 billion and $15 billion, with the vast majority of commerce conducted in dollars. Only $3 billion of the total is kept in hryvnia. “The withdrawal of money from the legal economy into the shadow economy is continuing,” Azarov told the daily Facti. The existence of the shadow economy has hampered tax collection and has deepened the federal budget deficit. Tax arrears for the five months of 1998 stood at 25 percent for value-added tax, 15 percent for excises, and 87 percent for rental payments for oil and gas extraction and transit pumping of natural gas. More than 40 percent of all transactions in the economy are made through barter.

- Wage and pension payments arrears remain high. Wage arrears continue to grow and are estimated at $2 billion. Strikes by some 12,500 miners nationwide halted around one-third of the country’s coal mines, cutting national coal production by some 35 percent since the beginning of the year. Miner organizers estimate total wage arrears to miners across the country at 2.21 billion hryvnias ($1.1 billion). The miners are owed on average eight months in back wages, according to the Coal Industry Ministry. According to World Bank calculations, the average production cost of Ukrainian coal is about $50 a ton, compared with a world market price of $35. The industry is also caught in a web of inter-enterprise debt. Only four of Ukraine’s 250-odd mines are profitable at present. At most, 50 of the bigger ones have a future if they shape up. But making the mines profitable would cause social tensions. In the eastern province of Donetsk, coal mining supports 13 percent of the workforce. The government recently provided some funds to coal-producing regions and promised to give an additional 600 million hryvnya allocated by parliament to help the miners.

At the beginning of June pension arrears stood at 1.6 billion hryvnias ($800 million). Elderly people in eastern Ukraine who have not received pension payments for five months have been offered free coffins as an alternative, Facti reported.

Presidental Measures

On June 19 Ukrainian President Leonid Kuchma signed 15 emergency economic decrees aimed at raising revenues, cutting expenditures, and stimulating production. He warned the country’s parliament, which was too paralyzed to act while heavy international borrowing was nearing a critical mark, that a crisis could undermine the stability of the hryvnia.

The Presidential Decrees include:

- Halving the obligatory payments by employers (of their workers’ salaries) to 5 percent to go to a special government fund dealing with the consequences of the 1986 Chernobyl nuclear disaster.
- Unifying the agricultural production tax (10 such taxes existed previously).
- Allocating some 1.25 billion hryvnia ($625 million) in state funds to pay wages,

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Career in post-socialism

"Oh, what a big boy you've become. Soon you can leave the country!"

From the Hungarian magazine Hócipő
pensions, and social benefits;
• Allowing the government to introduce new excise and import tariffs.
• Restructuring or canceling debts by agricultural enterprises.
• Setting up "special economic zones" in the coal-producing Donetsk region.
• Lowering the current 20 percent value-added tax and simplifying tax procedures for small businesses.

The president's latest decrees will be submitted as draft laws to parliament and will add to the stack of 42 draft bills languishing in the parliament's in-box. (The Ukrainian Constitution forbids the president from issuing decrees that contradict legislation. Many of Kuchma's economic decrees, including the latest ones, can be challenged on those grounds.)

The new measures were announced soon after the latest mission from the IMF started its consultations in Kyiv on June 15. In July 1997 the Fund refused to grant a three-year, Extended Fund Facility (EFF) loan worth $2.5-3 billion, instead awarding the one-year standby facility. But even that standby's disbursement was suspended after Kiev ran a budget deficit of almost 6.0 percent of GDP in the first quarter of 1998. The target set in the 1998 budget is 2.3 percent of GDP. The IMF has repeatedly faulted Ukraine for not implementing meaningful economic reforms, including sweeping privatization and structural economic changes.

"Ukraine is doing a better job of managing its economy and might qualify for a resumption of aid from the International Monetary Fund," First Deputy Managing Director Stanley Fischer was quoted as saying on June 21. Negotiations were focusing on a $2 billion EFF loan and the resumption of a $542 million standby credit. Fischer said that there are still some technical problems and that the final decision on the EFF loan will be made in late July.

**New EU Norms To Ease Customs Logjam in Eastern Europe**

by Peter Davies

DHL recently commissioned a report that looked into customs delays in Central and Eastern Europe. It revealed that major investors in the region were being stifled by a "red tape curtain" of excessive bureaucracy and a lack of understanding of their needs (Transition, December 1997, p. 14). The company, being well aware that customs delays hurt not only its clients—international businesses—but also the countries themselves, commissioned the report to open a debate involving governments, international organizations and businesses, and to jointly find a solution to these problems.

Recently, the European Commission completed its proposals about reforms that customs authorities in 10 Central and Eastern European countries—identified for eventual European Union (EU) membership—should adopt before accession. The recommendations go a long way toward addressing many concerns about customs in the region. If implemented by customs authorities, businesses will notice a real change for the better at border crossings and airports. In May the Commission passed a copy of their blueprints on to DHL. It is worth highlighting a number of the recommendations, even if customs rules change fairly frequently in Central and Eastern Europe, where the economies are still in a state of transition.

The blueprints deal extensively with communication. Customs authorities in the accession countries are asked to provide as much information as possible about customs procedures and legislation through brochures, seminars, free telephone lines, or internet sites. (To keep business clients up-to-date, DHL—besides dealing with its customers directly—will open up communication channels with other air express carriers as well as national chambers of commerce).

The blueprints stress the need for customs authorities to develop an efficient information technology system that ensures that shipments are cleared to the highest level of efficiency. Only systems that meet the needs of governments and businesses and that are compatible with EU standards should be installed. Obviously, with only a year and half to go before the next millennium, these systems should be "year 2000 compliant."

The EU suggestion that customs regulations should reflect the concept of proportionality is highly welcome. A lot of customs difficulties are caused by overzealous application of the rules. Not that customs officials in Central and Eastern Europe should stop being vigilant—far from it. However, in some cases shipments worth a few dollars are levied duties of 30 or 40 times that amount.

Another EU suggestion is also directly applicable: Governments should develop a stable, comprehensive, and modern legal framework to ensure EU customs legislation.

Emphasizing partnerships between customs authorities and businesses is perhaps the most encouraging aspect of the European Commission's blueprints. The issue of "trade facilitation" warranted a section of its own. Throughout the document one major leitmotif is how customs authorities can meet the needs of businesses, trade bodies, and air express op-
erators. In particular, customs authorities are asked to:

- Sign "memorandums of understanding" with major trade and transport bodies, provide electronic data interchange (EDI) links to the trade, and consult regularly with organizations such as chambers of commerce. (DHL has signed such agreements with customs authorities around the world.)

- Set up a Customs Consultative Committee "comprising representatives of national trade organizations and representative groups" that should meet on a regular basis.

- Keep the needs of businesses in mind when new legislation is introduced.

- Establish good relations with businesses as an integral part of the management plan, and to make sure it is communicated to all customs officials.

- Establish clear roles and responsibilities for customs officials, and ensure that businesses know about them.

- Commit to clearing shipments with the minimum of delay, and regularly monitor and reduce waiting times.

The blueprints do not specify time limits and would not say what will happen if countries do not conform. It is, however, understood that in each country a gap analysis will be made of the situation by the end of 1998. This will then form the basis of future EU support for improving the situation.

A brief glance at the World Economic Forum's latest Global Competitiveness Report should be enough to instill a sense of urgency. Even the three most successful Central European transition economies were laggards: the Czech Republic was 35th, Hungary, 43rd, and Poland, 49th—out of the 53 countries included. Meanwhile Russia and Ukraine ranked last and next to last. (The competitive index is built on the average of eight factors: openness, government, finance, infrastructure, technology, management, labor, and institutions.)

What goes on at customs points is of key importance to DHL and the businesses it serves, being the largest company handling the largest number of imports into Central and Eastern Europe and a major employer in the region. The European Commission's blueprints should be broadly welcomed. It could be an important step in the right direction, reducing some of the bureaucratic gridlock that is slowing down trade into and out of the region.

The author is DHL's regional director for Central, Eastern, and Southern Europe.

DHL would like to hear other organizations' views on customs in Central and Eastern Europe. Please contact Dirk Singer or Richard Kanareck. Tel. 44-171-465-7700; email: dirks@redconsultancy.com.

**Milestones of Transition**

Continued from page 18

A French-led consortium built the motorway using 95 percent private funding and 5 percent government funding. It then levied private tolls on car and truck drivers to recover the construction costs.

But Hungarians could not afford to pay the road tolls and when Austria joined the EU and six-hour queues built up on the Austro-Hungarian border, foreign drivers using the motorway turned to other routes. Public-Private Partnerships (PPPs), which include state involvement and private sector risk, hold the key to highway investment. (Ben Partridge of RFE/RL describing Peter Bennett's article, The Long and Winding Road, published in Central European, a banking and finance monthly).

**Poland.** First-quarter growth was 6.5 percent year-on-year, the Central Statistical Office reported recently. This is unchanged from the last quarter of 1997, confirming the continued strength of the economy. Industrial production was up 10.4 percent and investment 17.0 percent. The 1997 trade deficit was $16.5 billion, up 30 percent over 1996, according to the Central Statistical Office. Imports rose 13.9 percent to $42.3 billion while exports rose 5.4 percent to $25.7 billion. The growth in imports was led by investment goods. Together with strong inflows of foreign investment, this moderates concern about the external imbalances.
World Bank/IMF Agenda

World Bank Approves Funding Up to $700 Million to Bulgaria

The World Bank had approved a three-year funding strategy for Bulgaria, which envisages lending between $300 million and $700 million, depending on the country's needs and reform performance. "The actual level and composition of new lending will depend on the government's progress in achieving specific benchmarks outlined in the country assistance strategy," the Bank said in a statement. The World Bank's optimistic scenario for Bulgaria consists of several triggers, which include continued macroeconomic stability and sustained accords with the IMF. The pessimistic scenario with the lower figure covers projects that are less dependent on macroeconomic and structural reform as well as loans to reduce poverty with community participation. Since Bulgaria joined the Bank in 1990, the Bank has committed loans totaling more than $1.2 billion for 15 projects.

Caio Koch-Weser: CEE Entrants Need More Transparency

With the forthcoming accession of Central European countries to the European Union (EU), transparency remains a key challenge. Greater openness to trade and capital flows demands much better macro-management and financial systems, World Bank Managing Director Caio Koch-Weser said in Salzburg during the Central and East European Economic Summit in June. "Incestuous connections

Declining Income—World Bank Works on Solution

It has been more than a year since World Bank President James Wolfensohn first warned finance and development ministers at their spring meetings in Washington that the Bank was facing a long-term decline in its income. Income is being squeezed from two directions:

- The Bank's standard lending is no longer profitable at the margin, as income from its loan spread covers a declining share of costs. It implies that there is a growing level of subsidy to the borrowing members of the Bank. "If no action is taken, the subsidy would grow and the potential for using net income for other purposes would decline," warned the management in its recent report.

- Demand is increasing on the Bank's net income, including the debt-relief initiative for the heavily indebted poor countries (HIPC). As a consequence, net income from $1.3 billion in fiscal 1997 is likely to fall to about $1 billion in fiscal 1998, which ended on June 30, and may drop to $700 million next year and rise to $1 billion in subsequent years.

U.S. Treasury Secretary Robert Rubin, during the IMF/World Bank spring meetings warned that middle-income countries would have to pay more to borrow from the Bank, as loan charges should cover administrative costs at a minimum. There is now a wide consensus that the Bank needs new measures to raise its income. On June 11 the Bank's management team—backed by President Wolfensohn and led by Managing Director Jessica Einhorn, Acting Vice presidents Deborah Danker and John Wilton, as well as Principal Financial Policy Analyst Nirmal Paul, proposed a series of measures to shore up income by:

- Increasing the cost of loans in the new financial year by 30 basis points to 80 basis points above the Bank's funding costs.
- Charging a 1 percent front-end fee in addition to the 0.75 percent commitment fee.
- Eliminating the 25 basis points interest rate waiver to countries that service their debts on time on earlier loans for the next two fiscal years.
- Deferring cash payments to IDA and to the trust fund for debt relief, thus reducing the sums needed to be kept in reserves.

Nevertheless a group of 10 executive directors representing the middle-income borrowing countries asked for more work towards a more balanced solution than the one proposed. They suggested that the problem was one of increasing demands on income, not that borrowers were being subsidized. The directors therefore recommended that further demands on the Bank's income should be postponed, with the exception of post-conflict assistance, African capacity building, soft loans and debt relief for poor countries. They urged the Bank to reduce administrative costs.

In April, during the IMF/World Bank meetings, Chinese Finance Minister Xiang Huaicheng said that China is highly concerned about the idea of increased borrowing charges. China cannot agree to the proposal of changing the pricing policy for conventional lending services.

Despite the conflicting interests of the Bank's power blocs, an agreement is expected before the September annual meetings.

(Based on articles by Robert Chote of the Financial Times, and Kevin Rafferty of Bank's World.)
between the enterprise and banking sectors undermine the financial health of the banking sector and reduce competitive pressure on enterprises," he warned. Adequate banking and financial sector regulations and accelerated privatization of the banking sector were key issues to be tackled. With the Czech Republic, Poland, Hungary, Estonia, and Slovenia slated to join the EU and others working to meet the EU’s Maastricht criteria, the Bank’s programs in the region envisage help to ensure long-term fiscal sustainability, reforms of pension systems, better tax administration, infrastructure implementation, and agriculture and environmental projects. The Bank is also advising on adapting legislation to EU standards.

**China: World Bank’s Largest Borrower**

China continues to be the largest borrower of investment funds from the World Bank. In fiscal 1998, which ended June 30, 1998, it received $2.6 billion, accounting for about 9 percent of overall World Bank commitments. Fiscal 1998 lending to China brings total cumulative lending up to about $30.4 billion, of which $20.6 billion is from the International Bank for Reconstruction and Development (IBRD) and US$9.8 billion, from the International Development Association (IDA), for a total of 200 projects financed. Infrastructure lending (transport, energy, industry, and urban development) accounts for more than half of the total portfolio, with agriculture, the social sectors (health and education), the environment, and water supply and sanitation comprising the remainder.

In the final four weeks of fiscal 1998 more than $1.7 billion worth of loans and credits were approved for China as follows:

- $300 million to promote food security, irrigation reform, and environmental protection in 5 provinces in the Huang-Huai-Hai plain (approved on June 18)
- $300 million to alleviate power shortages in Hunan province, providing funds for building two new thermal power plants and reinforcing the transmission infrastructure (approved on June 18)
- $150 million to improve irrigation and water management and increase agricultural production in economically depressed Tarim Basin in southern Xinjiang. The incomes of about 200,000 poor households will rise. About 40 percent of households directly benefiting from the project are below the poverty line and have an annual net income of less than 530 yuan (about $64) per capita (approved on June 10)
- $200 million to improve urban transport in Guangzhou City (approved on May 29)
- $123 million to upgrade inland waterways in Guangdong and Jiangsu provinces (approved on May 29)
- $28.4 million to provide earthquake reconstruction assistance in Heibei (approved on May 29)
- $250 million to further develop the National Highway project in Huabei (approved on May 29)
- $200 million to develop forest resources in poor areas of central and western China (approved on May 26)
- $85 million to improve the management of health resources, upgrade rural health facilities, and increase the affordability of services in 97 counties with a total population of 48 million people (approved on May 23)
- 100 million to develop ocean farming techniques by establishing coastal zone management systems. (approved on May 19).

**Joseph Stiglitz: Aid Conditions Only Conditionally Effective**

Conditionalities imposed upon recipient countries of development aid do not always have a significant effect on policy. Countries should be at the center of forming development strategy and, besides their government, broader segments of society should also participate in the design and implementation of the project, World Bank Senior Vice President and Chief Economist Joseph Stiglitz told a symposium on development cooperation in Tokyo on June 23. Research shows that aid does not necessarily contribute to
growth, but the connection becomes stronger if aid is coupled with sound economic policies. One implication is that donors can achieve greater returns for their resources by shifting money from countries with unsound policies to countries with sound policies. "This is donor selectivity of countries." But recent World Bank findings also imply that donors need to be more selective in choosing projects, although they have only a limited ability to break the link between unsound policies and aid effectiveness. If donors, for example, took over the funding of a rural health project in a recipient country, this would free up resources for that government to use elsewhere, either as additional spending or tax reduction. "But donors, especially when they focused exclusively on projects, had little control over this additional spending," Stiglitz said.

$1 Billion Loan for Saving Poland's Coal Industry?

Polish Deputy Prime Minister Leszek Balcerowicz has said Poland may borrow some $1 billion from the World Bank over several years to finance the restructuring of the country's coal mining sector, whose debts total almost $4 billion. That statement followed a two-week visit by a World Bank delegation to Poland. Basil Kavalsky, World Bank country director for Poland and the Baltic states, cautioned that the loans would be forthcoming only if satisfactory implementation arrangements were included in the program. The plans have yet to gain cabinet approval and will not be debated in parliament until fall. As they stand, the plans envisage a cut in coal output from last year's 137 million tons to 112 million tons in 2002. The present employment level of 232,000 would be cut to 138,000 in that year. The loss-making industry would return to a profit in 2001, with productivity per miner growing by some 41 percent over the next five years. The Bank wants to tie incomes of coal management to improvements in profitability and to see miners' wage rises lagging behind productivity increases. The World Bank loans would finance about half the costs of the restructuring program and would help cover redundancy payments, job creation, retraining programs, and environmental cleanup costs.

IMF Will Resume Moldova's Support, If...

The IMF is ready to resume lending to Moldova in October if that country implements an austerity program agreed on by the two sides, said Oleh Havrylyshyn, IMF deputy director responsible for operations in the countries of the former Soviet Union on June 17. The agreement stipulates that the austerity program will be implemented in the coming months. As a result, economic growth should reach 3 percent in 1998, inflation should be slashed to 7 percent, and the budget deficit to 2.9 percent of GDP, enabling the IMF to release a $28 million tranche in October from a three-year Extended Fund Facility (EFF). The disbursement was suspended in July 1997. The successful implementation of the program would also make it possible for the World Bank to resume financing and the IMF to release another $100 million in 1999. Prime Minister Ion Ciubuc pointed out that 1998 and 1999 will be peak years for repaying external debts: $215 million has to be repaid this year and $235 million next year.

IMF Loan to Shore up Kyrgyz Republic's Currency, and....

The board of the IMF approved an economic structural adjustment facility (ESAF) loan for the Kyrgyz Republic. The Kyrgyz Republic will receive between $20 million and $36 million annually for the next three years. Finance Minister Talaibek Koichumanov said that the money will be used to support the national currency. The Enhanced Structural Adjustment Facility loan (ESAF) is available to the poorest members of the International Monetary Fund (IMF), at a 0.5 percent interest rate with five-and-a-half-year grace period.

......Support Tajikistan's Economic Plan

The IMF will provide Tajikistan with a three-year, $128 million loan to support the government's 1998-2001 economic plan, announced on June 25. The first installment of $24 million will be available immediately. A statement from the Fund said that the medium-term government plan was based on a 4 percent export-led growth. Inflation should drop to eight percent, and the fiscal deficit to 0.3 percent from the present 3.3 percent. Earlier, international donors, including the World Bank and the IMF, pledged $280 million to Tajikistan at a meeting at the World Bank's Paris office.

World Bank loan for Kazakhstan's Pension Reform and Private Farmers....

Kazakhstan will receive $300 million from the World Bank for pension reform making "transition from the Soviet-era retirement system to a model using individual savings accounts" possible. The loan that was approved on June 25 will assist the transition to a fully-funded pension system by financing part of the estimated 1.7 percent of GDP fiscal deficit brought about by pension reform. The new system is based on funded savings accounts that will accrue assets through individual contributions equal to 10 percent of earnings. On June 2 a $15 million loan was provided for Kazakhstan to support the development of newly privatized farms and agro-enterprises and to improve rural productivity and incomes. A series of small loans will finance information services to farm shareholders who at present are not well aware of their rights and opportunities. Also, local advisory centers will be set up to give farmers technical and commercial advice and training. Since Kazakhstan joined the Bank in 1992, Bank
commitments to the country have totaled $1.65 billion for 16 projects.

...Improved Heating System in Bishkek, Kyrgyz Republic...

The Kyrgyz Republic recently received $15 million in IDA credits for improving the heating and energy systems in the capital of Bishkek. The new credit will supplement a credit of $30 million provided for the same project. Since the Kyrgyz Republic joined the World Bank and IDA in 1992, credits to the country have totaled $436 million for 16 projects. During their May meetings in Paris donors approved $600 million in aid to the Kyrgyz Republic for the next 18 months. It is largely to support the country's public investment program.

...Privatization in Uzbekistan...

A $28 million World Bank loan to Uzbekistan, approved on June 26, will help in the privatization of large government enterprises. The loan will also contribute to establishing consulting services to private companies and developing capital markets. In May the World Bank gave $24 million for restoring Tashkent's solid waste management system. Since Uzbekistan joined the Bank in 1992, the Bank's commitments have totaled $379 million for seven projects.

...Water Supply in Yerevan, Armenia...

A $30 million credit to Armenia, approved on June 11, will make emergency improvements in the drinking water supply to Yerevan, particularly to the poorer, most affected population. It will also improve the management and delivery of water and wastewater services for the Yerevan area and lay the groundwork for the involvement of the private sector in these services. Since Armenia joined the World Bank in 1992 and IDA in 1993, IDA commitments to that country have totaled $344.5 million for 14 projects.

...Public Finances in Bosnia...

A $63 million IDA credit for Bosnia and Herzegovina will help the country reform its public finances and manage its foreign debts. The new credit was given a green light on June 6, following the IMF's approval of Bosnia's 1998–99 macroeconomic program and a $81 million standby loan. "The credit represents a move from reconstruction to consolidating institutions and policy reform," Country Director Christiana Poortman pointed out.

On May 26 the World Bank announced a $7 million loan to Bosnia and Herzegovina to relaunch the country's forestry industry. On May 19 a $25 million credit was granted to continue rehabilitation of Bosnia's electric power system, and a $5 million credit was granted to help local banks provide funding for private enterprises in Republika Srpska. Since the war ended the IFC has put $25 million into Bosnia and Herzegovina to stimulate growth in the private sector, particularly small and medium-size enterprises.

...and Reform Program in FYR Macedonia

The World Bank is prepared to extend a $200 million loan to FYR Macedonia to back a three-year reform program in that country. The loans will focus on boosting private sector investment and growth, reforming public sector administration, and alleviating poverty; as well as on investments in water supplies, transport, and agriculture.

A World Bank delegation in Skopje signed a $35 million loan aimed at the rehabilitation of Macedonia's six largest hydropower plants, which represent 91 percent of the country's hydropower capacity. Another $29 million in social sector adjustment credits that should help employees who have been laid off from privatized companies, is under preparation.

The IMF approved a $24 million loan on June 24. The IMF projected real annual GDP growth of 5 percent for 1998 through 2000, up from 1.5 percent in 1997. Inflation in Macedonia would be 3 percent a year for 1998 through 2000, up from 2.7 percent in 1997, according to Fund projections.

IFC Invests in FYR Macedonia's Telecom

The IFC has agreed to buy a stake in Makedonski Telekomunakcii (MakTel), FYR Macedonia's state-owned telecommunications utility. It has subscribed to $25 million of convertible bonds in MakTel in a preliminary move aimed at paving the way for the flagship privatization of the telephone operator later this year, and has also undertaken to invest a further $25 million more of bonds for the account of participating institutions. The government is hoping that the IFC investment will increase interest from Western telecom groups in the sale of a strategic holding in MakTel this summer. A successful privatization of MakTel is crucial to government plans for reforming the economy.

China Needs Pension Reform

China's existing pension system is underfunded and lacks clearly defined benefit plans. It will fail to fulfill requirements or provide sufficient social security for the elderly in the next century unless it is replaced or supplemented with a personal savings insurance system. Speaking at the International Symposium on China's Social Security on June 26, World Bank Researcher Estelle James predicted that the elderly problem will reach a peak around 2030, when more than one-fourth of the world's elderly population will live in China.
Conference Diary

For the Record

14th Colloquium: Stretching the Boundaries of Organization Studies into the Next Millennium
July 9–11, 1998, Maastricht, The Netherlands

Organizer: Maastricht University.
Information: EGOS Colloquium Secretariat, Faculty of Economics, Maastricht University, P.O. Box 616, 6200 MD Maastricht, The Netherlands, tel. 31-43-388-3655, fax 31-43-325-8495, Email: egos@mw.unimaas.nl

European Integration Towards 2000
July 11–13, 1998, Lodz, Poland

Organizer: Foundation for European Studies, European Institute.
Information: Dr. Maria Karasinska-Fendler, General Director, Foundation for European Studies, European Institute, 262/264 Piotrkowska str., Poland, tel. 48-42-37-5047/5048, fax 48-42-37-0586, Email: obeul@plnlo51.bitnet

Upcoming

International Workshop: Transition and Enterprise Restructuring in Eastern Europe
August 20–22, 1998, Copenhagen, Denmark

Organizer: Center for East European Studies.
Information: Center for East European Studies, Copenhagen Business School, Dalgas Have 15, DK-2000 Frederiksberg, Denmark, tel. 45-3815-3030, fax 45-3815-3037, Email: cp.cees@cbs.dk

European Meeting of the Econometric Society
August 29–September 2, 1998, Berlin, Germany

Organizer: Institute for Business and Economics, University of Wisconsin-Whitewater, United States.
Information: Prof. George Tesar, College of Business and Economics, University of Wisconsin-Whitewater, Wisconsin 53190, United States, tel. 1-414-472-4951, fax 1-414-472-4863, Email: tesarg@uwwvax.uww.edu, or Dean Karel Rais, Faculty of Business and Management, Technical University of Brno, Technicka 2, CZ-616 69 Brno, Czech Republic, tel. 42-5-4114-2685, fax 42-5-1421-1410, Email: rais@fbm.vutbr.cz

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Multilateral Investment Guarantee
Agency Guarantees Investment Fund

For the first time, the Multilateral Investment Guarantee Agency (MIGA) has issued a guarantee to cover an equity investment fund, the Kyiv-based Ukraine Investments Limited. Also for the first time, MIGA will cover local downstream investments made by this fund. The Ukrainian fund will invest in projects that focus on the agribusiness, construction, and infrastructure sectors, and that meet MIGA's criteria for developmental benefits and environmental soundness. MIGA, formed in 1988, supports foreign direct investment to developing and transition countries. It provides political risk insurance against such risks as transfer restriction, expropriation, breach of contract, and war and civil disturbance and offers investment marketing services.

Global Environment Facility Grants:
Protecting Aral Sea, and...

The World Bank on June 11 approved a GEF grant of $12.2 million for the Aral Sea Basin Program (Kazakhstan, the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan). This project will address the root causes of the overuse and degradation of the international waters of the Aral Sea Basin, reduce water consumption for irrigation by at least 15 percent by the end of 2002, and lay the groundwork for greater investment in the area.

...Saving Lake Ohrid

A $4.1 million GEF grant to Albania and the FYR Macedonia will help to conserve and protect the natural resources and biodiversity of Lake Ohrid, shared by both countries. The lake is 2–3 million years old, one of the largest biological reserves in Europe, possessing unique flora and fauna that are extinct elsewhere. The grant will be used to try to contain pollution in the lake, caused primarily by erosion, agricultural run-off, and high concentrations of phosphorus.

The Sixth Annual International Conference: Business and Economic Development in Central and Eastern Europe—Implications for Economic Integration into Wider Europe
September 2–3, 1998, Brno, Czech Republic

Organizer: Technical University of Brno, Czech Republic; Nottingham Trent University, United Kingdom; Nicholas Copernicus University, Poland; and the University of Wisconsin-Whitewater, United States.
Information: Prof. George Tesar, College of Business and Economics, University of Wisconsin-Whitewater, Wisconsin 53190, United States, tel. 1-414-472-4951, fax 1-414-472-4863, Email: tesarg@uwwvax.uww.edu, or Dean Karel Rais, Faculty of Business and Management, Technical University of Brno, Technicka 2, CZ-616 69 Brno, Czech Republic, tel. 42-5-4114-2685, fax 42-5-1421-1410, Email: rais@fbm.vutbr.cz

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5th Conference of the European Association for Comparative Economic Studies: Economies in Transition and the Varieties of Capitalism: Features, Changes, Convergence
September 10–12, 1998, Varna, Bulgaria

Organizers: ROSES–University of Paris, Institute of Economics–Sofia, Bulgaria
Topics: Distinctive general features of the varieties of capitalism, “From Capitalism to Capitalism” - the change of different models/types of capitalism; “From Transitional Economies to Capitalism” - the change of economic systems, cooperation, and integration of capitalism and economies.
Information: Professor Wladimir Andreff, ROSES, University of Paris I, 106-112 Boulevard de l’Hopital F-75013 Paris, France, fax 33-1-45847889, or Professor Mitko Dimitrov, Institute of Economics, BAS 3, Aksakov Street, BG-1040 Sofia, Bulgaria, fax 359-2882108.

The Problems of Economic Integration of Ukraine into the European Union: Regional and Socio-Economic Issues
September 14–16, 1998, Yalta, Ukraine
Organizer: Ternopil Academy of National Economy.
Information: Johann-Wolfgang Goethe University, Frankfurt on Main, Germany. Ternopil Academy of National Economy, Lvivska st. 11, Ternopil, 282000, Ukraine, tel. 352-334-773, fax 352-334-773.

Management of Organizations: Regional Factors in the Process of European Integration
September 24–26, 1998, Kaunas, Lithuania
Organizer: School of Business and Management, Vytautas Magnus University.
Information: Edita Slamaite, School of Business and Management, Vytautas Magnus University, Daukanto 28, Kaunas 3000, Lithuania, tel. 370-7-228197, fax 370-7-203858, Email: Editaslamaite@fc.vdu.it

Competitiveness of Agricultural Enterprise and Farm Activities in Transition Countries
November 22–24, 1998, Halle/Saale, Germany

Information: Dr. Frauke Pirscher, Institute of Agricultural Development in Central and Eastern Europe (IAMO), Magdeburger Str. 1, 06112 Halle/Saale, Germany, tel. 49-345-5008138, fax 49-345-5170611, Email: pirscher@iamo.uni-halle.de

Marketing Strategies for Central and Eastern Europe
December 2–4, 1998, Vienna, Austria
Organizers: Kellstadt Center for Marketing Analysis and Planning, DePaul University, Chicago; Department of International Business Administration of the University of Economics and Business Administration, Vienna.
Call for Papers: Abstracts due August 31.
Information: Dr. Reiner Springer, Wirtschaftsuniversitaet Wien, Althanstr. 51, 1090 Wien, Austria, tel. 431-313-36/4371, fax 431-313-36/751, Email: springer@isis.wu.wien.ac.at, or Dr. Petr Chadraba, Kellstadt, Center for Marketing Analysis and Planning, DePaul University, 1 East Jackson Boulevard, Chicago, Illinois, 60604, United States, tel. 312-362-6200, fax 312-362-5647, Email: pchadrab@wpwpost.depaul.edu

Third International Conference on Enterprises in Transition
May 27–29, 1999, Split, Croatia
Organizer: Faculty of Economics, University of Split.
Information: Faculty of Economics Split, Radovanova 13, HR 21000 Split, Croatia, tel. 385-21-366033 or 362465, fax 385-21-366026.

Sixth ICCEES World Congress
July 29–August 3, 2000, Tampere, Finland
Organizers: The International Council of Central and East European Studies, Finnish Association for Russian and East European Studies (FAREES), Finnish Institute for Russian and East European Studies (FIREES) and the University of Tampere.
Call for Papers: Proposals for panels and roundtables are invited, presenting the results of new research on Central and Eastern Europe and the former Soviet Union. For more information on making proposals, see the website: http://www.rusin.fi.iccees. Deadline is January 1, 1999.

Addresses of the Program Committee members responsible for Economics: Dr. Franz-Lothar Altmann, Suedost-Institut, Guellstr. 7, Muenchen, Germany, tel. 49-89-74613320, fax 49-89-74613333, or Professor Urpo Kivikari, Institute for East-West Trade, Turku School of Economics and Business Administration, Box 110, FIN-20521 Turku, Finland, tel. 358-2-383570, fax 358-2-3383268, Email: urpo.kivikari@tukk.fi, or Academician Nikolai Shmelev, Institute of Europe, Russian Academy of Sciences, Mohovaja ul. 8, dom 3, RU-103873 Moscow, Russia, tel. 7-095-2037237, fax 7-095-2004298.

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

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

World Bank Publications


Working Papers


Mongolia's informal entrepreneurial activity has spectacularly expanded since the 1990s, when a large number of workers lost their regular jobs and migration from rural areas to the cities accelerated. Demand for earlier neglected services, such as distribution and transportation, surged but the formal labor markets were unable to absorb the surplus labor.

To order: Paulina Sintim-Aboagye, Room MC3-422, tel. 202-473-7656, fax 202-522-1155, Email: psintimaboagye@worldbank.org. Author: janderson2@worldbank.org


Performance contracts—written agreements between the manager of a state enterprise, who promises to achieve special goals in a certain time frame, and government, which promises to award achievements—in general didn't improve productivity in China's state-owned enterprises. And if incentives were weak and information asymmetrical performance contracts may even have reduced productivity. But if managerial bonds and profit incentives have been strong, wage-elasticity high, and overhead costs low, productivity could take off significantly.

To order: Margaret Murray, Room MC-4-333, Tel. 202-473-6095, fax 202-522-1157, Email: mmurray@worldbank.org. Author: dellerman@worldbank.org


A simpler, broader tax base and lower rates facilitate tax administration, increase revenues, and reduce opportunities and incentives for tax evasion. The 1997 tax reform program in Bulgaria was a step in the right direction: tax notes for the top income brackets were reduced, the number of tax brackets were halved, and the tax burden on the poor was relieved by an increase in the exemption level.

To order: Alison Panton, Room H-11-033, tel. 202-458-5433, fax 202-477-0816, Email: apanton@worldbank.org. Author: fahassan@worldbank.org


To order: Miriam Christian, Room G-8-058, tel. 202-473-6736, fax 202-522-3233, Email: mchristian@worldbank.org. Authors: pmock@worldbank.org and hpatrinos@worldbank.org.


Voucher investment funds should have provided the right corporate governance that was needed to restructure mass-privatized enterprises. Instead, investment fund managers collude with the enterprise managers in several countries to exploit the post-socialist version of the separation of ownership and control. They grabbed what they could by awarding fat salaries and bonuses to each other or fixing shady deals. [In the Czech Republic funds have been "tunneled" out of the enterprises to the pockets of the fund and enterprise managers. The editor.] The result has been stagnation and decapitalization of the privatized industrial sector.

To order: Alison Panton, Room H-11-033, tel. 202-458-5433, fax 202-477-0816, Email: apanton@worldbank.org. Author: alisonp@worldbank.org


Fighting inflation and keeping exports competitive requires cuts in the budget deficit and a reduction in government borrowing. As growth reduces inflation, infrastructure development and structural reforms should be part of a stabilization program.

To order: Fran Lewis, Room MC-8-168, tel.202-458-2979, fax 202-522-1784, Email: flewis@worldbank.org. Authors: idomac@worldbank.org and celbirt@worldbank.org.

Constantine Michalopoulos, WTO Accession for Countries in Transition, WPS...
Since the transition process started, inequality has increased in all post-socialist economies. That was the result of:

- Employees moving from a relatively egalitarian state sector to a less equal private sector
- The growing number of self-employed and property owners who are holding a rising share of income
- The declining income of unemployed state employees.

Increased inequality is accompanied by the thinning out of the earlier middle class (largely former state employees). Unfocused social transfers failed to dampen the increase in inequality.


Based on a farm-level survey conducted in Ukraine's 11 provinces between January and March 1996 on the first five years (1991–96) of agrarian reforms, the study argues that the growth of private farming has slowed down after a vigorous start. There are now around 33,000 independent family farms. The distribution of land and asset shares has been completed in roughly half the farms surveyed. Ukrainian agriculture remains dominated by large collective structures, and the failure of large farms to adapt to new economic conditions has resulted in a significant deterioration in their financial performance. The survey suggests that land reform in Ukraine is in danger of stagnation and the government must create the necessary institutional and market conditions to invigorate reforms.


Cost-effective environmental investments that address high-priority environmental problems are studied in seven industrial sectors: power and heat, oil refining and petrochemicals, organic chemicals, inorganic chemicals, iron and steel, nonferrous metals, and pulp and paper.


In the early years of transition both state and private firms began to adjust wages and employment in response to the hardening budget constraint and the prospect of institutional changes. Insider (manager-worker-owned firms) were ready to trade off wages for employment stability. These firms react defensively to changes, which slows down restructuring. More and faster restructuring was carried out by firms that were bought mainly by outside, foreign investors. Bulgaria's example demonstrates that allowing firms to remain in public hands permits insiders to decapitalize firms and plunder public resources. Several questions need further attention: Will the insider influence in privatized firms wane as the growth of the new private sector accelerates? Why do private employers prefer to hire workers from other companies and not from the ranks of the unemployed? What are the chances of gaining active labor market policies, including employment subsidies and retraining?


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In Lithuania a banking crisis erupted in January 1996, driven by a combination of ineffective bank supervision, poor bank practices, and deep-rooted sectoral imbalances. With the World Bank's financial support, Lithuanian authorities embarked on a program to solve operational problems of the undercapitalized banks.


IMF Publications

To order: IMF Publications, 700 19th Street, NW, Washington, D.C. 20431, United States, tel. 202-623-7430,
Working Papers

Marta de Castello Branco, Pension Reform in the Baltics, Russia, and other Countries of the Former Soviet Union (BRO), IMF WP 98/11, February 1998, 40 p.

So far, the typical short-term responses of the BRO countries to the increasing financial stresses on pension funds have been to compress benefits, increase contribution rates, and accumulate pension arrears. (The present pension systems in the BRO countries are run on a pay-as-you-go (PAYG) basis, with pension benefits of current pensioners financed by current payroll contributions.) The piecemeal approach to pension reform is to reduce expenditures and increase revenues without changing the basic structure of the PAYG system. The systemic reform approach is to introduce a multipillar system that includes privately managed, funded pension plans. Kazakhstan and Latvia opted for this system reform approach. By strengthening the contribution-benefit link and increasing compliance and coverage within the PAYG system, Latvia will gradually provide a balanced mix between PAYG and funded systems (similar to the Swiss model), while Kazakhstan aims to replicate the pure Chilean model, dominated by mandatory, privately managed pension schemes.


Despite strong connections between the spot and futures markets, volatility on the futures market does not explain spot market volatility. Introducing futures market will not increase spot rates volatility.


Centre for Economic Policy Research (CEPR) Publications

To order: Centre for Economic Policy Research (CEPR), 90-98 Goswell Road, London EC1V 7DB, United Kingdom, tel. (44171) 878-2900, fax (44171) 878-2999, Email: cepr@cepr.org


The share of intratrade (IIT) in total trade between Central and Eastern European nations and the EU is among the highest of all the EU bilateral trade flows. Vertical IIT (exchange of similar goods of different quality) accounts for 80–90 percent of total IIT and is positively associated with product differentiation, labor intensity of production, economies of scale, and foreign direct investment (FDI). Controlling for country-specific effects, a statistically significant positive association is found between horizontal IIT (the exchange of close substitutes of similar quality) and FDI, product differentiation, and industry concentration; a significant negative relationship is found for scale and labor intensity.


Since the monetary union with West Germany on July 1, 1990 the monthly wages of East German females have risen by 10 percent relative to male wages, but female employment has fallen 5 percent more than male employment. In 1990–94 low earners were more likely to leave employment, and they were disproportionately female. This withdrawal from employment by low earners can account for 80 percent of the relative rise in female wages. There is no evidence that reduction in child care availability is a major factor in reducing female employment rates.


Transition economies need to invest heavily in order to modernize their obsolete capital stock and become competitive in world markets. Overall 1992–95 estimates support the hypothesis that an imperfectly functioning legal system in transition economies encourages firms to ignore commitments to their partners (this is a form of soft budget constraint) a phenomenon that affects investment.


Rural Development Institute Publications

To order: Rural Development Institute (RDI), 4746 11th Avenue, NE, #504, Seattle, Washington 98105, United States, tel. 206-528-5880, fax 206-528-5881, Email: rdi@u.washington.edu, Internet: http://www.law.washington.edu/rdi.

Reene Giovarelli, Land Reform and Farm Reorganization in the Kyrgyz Republic, RDI Reports on Foreign Aid
While the Constitution of the Kyrgyz Republic does not allow private ownership of land, use rights of up to 99 years are permitted for agricultural land. These rights can be sold, mortgaged, bequeathed, gifted, or leased out. Members of collectives or state farms are common share owners of the land and property and can withdraw from such farms and receive land and property in kind. Nevertheless, registered land transactions are few. Federal laws on registration and mortgage are needed as well as regulations for purchase and sale of land use rights. A public information program is necessary to inform land share and land plot owners about their rights.


There is very little empirical evidence to support the cost benefits of large-scale farming. Rental machinery markets, the hiring of managerial and technical skills, and publicly financed extension services can offset the extra cost of cultivating smaller farms. At-large farms that are monitoring the quality and amount of effort expended by workers are also particularly costly, while family-operated farms tend to minimize labor-monitoring costs. In a market economy farm size is determined by market signals. Granting subsidies or preferential access to credit to larger farms, can negate the natural advantages enjoyed by small farms.

In the former Soviet republics policymakers should strive to eliminate such market imperfections and encourage farms to reorganize into smaller units. A legal and policy framework, including an open land market, should enable farmers to adjust farm size in response to market signals.

The William Davidson Institute, Working Papers

To order: The Davidson Institute, 701 Tappan Street, Ann Arbor, Michigan 48109-1234, United States, tel. 734-763-5020, fax 734-763-5850, Email: wdi@umich.edu, Internet: http://www.wdi.bus.umich.edu


Leuven Institute for CEE Studies Working Papers

To order: Leuven Institute for Central and East European Studies, Ch. Deberiotstraat 34, 3000 Leuven, tel. 3216-326-598, fax 3216-326-599.


Saul Estrin, Adam Rosevar, and Paul Hare, Company Restructuring and Privatization in Ukraine, WP 70, 1998.

An enterprise survey of 150 Ukrainian firms taken between March and July 1997 reveals that the Ukrainian privatization process has favored insiders (managers workers). Insiders owned 53 percent of shares, outsiders 31 percent, and the state had a residual holding of 17 percent. Insiders holdings are concentrated in smaller firms and the state holdings in larger ones. The sample confirmed that since 1991 the output and employment of Ukrainian firms has dropped precipitously. The performance of most firms deteriorated but insider-owned firms have been performing relatively better than the state-or outsider-owned ones. Restructuring is slow, especially financial restructuring and change of product mix. As expected, outsiders were more willing to downsize their enterprises than were insiders—the state or manager-owners.

Other Publications


A uniform, 22 percent value-added tax (VAT) with few exemptions was introduced in Croatia this year. It replaced the
earlier consumer sales tax on goods and services. The new tax could lift the 1998 consumer price index by 3.27 percent (optimistic scenario) or 5.2 percent (pessimistic scenario).

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


To order: Katy Wight, Edward Elgar Publishing Inc., 6 Market Street, Northampton, Massachusetts 01060, United States, tel. 413-584-5551, fax 413-584-9933, Email: kwight@e-elgar.com


To order: Gregor-Delacroix Kiado, Sales Department, 1066 Budapest, Terez krt. 28, Hungary, H-1066.


The economic situation improved significantly in much of Eastern and Central Europe in 1997. It was the first time since 1989 that these economies showed an average growth in GNP (1.7 percent). This improved performance was largely due to events in the economies of Albania, Bulgaria, and Romania, where a return to growth at least stopped the downturn.

In the faster-growing economies (Croatia, Poland and Slovakia) policymakers should probably try to slow down the pace in order to halt their worsening current account deficits. Even so, these three economies are expected to expand by at least 5 percent this year. High growth rates (between 5 and 7 percent) are also expected in the Baltic states, despite a slow down in Estonia in order to avoid inflation.

Large current account deficits are serious problems in other CEE economies as well. (In most of these countries current account deficits can reach 6 percent or more of GDP, and even more in the Baltic states.) It is difficult to see a significant strengthening of the recovery in Russia if monetary policy remains as tight as it now is for any length of time. Moreover an important constraint on medium-term growth in Russia is the effect of a large, 10-year decline of fixed investment on productive capacities.

To order: Economic Analysis Division, United Nations Economic Commission for Europe (UN/ECE), Palais des Nations, CH-1211 Geneva 10, Switzerland.


The crisis in Southeast Asia has added impetus for improved capital market regulations. The supply of government securities offering high yields is likely to be restricted. With more cautious policies, growth in 1998 and 1999 is likely to slow down in Poland and Slovakia. Hungary is unlikely to get carried away by its recent success. Slovenia and the Czech Republic will aim for stability and moderate rates of growth, while Bulgaria may well achieve stability. There are still questions surrounding Romania and, in particular, Russia, but long overdue stabilization in Ukraine may now be in sight.

In 1997 Hungary overcame the effects of its 1996 stabilization policy, recording a quite high export-driven growth of 4 percent. Strong improvements in industrial production and labor productivity remained steady in Poland and Hungary. The Czech economy, until recently a paragon of successful transformation, was hit by a crisis arising from sustained appreciation under expanding current account deficits and grew by slightly more than 1 percent. Bulgaria and Romania suffered huge output declines following macroeconomic mismanagement in 1996. The long-standing fall in Russia’s GDP has come to a halt, but Ukraine’s GDP is still falling though not as much as in earlier years. Investment performance in Russia and Ukraine was still rather dismal.

Moderate inflation in the faster growing countries of Central and Eastern Europe turned out to be difficult to suppress further. Under the currency board arrangement inflation fell precipitously in Bulgaria and was far from safe levels in Romania. Russia and Ukraine succeeded in reducing inflation to moderate levels. In all Central and Eastern European countries, except Poland and Croatia, trade deficits were lower than in 1996.

Lower trade deficits contributed to healthier current account balances in most Central and Eastern European countries. External imbalances increased further in Croatia and Poland. The current account deficit was still rather low in relation to the GDP in Poland, but rather too high in the Croatia, Czech Republic, Romania, and Slovakia.

To order: Vienna Institute for International Economic Studies (WIWI) A-1010 Vienna, Oppolzergasse 6, Tel. 431-533-66-1011, Fax 431-533-66-1050, Email: straka@wsr.ac.at


This volume analyzes the economic process of assimilating eastern Germany into the institutions and performance levels of western Germany. Topics include: The relative backwardness of East Germany’s economy, the prospects for eastern Germany catching-up economically with western Germany and the repercussions for German competitiveness nationally and within the wider European context.

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Massachusetts 01060, United States, tel.

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Volume 9, Number 3
June 1998
ISBN 0-8213-4220-7
ISSN 1020-5470

Printed on recycled paper